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Fixed income outlook remains constructive despite volatility

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US Treasuries continued to fall amid concerns over surging global public debt and rising odds in the prediction markets of Donald Trump winning the presidency.

With PredictIt showing the odds for a Trump win rising to 58% just two weeks before the election, markets are moving to price the potential for increased Treasury supply due to a rising deficit. A recent International Monetary Fund report estimating global public debt to exceed USD 100tr by year-end also added to deficit worries, while volatile oil prices amid elevated geopolitical tensions contributed to inflation concerns.

But we caution against reading too much into betting odds ahead of a tight race. Instead, we think the macro backdrop remains constructive for fixed income as the Fed pushes ahead with further interest rate reductions.

Economic data warrant more easing ahead. While recent data indicate a more resilient US economy than previously thought, the broad disinflation trend is still intact, and downside risks—albeit lower—to the labor market remain. Additionally, the fed funds rate remains well above the Fed’s estimate of neutral, which implies Fed officials believe policy remains restrictive. We continue to expect a further 50 basis points of rate cuts in 2024 and 100 basis points of cuts in 2025. This should bring Treasury yields lower.

The latest comments from Fed officials point to further rate cuts. While they differed on how fast or far future Fed cuts should go, four Fed policymakers on Monday expressed support for further rate reductions. Minneapolis Fed President Neel Kashkari reiterated that he favors reducing interest rates at a slower pace in the coming quarters, and Kansas City Fed President Jeffrey Schmid said he hoped for a “more normalized” policy cycle where the Fed makes “modest” adjustments. Dallas Fed President Lorie Logan made similar remarks, saying a strategy of gradually lowering the policy rate would be appropriate. San Francisco Fed President Mary Daly, in contrast, said she feels Fed policy is "very tight" and that the US central bank would continue cutting rates to guard against further weakening in the labor market.

Investment grade (IG) corporate bond fundamentals remain solid. Against a resilient economic backdrop, we believe credit fundamentals on IG corporate bonds are solid, with limited credit quality deterioration. We see returns in the high-single-digit range over the coming 12 months, supported primarily by elevated yields and low spread volatility. Any widening of spreads due to growth concerns should also be more than offset by falling interest rates, as the focus shifts to rate cuts.

So, we continue to recommend investors shift excess cash into quality fixed income as the rate-cutting cycle advances and erodes cash returns. In addition to IG bonds, which we rate as Attractive, investors can also consider diversified fixed income strategies—including selective exposure to higher-yielding parts of the asset class—as a way of further enhancing portfolio income.

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