

HOW THE FED UNDER KEVIN WARSH MAY IMPACT MARKETS

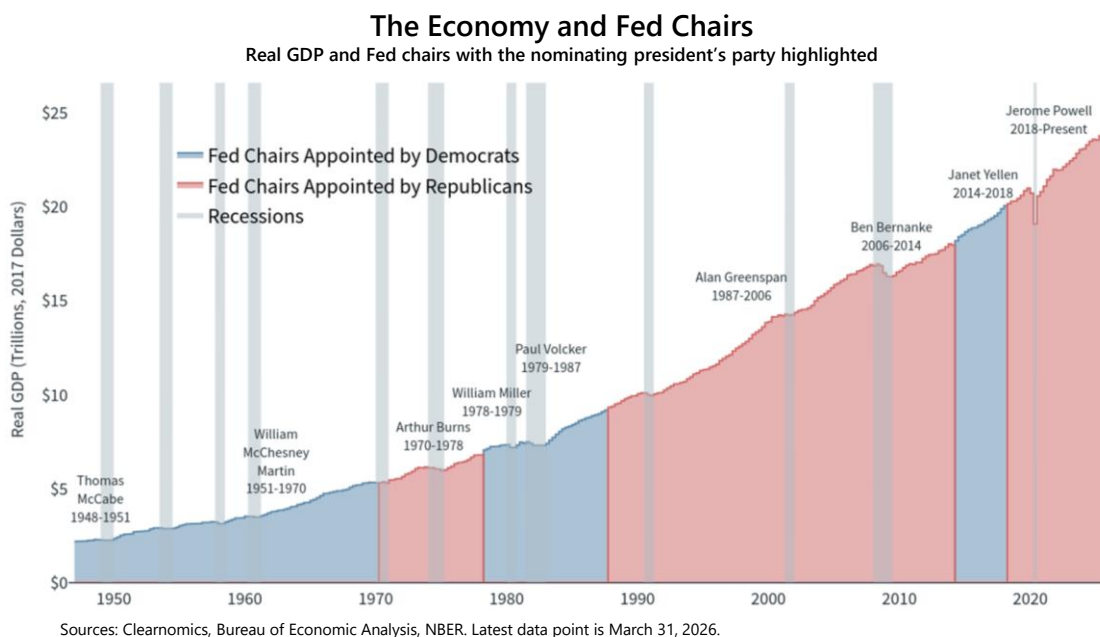
The Federal Reserve plays a central role in markets and the economy. How will the central bank evolve under Kevin Warsh as the new Fed Chair?

The Federal Reserve occupies a central position in financial markets and the broader economy, and its influence has expanded considerably in recent decades. From the 2008 global financial crisis to the inflationary pressures of recent years, investors have closely followed every Fed decision. Leadership changes at the Fed therefore attract significant attention from investors and the public alike. Even so, it is important to understand what the Fed can and cannot control in the context of long-term investing.

Kevin Warsh, an experienced policymaker who served on the Fed's Board of Governors during the global financial crisis, has been confirmed by the Senate as the new Fed Chair. Markets have responded positively to his nomination, viewing him as a familiar figure with deep knowledge of monetary policy. The key question for investors is what his leadership might mean for Fed policy and portfolios in the years ahead.

The Economy Has Expanded Under a Variety of Fed Leaders

A broader historical perspective is useful when considering Fed leadership transitions. The Fed Chair serves a four-year term, while members of the Board of Governors serve rotating 14-year terms. This structure is designed to insulate monetary, regulatory, and supervisory decisions from political pressure, a principle commonly referred to as "Fed independence." The accompanying chart illustrates that the U.S. economy has grown across the tenures of multiple Fed chairs, regardless of which president appointed them. Leaders such as Paul Volcker, Alan Greenspan, Ben Bernanke, Janet Yellen, and Jerome Powell each faced distinct economic challenges, from stagflation to the global financial crisis and the recent surge in inflation.



The Federal Reserve Reform Act of 1977 established a "dual mandate" to promote maximum employment and stable inflation, which ideally supports predictable long-term borrowing costs. However, the Fed does not control all aspects of the economy. Many of its tools, including the federal funds rate, are considered blunt instruments that operate with what economists describe as "long and variable lags." Economic shocks, technological change, demographics, and global events all play significant roles that the Fed can react to but cannot directly control. For investors, maintaining a long-term perspective means looking beyond any single Fed decision to understand the broader drivers at work.

