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SUMMARY

- Fed Chairman Warsh signaled that rate hikes are needed to improve its price stability mandate.
- The US Treasury's plan to buy long maturities is a short-term fix for a growing unmanageable problem, in our opinion.
- Assessment of the Fed more nuanced with fiscal and monetary policy at odds.

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Fed and Treasury at Odds

The Message, the Data, and the Reality

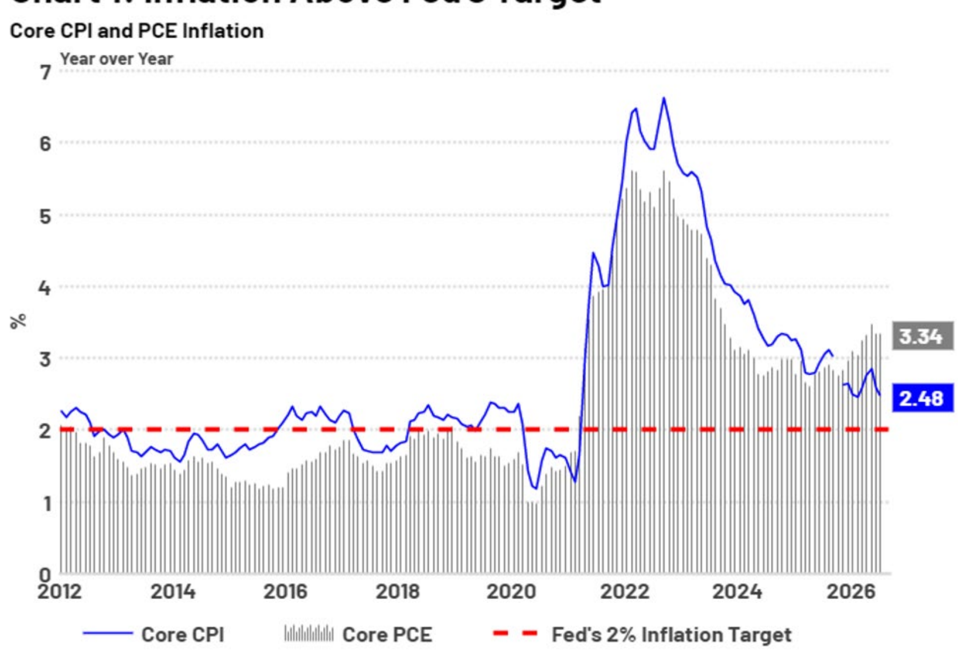
The Kansas City Federal Reserve's annual retreat in Jackson Hole, Wyoming, took place August 27–29. As always, the Jackson Hole Symposium, which brings together central bank officials and the world's most powerful bankers, did not disappoint. Investors tuned in anxiously to hear Fed Chairman Kevin Warsh's take on inflation and the likely direction of monetary policy. **Warsh's message: inflation remains too high, with the Fed having missed its target for sixty-five consecutive months.** The reality is that Warsh feels solving elevated inflation falls squarely on the Fed, even though both monetary and fiscal policy play a role with the Fed setting the Fed funds rate and the Treasury managing debt issuance and spending. For its part, the Treasury – led by former activist investor Scott Bessent - has attempted to contain bond yields by announcing plans to buy long maturity bonds – a form of quantitative easing. **We believe that these efforts will ultimately put the Fed and Treasury at odds with one another.**

The Fed Chair's Message...Price Stability by Any Means Necessary

The Fed's dual mandate—full employment and price stability—has faced scrutiny at various points over the past year. In his Jackson Hole speech, Chairman Warsh said the employment side remains stable, even as low labor supply keeps monthly job gains modest. With unemployment currently at 4.1%, Warsh considers the labor market to be at full employment.

Turning to the price stability side of the mandate, the Chairman struck a less optimistic tone. **Warsh believes inflation remains elevated—whether measured by PCE or CPI—and that the Fed must focus on bringing it down.**

Chart 1: Inflation Above Fed's Target



Source: LSEG Datastream, RiverFront. Data monthly as of July 15, 2026. Chart right shown for illustrative purposes only. Past performance is no indication of future results.

While acknowledging that inflation has recently slowed, he does not think the underlying trend has materially improved. As Chart 1 (Page 1, above) illustrates, it has been over five years since the Fed last hit the 2% target it formally adopted in January 2012. In our view, we think that the 2% inflation target is more aspirational than rigid, but right now inflation is too high.

The Data Will Help to Shape the Fed's Decision

The Fed will focus on economic data ahead of its September 16th meeting, as FOMC members weigh a slowing labor market against elevated inflation. The August CPI report— due to be released September 11th, close enough to the meeting to carry recency-bias risk—could heavily influence whether the Fed raises rates or holds steady. Headline CPI is expected to rise 0.4% month-over-month, driven by gas price spikes tied to the lingering Iran war, while core CPI (ex-food and energy) is expected to hold steady at 0.2% month-over-month. **In our opinion, if core CPI meets or comes in below expectations, the FOMC may treat elevated headline inflation as transitory, reasoning that the war will not last forever. However, if oil prices stay above $90 per barrel in the week before the meeting, that transitory argument may no longer hold.**

One inflation data point the Fed expects to improve in the coming months is core Personal Consumption Expenditures (PCE). Starting this month, the Bureau of Economic Analysis (BEA) will change how it measures prices for select categories in the core PCE basket, including legal services, computer software, and investment advice—which economists expect will lower the core PCE reading. A lower reading would give the Fed more cover to delay action and leave interest rates unchanged.

