There's a new sheriff in town!

Our new Federal Reserve Chairman, Kevin Warsh has conducted his first speech in his new role. Similar to the statement published after the meeting, his speech was short and to the point. The Fed will remain laser focused on returning the inflation rate (Core PCE) to its 2% target, while remaining vigilant regarding the unemployment rate. Forward guidance will be less transparent than what was provided by the prior regime, which could place a greater requirement on markets to monitor economic data and interpret the implications for future Fed monetary policy.

Warsh's comments included plans to form five task forces to address various issues as he seeks to revamp the Fed. There is a communications task force—Warsh has been critical of forward guidance and the Summary of Economic Projections. There is a balance sheet policy task force—Warsh has advocated for a smaller Fed balance sheet. There is a data collection and analysis task force—Warsh has advocated for more timely or high frequency indicators than what are currently used. There is a productivity and jobs task force—Warsh believes AI will ultimately prove to be productivity enhancing and disinflationary. Finally, there is an inflation framework task force—Warsh intends to re-examine the drivers of inflation and the Fed's framework for achieving price stability. Notably, he reaffirmed the Fed's current 2% inflation goal and this does not appear to be something that will be reviewed. We believe the task forces will function as a mechanism for Warsh to build consensus within the Fed around his preferred reforms. The communications and balance sheet policy changes will likely be the most important for markets.

Monetary Policy: At their June 16-17 meeting, the Federal Reserve kept the Fed Funds Target Rate unchanged at 3.50%–3.75%, but removed the easing bias from the statement. This was in line with market expectations amid elevated uncertainty related to the Iran War, improving labor market conditions, firm inflation readings and upside risks to the inflation outlook from energy prices. Within the Summary of Economic Projections (SEP), the median Fed Funds rate projection for year end 2026 was raised from 3.4% to 3.8% (a move from one anticipated cut to one hike). Expected 2026 GDP growth was lowered from 2.4% to 2.2%. Year end 2026 unemployment was nudged lower from 4.4% to 4.3%, and Core PCE inflation was raised from 2.7% to 3.3%.

Since this was Kevin Warsh's first post-FOMC press conference, markets were keenly focused on indications of how he might lead going forward. During his campaign for nomination, Warsh developed a dovish reputation and concerns about his independence from the administration arose. Warsh has been clear in his distaste for forward guidance and the dot plot and he opted to not provide his own projections to the June SEP, denying markets a clear view into his thinking. However, during the press conference he was adamant that price stability would be a priority and he reaffirmed his commitment to the Fed's long-run inflation objective of 2%. After the meeting, markets adjusted their perception of Warsh from a politically influenced dove to a politically independent hawk and adjusted Fed Funds rate expectations higher.

We suspect the market may be over appreciating the extent of Warsh's hawkishness. He really had no choice in prioritizing price stability (that's the job) and reaffirming the 2% inflation target (impossible to change before hitting target without losing credibility). Inflation and employment rose into the meeting and the committee had turned clearly hawkish. The announced task forces suggest that Warsh will seek reforms that allow for more dovish outcomes. For example, the data and collection task force may decide that the Dallas Fed's trimmed mean PCE is superior to Core PCE. This measure has often shown lower reported inflation and Warsh is a fan. Reducing the balance sheet, another Warsh idea to be evaluated in a task force, would tighten financial conditions and would be offset through a lower Fed Funds rate.

Tariffs: As of 5/31/2026, the USITC effective tariff rate was 6.89%, down from a peak of 10.84% in October 2025, but still well above the ~2.3% rate prior to Liberation Day. The recent decline reflects the Supreme Court's February 20, 2026 ruling striking down IEEPA-based tariffs and their replacement with a 10% global tariff under Section 122, layered on top of existing MFN and Section 232/301 measures. On July 1, 2026, the US decided to not renew the USMCA which will trigger annual reviews during which any party can push for changes. The US is expected to seek greater protections for autos, steel and/or agriculture. At the current time, the lower tariff rates after the Supreme Court decision should be a modest tailwind for growth and modestly disinflationary. We believe upside tariff risk remains going forward.

