WEEKLY STRATEGY
Perspectives

BMO Private Wealth

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Guest Feature – Fixed Income in Focus

"Discrepancies – and hence opportunities – in securities originate most often when events move faster than quotations."
– Benjamin Graham

The Through Line: Volatility in treasury markets has surprised investors in recent weeks as participants have grappled with a matrix of issues including the sustainability of global growth, fluidity in U.S. trade policy and the growing relative attractiveness of non-U.S. assets. Over the long run, we expect fixed income investments to continue to provide income and durability for diversified portfolios as they have in the past. However, near term-market volatility could continue as policy and growth issues sort themselves out.

Treasury market grabs the spotlight

In times of duress in financial markets, investors typically rush to the security of U.S. dollars and Treasury markets. Surprisingly, this hasn't happened amid the recent volatility. For example, 10- and 30-year U.S. government bond yields increased by over 50 basis points, while the greenback weakened 4% relative to major currencies when initially confronted with the "Liberation Day" reciprocal tariff news. This was the largest upward move in the 30-year since 1987. Even tamer-than-expected inflation reports later in the week had no sustained impact on bringing bond yields back down.

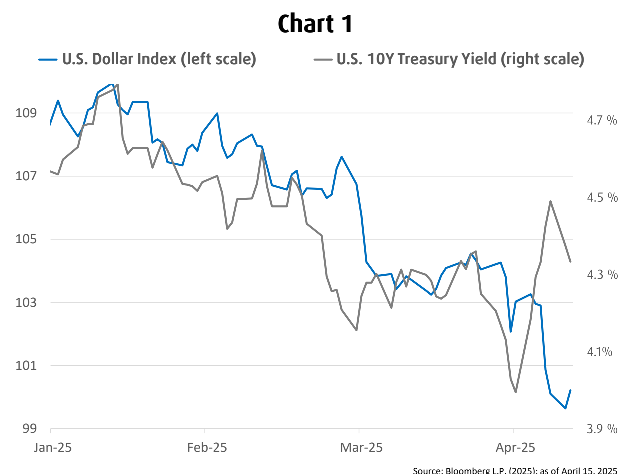
Why is the 10-year interest rate increasing?

The U.S. 10-year interest rate initially decreased after the "Liberation Day" announcements (April 2) but reversed soon afterwards leading to speculation about the factors driving this unusual behavior. Some probable influences were:

- Investor concern related to whether the growth and inflation impacts of tariffs will be transitory or more persistent
- Unease over the current path of fiscal policy and the risk for larger deficits
- Current market disruptions and the potential impact on global trade, prompting investors to demand a greater yield in return for holding longer-term U.S. Treasuries
- Portfolio repositioning and margin calls as volatility led hedge funds to sell their most liquid positions
- Foreign investors reducing U.S. exposure amid the trade war and when presented with more competitive investment opportunities in their home markets (e.g., 10-year interest rates in Japan and Germany have reached their highest levels in over a decade due to domestic economic developments)

In the past, strong divergences between the U.S. dollar and the 10-year U.S. Treasury (chart 1) have been led by episodes where foreign investors were reducing holdings of U.S. dollar investments and repatriating to their home market. It can also occur during periods of rapidly rising U.S. inflation.

Chart 1



While this is certainly playing a role, we believe a combination of factors is behind the recent rise in bond yields, a trend that potentially contributed to the decision to temporarily pause reciprocal tariffs.

Are higher inflation expectations a factor?

Financial market pricing of long-term inflation has been largely contained. In contrast, recent consumer surveys indicate the public is anticipating much higher inflation over the next 12 months and beyond. Several factors could be clouding the picture:

- Higher prices will lead to less consumer demand
- Tariffs are expected to have a one-time impact rather than a sustained influence

- High tariffs may not be maintained over the long term
- The financial market has yet to catch up as investor flows may be creating some distortions

Should the Fed intervene?

Federal Reserve (Fed) Chair Jerome Powell has spoken several times in recent weeks specifically calling out the challenges tariffs and trade policy are placing on the ability to model potential economic outcomes. He has acknowledged a high likelihood of at least a temporary increase in inflation and reiterated that the Fed's job is to ensure that this does not become an ongoing problem. The Fed will do all it can to reinforce consumer expectations that inflation will float near its 2% target ensuring they remain well-anchored.

It is critical to the Fed's objectives and success to prevent the public from believing that prices will rise by more than 2% in the long run. Persistently high inflation has historically had a negative impact on economic growth and stability.

Markets had been pricing in very low odds that the Fed will reduce its policy rate at its next meeting on May 7 – but were still taken a bit off guard when Chairman Powell reiterated this view at an Economic Club of Chicago event on Wednesday. While the economic environment is changing rapidly, rate cuts appear to be a more likely story for the second half of the year. BMO Economics anticipates policy easing to return to the U.S. with two cuts in the final four months of the year.

