

What does the Warsh era mean for Fed policy?

UBS House View Briefcase

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Key message

Kevin Warsh's tenure as chair of the Federal Reserve began on a hawkish note. But while inflation risks are likely to keep the central bank on hold for the rest of the year, we believe market pricing for rate hikes is somewhat aggressive. We see an opportunity for investors to lock in yields by adding to short- and medium-duration quality bonds.

01 **The June Fed meeting was more hawkish than expected.**

- The easing bias was removed from the Fed's statement, while inflation projections were revised higher.
- Roughly half of officials anticipate at least one rate increase before year-end.
- Structural changes to Fed communications and the launch of multiple task forces (spanning communications, the balance sheet, data, productivity and labor markets, and inflation frameworks) suggest a more cautious policy approach.

02 **But we believe the Fed is more likely to keep rates on hold than to hike them.**

- The combination of a new chair regime and a wide dispersion of views among FOMC members implies a higher bar for near-term action in either direction. We expect the Fed to keep rates on hold for the rest of the year.
- Slower growth trends and disinflation in the second half should help support a pivot toward lower policy rates in 2027.
- If supply disruptions tied to the Middle East conflict ease, some of the June meeting's hawkish tone could fade.

03 **We continue to like short- and medium-duration quality bonds.**

- Current market conviction around Fed rate hikes in 2026 appears somewhat too aggressive, in our view.
- We see an opportunity to lock in yields on short- to medium-duration quality bonds. Investors looking to enhance or diversify portfolio income can also consider emerging market bonds, and equity income and yield-generating strategies.
- We believe Fed policy overall will remain supportive for US equities, and we favor a balanced and diversified approach to the asset class.

New this week

The Fed kept the federal funds rate unchanged at 3.50-3.75% for a fourth consecutive meeting, underscoring a cautious stance amid persistent inflation and a still-resilient economy. While the decision was widely anticipated, the Fed's guidance and projections signaled greater vigilance on inflation risks.

One liner

We believe markets are overpricing the risk of tighter Fed policy this year and we favor locking in yields in short- and medium-duration quality bonds.

Did you know?

- The FOMC's June statement removed both the easing bias and forward guidance, reinforcing the idea that the Committee is no longer attempting to guide market expectations explicitly. The post-meeting statement was significantly shortened, offering only a high-level assessment of economic conditions.
- Chair Warsh did not submit rate projections, consistent with his earlier criticism of the dot plot framework, while another participant did not provide longer-term projections. This partial participation highlights growing skepticism toward the dot plot framework and raises questions about its role over time.
- Cash tends to underperform other assets over time: Stocks have outperformed cash in 86% of all 10-year periods and 100% of all 20-year periods since 1926.

Investment view

We believe markets continue to overprice the risk of a tighter Fed policy, presenting an opportunity for investors to lock in yields. We like short- and medium-maturity quality bonds. We also expect Fed policy to remain supportive for equities.

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