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## A Return to Normality – Really?

In times of political unrest, a certain degree of normality is returning to the bond market.

Politically, the world is undergoing the most profound shifts in values and power since the Second World War. And yet, financial markets have proven remarkably resilient amid these geopolitical drifts. More than that – central banks and bond markets are regaining, in several respects, a degree of normality unseen since the era of financial repression. Looking beyond the overarching sovereign debt issue, opportunities are emerging in the details.

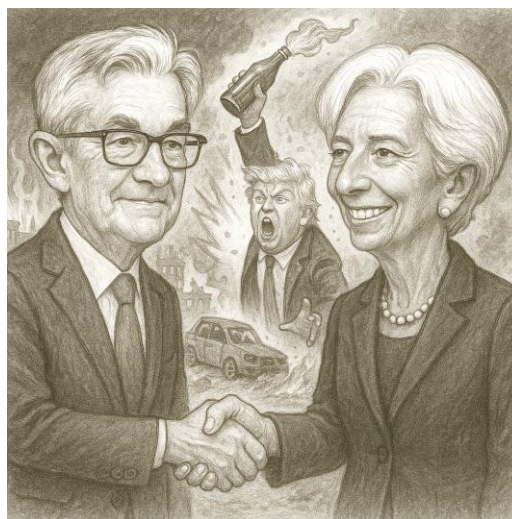
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### Normalization: A Tribute to the Fed

“Doing is like wanting – only stronger.” Those who bear responsibility for decisions under pressure – particularly in a Web 3.0 world – know that the downside is significant and public backlash is almost guaranteed.

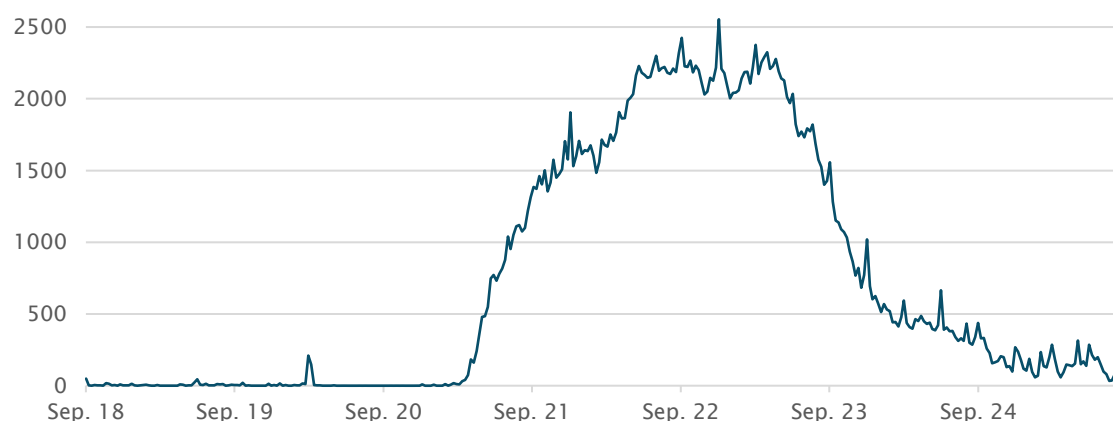
Against this backdrop, the measures taken by central banks to counter the fallout of global lockdowns during the pandemic can almost be described as heroic. They acted without a tested playbook, fully aware that failure could impair national prosperity for years.

In March 2020, the Fed acted decisively, deploying support measures of more than USD 4 trillion to avert a collapse of global growth and wealth. That Jerome Powell, who orchestrated this response, still presides over Fed policy today is no small matter – it underscores both the



success of his crisis management and his handling of the subsequent side effects. His determination to continue normalizing monetary policy, despite the political noise, commands the highest respect.

## FED - Reverse Repo Operations, in USD billion



Source: New York Fed, September 2025

## US Money Markets – Balance Restored

At the onset of the pandemic, central banks massively expanded their balance sheets to shield the economy and financial markets from collapse. Combined, the Fed and the ECB added around USD 10 trillion. Enough fuel, in hindsight, for the subsequent surge in inflation.

To fight this inflation effectively, central banks abruptly reversed course in October 2021. Leading the shift were the Bank of England and the Reserve Bank of Australia, which were the first to end emergency policies and adopt a restrictive stance.

Since then, Quantitative Tightening (QT) and rate hikes have reduced Fed and ECB balance sheets by around 25% and 30% respectively from their 2022 peaks. Signs of normalization are now clearly visible in US money markets. Volumes in the Fed's reverse repo (RRP) facility have dropped back to near zero, essentially pre-crisis levels.

