

**“The Time Has Come for Policy to Adjust.” – Maintaining a Bullish Stance on USD Bonds.****Summary**

- » Jerome Powell's speech at the Jackson Hole Symposium signals potential Fed rate cuts starting in September, with the Fed's confidence in reaching its 2% inflation target, but concerned about rising labour market risks.
- » The market anticipates significant 225bps rate cuts by the end of 2025, with expectations already reflected in current Treasury yields.
- » USD bond yields are expected to trend lower over the long term, and investors are advised to invest in fixed income now to benefit from the anticipated easing cycle.

**Key Message****A significant milestone**

Jerome Powell's speech at the Jackson Hole Symposium on 23 August 2024 marks a significant milestone in the current interest rate cycle, signaling that rate cuts may finally begin on 18 September, the next FOMC meeting date.

The Fed is more confident that inflation is on track to hit its 2% target. However, labour market risks are rising, with concerns that further economic slowdown could increase the unemployment rate. The Fed will now shift focus to adjusting monetary policy to attain a healthy job market, instead of being solely inflation-focused.

Overall, Jerome Powell's dovish pivot is a welcome development, long awaited by fixed income investors

**US Treasury is overly bullish now**

The market responded enthusiastically to Powell's speech, anticipating deep rate cuts of up to 225bps by the end of 2025. With 10Y and 30Y US Treasury yields consolidating near 3.80% and 4.10%, respectively, the US Treasury market reaction seems overly bullish by pricing in much ahead of the actual rate cuts.

**Direction of US Treasury yields**

In the next few weeks and months, 10Y and 30Y US Treasury yields could trend higher to 4.00% and 4.30% short-term resistance levels, respectively, due to technical rebounds and profit-taking activities after the euphoria subsides. Subsequently, we expect downward yield momentum to continue until the end of 2025, driven by fresh catalysts such as deterioration of labour market conditions.

The Bloomberg survey forecasts an August consensus target for Non-farm payroll gains at 155k, below the 12-month rolling average of 215k as of July. If actual payroll gains surpass 155k, the Fed might consider a smaller 25bps rate cut at the September meeting, potentially unwinding bullish US Treasury trades. Conversely, if payroll figures fall short, the likelihood of a 50bps Fed rate cut increases, potentially sparking a rally in US Treasury bonds.

**Our more prudent rate cuts expectations**

In our base case, the Fed will achieve its dual mandate goals over the next 12 months, allowing for a steady reduction in the policy rate by 50bps by the end of 2024 and a further 125bps over 2025. This is likely to result in 10Y and 30Y US Treasury yields trending lower to at least 3.50% and 3.80%, respectively, by the end of 2025. Should the US economy weaken unexpectedly, the Fed may accelerate its policy easing, causing US Treasury yields to overshoot these end-2025 targets.

**Maintaining our barbell investment strategy**

In line with the above, we expect strong performance in long-duration USD investment-grade corporate bonds and good income from short-duration USD high-yield corporate bonds. We strongly advocate investing in fixed income now and holding through the anticipated easing cycle at least until the end of 2025.

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