Is the treasury market behaving as it should?

Recent volatility in the Treasury market was high and led some to question how well it was functioning and whether the Federal Reserve would need to step in with support. Some of these fears were allayed, however, as the U.S. Treasury Department auctioned off new 10-year and 30-year bonds last week, which was a very timely test for demand. The auctions ended up going very well, with lots of buyers, and the yields on the new bonds were actually lower than before the auction took place. That result gave confidence that there are buyers of Treasuries ready to invest.

What about the Canadian 10-year?

The Canadian economy tends to closely follow the U.S. economy. As a result, the Canada 10-year typically follows the direction of U.S. Treasuries, but with a bit less volatility. This held true recently as the Canadian 10-year has moved within a smaller range, and the difference between the two 10-year rates has returned to the same level where it sat at the end of March. The Canadian 10-year interest rate remains well below the U.S. rate as a result of slower economic growth, lower inflation, and a lower central bank rate.

Since the Canadian economy relies much more on international trade, its growth is more at risk to trade shocks. This comes not only from the U.S. side but also from retaliatory tariffs on goods entering Canada. This results in a larger impact on Canadian consumers and businesses.

What's the Bank of Canada going to do?

The Bank of Canada (BoC) must also weigh the impacts of higher prices from tariffs against slower economic growth and a possible recession. Since Canada is more sensitive to a reduction in trade, the impact on growth is likely to be larger and with heightened focus on the unemployment rate. The BoC has been reducing its policy rate rapidly since last year and is likely to continue. BMO Economics forecasts three more rate cuts this year.

Canadians go to the polls on April 28, with candidates promising to focus on pro-business policies and economic growth. New leadership could boost business and consumer sentiment.

What about credit spreads?

Until recently, credit spreads were at a historically low level. The recent trade announcements and volatility in the market have sent them abruptly wider, but not nearly as wide as past periods of strain. Credit spreads are still tighter than at other times of market stress such as the U.S. regional banking crisis in 2023, or the highly inflationary period in 2022 (Chart 2).

Chart 2
Corporate Credit Spreads

Source: Bloomberg L.P. (2025); as of April 15, 2025

Corporate bonds are now more attractive as credit spreads have widened, but improved market stability will create a better entry point.

Implications for investors

For Treasuries, a battle is raging between inflation (which pushes bond yields higher) and slower economic growth (which tends to pressure them lower). Trying to forecast yields will be difficult, considering the uncertainty about what comes next. To the downside, the longer the trade war persists the greater the risk of growth impairment that could lead to lower interest rates. However, pauses on tariffs and new trade deals could also result in further economic expansion.

Recently, market flows and trade reversals have heightened volatility and short-term swings in the market – and are unpredictable. Typically, over most investment horizons, fixed income securities offer ballast to an overall portfolio by offering a low level of correlation with equities – that typically means investors would expect positive fixed income returns during times of equity market downdrafts. Our experience in 2022 and over the past month highlights that during short periods of rapidly rising inflation expectations both stocks and bonds can be challenged. However, the broad long-term relationship remains intact. While the recent increase in bond yields and corporate credit spreads have not put them into a territory we would consider "cheap", it has restored some value to this market for investors deploying longer term capital.

In focus in North America

Jon Borchardt, Sr. Analyst
George Trapkov, CFA, VP and Portfolio Manager

This week

The Bank of Canada holds rates unchanged – Overnight rates remained unchanged at 2.75%, the first hold for the BoC in almost a year. The market viewed the decision as a close call but had been leaning to no move as well. In the view of BMO Economics, the downward pressure on growth from tariffs and trade uncertainty will ultimately override upward pressure on cost increases, especially with oil prices weak and the Canadian dollar on the mend. **BMO Economics continues to look for three additional rate cuts this year** as the BoC grows more comfortable with the inflation outlook, eventually taking the overnight rate down to 2.0% – a touch below the central bank's latest estimate of neutral (2.25% to 3.25%). BMO Economics believes that the deep trade uncertainty will weigh heavily on growth in Q2 and Q3, blunting inflationary pressures.

U.S. Fed Speak – Federal Reserve Chair Jerome Powell delivered a speech and participated in a fireside chat at the Economic Club of Chicago on Wednesday. Equity markets turned lower following the comments in which he reiterated that the Fed's dual mandate could come under pressure if trade policies were to prevent inflation from continuing its downward path while pushing unemployment higher. He also reaffirmed the view that the central bank is well positioned to wait for greater policy clarity from the Trump Administration. This latter point implies the Fed may deliver fewer rate cuts than markets had been pricing in at the start of the day. Prior to the Chairman's remarks, investors had been anticipating four rate cuts in 2025. **BMO Wealth Management-U.S. Chief Investment Officer Yung-Yu Ma continues to suggest that two rate cuts remain the most likely outcome, with the economy slowing but a recession still likely to be avoided.**

