

The Powell Pivot | August 2025

‘When the facts change, I change my mind - what do you do, sir?’

John Maynard Keynes

Seven years ago, we penned a commentary titled, ‘Don’t Fight the Fed’ (November 2018). It was during President Trump’s first term in office, back when his preferred social media platform was Twitter.

At the time, the target of the Twitter bombs was Jerome Powell, the ‘wise steward’ the President appointed to chair the Federal Reserve. The attacks came in the midst of a 20% sell-off in the equity market, with Trump blaming it on rate hikes and the monetary policy being pursued by Powell. ‘Every time we do something great, he raises the interest rates.’ The President even went so far as to call the Fed ‘loco’ (a word we thought only ‘bad hombres’ used).

Fast forward to today, and ‘numbskull’ Powell once again finds himself in the President’s crosshairs. Albeit this time, the barbs are being lobbed on Truth Social and include direct attacks on the Fed’s independence.

The President’s objective is to pressure the central bankers into lowering rates. And based on recent developments, his wish might come true. Amidst all the noise and headlines about the Fed, at their annual Jackson Hole conference, there was a material shift in their messaging.

After holding rates steady at the end of July, Chairman Powell’s press conference had a notably hawkish tone. He indicated that the decision to hold was predicated on the Fed being further from its inflation target than its employment goal.

A few short weeks later, the script was flipped. The Chairman’s remarks at Jackson Hole cited increasing downside risks to the labour market, as companies adjust costs to offset tariffs. And while price increases from tariffs are visible, the Fed views these as one-off adjustments and unlikely to lead to an inflation spiral (no, he did not use the ‘transitory’ word).

In response, bond traders shifted the probability of a September cut from 40% to 88%. And after last week’s disappointing payrolls report, the market is now pricing in a full cut and flirting with the idea of a 50 bps move. Furthermore, from now to the end of 2026, the expectation is for a total of 1.5% of easing.

In the short term, lower policy rates have the potential to stimulate the economy and propel markets higher. Such a boost can help win over voters, but what about the fabled bond vigilantes?

Since the end of July, the US 2y yield has dropped 43 bps. Over the same time period, the 30y rate is only 13 bps lower. The steepening of the curve indicates lingering concerns over inflation, deficits, and Fed independence. But this is hardly the handiwork of vigilantes. Relative to other global markets, US long bonds have held in rather well (so far).

So what does it take for the US bond vigilantes to emerge and pressure long-term yields higher?

The current policy rate of 4.25% - 4.50% is assumed to be at least 1% above the neutral rate. Thus, there is room for the Fed to ease and still maintain a restrictive monetary policy. If, for example, the overnight rate is reduced by a modest 50 bps, the vigilantes would likely be kept at bay.

However, in the absence of a recession, a more aggressive cutting cycle could lead to the emergence of vigilantes. As we learnt from the COVID-19 crisis, an inordinate amount of monetary stimulus can lead to an inflation spiral.

If, as the President wishes, the Fed were to lower rates by 3%, it seems safe to assume the vigilantes would be out in full force, driving up long-dated yields and increasing borrowing costs for the government, companies, and consumers (mortgages).

Thus, an overly aggressive easing campaign could be too much of a good thing. So, the President should be careful what he wishes for.

The Month of August.

Credit.

The normally sleepy month of August was anything but, with a record-breaking \$11.6 bn of new issuance hitting the domestic market. In part due to the deluge of supply, the rally in credit lost its steam, with Canadian investment-grade credit spreads generically widening 6 bps. Despite this modest widening, the decline in rates meant companies could lock in funding at attractive all-in yields.

August also saw Canadian banks report Q3 earnings. Overall, the reports looked decent, with margin expansion, robust capital markets activity, lower loss provisions, and strong capital ratios. We anticipate significant supply in this sector through September, with RBC expected to issue AT1s and bail-in bonds across the board. Whether these deals come to the domestic or US market will depend on which market offers the lowest cost of funds.

Investment-grade credit spreads:

- Canadian spreads widened 6 bps to 91 bps.
- US spreads widened 3 bps to 79 bps.

Interest Rates.

The 'Powell Pivot' and weakness in labour markets opened the door wider to rate cuts. The expectations for the number of 25 bps cuts from now to the end of 2026 increased from 4.5 to 5.5. This led to a sharp rally in rates with US 2y yields dropping 34 bps.

