New Fed Chair, Old Problems

Market Update From Advanced Asset Management Advisors

June 30, 2026

Kevin Warsh was sworn in on May 22nd. He inherited a five-year-old inflation problem. The Fed's favorite supercore PCE, which is heavily influenced by what consumers pay for services (i.e. electricity, insurance, and repairs), has averaged 3.8% over five years, nearly double the 2% target. Worse yet, the 6-month average accelerated from 1.9% last June to 4.5% in January, before the Iran conflict started[1].

Broad-based inflation indices that include food and energy have also spiked, as higher energy costs have simply exacerbated the pre-war inflationary environment.

The New Federal Reserve

Kevin Warsh resigned from his prior Federal Reserve role in 2011, protesting what he felt was the unnecessary continued expansion of the Fed's balance sheet (commonly known as Quantitative Easing, or QE). Monetary easing in response to weak markets had been adopted by the Alan Greenspan Fed in response to the crash of 1987 and the technology stock crash in 2000.

Topics

The **five-year inflation problem** inherited by the new Federal Reserve regime.

Growing **concentration in economic growth**, and the divergence between business investment and consumer strength.

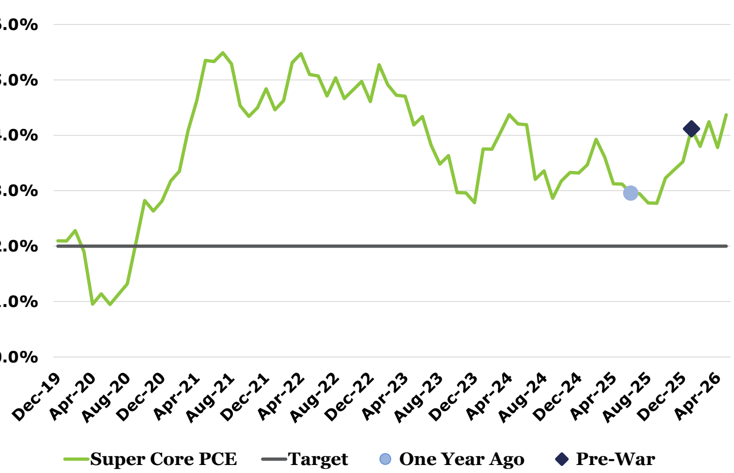
What the **long-term bond market** can tell us about interest rate expectations amid Federal Reserve policy uncertainty.

Historic earnings projections, led by AI hyperscalers, and the interdependence of technology growth and the wider stock market today.

Where AAMA sees **relative value** in the equity and fixed income markets today.

Super Core PCE

Six Month Moving Average



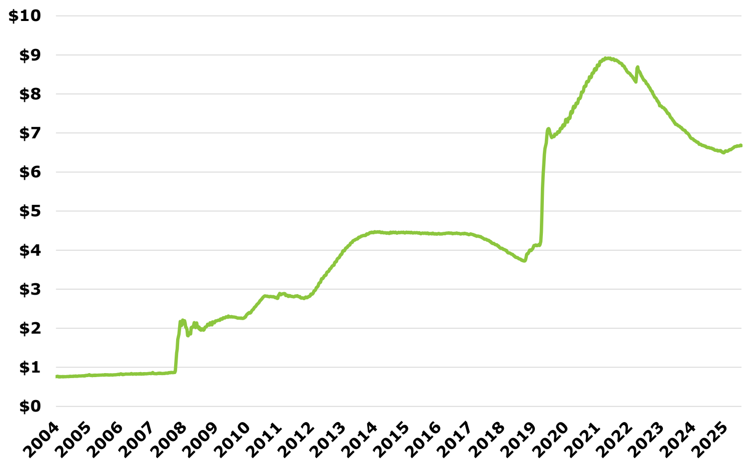
Source: Bureau of Economic Analysis

These policies were dubbed the "Greenspan Put", and are now widely known as the "Fed Put". QE became the tool of choice in 2008 when zero interest rates failed to quickly cure markets.

The Fed balance exceeded $1 trillion for the first time in the fall of 2008. It eventually grew to $9 trillion in 2022 and has settled between $6 and $7 trillion over the last two years[2].

Federal Reserve Balance Sheet

Trillions of Dollars



Source: Federal Reserve Bank of St. Louis

As expected, Warsh seems intent to further reduce the size of the Fed's balance sheet. He has also voiced the desire to reduce interest rates (although this plan is clearly on hold given the recent inflation trend).

The Populist Fed?

We are theorizing the new Warsh-led Federal Reserve could evolve into the "Populist Fed". Lower interest rates mostly help small businesses and consumers (large companies already have direct access to public credit markets). A smaller Fed balance sheet would reduce its wide support of capital markets and securities trading. A Populist Fed would likely rely on emergency lending against good collateral to preserve liquidity in the banking system. However, it would be less likely to resort to the "Fed Put" in response to weak equity markets.

Populist Fed policies would be more supportive of main street and less supportive of wall street. The Fed has already cut the content of its post-meeting report by one third (136 words vs. 412 words). Forward guidance has been abandoned — meaning wall street economists will need to form their own opinions on the future course of monetary policy and not rely on Federal Reserve promises. Fed task forces will address balance sheet policies (along with communications, productivity, data integrity, and inflation). Nothing in the first 50 days of the Warsh Fed contradicts the theory the Fed is trending towards a more Populist Fed.

Treasury Secretary Scott Bessent shared similar populist views in his 2025 article, "The Fed's New 'Gain-of-Function Monetary Policy'". The Chair of the Federal Reserve and the Treasury Secretary have a long-standing tradition of a weekly breakfast meeting, even though collaboration between the two has always been denied. We find it interesting that the two pillars of U.S. (and global) monetary and fiscal policies share similar philosophies.

