

Special Update

October 13, 2025
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What's Going on with Bonds??

The US bond market experienced positive performance in September 2025, driven primarily by declining Treasury yields amid Federal Reserve policy adjustments and cooling inflation pressures. Key indices, such as the Bloomberg US Aggregate Bond Index, posted gains as lower interest rates supported bond prices. Looking ahead to the remainder of 2025 (Q4), expectations are generally optimistic for bonds, with potential for further yield declines and solid returns, though challenges like tight spreads and economic slowdowns could temper gains. Near-term influences include ongoing Federal Reserve rate cuts, inflation dynamics, fiscal policy uncertainties (including the US government shutdown), tariffs, and broader economic growth concerns.

Performance of the US Bond Market in September 2025

The last month, September 2025, marked a period of solid performance for the US bond market, benefiting from a declining interest rate environment. US core bonds achieved positive returns as demand for yield remained strong amid Federal Reserve policy pivots. The third quarter as a whole (including September) saw exceptional returns across asset classes, but bonds specifically gained from the Fed's actions.

Treasury Bonds

Treasury yields trended lower throughout September, contributing to price appreciation in the sector. The 10-year US Treasury yield closed August at 4.23% and declined to 4.16% by the end of September, a drop of 7 basis points. Similarly, the 30-year Treasury yield fell from 4.93% to 4.73%, a more significant decline of 20 basis points. This movement provided a tailwind for bond prices, as yields and prices move inversely.

In the broader context of Q3 2025, the Morningstar US Treasury Bond Index gained 1.52%, reflecting the positive impact of the rate environment during the quarter's final month. Daily yield data from early October shows continuation of this stability, with the 10-year yield hovering around 4.12% to 4.16% in late September and early October.

Corporate and Municipal Bonds

Corporate bonds also performed well, supported by stable credit fundamentals and investor demand. US corporate bond issuance reached \$1,736.6 billion year-to-date through September, up 5.9% year-over-year, with average daily trading volume increasing 12.6% to \$58.8 billion. The Bloomberg US Aggregate Bond Index benefited from lower long-term rates, contributing to overall positive fixed income returns.

Municipal bonds outperformed Treasuries in Q3, with the Morningstar US Municipal Bond Index gaining 3.14%, indicating stronger performance in tax-exempt sectors during September's rate decline. Overall, fixed income markets posted broad gains, with Treasury yields declining across the curve.

Key Indices Summary

Index	September 2025 Performance	Q3 2025 Performance
Bloomberg US Aggregate Bond Index	Positive (supported by yield decline)	N/A (Q3 focus on broader gains)
Morningstar US Treasury Bond Index	Part of declining yield trend	+1.52%
Morningstar US Municipal Bond Index	Strong demand	+3.14%
Morningstar US Core Bond Index	Positive returns	Positive (Q3 high note)

These gains defied seasonal weaknesses often associated with September, aligning with broader market rallies in equities and fixed income.

Expectations for Performance in the Rest of 2025 (Q4)

The outlook for the US bond market in Q4 2025 remains constructive, with bonds positioned to benefit from ongoing Federal Reserve rate cuts and cooling inflation. Analysts anticipate bonds could perform well, potentially generating attractive returns amid economic uncertainty. Yields may fall further in the near term, even as structural pressures like loose fiscal policy exert upward influence over the longer horizon.

For corporate bonds, above-average yields and solid investor demand are positive factors, though tight spreads and rising event risk could limit upside. High-yield bonds, with index yields around 7%, face challenges in achieving 8%+ returns, but the environment supports moderate gains. Forecasts point to a slowdown in GDP growth in late 2025 and into 2026, driven by waning AI investment tailwinds and consumer spending, which could enhance bonds' appeal as a safe haven.

Market calm has been restored as economies adapt to US tariffs, and the Fed's rate-cutting cycle is expected to continue, potentially with additional 25 basis point cuts by year-end. Overall, 2025 is viewed as a potential "year of the bond," with fixed income outperforming in a transitioning economic landscape. However, investors are urged to diversify, as term premiums rise and long-term bond risks evolve.

Issues Expected to Influence the US Bond Market in the Near Term

Several key factors are poised to shape the US bond market from October to December 2025, including monetary policy, economic indicators, and geopolitical developments. These influences could drive volatility but also create opportunities.

Federal Reserve Policy and Interest Rates

The Fed's ongoing rate-cutting cycle, including a recent 25 basis point cut to the federal funds rate (now 4.00%-4.25%), will be a primary driver. Projections include further cuts, potentially to 3.5%-3.75% by year-end, amid softer inflation and weaker growth. Interest rate risks remain, with bond prices sensitive to changes in inflation and default risks.

Economic Growth and Inflation Dynamics

Economic uncertainty, including potential recession fears amplified by tariffs, will influence yields. Slower GDP growth forecasts for Q4 could support lower yields, but persistent inflation may counter this. Factors like weaker economic data and cooling consumer spending are expected to justify current yield levels.

Fiscal and Policy Uncertainties

The ongoing US government shutdown is a focal point, with little change in Treasury yields as investors await resolution. High tariffs, federal spending cuts, and immigration limits pose obstacles to growth while pushing prices higher. Rising fiscal deficits and the record \$28.6 trillion in outstanding Treasurys (Q1 2025) add pressure.

Other Factors

Shifting stock-bond correlations increase portfolio risks, necessitating rethinking diversification. Global inflation persistence and hawkish Fed signals from December could spill over. Businesses have adapted to tariffs, but event risks remain.

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