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The Fed waits out a cloudy picture

Breaking news

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The U.S. Federal Reserve held rates steady at today's meeting, balancing a resilient economy against rising uncertainty. Growth remains healthy and inflation has moderated, but oil price volatility and a softening labor market complicate the picture.

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Key takeaways

- The Fed voted 9 to 3 to keep interest rates unchanged once again, with the target policy rate range remaining at 3.50% to 3.75%.
- Three regional Fed presidents dissented in favor of a rate hike.
- The policy statement remained brief, continuing the streamlined approach Chair Warsh introduced at the last meeting, with no substantive changes.
- Chair Warsh announced a series of task forces to review the Fed's policy frameworks, though he declined to offer material signals about his near-term expectations for inflation or rates.

What happened?

The FOMC voted 9 to 3 to hold rates steady at its July meeting, keeping the policy rate range at 3.50% to 3.75%. Three regional Fed presidents — Hammack (Cleveland), Kashkari (Minneapolis) and Logan (Dallas) — dissented in favor of a 25 basis point hike. The Hammack and Logan dissents were expected; Kashkari's was a mild hawkish surprise. The policy statement saw no substantive changes from the prior edition, which itself had been heavily trimmed at the last meeting.

In his press conference, Chair Warsh leaned slightly dovish. He repeatedly emphasized that financial conditions — proxied by the Treasury yield curve — have tightened since the last meeting: nominal and real rates rose, while inflation breakevens stayed close to levels consistent with the Fed's 2% target. Warsh implied this reduces urgency for the FOMC to hike, since markets are already doing some of the work.

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Warsh also downplayed June's CPI print, which showed slowing inflationary pressure. He said he continues watching a broader range of inflation metrics, focusing on what "underlying inflation" is doing "amid shocks." Given his past praise for alternative measures like trimmed-mean PCE, this suggests less concern over recent inflation upticks — which may reflect energy and tariff shocks rather than a shift in underlying conditions.

We continue to forecast no change in Fed policy rates this year. We expect inflation to moderate more than implied by prior FOMC forecasts, with labor markets remaining stable or loosening slightly — easing pressure to tighten and supporting a steady policy stance. We maintain our year-end forecast of 4.25% to 4.50% for the 10-year Treasury yield.

Inflation cools as risks shift

Macro developments since last month's FOMC meeting have been broadly positive — growth remains healthy and inflation has moderated. Geopolitical uncertainty has increased, however, clouding the outlook. Our base case: stable growth and moderating inflation through 2027.

Oil prices have remained volatile. Prices closed at $76 per barrel the day before the last FOMC meeting, surged to near the $100 mark last week as the Middle East conflict intensified, then settled back around $85 today. Given this volatility and the uncertain outlook, energy prices remain an upside risk to inflation for the rest of the year.

Core inflation data has been encouraging, oil noise aside. Shelter prices rose at their slowest rate since early 2021. "Supercore" services (ex-shelter) fell materially — the second-largest monthly drop since 2020, helped by softer airline fares. More broadly, disinflation is spreading to non-energy categories. Tariff effects are fading too: Core goods inflation posted a negative print for the second straight month, following 10 months of outsized increases. These trends support our call for slower inflation in the second half of the year, especially combined with upcoming methodological changes that we believe will shave roughly 0.2 percentage points off core year-over-year PCE.

The consumer picture is more mixed, as elevated inflation compresses real income growth. Job creation slowed in the latest reading, and downward revisions to the prior two months point to a looser labor market than existed at the last FOMC meeting. Unemployment fell further to 4.2% — but alongside a declining participation rate, suggesting workers are leaving the labor force rather than finding jobs. Real income growth has turned negative, a potential headwind to future consumption, though we see little sign of a slowdown yet.

Accelerating tech investment is offsetting that risk. We expect hyperscaler capex to now exceed $700 billion in 2026, up 34% from expectations at the start of the year. In 2027, capex should approach $1 trillion — a 40% increase on an already massive base. This spending should keep supporting growth for several quarters, comfortably offsetting oil-related drag.

Our outlook reflects these crosscurrents. Factoring in persistently higher oil prices, accelerating tech investment and recent labor data, we expect GDP growth to moderate slightly but remain healthy at around 2.0% this year. Core PCE inflation should end the year near 3.0% year-over-year.

What does this mean for investors?

Markets look rich given the uncertain geopolitical, macro and policy backdrop. The S&P 500's forward P/E sits above its long-run average, and growth expectations are already optimistic: Analysts forecast nearly 25% EPS growth this year—more than triple the 7.5% long-run average. Credit is tight too, with investment grade spreads at 80 bps, tighter than current levels just 4% of the time over the last 25 years. We see this as an opportunity, and think investors should diversify beyond traditional equity and credit, position for income and guard against downside market moves.

Listed infrastructure appears attractive. The AI boom needs power, and power needs the regulated infrastructure that generates and transmits it. Data centers can be built in 12 to 36 months; transmission upgrades and new generation capacity take far longer. That mismatch may create durable scarcity value for utilities that can deliver capacity ahead of demand—value that may create earnings.

As equity portfolios grow more concentrated in the AI trade, listed infrastructure may offer a compelling complement: exposure to the forces driving the digital economy, anchored in physical assets insulated from disruption by the very technology they power.