The Economy

The economy continues to grow, although gains are dominated by capital spending in support of AI development.

Projected hyperscaler investments for 2026 equal approximately 3.5% of GDP[3]. Cutbacks in capital expenditure within the space would be a significant negative for total growth. At the same time, first quarter consumer spending growth has been revised lower (from 1.4% to 0.5%).

Economic growth continues. However, it's more concentrated and therefore more fragile than the last several years.

Interest Rates

Interest rates have increased over the last six months in response to rising inflation. Higher inflation before the Iran conflict un-nerved the bond market and led to expectations for higher Fed policy rates vs. the lower rates that had been widely expected late last year. AAMA has been consistently skeptical of the "inflation is solved — lower interest rates" view that was championed by the Federal Reserve and Wall Street. The longer-term bond market has been pricing in higher inflation while keeping a close eye on Federal deficits, which are not improving.

Long term Treasury bonds continue to be the worst performing asset class over the last five years. AAMA continues to focus income portfolios in short-term, high-quality bonds.

Clear progress towards reducing inflation would afford the new Fed credibility and would reduce volatility in interest rate markets.

Corporate Earnings

Expectations for earnings growth have reached historical levels for the S&P 500 index at 22% — a 25-year high (excluding recession recovery periods)[4]. Not unlike the economy, earnings growth is concentrated in the technology sector with a 46% gain forecast for the full year 2026. The next four most represented sectors sport an average forecast of 8.6%. (Financials +7.4, Telecom +10.9, Consumer Discretionary +5.4, and Healthcare +10.5)[5].

The Stock Market

Stock prices rebounded and fully recovered first quarter losses, leaving the S&P 500 higher by 10.2% for the year.

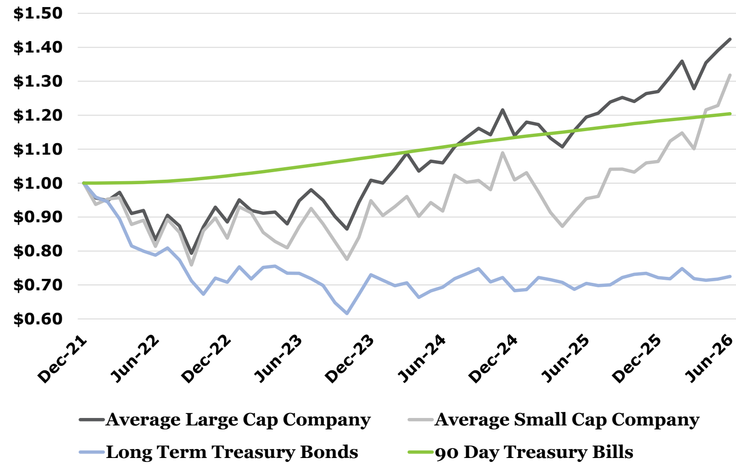
Given the AI-influenced earnings forecast, it is not surprising that the technology sector led returns for the quarter with a gain of 31.8%. Technology's one-third weighting in the S&P 500 is a heavy influence on the index return. In fact, just ten stocks contributed 7.8 percentage points of the gain while the other 490 stocks contributed 2.2 percentage points[6].

Looking at the trend of asset class performance since the Federal Reserve began increasing interest rates four and a half years ago, the average large cap stock has led and long-term Treasuries have cumulatively lost 28%. The cumulative T-bill return has lagged stock returns with zero volatility.

Stock prices remain over-valued by every traditional metric.

54 Months of Volatility

Equal Weighted Equity Indices



Source: Morningstar

High valuations do not necessarily imply significantly lower prices will follow immediately. However, they do indicate higher risk and sensitivity to disappointing events.

Artificial Intelligence And Market Risk

AI spending has been driving the economy, technology earnings expectations, and stock prices, as the future success of AI is widely assumed. We agree that AI will be successfully adopted for certain applications. However, our key question remains: When will future revenues justify the capital expenditures, if ever? Many investors suggest we should simply trust the rosy forecasts, but there are hurdles. There are continued questions about the accuracy of complex AI applications (how intelligent are they?), speed (can they work fast enough in critical situations?), and costs (are they worth it?).

Model costs translate into model provider income and potential return on investment. Currently, AI model providers are struggling with pricing. Unlimited usage subscriptions have exacerbated providers' losses. Paying customers are starting to curtail employee usage under pay-per-use subscriptions. Construction of data centers and power sources have a long and variable lead time, which can delay services, which in turn delays revenues. Government regulators have initiated selective export controls. And cheaper foreign competition can unseat legacy providers in specific applications.

All these issues affect the course of revenue streams and add extreme uncertainty to forecasts. When revenue forecasts are subject to significant uncertainty, investment values follow with high risk. High risks in the AI environment translate into high risk in the stock market. AAMA continues to focus on high quality companies in the technology sector and in other economic sectors with less volatile and more predictable earnings.

[1]Bureau of Economic Analysis [2]Federal Reserve Bank of St. Louis [3]Federal Reserve Bank of Atlanta & Federal Reserve Bank of New York

[4]Standard & Poor's [5]FastTrack [6]Morningstar

Disclosures

The information and opinions in this report have been prepared by the investment staff of Advanced Asset Management Advisors (AAMA). This report is based upon information available to the public. The information herein is believed to be reliable and has been obtained from sources believed to be reliable, but AAMA makes no representation as to the accuracy or completeness of such information. Opinions, estimates and projections in this report constitute AAMA's judgment and are subject to change without notice. This report is provided for informational purposes only. It is not to be construed as a recommendation to buy or sell or a solicitation of an offer to buy or sell any financial instruments or to participate in any particular trading strategy in any jurisdiction in which such an offer or solicitation would violate applicable laws or regulations.