



INVESTMENT UPDATE

With Jerome Powell's tenure as Federal Reserve Chair now concluded and Kevin Warsh officially confirmed by the Senate, it seems an appropriate moment to step back and assess what the Powell years meant for bond investors, and what the transition to new leadership may portend for our market going forward.

The Powell Era in Context

Jerome Powell assumed the chairmanship in February 2018, inheriting an economy that was growing steadily and a Fed that had already begun the careful process of normalizing interest rates after the extraordinary accommodation of the post-financial crisis years. By most measures, the early part of his tenure was unremarkable in the best possible sense: steady, credible, and well-communicated. When COVID-19 struck in March 2020, the Fed's response under Powell was swift and decisive: rates were cut to zero, asset purchases were expanded dramatically, and emergency lending facilities were created in a matter of days. These actions were broadly credited with preventing a financial crisis from compounding an already devastating public health emergency.

The more complicated chapter of Powell's tenure came in the years that followed. As the economy reopened, supply chains struggled to meet surging demand, and consumer price inflation began to accelerate through 2021. In retrospect, the Fed, along with most major economic forecasters, underestimated both the breadth and persistence of that inflationary surge. The characterization of inflation as "transitory" proved, with hindsight, to be an overly optimistic read of what was unfolding. By the time the Fed began raising rates in March 2022, headline CPI had reached 9.1%, the highest reading in four decades.

The pace of tightening that followed was among the most aggressive in the Fed's modern history. The rate hiking cycle that ensued - seventeen increases totaling 525 basis points between March 2022 and July 2023 - was, by the Fed's own admission, shaped by incoming data rather than forward-looking guidance, which made it difficult for investors to position ahead of policy moves. For bond investors, the consequences were severe and, in some respects, historically unusual. The Bloomberg U.S. Aggregate Bond Index posted its worst calendar-year return on record in 2022, and longer-duration portfolios fared considerably worse. The repricing of the risk-free rate was both rapid and disorderly, and the absence of clear forward guidance meant that market participants were consistently behind the curve.

A more structural critique of the Powell era, and one that deserves greater attention than it has received, is the degree to which monetary policy became disproportionately focused on financial asset prices as a transmission mechanism for economic support. The Fed's extraordinary balance sheet

expansion and sustained suppression of interest rates, while defensible as crisis tools, had the effect of disproportionately enriching those with significant financial asset holdings: equities, real estate, and fixed income portfolios. Meanwhile, wage earners and those dependent on savings income saw comparatively modest gains in real purchasing power, particularly as inflation eroded wage growth in 2021 and 2022.

The result was a deepening of what economists have termed the "K-shaped" recovery, one in which higher-income/assets households continued to pull away from middle- and lower-income/assets cohorts, not because of deliberate Fed policy, but as an unavoidable consequence of the tools it chose. This dynamic is not unique to Powell's tenure, but it became more pronounced under his watch, and it raises legitimate questions about whether the Fed's definition of its maximum employment mandate adequately accounts for these types of distributional outcomes, and not merely aggregate labor market statistics.

Powell did oversee a significant decline in inflation, with core PCE falling from above 5.6% to roughly 2.7% by mid-2024. But he declared victory too soon. The Fed began cutting rates in September 2024, while inflation was still running well above its own 2% target, a move that prioritized economic soft-landing optics over the discipline the moment required. The Fed avoided recession, but it did so by lowering rates before inflation was truly conquered, leaving open the question of whether the final mile of disinflation will prove far more stubborn as a result.

Institutional Questions

The Powell years were also marked by an episode that raised important questions about governance and institutional standards at the Federal Reserve. In late 2021, it emerged that two regional Federal Reserve presidents, Robert Kaplan of the Dallas Fed and Eric Rosengren of the Boston Fed, had engaged in active personal investment trading during 2020, a period when the Fed was making extraordinary market-moving policy decisions. Both resigned from their positions. A subsequent review also raised questions about the timing of asset rebalancing by Vice Chair Richard Clarida. The controversy drew heightened public attention because the Federal Reserve's emergency pandemic interventions had become such a dominant force in financial markets. Although there was no finding of illegal conduct, the episode prompted broader concerns about whether the institution's ethical safeguards had kept pace with the expanding influence of modern central banking.