U.S. big bank earnings helped by market volatility and robust trading activity – According to FactSet, financials have been the largest contributor to overall S&P 500 earnings growth thus far in the Q12025 reporting season. On the flip side, firms including BlackRock (BLK), JPMorgan (JPM), Morgan Stanley (MS) and Goldman Sachs (GS) report that tariff-related uncertainty has prompted many clients to hit the pause button, with M&A and equity deal activity on hold. Corporate and small business clients are focused on optimizing supply chains and crafting strategies to navigate the evolving environment. Economic growth forecasts have been revised lower, and all four institutions flagged elevated recession risk. Despite the clouds, both corporate and retail clients exited Q1 in relatively strong financial shape. Investment banking pipelines remain elevated, and client engagement is robust.

U.S. consumer sentiment remains soft – In early April, consumer sentiment deteriorated again, with the University of Michigan index falling 11% to 50.8 – its lowest level since June 2022. Despite softer headline inflation at 2.4%, year-ahead inflation expectations surged to 6.7%, the highest since 1981. Recession concerns and weaker outlooks for income, business conditions and labor markets dragged the expectations index to 47.2, well below forecasts.

Tariff Update – Last week, President Donald Trump raised tariffs on Chinese imports to 145% and asserted that President Xi Jin Ping would need to directly initiate trade negotiations if a deal were to be made. Despite escalating tensions, Mr. Trump praised President Xi as "one of the smartest people in the world," again referred to him as a "friend," and reiterated his desire to reach an agreement. Late on Friday, the administration announced that 20 product categories, including consumer electronics and semiconductors, would be granted exemptions. Bloomberg reports that the new exemptions on Chinese goods apply to approximately $101 billion in U.S. imports. In this week's BMO Wealth Management Weekly Talking Points, CIO Yung-Yu Ma, Ph.D., noted that China is better positioned than the U.S. to withstand political pressure, absorb stock market volatility and deploy economic support measures. In addition, China is a bit more diversified in its customer base since its exports to the U.S. account for only 3% of the nation's GDP. He also observed that China has halted purchases of certain U.S. agricultural goods, implemented export restrictions on critical rare earth minerals, controls difficult-to-replicate manufacturing capabilities and now leads the world in 57 of the 64 most important technologies. In short, despite the trade deficit, President Xi is holding a strong hand.

Canada's inflation unexpectedly softens – Canadian consumer prices rose 0.3% in March (flat in seasonally adjusted terms), much lower than expected and cut the annual inflation rate by 0.3% to 2.3%. The pullback in headline inflation is a pleasant surprise, given that this month represents the full removal of the GST holiday (which was still in effect for half of February). The big story here was a steep drop in travel tour prices and a meaty drop in airfares from year-ago levels, as Canadians pulled back abruptly on U.S. travel in prime time. After a few months of high-side surprises, Canadian inflation caught a serious March break, held down by much milder-than-normal travel costs. This speaks to the fact that the inflation impact of the trade war is more of a two-way street for Canada than the U.S., since Canada's tariffs are so much lighter so far, while the U.S. domestic economy is under more pressure.

Canada's housing market softens – Canada's housing market remained under pressure in March, with sales and prices both weakening further. Existing home sales fell 4.8% in seasonally adjusted terms in March, marking four consecutive months of downward momentum. New listings rose 3.0% in the month and were up 13.1% from a year ago. That combination weakened the market balance in March. All told, lower mortgage rates have yet to spur market activity. The trade war has clearly impacted confidence.

Next Week

Earnings season rolls on in both the U.S. and Canada. The Fed's Beige Book on Wednesday should give solid frontline hints at how sentiment and activity are responding to the ongoing trade war.

- **Monday 4/21** – U.S. leading economic indicators
- **Tuesday 4/22** – Canada PPI
- **Wednesday 4/23** – U.S. PMIs, Fed's Beige Book | Canada New Housing price index
- **Thursday 4/24** – U.S. initial jobless claims, Durable goods orders | Canada average weekly earnings
- **Friday 4/25** – U.S. consumer sentiment | Canada retail sales, budget balance

