

Major Markets Letter #1

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Not the 2026 outlook

Outlooks, in our experience, tend to have the shelf life of yesterday's fish and chips. So this is not an outlook, rather a reminder of the need for humility. We recall that the consensus of 2025 analyst forecasts had the US 10-year Treasury yield at about 5% by now. Instead, yields have moved sharply lower: after a brief move through 4%, the benchmark is trading almost 100bp beneath these forecasts.

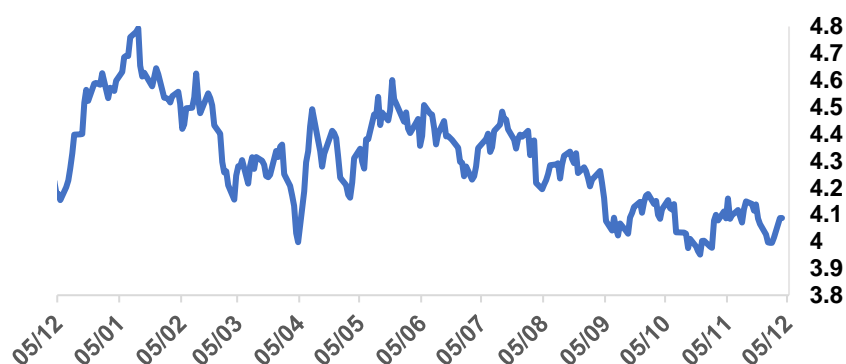
The next Fed chair, whoever that may be, will likely view the neutral policy rate as lower than both current market pricing and the last FOMC dot plot. If markets continue to push expectations for this rate down towards 2.0% for the second half of 2026, the 10-year yield would more naturally gravitate towards 3.0%, not 4.0%.

This matters because the USD29trn Treasury market anchors global fixed-income pricing. Treasury yields influence mortgages, currencies, equity valuation, and expectations for long-run growth and inflation. In practice they also reflect market confidence in political and economic stability. Yields fell this year for four main reasons:

First, fiscal fears failed to materialise. Early in the year, many argued that larger deficits, driven partly by the administration's intention to extend the 2017 Tax Cuts and Jobs Act, would push yields higher. Yet strong demand at Treasury auctions has undermined that view.

In October, the Congressional Budget Office projected a 2025 deficit of USD1.8trn (5.9% of GDP), still historically large but slightly lower than the previous year. Increased tariff revenue has helped to narrow this deficit by roughly 0.4%. Whether this improvement endures is unclear, but the feared surge in term premium has not appeared. Treasury auctions continue to see consistently strong demand.

US 10-year Treasury - the last year
Defying expectations of 5.0% yields



Source: Bloomberg

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Second, new sources of Treasury demand are emerging. True, some foreign investors have been trimming their holdings, but the Treasury Borrowing Advisory Committee (TBAC) projects the stablecoin market could reach USD2trn by 2028, creating a major new buyer base for Treasury [Bills](#). Even an additional USD500bn of demand would meaningfully alter the T.Bill landscape.

Third, the economy is cooling. Economic data relative to expectations has softened. Labour-market surprise indices show consistent undershooting, and survey expectations such as the ISM manufacturing index have slipped into contraction. The slowdown is not dramatic but it's been clear enough to challenge earlier assumptions about economic resilience.

Fourth, there is the feedback loop from other asset classes. Treasuries may be a benchmark for global bonds, but they are influenced by risk sentiment across markets. Recent declines in bitcoin – viewed by some as a proxy for leveraged risk appetite – have maybe contributed to flight-to-quality flows into Treasuries. Such dynamics could amplify the drop in yields if there was a deeper 'risk-off' move.

Today the 10-year Treasury is not far off 4.0%, largely reflecting the 100bp drop in policy rate expectations. If the FOMC cuts by 25bp on 10 December, the Fed funds rate will sit just three 25bp cuts from the longer-run dot, at 3%, yet a more dovish Fed would likely be willing to move well below that.

Where next for the 10-year Treasury?

Expect bearish commentary to lean heavily on the new Fed chair as justification for higher yields or curve steepening. But as with the earlier fiscal-driven term premium argument, this risks being another narrative that is already priced-in.

The more meaningful upside risks to Treasury yields may come from abroad. Global markets are highly interconnected, and foreign developments frequently ripple through US rate markets, regardless of domestic fundamentals. A recent example is Japan: higher JGB yields – driven again by fiscal fears, along with the risk of future rate hikes – have temporarily pushed global yields higher, as JGBs became more attractive relative to Treasuries; long-dated JGB forwards are close to 5%.

For now, the absence of strong conviction keeps forecasts anchored near current levels. Bloomberg's median end-2026 projection is 4.06%, and the forward (1Y10Y) stands at 4.23%. Yet if the Fed moves decisively into accommodative territory - below outdated estimates of the neutral rate - bearish positions may again be caught offside. The downside potential for yields increasingly resembles the 100bp decline seen over the past year.

Let's see how long that prediction lasts before it starts to smell like last year's fish and chips.

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