

KEY MARKET DEVELOPMENT

The Fed Ends QT: What It Means for Markets

29 OCTOBER 2025 | MFS MARKET INSIGHTS TEAM

Key insights

01

The end of the Federal Reserve's (Fed) quantitative tightening leads to an improvement in the liquidity backdrop.

02

This policy move may send a tactically bullish signal for both fixed income and equities.

03

We anticipate market rates to move lower, supporting the tactical case for US duration.

04

This also sends a tactically bullish signal for risky assets, including credit and equities.

The Fed Just Announced it is Ending Quantitative Tightening

This policy move will result in an improvement to the financial system's liquidity backdrop. First, what is quantitative tightening (QT)? During QT, the Fed allowed a set monthly amount of Treasuries and mortgage-backed securities to mature each month. This, in turn, reduced the central bank's holdings of these securities and decreased reserves in the banking system. So why will the Fed terminate QT on December 1? Mainly to address signs of mounting stress and elevated volatility in money markets. With the understanding that there is a clear relationship between developments in money markets and banking system liquidity, the Fed would have taken notice that bank reserves have declined substantially over the past few weeks — to their lowest level since late 2024 — squeezing liquidity. The end of QT will improve liquidity in the financial system.

Looking back, QT was put in place in mid-2022 to reduce the Fed's balance sheet as part of a broader policy normalization to unwind the large liquidity stimulus implemented in response to the pandemic.

A Bullish Market Signal in the Short Term

This policy move is likely to send tactically bullish signals for both fixed income and equities. On the rates side, expectations for an improved liquidity backdrop are likely to push market rates lower. On this basis, it is entirely possible that we may decisively break the 4% level in 10-year US Treasuries to the downside. In other words, the near-term market backdrop may be turning more supportive of long US duration. Beyond rates, the end of QT is also likely to boost appetite for riskier assets. These include IG and HY credit in fixed income as well as US equities. Reflecting the impact of potentially lower rates, we believe that the more interest-rate sensitive sectors — including consumer discretionary, utilities or real estate — as well as the more interest-sensitive factors — such as small caps or growth — may benefit the most from the Fed's policy shift. Finally, another market implication of the end of QT may be renewed downward pressure on the USD in the near term. ▲

KEY CONSIDERATIONS

- Favor being long US duration on a tactical basis
- Favor tactical exposure to risky assets both in fixed income and equities
- Within equities, favor exposure to more rate-sensitive sectors and factors

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