The Fed hiked rates, so why did bonds and stocks rally?

The Federal Reserve did what markets expected this week.

It raised the federal funds target range by **25 basis points to 3.75%–4.00%**.

Normally, a rate hike sounds negative for both stocks and bonds.

Higher rates increase borrowing costs and usually put pressure on asset prices.

But something interesting happened after the decision.

Long-term Treasury yields **fell**, TLT moved higher, and the stock market rallied.

That raises an interesting question:

> If the Fed just raised interest rates, why did long-term Treasury yields fall while stocks went up?

What is actually happening?

The first important point is that the Fed does not control every interest rate.

The Fed directly controls a **very short-term rate**: the federal funds target range.

But yields on the **10-year, 20-year, and 30-year Treasury bonds** are determined by the market.

Investors price those bonds based on expectations about:

- future Fed policy
- inflation
- economic growth
- government borrowing
- risk

So the Fed can raise its short-term rate while long-term yields move in the opposite direction.

That is what happened after Wednesday's meeting.

Long-term Treasury yields moved lower, while **TLT**, the iShares 20+ Year Treasury Bond ETF, moved higher.

TLT owns Treasury bonds with more than 20 years remaining until maturity, so it is very sensitive to changes in long-term yields.

And because **bond prices and yields move in opposite directions**:

Long-term yields fall
→ long-term bond prices rise
→ **TLT rises**

Why this matters

At first, the market reaction seems backward.

Fed hikes rates
→ rates go higher
→ bonds fall
→ stocks fall

But the key is expectations.

The Fed's 25-basis-point hike was already heavily expected before the meeting.

Markets had been pricing roughly a **90% probability of a hike**.

So when the Fed actually raised rates, investors did not receive much new information.

The hike was already largely priced in.

Instead, investors started asking what the decision meant for the **future**.

A stronger response to inflation today could make investors more confident that inflation will eventually come down.

And if investors expect lower inflation in the future, they may require less compensation to hold a 20- or 30-year Treasury bond.

That can push long-term yields lower.

So strangely:

A rate hike today can sometimes cause long-term yields to fall if investors believe the hike reduces future inflation risk.

Why did stocks rally?

This is where the bond market connects directly to stocks.

Stock valuations depend partly on the present value of future company profits.

When long-term Treasury yields rise, investors generally use a higher **discount rate** to value those future cash flows.

Higher discount rate
→ future profits are worth less today
→ stock valuations face pressure

But Thursday brought the opposite move.

Long-term Treasury yields fell.

That reduced some of the pressure on stock valuations.

The S&P 500 gained about **1.1%**, while the Nasdaq rose around **1.6%**.

Lower oil prices also helped because cheaper energy can reduce inflation pressure and costs for consumers and businesses.

So stocks were not rallying because investors suddenly believed higher rates were good.

They were reacting to a combination of:

the hike being expected + long-term yields falling + inflation concerns easing

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The question investors are really asking

The important question is no longer:

“Did the Fed raise rates?”

That is already known.

The more important question is:

> What does today's hike tell the market about inflation and the future path of interest rates?

The Fed raised the overnight rate.

But investors are looking years ahead.

If the Fed tightens enough now to bring inflation under control, it may not need to keep raising rates forever.

That creates two different forces:

Fed hikes today
→ short-term rates stay high

But:

Greater confidence inflation will fall
→ long-term inflation risk declines
→ long-term yields can fall

Both can happen at the same time.

That is why saying **“the Fed raised rates, so interest rates went up”** can be misleading.

CFA Level I connection

This connects directly to two CFA Level I Fixed Income concepts: **duration and the yield curve**.

The yield curve shows interest rates across different maturities.

Short-term yields are more closely connected to current Fed policy.

Long-term yields depend much more on expectations about future inflation, growth, and interest rates.

Duration tells us how sensitive a bond's price is to changes in yield.

TLT has a long duration because it owns very long-term Treasury bonds.

A simplified relationship is:

Bond price change ≈ –Duration × change in yield

So even a small decline in long-term yields can cause a noticeable increase in TLT.

For example:

Long-term yield falls
→ long-duration bond price rises more
→ **TLT can rally even while the Fed raises its short-term rate**

That is the part that makes this market reaction much easier to understand.

Simple model

Fed raises rates by 25 bps
→ hike was already expected
→ investors focus on future inflation
→ confidence in the inflation fight improves
→ long-term Treasury yields fall
→ long-duration bond prices rise
→ **TLT rises**

At the same time:

Long-term yields fall
→ discount rates decline
→ future company profits become more valuable today
→ **stocks rally**

Today's takeaway

The biggest lesson is that **the Fed's interest rate and long-term Treasury yields are not the same thing**.

The Fed can raise the overnight rate while 20- and 30-year yields move lower.

That happens because markets are always looking ahead.

Wednesday's hike was already expected.

What mattered more was how the decision changed expectations about future inflation and future interest rates.

The same idea explains why stocks could rally after a rate hike.

Lower long-term yields reduced the discount rate used to value future profits, giving stock valuations some relief.

So a Fed hike, a Treasury bond rally, and a stock-market rally are not necessarily contradictory.

The Fed controls today's short-term rate. The market prices what it thinks rates will look like tomorrow.

Sources

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Reuters: Used for the stock-market rally, including approximately **1.1% for the S&P 500 and 1.6% for the Nasdaq**. Reuters — Wall Street rebounds after Fed hike

iShares: Used for TLT's structure as an ETF holding Treasury securities with more than 20 years remaining until maturity. iShares — TLT