

Patience required: The Fed holds as inflation lingers

The Federal Reserve held rates steady at its June meeting, but struck a notably hawkish tone. New Chair Warsh streamlined the policy statement and dropped forward guidance. Nearly half of committee members now project a rate hike this year. We do not expect a rate cut until 2027.

Key takeaways

- The Fed unanimously voted to keep interest rates unchanged once again, with the target policy rate range remaining at 3.50% to 3.75%.
- The dot plot of rate expectations showed that nine of 18 members expect a rate hike this year, a change from March when the median showed an expected rate cut.
- The policy statement reflected new Chair Warsh's preferences, which contained much less detail and forward guidance than previous editions.
- 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 U.S. Federal Reserve held rates steady, keeping the target range at 3.50% to 3.75%, in line with market expectations. The pause in rate cuts that began in January continues, though the Fed shifted its signaling in a notably hawkish direction.

In Chair Warsh's first meeting, the FOMC cut the policy statement by nearly half. It now contains just three substantive paragraphs: the decision to hold rates steady, a reference to solid economic growth and a comment on elevated inflation.

Breaking news

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The statement also removed its easing bias on future policy and included a reference to “maintaining ample reserves in the banking system,” which we interpret as a signal that the FOMC does not support material changes to balance sheet policy. It referenced “price stability” but not “maximum employment.”

The updated Summary of Economic Projections (SEP) reflected materially hawkish shifts. The median forecast for core PCE inflation rose 0.6 percentage points to 3.3% this year. More notably, nine of 18 committee members now anticipate a rate hike this year, nudging the median rate forecast higher. Chair Warsh did not submit forecasts.

In his first press conference, Chair Warsh devoted more attention to broader themes around the Fed’s high-level policy framework rather than the near-term policy outlook. He announced the creation of five “task forces” to recommend changes to communication policy, balance sheet policy, economic data usage, productivity and jobs, and inflation frameworks. He reiterated the Fed’s commitment to the 2% inflation target, but declined to answer questions about his own near-term inflation or rates forecast.

Recent labor market and inflation data prompted us to revise our forecasts, removing all rate cuts from our outlook this year. We expect elevated near-term inflation to keep the Fed on hold into 2027, at which point we still anticipate the next move will be a cut. We also raised our year-end target range for the 10-year Treasury yield by 25 basis points, to 4.25% to 4.50%.

Oil prices and tech investment shape the outlook

Economic data has been broadly healthy in recent months. Higher oil prices have pushed inflation higher but have not yet meaningfully weighed on growth. Tech investment remains a key dynamic — supporting growth while adding further upward pressure on inflation. We expect growth to moderate but remain healthy, and for inflation to stay elevated before moving lower toward year-end.

Oil prices remain elevated amid the ongoing Middle East conflict. While optimism about a potential resolution has recently resurfaced, year-end WTI futures still imply prices near \$80 per barrel — up roughly \$20 from pre-conflict levels. That increase has already pushed headline CPI above 4% year-over-year and will continue to exert upward pressure on core inflation in coming months. Higher inflation erodes real income growth, which we expect to drag on consumer spending later this year.

Tech-related infrastructure investment continues to provide meaningful support to overall growth. Even as residential investment and non-tech business fixed investment have contracted in recent quarters, spending on hardware and software has surged. Demand from the tech sector has also lifted certain consumer prices, with the software and accessories subindex rising at an annualized pace of nearly 50% through the first five months of the year.

Despite the disruption from oil prices and inflation, labor markets have remained resilient. The unemployment rate has edged down and job openings have increased, though other measures remain tepid, including business hiring expectations, the quits rate and the hiring rate. We continue to expect modest loosening in coming months, but from a stronger starting point than previously assumed.

Our updated macroeconomic forecasts reflect persistently higher oil prices, the latest trends in tech investment and recent labor market data. We continue to expect GDP growth to slow to a slightly below-2% annualized pace, while we now project core PCE inflation to end the year around 3.0% year-over-year, somewhat higher for longer than our prior forecast.

What does this mean for investors?