We would not render judgment on the legal merits of any individual case. However, what we would observe is that the Federal Reserve's authority rests in large part on the



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confidence that its deliberations and communications are untainted by personal financial interest. For investors in particular, operating in a market where Fed communications are the dominant price-setting force, the integrity of those communications matters immensely. To his credit, Powell moved to strengthen trading restrictions for Fed officials following these disclosures, implementing new rules in 2022 that substantially curtailed permissible investment activity for senior Fed employees. The reforms were widely viewed as necessary and underscored the need for continual attention to institutional governance standards.

The Transition to Kevin Warsh

Kevin Warsh was confirmed by the Senate on May 13th in a largely party-line vote of 54-45, making him the 17th Chair of the Federal Reserve. Warsh is a former Fed Governor who served on the Board from 2006 to 2011, and he enters the chairmanship with strong views and a formidable set of challenges.

Perhaps the most pressing is the inflation environment he inherits. Despite the progress made during Powell's tenure, consumer price inflation has remained well above the Fed's 2% target for more than five years. Wholesale prices surged 6% in April on a year-over-year basis, driven in significant part by energy prices elevated by geopolitical instability, and the pass-through of higher input costs appears to be broadening to consumer prices more generally. This is not the backdrop a new Fed Chair would choose. Warsh has acknowledged as much, stating during his confirmation hearing that the US economy is still dealing with the ripple effects of the pandemic-era inflation spike, and that the Fed requires a different framework for thinking about its inflation target.

On that framework, Warsh has signaled a preference for what he describes as "trimmed averages" of inflation, measures that remove outlier data to capture the underlying trend and has suggested that on those metrics, the inflation picture looks more encouraging than headline figures imply. He has also been a consistent advocate for reducing the Fed's reliance on its bloated balance sheet, which expanded dramatically during the COVID era and has not been reduced to anything approaching pre-pandemic levels. In Warsh's view, the Fed's balance sheet has become a source of distortion rather than a tool of stabilization, and he has indicated a desire to reduce it significantly over time.

For bond market participants, this agenda carries direct implications. Continued quantitative tightening, or an acceleration of it, would reduce a significant source of demand for Treasury and agency securities, placing upward pressure on term premiums at the longer end of the curve. How aggressively Warsh pursues balance sheet

normalization, and over what timeline, will be a central overhang for the market.

Kevin Warsh is widely regarded as a hawkish voice on inflation, a reputation earned during his time on the Board, when he was among the earliest to warn of inflationary risks in the post-financial crisis era. More recently, however, he has shifted toward advocating for lower interest rates, arguing that advances in artificial intelligence and productivity gains are structurally disinflationary forces that give the Fed more room to ease than the headline numbers might suggest. Whether that view survives contact with the current inflation data remains to be seen; the conflict in the Middle East and associated energy price pressures are a complicating factor that was not fully in view when those comments were made.

Beyond monetary policy, Warsh has been emphatic about a return to the Fed's core mandate, price stability and maximum employment, and a step back from what he views as mission creep. He has also indicated skepticism toward the Fed's reliance on forward guidance as a policy tool, preferring instead a more data-dependent posture that responds to incoming information rather than committing to a projected path. Bond investors, accustomed to parsing Fed guidance carefully, will need to adapt to a communication style that may be less prescriptive and potentially more volatile in its market impact than what they have grown used to.

A Final Word

Leadership transitions at the Federal Reserve are rarely seamless, and the early months of a new chairmanship tend to generate elevated uncertainty as markets calibrate to a new communication style and policy framework. Warsh enters the job with strong views, pitted against a genuinely difficult inflation environment. How he navigates the tension between his stated preference for lower rates and the inflation data he has inherited will be among the most important stories in the bond market over the next twelve to eighteen months. Investors will be watching closely not only for changes in policy direction, but also for shifts in the tone and cadence of Federal Reserve communication, which can influence financial conditions well before any formal change in rates occurs. The challenge for any incoming chair is that credibility, once questioned, is difficult to rebuild quickly, particularly in an environment where inflation expectations remain sensitive to policy signals.