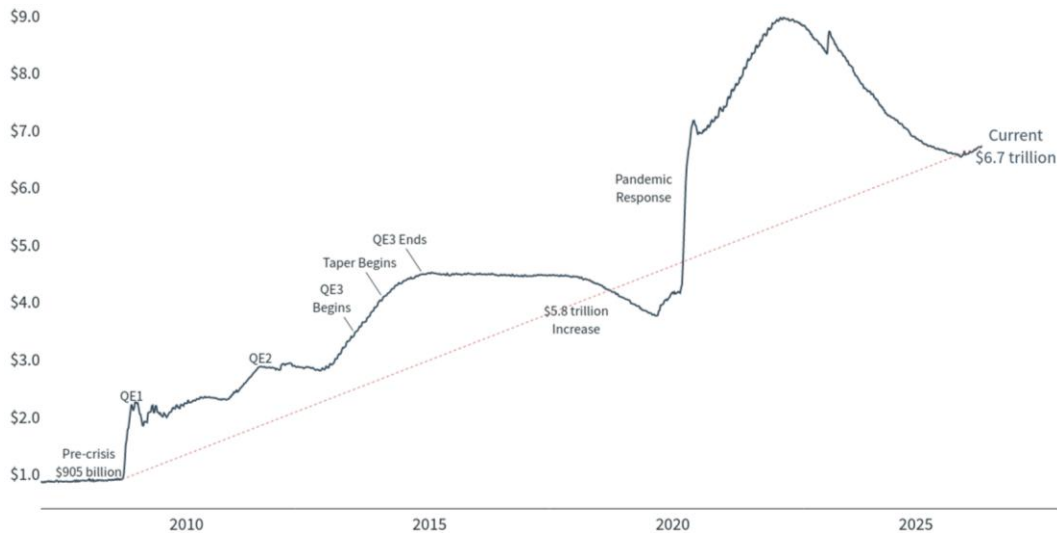
Warsh Advocates for a More Narrowly Focused Federal Reserve

In his Senate testimony, Warsh stated that he favors "a clearer, cleaner match between the Fed's powers and responsibilities," signaling a preference for a more focused central bank. He also emphasized that "monetary policy independence is essential" and that policymakers must act in the nation's interest. Warsh has historically been viewed as an "inflation hawk," meaning he tends to favor higher interest rates to guard against rising inflation, along with broader institutional reform at the Fed.

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There are several implications for investors. First, it will take time to see how Warsh's views translate into policy, particularly if they come into tension with the White House's preference for lower rates. This would not be unprecedented. Conflicts between the executive branch and the Fed have occurred throughout history, including between President Lyndon B. Johnson and Fed Chair William McChesney Martin Jr., Ronald Reagan and Paul Volcker, and more recently between Donald Trump and Jerome Powell. Such tensions have even arisen when the sitting president appointed the Fed Chair.

Federal Reserve Balance Sheet



Sources: Clearnomics, Federal Reserve. Latest data point is May 13, 2026.

Inflation and the Money Supply Add Complexity to Fed Decision-Making

Warsh supports the Fed's crisis-era balance sheet expansion as having been appropriate at the time, given that he was directly involved in those decisions. However, he believes the Fed should "retrace its steps" once conditions normalize. With the balance sheet still sizable at \$6.7 trillion, he argues that further reduction is warranted now that the 2008 financial crisis and the pandemic are well behind us. Shrinking the balance sheet, often called "quantitative tightening," can affect bond prices, mortgage rates, and corporate borrowing costs by tightening financial conditions over time.

Warsh also believes that Fed policy since the pandemic has contributed to the growth of the federal deficit and national debt. While he acknowledges that spending may be justified during recessions, he argues it should be symmetric and that monetary policymakers should avoid fiscal commentary. The Fed does not directly control federal spending, so its influence in this area would likely be limited to guidance or interest rate decisions.

The new Fed Chair inherits a challenging economic environment. Inflation has accelerated in recent months due to higher oil and gasoline prices driven by the war in Iran. Headline CPI stood at 3.8% year-over-year as of April 2026, with core CPI at 2.8%, both above the Fed's 2% target. While rate cuts had previously been anticipated, fed funds futures now reflect the possibility of a rate increase by early 2027. These expectations shift frequently with new data and global developments, underscoring the uncertain path ahead for monetary policy.



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