The current backdrop — healthy growth, elevated near-term inflation, geopolitical uncertainty and stable Fed policy — presents both challenges and opportunities for investors. While market returns this year have been dominated by higher energy prices and AI investment, we see scope to broaden portfolio exposure and take advantage of potential dislocations. In equities, we think elevated valuations and

growing concentration favor increased diversification, particularly in non-U.S. equities and small caps. In fixed income, we favor municipal bonds and senior loans/collateralized loan obligations (CLOs).

Non-U.S. equity markets are well positioned to provide their traditional diversification benefit, and relative valuations add to their appeal. The U.S. market currently trades at roughly 22x forward earnings — materially above its historical average — while markets in Japan (18x), Europe (16x) and emerging markets (13x) are considerably more reasonably priced.

The U.S. payout advantage (dividends plus buybacks) over non-U.S. equities has also narrowed sharply, from a 2014–2022 average of nearly 40% to just 5% today, per Bloomberg, further strengthening the case for non-U.S. exposure. Globally, earnings growth remains positive, with double-digit forward estimates for both U.S. and emerging markets indexes.

Fundamentals support the case for **U.S. small cap equities**. Historically, the asset class has outperformed when the Fed is holding or cutting rates, rather than hiking. Given our outlook for no rate hikes, we believe the current backdrop is supportive.

The performance differential is even more pronounced when viewed through the lens of the 10-year Treasury yield: small caps gained 13.7% annualized when the 10-year yield was stable or falling, versus just 5.0% when it rose — a nearly 9 percentage point gap. Rising inflation erodes the operating economics of smaller companies, while higher long-term rates compress their future cash flows. Long-end rates have already stabilized, with the 10-year yield down 22 basis points from its May peak, and we expect a modest rally over the balance of the year.

In our view, the balance of opportunity and risk for U.S. small caps is as attractive today as it has been in years, making this a compelling time to consider a strategic long-term allocation.

Municipal bonds have performed well this year. The investment grade and high yield segments of the ICE BofA Municipal Bond Index have returned 1.7% and 3.1% year-to-date, respectively, compared to just 0.4% for the Bloomberg U.S. Aggregate Index. Despite rate volatility, municipal fundamentals have remained resilient, spreads have tightened since the start of the year and fund inflows are at their second-highest year-to-date total at this point in the year since Lipper began reporting in 1992, trailing only 2021.

High yield municipals currently offer adequate compensation for the risks assumed, in our view. Based on the ICE 1–12 Year Broad High Yield Crossover Municipal Index, the shorter end offers a taxable-equivalent yield of 7.9% for investors in the highest tax bracket, with a duration of four years — a compelling combination of generous yield and limited interest rate risk. Longer-duration high yield munis may offer even stronger total return potential, with taxable-equivalent yields exceeding 9.0%. With a low long-term correlation to U.S. equities of 0.32 (per Morningstar Direct), high yield municipals may also serve as an effective portfolio diversifier.

Senior loans, also known as syndicated or leveraged loans, present an attractive opportunity. These loans are made to below-investment grade companies — typically larger private equity-backed issuers with average annual revenues of roughly \$750 million — and sit atop the capital structure, giving them the highest repayment priority ahead of other debt and equity. Their floating-rate coupons reduce price sensitivity to interest rate changes and allow them to benefit from higher Fed policy rates.

Collateralized loan obligations (CLOs) offer another avenue into the senior loan market. These securitized portfolios of broadly syndicated loans provide diversified exposure to a large pool of issuers within a single structure. Although the underlying loans are below investment grade, securitization diversifies credit risk across multiple issuers. The 30-year cumulative default rate for investment grade CLO tranches is just 0.2% — well below the 2.1% for comparably rated corporate bonds — while still offering attractive yields.

In a year marked by rate volatility and wide dispersion of fixed income returns, senior loans and CLOs stand out. Floating-rate exposure mitigates duration risk, while broad diversification supports more consistent income potential, making this asset class a worthy consideration for investor portfolios.

For more information, please visit us at nuveen.com.

Endnotes

Sources

Federal Reserve Statement, June 2026.

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

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Taxable-equivalent yields are based on the highest individual marginal federal tax rate of 37%, plus the 3.8% Medicare tax on investment income. Individual tax rates may vary.

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