Data scorecard as of April 16, 2025

Equity Market Total Returns						
	4/16/2025 Level	WTD	YTD	2024	2023	2022
S&P 500	5,276	-1.6%	-10.0%	25.0%	26.3%	-18.1%
NASDAQ	16,307	-2.5%	-15.4%	29.6%	44.7%	-32.5%
DOW	39,669	-1.4%	-6.3%	15.0%	16.2%	-6.9%
Russell 2000	1,863	0.2%	-16.1%	11.5%	16.9%	-20.5%
S&P/TSX	24,107	2.2%	-1.7%	21.7%	11.8%	-5.8%
MSCI EAFE	8,602	3.9%	6.4%	3.8%	18.2%	-14.5%
MSCI EM	569	1.4%	-0.9%	7.5%	9.8%	-20.1%
Bond Market Total Returns						
		WTD	YTD	2024	2023	2022
Bloomberg U.S. Aggregate		1.1%	2.2%	1.3%	5.5%	-13.0%
Bloomberg U.S. Treasury		1.0%	2.7%	0.6%	4.1%	-12.5%
Bloomberg U.S. Corporate		1.4%	1.1%	2.1%	8.5%	-15.8%
Bloomberg U.S. High Yield		0.9%	-0.5%	8.2%	13.4%	-11.2%
Bloomberg 1-10 Year Munis		0.6%	-0.4%	0.9%	4.5%	-4.7%
Bloomberg Canada Aggregate		1.3%	1.0%	4.0%	6.5%	-11.3%
Bloomberg Canada Treasury		1.1%	1.4%	2.9%	5.0%	-9.9%
Bloomberg Canada Corporate		1.0%	0.8%	6.9%	8.2%	-9.5%
Government Bond Yields						
	4/16/2025	Last Month End	Last Quarter End	2024	2023	2022
U.S. 10-Year Treasury	4.28%	4.21%	4.21%	4.57%	3.88%	3.88%
Canada 10-Year Government	3.08%	2.97%	2.97%	3.23%	3.11%	3.30%
U.K. 10-Year Gilt	4.60%	4.67%	4.67%	4.56%	3.53%	3.66%
German 10-Year Bund	2.51%	2.74%	2.74%	2.36%	2.02%	2.57%
Japan 10-Year Government	1.26%	1.49%	1.49%	1.09%	0.61%	0.41%
Currencies & Real Assets						
	4/16/2025 Level	WTD	YTD	2024	2023	2022
USD Index	99.38	-0.7%	-8.4%	7.1%	-2.1%	8.2%
CAD:USD	$0.72	0.1%	3.8%	-7.9%	2.3%	-6.7%
Bitcoin	$84,308.09	0.6%	-10.0%	120.5%	157.0%	-64.3%
Gold	$3,343 12	3.3%	27.4%	27.2%	13.1%	-0.3%
Oil (WTI)	$62.47	1.6%	-12.9%	0.1%	-10.7%	6.7%

Benchmark data does not reflect actual investment performance but reflects benchmark results of the underlying indices referenced. You cannot invest directly in an index. Index definitions can be found at the end of this publication.

Index Definitions

Equity indices

S&P 500® Index is an index of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

NASDAQ Composite Index is a market-cap weighted index of the more than 3,000 common equities listed on the Nasdaq stock exchange.

Dow Jones Industrial Average ("DOW") is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq.

Russell 2000® Index (Russell 2000®) is an unmanaged index that measures the performance of the smallest 2000 U.S. companies in the Russell 3000® Index.

S&P/TSX Index is a capitalization-weighted equity index that tracks the performance of the largest companies listed on Canada's primary stock exchange, the Toronto Stock Exchange (TSX).

MSCI EAFE Index (Developed Markets —Europe, Australasia, and Far East Index) is a standard unmanaged foreign securities index representing major non-U.S. stock markets, as monitored by Morgan Stanley Capital International. The index captures large and mid-cap representation across 21 developed markets countries around the world, excluding the U.S. and Canada.

MSCI Emerging Markets Index is a market capitalization weighted index representative of the market structure of the emerging markets countries in Europe, Latin America, Africa, Middle East and Asia. Prior to January 1, 2002, the returns of the MSCI Emerging Markets Index were presented before application of withholding taxes.

Fixed income indices

Bloomberg U.S. Aggregate Bond Index is an unmanaged index that covers the U.S. investment-grade fixed-rate bond market, including government and credit securities, agency mortgage pass-through securities, asset-backed securities and commercial mortgage-based securities.

Bloomberg U.S. Treasury Index is an unmanaged index that includes a broad range of U.S. Treasury obligations and is considered representative of U.S. Treasury bond performance overall.

Bloomberg U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers.

Bloomberg U.S. Corporate High Yield Index is an unmanaged index that covers the USD-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+ or below.

Bloomberg 1-10 Year Blend Municipal Bond Index is a market value-weighted index which covers the short and intermediate components of the Bloomberg Capital Municipal Bond Index — an unmanaged, market value-weighted index which covers the U.S. investment-grade tax-exempt bond market.

Bloomberg Canada Aggregate Bond Index measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market. It includes treasuries, government-related, and corporate issuers.

Bloomberg Canada Aggregate Bond Index - Treasury is the treasury sub-component of the Bloomberg Canada Aggregate Bond Index, which measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market.

Bloomberg Canada Aggregate Bond Index - Corporate is the Corporate sub-component of the Bloomberg Canada Aggregate Bond Index, which measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market.

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