Don’t fight the Fed…

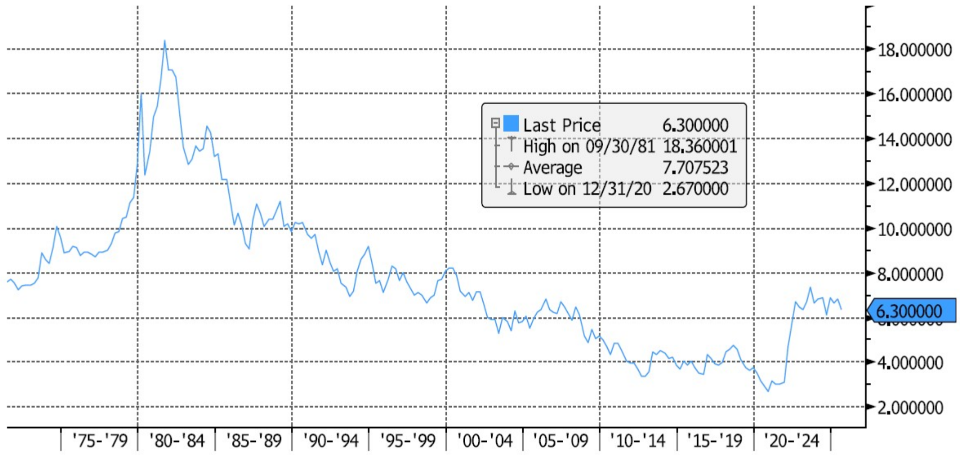
Despite the uncertainty in the market regarding the health of the U.S. and Global economy, the impact of a global trade war, as well as global conflicts, there may well be one predominant factor to drive risk markets going forward – an easing Fed. At the end of the day, additional liquidity to incentivize growth combined with the paradigm shift in global productivity driven by AI capabilities will allow the U.S. economy to muddle through a slowdown and continue to grow. In addition, there is an active and a passive factor that we believe will support an easing Fed and a muddle through view in the short run.

- From an active factor standpoint, it is evident through rhetoric and actions taken that the Administration cares about three things:

    - Asset Price Inflation – Although slightly counterintuitive, asset price inflation is a positive impact to financial and capital assets like stocks, housing prices, and, in this digital world, crypto currencies. The positive of this is that it will create a wealth effect for the nation. For clarity’s sake, this is not the same as price inflation for goods and services as measured by CPI. And as much as we all know the negative implications of goods and services inflation, there are also some negative implications for asset price inflation. Higher asset prices can create income inequality where high-income individuals who own more assets will be disproportionally benefited more than lower income individuals that own less assets. Asset price inflation can also lead to financial instability by creating asset bubbles that if they burst could destabilize the entire financial system. The most recent example, of course, is the Great Financial Crisis in 2008 which was the result of a housing bubble. As much as these are potential risks, the short-run effect of this suggests the Trump 1.0 playbook is still at play where asset prices define the success of the Administration and suggest risk-assets have more room to run especially in an easing Fed environment.

    - National Housing Emergency – Earlier this month, Treasury Secretary Bessent stated that the Administration “may declare a national emergency in the fall.” Despite the conflict this potential initiative may have with asset price inflation, they are trying to solve for the lack of affordability in home prices; historically elevated mortgage rates which, until recently, were as high as they were in the early 2000s, although nowhere near the long-term double-digit highs of the 1980s; and record high homeowner insurance premiums among other things. Details were limited for what this would look like, but the Administration already formally announced the use of federal lands for housing back in March to ease the affordability crisis. Additional potential steps could be to simplify, or standardize, building regulations around permitting and zoning to allow builders to more easily start developing additional housing supply. They could also potentially use the Treasury’s balance sheet to start buying mortgages in the open market to reduce mortgage rates available to consumers and incentivize home purchases. Considering that Bessent is the one that floated this idea in the first place, that could even be the first lever they pull. If a National Housing Emergency becomes a reality, not only would this support continued asset price inflation, but it would also potentially incentivize increased GDP and stronger labor demand as construction companies ramp up to take advantage of new available land, potentially less onerous regulations, and lower mortgage rates. Partner this with an easing Fed and, again, risk assets should continue to perform.