The Canadian market saw similar moves. At the end of July, yields implied a 60% chance of another cut from the BoC. By the end of August, the market had fully priced in another cut.

It is interesting to note that 30y rates on both sides of the border finished August modestly higher. The steepening of curves indicates that either inflation pressures could persist, or that growing fiscal deficits are increasing the term premium required by investors to hold longer-dated government debt.

- Canadian 2y finished at 2.64% (-13 bps) and the 10y at 3.37% (-8 bps)
- US 2y finished at 3.62% (-34 bps) and the 10y at 4.23% (-15 bps)

The Funds.

Algonquin Debt Strategies Fund.

The Fund's conservative risk posture minimized the losses from the credit spread widening, which was more than offset by the yield earned, active trading, and tactical rate positioning.

Portfolio Metrics:

- 4-6% yield
- Average credit rating: BBB+
- Average maturity: 2.3y
- IR Duration: 1.2y

	1M	3M	6M	YTD	1Y	3Y	5Y	10y	SI
X Class	0.25%	1.60%	2.42%	2.77%	7.28%	9.36%	6.23%	7.71%	8.20%
F Class	0.20%	1.38%	2.02%	2.27%	6.33%	8.35%	5.35%		5.55%

* As of August 31st, 2025

The Algonquin Debt Strategies Fund LP was launched on February 2, 2015. Returns are shown on 'Series 1 X Founder's Class' since inception and for 'Series 1 F Class' since May 1st, 2016, and are based on NAVs in Canadian dollars as calculated by SGGG Fund Services Inc. net of all fees and expenses. For periods greater than one year, returns are annualized.

Algonquin Fixed Income 2.0

The Fund benefited from having duration exposure concentrated in the short-end of the US and Canadian yield curves. On the credit side, the Fund's defensive positioning limited losses from the sell-off in spreads and was more than offset by active credit trading.

Portfolio Metrics:

- 4-5% yield
- Average credit rating: BBB+
- Average maturity: 2.6y
- IR Duration: 3.9y

	1M	3M	6M	YTD	1Y	2y	3y	5y	SI
F Class	0.76%	1.62%	2.35%	3.50%	7.57%	9.66%	8.03%	4.62%	5.07%

* As of August 31st, 2025

Algonquin Fixed Income 2.0 Fund is an Alternative Mutual Fund and was launched on December 9, 2019. Returns are shown for Class F since inception and are based on NAVs in Canadian dollars as calculated by SGGG Fund Services Inc., net of all fees and expenses. Investors should read the Simplified Prospectus, Annual Information Form, and Fund Facts Documents and consult their registered investment dealer before making an investment decision. Commissions, trailing commissions, management fees, and operating expenses all may be associated with mutual fund investments. An Alternative Mutual Fund is not guaranteed, its value changes frequently and its past performance is not indicative of future performance and may not be repeated. Payment of quarterly distributions is not guaranteed and paid at the discretion of the manager; therefore, it may vary from period to period and does not infer fund performance or rate of return.



Looking Ahead.

Rate cuts are coming. The question is how many? South of the border, this will depend on whether the environment warrants restrictive, neutral, or stimulative monetary policy. The market is pricing in expectations of a terminal rate of 2.75%-3%. Whether or not this comes to fruition, our experience tells us that whatever the path is, it will not be a straight line. Given the wide range of potential outcomes, we expect the market to readjust its expectations based on the economic data and Fed headlines.

Canadian markets are now pricing a ~80% probability that the BoC will cut this month and are 50/50 on another cut coming later this year. In our opinion, bond investors are underpricing the odds of two or more cuts to cushion the economy against the drag of US trade policy. For now, Canadian companies are under the protective umbrella of CUSMA. But that is open for renegotiation next year with a US administration that is enamoured with tariffs.

As we move further out on the yield curves, the picture becomes much murkier. Our view is that barring a significant economic slowdown, it is difficult to foresee a material rally in long-end yields. If the Fed limits its cuts and maintains a restrictive policy, then 4% 10y yields might not be sufficient to entice investors out of cash. And if they are too aggressive with cuts, it could stoke inflation fears and bring out the bond vigilantes. Accordingly, our preference is to avoid long-duration and focus rate exposures in the 2-5y part of the curve.

In terms of credit, we expect September to be a supply-heavy month. Similar to August, this could result in some supply-based widening of spreads. Depending on the extent and nature of such a widening, it could represent an opportunity to add modest amounts of exposure.

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