The numbers back this up. Infrastructure has long offered defensive diversification against tech—and with correlation between the two turning negative recently, that benefit has only strengthened. For portfolios concentrated in tech, listed infrastructure may offer exactly the diversification investors have struggled to find in the broader equity market.

Preferred securities stand out amid rate volatility that has weighed on broader fixed income. Spreads have tightened in both $1000 par and contingent capital securities (CoCo) segments, helping to drive outperformance versus most U.S. investment grade sectors this year.

Preferred issuers appear fundamentally strong. About 80% of preferred securities come from banks, insurers and utilities — heavily regulated sectors, all showing sound fundamentals today. Banks have broadly beaten earnings estimates and continued passing the Fed's stress tests. Insurers hold near-record surplus capital and have posted record annuity sales. Utilities appear well positioned to benefit from structural tailwinds: relentless demand from AI data centers and broader electrification.

Technicals support the asset class too. European AT1 CoCo issuers have front-loaded supply, with roughly 80% of full-year volume already issued — and the market has absorbed it well. Supply should moderate in the second half, a tailwind for the sector. Demand stays strong for the tax-advantaged qualified dividend income (QDI) certain preferred structures provide, while hybrid preferreds remain eligible for corporate bond index inclusion.

Fresh opportunities also exist beyond traditional credit. We favor an integrated approach combining convertible arbitrage, long-short credit and opportunistic collateralized loan obligation (CLO) investing — dynamically allocated within a single framework.

Convertible arbitrage anchors this approach. Convertible bonds' embedded optionality means they benefit from volatility rather than suffer from it — as equity volatility spikes, option value rises, improving returns exactly when traditional strategies struggle. The global convertible market has reached $600 billion, with liquidity at record levels: a deep, diverse opportunity set.

Long-short credit adds flexibility. Taking both long and short positions across high yield bonds and senior loans — including distressed situations and tactical hedges — this component seeks to drive alpha while actively managing downside. It's not a passive bet on spreads; it's a dynamic tool for navigating cyclical turns.

Opportunistic CLO debt and equity investing completes the framework. High-conviction positions in structured credit, deployed selectively when valuations compel, can offer a differentiated return stream with low correlation to the other two strategies — enhancing overall portfolio diversification.

Together, we think these three strategies are built to perform across cycles with low volatility: compelling risk-adjusted returns, real downside protection, genuine diversification from both equities and traditional credit. Investors who embrace this multi-strategy thinking may be better positioned to turn today's uncertainty into tomorrow's results.

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Endnotes

Sources

Federal Reserve Statement, July 2026.

Bloomberg, L.P., S&P Markit.

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Important information on risk

All investments carry a certain degree of risk and there is no assurance that an investment will provide positive performance over any period of time. Equity investing involves risk. Investments are also subject to political, currency and regulatory risks. These risks may be magnified in emerging markets. Diversification is a technique to help reduce risk. There is no guarantee that diversification will protect against a loss of income.

Debt or fixed income securities are subject to market risk, credit risk, interest rate risk, call risk, derivatives risk, dollar roll transaction risk and income risk. As interest rates rise, bond prices fall. Investing in municipal bonds involves risks such as interest rate risk, credit risk and market risk, including the possible loss of principal. The value of the portfolio will fluctuate based on the value of the underlying securities. There are special risks associated with investments in high yield bonds, hedging activities and the potential use of leverage. Portfolios that include lower rated municipal bonds, commonly referred to as "high yield" or "junk" bonds, which are considered to be speculative, the credit and investment risk is heightened for the portfolio. Credit ratings are subject to change. AAA, AA, A, and BBB are investment grade ratings; BB, B, CCC/CC/C and D are below-investment grade ratings.

Preferred securities are subordinate to bonds and other debt instruments in a company's capital structure and therefore are subject to greater credit risk. Certain types of preferred, hybrid or debt securities with special loss absorption provisions, such as contingent capital securities (CoCos), may be or become so subordinated that they present risks equivalent to, or in some cases even greater than, the same company's common stock.

Concentration in infrastructure-related securities involves sector risk and concentration risk, particularly greater exposure to adverse economic, regulatory, political, legal, liquidity, and tax risks associated with MLPs and REITs.

Convertible arbitrage involves significant risks, including the potential for loss on both long convertible security positions and short equity positions if the anticipated pricing relationship between the two does not perform as expected. These strategies may employ leverage, which can magnify losses, and are subject to liquidity, credit, and market volatility risks that may be heightened during periods of market stress. Below investment grade or high yield debt securities are subject to heightened credit risk, liquidity risk and potential for default. These securities, while generally offering higher yields than investment grade debt with similar maturities, involve greater risks, including the possibility of interest deferral, default or bankruptcy, and are regarded as predominantly speculative with respect to the issuer's capacity to pay dividends or interest and repay principal. Issuers of high yield securities may be highly leveraged and may have fewer methods of financing available. The prices of these lower-grade securities are typically more sensitive to negative developments, such as a decline in the issuer's revenues or a general economic downturn, than are the prices of higher-grade securities. The secondary market for high yield securities may not be as liquid as the secondary market for more highly rated securities, a factor which may have an adverse effect on a portfolio's ability to dispose of a particular security. There are fewer dealers in the market for high yield securities than for investment grade obligations. Any investment in collateralized loan obligations or other structured vehicles involves significant risks not associated with more conventional investment alternatives.

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