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Hope for Rate Cuts Tempts Investors To Bonds

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Investors are warming to bonds again, underscoring how hopes for further interest- rate cuts have boosted Wall Street's outlook.

Signs this week that the Federal Reserve remains open to reducing rates in 2026 have been welcomed by investors, who had been prepared for the central bank to deliver a "hawkish cut"—lowering its benchmark federal funds rate but signaling strong reluctance to make further adjustments. Stocks have rallied alongside bonds, with the Dow Jones Industrial Average on Thursday climbing almost 650 points, or 1.3%, to a record.

Despite mixed messages on Wednesday from a divided Fed panel, many still saw indications that even modest further weakening in the labor market could spur the central bank to cut again within the next few months. Note Investors were also cheered by the Fed's announcement that it would expand its balance sheet by buying shortterm Treasurys, a move intended to relieve recent pressure in overnight lending markets. Note

"We went into the meeting looking for a hawkish" cut, said Priya Misra, a fixed-income portfolio manager at J.P. Morgan "It was not as hawkish as I think the market feared…so there was a sigh of relief on that front."

Yields on U.S. Treasurys, which fall when bond prices rise, slipped for the second straight session Thursday, eroding a two-week climb that had lifted them to their highest levels since September.

Treasury yields are heavily influenced by investors' expectations for rates set by the Fed. Note They in turn set a floor on borrowing costs across the economy, from mortgages to interest payments on new corporate bonds. Their recent climb had raised concerns on Wall Street, especially because a portion of the increase seemed to be driven by factors outside of the Fed's control, such as rising bond yields in other countries including Japan. Note

The Fed's messaging on

Wednesday was nuanced, and its decision to cut drew three dissents, two from officials who wanted rates left unchanged. Language in the central bank's initial policy statement signaled a higher bar to additional cuts, echoing a similar pivot after cutting rates one year ago.

Early in his postmeeting press conference, Fed Chair Jerome Powell signaled that the central bank wouldn't be in a rush to cut rates. Note Interest rates, he said, are now around their "neutral value," making the central bank "well-positioned to see how the economy evolves from here."

But as he answered questions, Powell struck many investors as sounding more concerned about the employment situation than inflation, Note at one point saying that the jobs market faces "significant downside risks."

Interest-rate futures showed Thursday afternoon that traders saw a nearly 50% chance that the Fed cuts rates again at or before its meeting in March, Note according to CME Group, up from 39% on Tuesday. The chances of at least three total cuts next year rose to around 40% from 30% Tuesday, helping push the yield on the 10-year Treasury note down to 4.14% from 4.185%.

Blake Gwinn, head of U.S. rates strategy at RBC Capital Markets, said the shift largely reflected investors' understanding of what Powell's own "reaction function" would be to coming economic data, including next week's November jobs report. However, he also noted that Powell's own views might start carrying less weight as he nears the end of his term of chair in May.

Investors anticipate a very different Fed next year, after President Trump this week started his final round of interviews with candidates to be Powell's successor.

Note

If Trump succeeds in his effort to get the Fed to significantly cut rates, analysts warn that it could backfire by causing investors to lose faith in the central bank's commitment to stable prices. That could cause yields on longerterm Treasurys to rise, as investors worry about higher inflation and the potential need for much higher rates down the road.

More likely, investors say, divisions at the Fed will just make it harder to predict what it will do with rates at each meeting. That could lead to more volatility in the bond market and possibly keep yields a bit higher than they would be otherwise, as investors demand compensation for that turbulence.

Note

Global factors could also keep upward pressure on yields. While yields on U.S. Treasurys have come down this year thanks to the Fed's pivot to rate cuts, yields have been climbing elsewhere, including in Germany and Japan, thanks to the prospect for increased government borrowing and, in Japan's case, interest-rate increases.

Rising yields in other major developed economies can sometimes spill into the U.S. market, drawing cash away from Treasurys. If yields on Japanese government bonds continue "to ratchet higher, that probably is not good for the longer end of any market, including the U.S. market," said Rob Waldner, chief fixed income strategist and head of macro research at Invesco.

Still, many investors see a path for the 10-year Treasury yield to fall below 4% even absent a major deterioration in the U.S. economy.

"There's nothing magical about 4%—we could drift below 4," said J.P. Morgan's Misra.