Interest Rates: The War in Iran and the subsequent closure of the Strait of Hormuz caused the price of oil to spike, introducing risks of both slower growth and higher inflation. During the conflict, oil prices did not rise as high as many feared and, after the cease fire, have come down quicker than most expected. The US economy has proven resilient to shocks once again. Growth forecasts have mostly held up, employment data has been improving from a low base and oil price related inflation is expected to be temporary with limited pass through to core measures. Interest rates have generally trended higher year to date supported by improved economic performance, sticky inflation and the hawkish Fed pivot. In the second half of 2026, we expect the Fed to be on hold and the 10-year Treasury to remain range bound 4.25%-4.60%.

Investment Grade Corporate Bond Outlook: We believe fixed-income remains an attractive asset class as investors have opportunities for potential increased income and yields in the future. Corporate spreads are tight to comparable U.S. Treasury securities but we expect fundamentals and technical factors to remain supportive throughout 2026. We continue to believe credit selection will be paramount as the focus shifts toward the ability of corporates to navigate macro uncertainty. Based on current market conditions, in our opinion, the securities we hold are well positioned to weather the current market cycle. Capital preservation continues to be our foremost priority followed by seeking to generate income consistent with the strategy's objectives.

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High Yield Bond Outlook: After zigzagging messaging during the quarter, market fears were quelled in the middle of June when the US and Iran entered into a "memorandum of understanding" that provided the framework to end the war while opening the Strait of Hormuz in the interim. As long as oil continues to flow through the Strait and commodity prices remain contained, there should be an appetite for risk that keeps a lid on spreads. That said, credit selection will be important as refinancing risk is on the rise. Despite tight spreads, all-in yields remain elevated which has resulted in companies delaying refinancing and has increased the percentage of high yield debt maturing in the next 3 years to 20-year highs.

Investment Grade Corporate Bond Second Quarter Performance: The markets ended June on mostly good sentiment with AI and Fed policy at the forefront of market concerns. Interest rates moved higher in the second quarter with the Fed currently in a holding pattern. The target fed funds rate remained at 3.50%-3.75%. The Bloomberg Aggregate Index returned +0.24% in June and now +0.60% year-to-date. The 2-year Treasury yield ended June at 4.18%, 18 basis points (bps) higher in the month. The 10-year Treasury yield ended June at 4.47%, 3 bps higher while the 30-year Treasury yield ended the month at 4.95%, 2 bps lower. Corporate bonds slightly underperformed U.S. Treasury securities in the month and outperformed for the quarter. Corporate demand remained strong on the back of attractive all-in yields amid significant issuance.

High Yield Bond Sector Second Quarter Performance: High yield fixed income posted another quarter of strong returns at +2.45%. High yield spreads tightened during the quarter, starting at 328 bps and ending at 272 bps as economic data remained strong and the market displayed resilient optimism toward resolution in the Middle East despite inconsistent messaging. For the quarter, the 2.45% total return was comprised of +1.70% from coupon and a +0.75% price return. From a quality perspective, Single-Bs performed the best, returning +2.84%, and BBs underperformed at +2.23%. The CCC index split the difference at +2.40%. High yield bond data is representative of the U.S. High Yield Corporate Bond Index which is designed to track the performance of U.S. dollar-denominated, high-yield corporate bonds issued by companies whose country of risk use official G-10 currencies, excluding those countries that are members of the United Nations Eastern European Group (EEG).

Thank You

We trust you will be pleased by how your fixed income portfolios performed under our watch during the first half of 2026. Volatility across the entire yield curve continues, but we remain very comfortable with our positioning. In addition, we believe our clear and deep understanding of our credit exposures contributed to attractive returns. Holding through volatility is the way to win for clients.

If you have any questions on strategy, performance, or business development, please do not hesitate to contact us.

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