Freddie Mac Enhanced PMMS US 30 Year Fixed Mortgage Rate



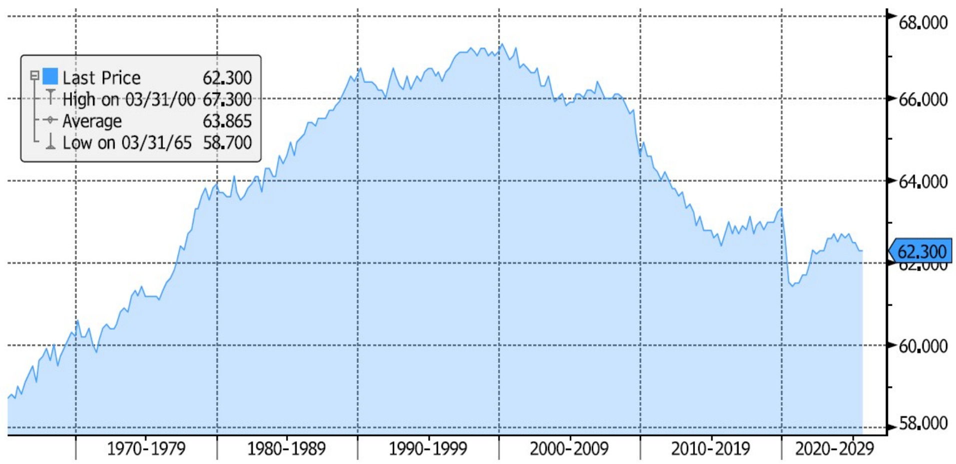
- Mid-Term Elections – Mid-term primary elections will start in early 2026 with general elections in November. A barometer for the country's opinion on how the sitting President is doing will play out at the half-way mark of their term. Trump and his Administration will want to retain and potentially gain further majority in the House and the Senate. What drives how American's vote is their perception if they are better or worse off than they were before the President took office. The health of the economy, employment and the health of the consumer will be paramount for the Administration to retain and grow the Republican majority. This is just another reason that Trump will do whatever it takes to continue to make strides here which should support the economy and risk assets.

- With respect to the passive factor, we believe there are a couple deflationary forces at play that are not really being talked about at the moment but will continue to be supportive of an easing Fed:

  - The impact of AI on the labor force and wages is most likely going to have a negative impact on consumer spending. If companies enabled with AI capabilities are able to do the same, or potentially more, with a smaller workforce, they will. As an example, as reported by CNBC, JP Morgan is envisioning a world where they can handle more work and pitch more companies with less people. An internal proposal discussed the idea of harnessing their internal data and the power of AI which could change the ratio of junior bankers to senior from 6-1 to 4-1. Entry level junior bankers, that typically work on pitch decks for prospects and clients, would not be in as much demand when AI can create the same deck in 30 seconds. In addition, with AI powered junior bankers they can also hire talent in cities from around the world with cheaper labor where the team can work in shifts around the globe. As much as this would improve the bottom line for the banks, the spending power of the consumer will be challenged.

- It is also important to highlight the rising trend of workers that are leaving the work force. Excluding the Covid pandemic impacted period from 2020-2022, the U.S. Labor Force participation rate is at its lowest levels since the 1970s. What is likely at play here is a wealth effect driven by asset price inflation that has incentivized the boomer generation to retire and leave the workforce. There could also be a return-to-office factor for individuals that were only able to work if they could work from home that are also leaving the workforce. Whatever the reason, although the impact on consumer spending is not perfectly clear, one could argue that less people earning wages and living off savings could lead to less spending and have deflationary effect on goods and services.

U.S. Labor Force Participation Rate



As much as the combination of the factors listed above and the Fed's dovish policy are likely drivers for a continued positive environment for the financial markets, the Fed might *also* be the risk to this view. The risk comes from the Fed's timing. To put it simply, without the economic uncertainty created by Liberation Day in early April, the Fed likely would have cut rates earlier this year as opposed to in September. The risk that the Fed could be late to the party is real, but the active and passive factors we highlighted above will be the driving forces going forward. By nature of that, these forces will outweigh any negative implications of the Fed's timing. In summary, we believe that the economy, at worst case, will continue to muddle through and will provide an environment for risk-assets to continue their positive trajectory.

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