CIO believes quality bonds offer appealing expected returns and potential for capital gains, and see value in diversified fixed income strategies, including senior loans. (UBS)

# CIO expects Treasury yields to decline in a lower-rate environment

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**US Treasury yields rose to the highest level since late November last week, even though markets remain convinced that the Federal Reserve will cut interest rates further when the Federal Open Market Committee meets this week. The 10-year and 30-year yields rose 25 basis points and 28 basis points to 4.4% and 4.6%, respectively.**

The rise in yields pointed to renewed investor concerns over how US President-elect Donald Trump's potential policies could expand government borrowing while putting upward pressure on inflation. November's producer price index (PPI) release turned out stronger than expected, while the US Treasury's auction of USD 22bn of 30-year bonds met with soft demand.

But we see limited room for Treasury yields to rise much further and expect them to move lower in 2025, benefiting quality fixed income.

**Disinflation looks likely to continue, even if the path is as bumpy as it was this year.** While headline PPI inflation readings overshot expectations, the core PPI and components that feed directly into the Fed's preferred inflation gauge were softer. November's consumer price index also showed slower increases in shelter costs on both a monthly and annual basis. We continue to believe that overall inflation should moderate further, and that potential tariffs should not lead to sustained higher inflation over the medium term. In fact, as the election in November demonstrated the high political cost of inflation, we believe universal tariffs are less likely. Blanket tariffs through executive action would face legal challenges, and they are unlikely to garner enough support from Congress.

**The Fed should continue to lower interest rates in 2025, albeit at a slower pace.** We expect the US central bank to cut rates by 25 basis points this week, and by a more gradual once-per-quarter pace in 2025. Guidance on future easing remains to be seen, including policymakers' projection on the number of rate cuts for next year and where the terminal policy rate likely is. But with the Fed signaling its commitment to bring rates toward "neutral" against the backdrop of moderating inflation and a softening labor market, we believe further Fed easing should keep any rise in yields in check.

So while further volatility is likely, we expect Treasury yields to decline in a lower-rate environment. We believe quality bonds offer appealing expected returns and potential for capital gains, and see value in diversified fixed income strategies, including senior loans.

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