# What does the Warsh era mean for Fed policy?

## UBS House View Briefcase

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## Key message

Federal Reserve Chair Kevin Warsh has adopted a more hawkish stance, warning that the Fed has "work to do" unless inflation moves toward its target clearly and quickly. Strong employment and inflation data have reinforced the case for tighter policy, and we now expect two rate hikes in 2026. But the economic resilience contributing to this shift also supports our constructive investment outlook.

### 01 Chair Warsh has adopted a more hawkish stance, supported by strong US data.

- At Jackson Hole, Warsh said the Fed "must be confident that underlying inflation is moving to our objective, clearly and at sufficient speed.
- He warned that rate hikes are likely if inflation does not improve at a "satisfactory speed."
- Strong August employment data and firmer-than-expected inflation have reduced confidence that price pressures will continue to ease without higher rates.

### 02 But a more hawkish Fed does not necessarily imply a deteriorating investment outlook.

- Employment demand remains firm, economic activity is holding up, and GDP growth tracking suggests that policy is not currently restrictive.
- Some of the same forces supporting markets, including AI-related capital spending, resilient activity, strong employment, and broad earnings growth, are also contributing to the more hawkish policy outlook.
- We expect the growth effects of two rate hikes to be modest and still see economic growth remaining near trend.

### 03 So we retain a constructive investment outlook and favor diversified equity exposure.

- We now expect 25-basis-point rate hikes in September and December, taking the federal funds target range to 4.00-4.25%.
- We continue to position for further gains in equities, although higher yields could create short-term volatility and weigh on rate-sensitive areas.
- Investors should maintain diversified exposure and use market volatility around economic data and Fed decisions to rebalance portfolios toward their long-term targets.

## New this week

Chair Warsh's more hawkish communication, strong August payrolls, and firmer inflation data caused markets to price in a higher probability of a rate hike at the central bank's policy meeting next week.

## One liner

Warsh's more hawkish stance and strong US data have increased the likelihood of rate hikes, but the economic resilience behind that shift supports our constructive investment outlook.

## Did you know?

- US nonfarm payrolls rose by 162,000 in August, compared with consensus expectations for 55,000, while positive revisions added another 55,000 jobs to prior months.
- The Fed's preferred personal consumption expenditures measure of inflation rose 3.7% year over year in July, slightly more than expected.
- Market-implied odds of a September rate hike rose to around 60% following the employment report.

## Investment view

Investors should not mistake a potential change in Fed rates for a change in the investment outlook. Resilient economic activity, AI investment, strong employment, and healthy profits support our constructive view on global equities, even if higher yields create short-term volatility.If the Fed moves onto a hiking path, the relative advantage of short-duration bonds over cash would likely narrow. But recent moves higher in yields may be opening up portfolio diversification opportunities in medium- to long-maturity high-quality bonds. Entry points should nevertheless be assessed carefully.

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