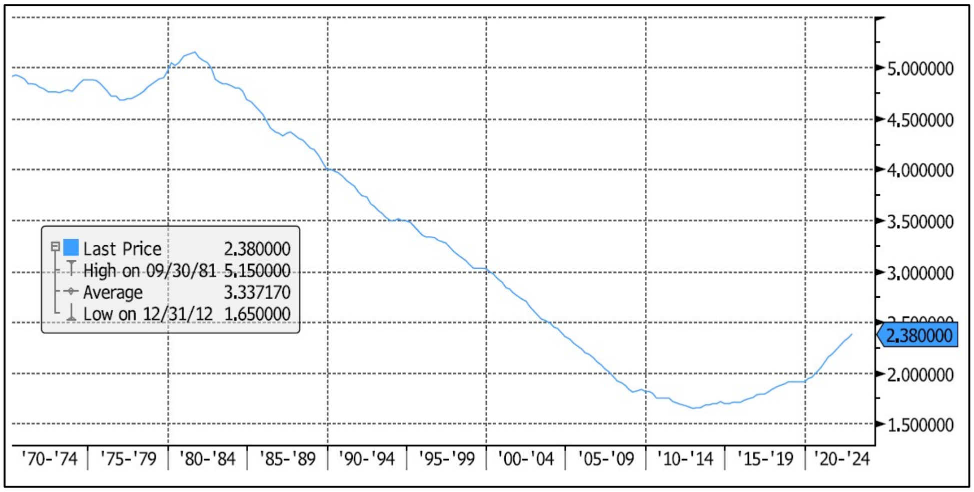
The Fed has capitulated. So what happens now?

At the Fed's Jackson Hole Economic Policy Symposium last Friday, Jerome Powell used his keynote speech to convey to the market that "risks to inflation are tilted to the upside, and risks to employment to the downside—a challenging situation." This is the Fed's conundrum that we have mentioned numerous times in this commentary as to why it is challenging for the Fed to do anything. But as we have also repeatedly stated, the Fed's policy is currently restrictive and because of that Powell also noted "the baseline outlook and the shifting balance of risks may warrant adjusting our policy stance." In other words, the Fed is messaging the market to prepare for a September Fed rate cut. The market reacted positively with stocks rallying and the U.S. 10-year Treasury rallying about 10bps to ~4.25% which is close to where we still are today. As much as this initial reaction was positive, we believe investors need to be prepared for many potentially different market outcomes in the coming weeks.

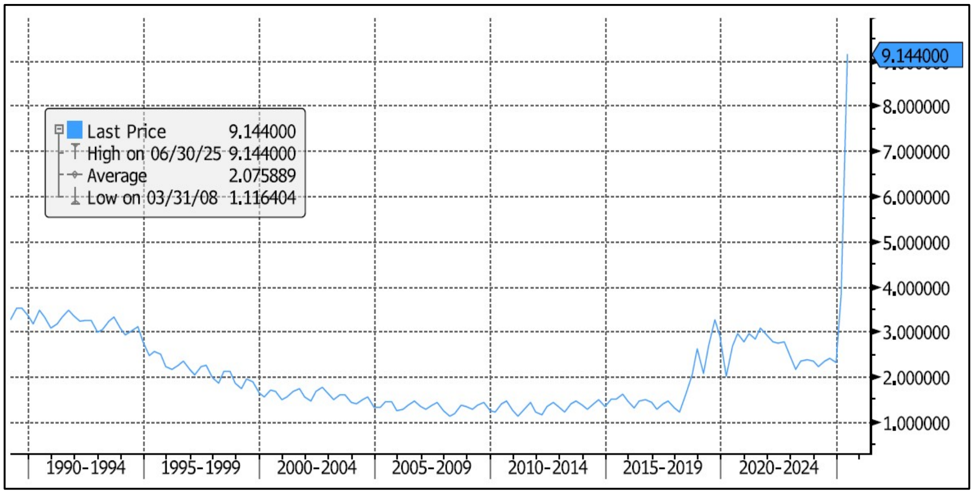
- The next Fed meeting is Wednesday, September 17th and the three items, as always, to focus on are direction, magnitude, and messaging. As suggested earlier, the Fed is purposely leaning hawkish, and they would not do that if they did not intend to cut. Doing something other than what they say they are going to do may be worse (stocks down, bonds down) than the President undermining the Fed. Secondly, the magnitude of cut matters. A 25bps cut is what is expected by the market currently, but that "good news" could lead to a buy the rumor (Jackson Hole), sell the fact (actual cut). On the other hand, if the Fed cuts more than 25bps, that could be a signal to the market that the Fed is behind on removing restrictive policy and would be interpreted negatively by the equity market. And let us not forget the implications of cutting too much, or too quickly, with still potential inflation impacts from tariffs (more on that below). Finally, from a messaging standpoint, if the Fed does not clearly message an expectation of cuts in the future, this could also be interpreted negatively by the market (stocks down, bonds down).

- Another factor to consider beyond Fed policy, although very relevant, is the global trade war which is still far from over. Tariff volatility has subsided recently and seems to be discounted by the market. That may be a premature position. As Powell mentioned in his speech at Jackson Hole, "one-time" does not mean "all at once." It will continue to take time for tariff increases to work their way through supply chains and distribution networks. Moreover, tariff rates continue to evolve, potentially prolonging the adjustment process. This factor needs to be considered if the Fed's magnitude of cuts, and frequency, removes all restrictive policy and gets policy to the neutral rate before all tariff related inflation is fully priced in. A very negative scenario to the U.S. equity and rates markets would be a quick reversal from hawkish to dovish. This would be especially challenging if this comes at a time when labor markets are potentially showing greater signs of stress. In fact, last month we showed the U.S. International Trade Commissions Approximate Effective Tariff Rate was at ~8.8% at the end of May. As of the end of June, that rate continues to move higher and is now at ~9.1% which means the risk of a policy overshoot is real.

Bloomberg Economics Long-Term Natural Rate of Interest U.S.



United States International Trade Commission Approximate Effective Tariff Rate



- From a positive perspective, The Trump Administration claims (www.whitehouse.gov/investments) that $8.7tn in investments in the U.S. have been pledged or announced under their leadership. As much as there is likely a significant amount of gray area in these numbers with respect to the

Commentary as of 8/27/25. Data and charts as of 8/27/25, per Bloomberg.

administration taking credit for investments made prior to being in office, it is possible to conclude that the investments from both corporations and countries will be significant and will likely continue. The timing of these investments matters and, of course, the job creation that it could create. In addition, additional tariff revenue will also have some impact. With investments potentially leading to job creation, which will need to play out in the labor data, this could support a lower Fed funds rate in the face of inflation. Additionally, the impact from additional tariff revenue to pay down the national debt, could also bring down U.S. Treasury yields due to less supply and overall improved financial health of the nation.

- Finally, despite markets seeming to care less about global conflicts, geopolitical risks could be on the verge of subsiding. With greater coordination between the U.S. and European nations, and with countries like India being hit with additional tariffs (increasing today to 50%!) because of their trade with Russia, the Ukraine-Russia conflict could be closer to an end. In addition, Israel's war with Gaza and Hamas could also potentially be getting closer to a turning point. Improvements on all fronts (no pun intended) could lead to further risk taking by investors. As much as this may have a negative impact on treasuries, global investment in risk assets could increase as rebuilding efforts begin in effected regions and European nations continue to invest to support their increased commitment to defense efforts.

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