The original rationale for RRP was twofold: to absorb excess liquidity that had built up during QE and to alleviate shortages of high-quality collateral caused by the Fed's securities purchases.

The recent decline in RRP usage does not, however, signal a return to tight money-market liquidity. Both in the US and Europe, the "ample reserves system" – structural excess liquidity in the banking system – remains the new normal and the stated goal of both Fed and ECB.

Normalization here means that the availability of high-quality collateral has been restored through QT and balance-sheet reduction. This in turn gives policymakers more flexibility, reduces the complexity of monetary operations, and should strengthen investor confidence in the Fed's ability to manage future episodes of market stress.

## Term Premium 10-year US-Treasuries in %



Source: New York Fed, September 2025

### Capital Markets –

#### Term Premia Turn Positive

Another sign of normalization is the re-emergence of positive term premia in long-dated sovereign bonds, not only in the US but also in Europe.

Term premia compensate investors for holding long-term debt as opposed to rolling short-dated instruments, reflecting exposure to duration, inflation, and liquidity risks.

For much of the past decade, term premia were negative – a hallmark of financial repression, alongside negative real yields on long-dated sovereigns. The turnaround reflects balance-sheet reduction and diminished central-bank holdings of government bonds.

In our base case, US 10-year Treasuries are still around 100 bps, and German Bunds around 50 bps, away from levels we would consider sufficiently compensatory. Interim overshooting is even possible.

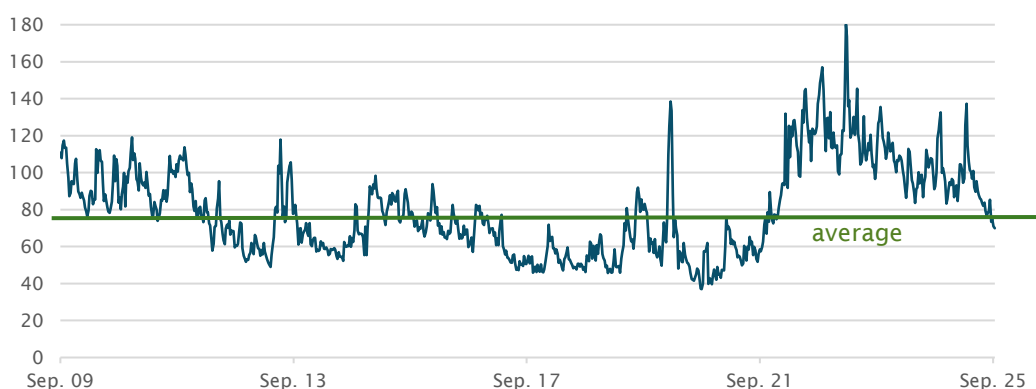
This normalization of term premia enhances the stabilizing role of bonds in multi-asset portfolios. For years, negative premia undermined this function and distorted asset allocation.

Looking ahead, the Fed's current rate-cutting cycle, combined with a rising term premium, limits upside potential for the 10-year Treasury but supports a bull steepening of the US curve, making short to intermediate maturities more attractive on a risk-reward basis than the long end.

As the ECB is approaching, or may already have reached, the end of its rate-cutting cycle, we view the renewed rise in the term premium on German Bunds as an isolated driver of a bear steepening. Of course, the term premium is only

one of many factors influencing the absolute yield level. While we initially regard this factor as a headwind for the long end of the curve (our base case projects 10-year Bund yields somewhat above 3%), we nonetheless consider the return to positive territory as a welcome normalization.

## ICE BofA MOVE Index - Implied volatility of US-Treasuries



Source: ICE Data, September 2025

## Volatility – Back to Lower Levels

The normalization theme also extends to volatility. Recall 2019, when implied volatility in Bund derivatives collapsed to historic lows, sparking a dramatic duration rally. Today, implied volatility has again fallen sharply – evident in the MOVE Index for US Treasuries and in futures on 10-year Treasuries and Bunds.

Unlike 2019, however, we see few parallels that would suggest another outsized duration rally. Central banks are data-dependent and steering on sight, rather than relying on long-term forward guidance. We interpret the low volatility levels more as a reflection of compressed risk premia. In our view, this environment favors “long vol” positions over “long duration.”

**Our Conclusion:** Amid historic political upheaval, central banks have managed to stay the course on normalization – achieving a degree of stability that politics has failed to deliver. For investors, this translates into a more functional role for bonds within portfolios and more compelling opportunities across maturities.

**Our rates outlook:** On both sides of the Atlantic, we view duration risk up to 7 years as attractive. Beyond that, steeper curves and higher yields remain likely. Given low risk premia in risky assets, money-market rates continue to offer genuine opportunities on a risk-adjusted basis.

Best regards

  
 (Wilhelm Wildschütz)

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