The Reality: Long Term Risks Driving Long Term Rates Higher

Beyond declaring that the Fed would fight inflation, Warsh's second key message was that he wants to change the dynamic between the market and the Fed. Historically, the market looked to the Fed for guidance; now, the Fed wants to look to the market instead, which Warsh believes gives the Fed a more unbiased view. The Fed has already put this plan into action, letting the market tighten monetary policy without changing the fed funds rate. Since the end of February, the 2-year Treasury yield—most closely tied to the fed funds rate—has risen a full percentage point, the equivalent of four 25-basis-point rate hikes the Fed did not have to initiate itself.

Chairman Warsh's hawkish speech raised investor expectations for a rate hike this year but failed to stop long-maturity Treasury yields from rising in the process. We believe the market is signaling a credibility issue with the Fed, declining to give the FOMC the benefit of the doubt by pushing yields lower ahead of the meeting. The market wants more action.

On the front end of the yield curve, the market is looking for a series of rate hikes from the Fed to demonstrate its commitment to fighting inflation, with fed funds futures forecasting two to three hikes into 2027. At the long end, the market wants greater fiscal restraint in the form of lower deficits, with higher yields serving to put lawmakers on notice to change spending habits. Historically, rising yields at the long end of the curve signal growth acceleration, inflation, or a rising term premium—the additional compensation investors require to lend money for extended periods. This cycle, the Fed faces all three.

The Fed's credibility issue stems from market watchers worrying that the central bank is behind the curve on rate hikes and will be forced to support fiscal objectives by working with the Treasury to lower long-end yields. Treasury Secretary Scott Bessent recently announced that the Treasury would increase the quarterly refunding of 10–30-year Treasuries from $2 billion to $4 billion. While not a massive amount, the intent is for the government to buy older Treasury issues, boosting demand for the new auctions. Higher demand tends to mean lower yields and lower interest costs for the US government — important given that public debt recently crossed $40 trillion. **However, we believe the Treasury's maneuver is a short-term fix for a growing, unmanageable problem.**

On the other end of the yield curve, the Fed may be raising interest rates to fight inflation—an action that puts it in direct conflict with the Treasury Department. One mechanism the Treasury uses to fund its purchases of older, long-maturity Treasuries is issuing T-bills and shorter-maturity notes. A higher fed funds rate raises interest costs on those T-bills and notes, undercutting the effort to push long-end yields down and save on interest costs.

Conclusion: Positioning Based on Fed Decisions has Become More Nuanced

Between the Fed and the Treasury, there are now two hands on the rate lever… and they are potentially pulling in opposite directions. Between Warsh's Fed focusing on restricting guidance and maintaining inflation credibility - at the same time that

Bessent's Treasury is actively trying to bring down longer-term rates – we are left with low visibility into whether investors are currently investing alongside or 'fighting' the Fed. Further clouding the outlook is the ongoing war in Iran keeping commodity prices elevated, and a US budget deficit issue that shows no signs of near-term resolution…two additional factors causing long-term rates to potentially head higher.

In a low visibility environment, prudent investors tend to hedge their bets on an uncertain outcome, especially something as hard to predict as rates. As befitting this backdrop, we remain neutral to slightly underweight interest rate sensitivity across our balanced portfolios, depending on the time horizon.

This does not, however, change our previously stated view that, regardless of the near-term path of rates from here, risk-free yields are now high enough in absolute terms to effectively compete for stock investors' capital. Positioning ourselves fairly neutrally and 'getting paid to wait' while these potential competing forces vie for supremacy appears to us a prudent path. Fortunately, companies continue to have strong earnings growth in our view, and we believe the economy will grow fast enough to avoid 'stagflation,' …two factors that we believe will allow stock markets to persevere through this period of interest rate uncertainty.

Risk Discussion: All investments in securities, including the strategies discussed above, include a risk of loss of principal (invested amount) and any profits that have not been realized. Markets fluctuate substantially over time, and have experienced increased volatility in recent years due to global and domestic economic events. Performance of any investment is not guaranteed. In a rising interest rate environment, the value of fixed-income securities generally declines. Diversification does not guarantee a profit or protect against a loss. Investments in international and emerging markets securities include exposure to risks such as currency fluctuations, foreign taxes and regulations, and the potential for illiquid markets and political instability. Please see the end of this publication for more disclosures.

In a rising interest rate environment, the value of fixed income securities generally declines.

Technical analysis is based on the study of historical price movements and past trend patterns. There are no assurances that movements or trends can or will be duplicated in the future.

Dividends are not guaranteed and are subject to change or elimination.

Index Definitions:

Basis point (bps) = 1/100th of a percent

Personal consumption expenditures (PCE), also known as consumer spending, is a measure of the spending on goods and services by people of the United States. According to the Bureau of Economic Analysis (BEA), a U.S. government agency, PCE accounts for about two-thirds of domestic spending and is a significant driver of gross domestic product (GDP).

The Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them. Changes in the CPI are used to assess price changes associated with the cost of living. The CPI is one of the most frequently used statistics for identifying periods of inflation or deflation.

Definitions:

Federal Open Market Committee (FOMC) refers to the branch of the Federal Reserve System (FRS) that determines the direction of monetary policy in the United States by directing open market operations (OMOs). The committee is made up of 12 members, including seven members of the Board of Governors, the president of the Federal Reserve Bank of New York, and four of the remaining 11 Reserve Bank presidents on a rotating basis.

Fed funds futures are financial futures contracts based on the federal funds rate and traded on the Chicago Mercantile Exchange (CME) operated by CME Group Inc. (CME). The federal funds rate is the rate banks charge each other for overnight loans of reserves on deposit with the Federal Reserve.

The Bureau of Economic Analysis (BEA) is a division of the U.S. Department of Commerce that produces official economic accounts, including data on GDP, personal income, and the balance of trade. Its reports are widely used to inform government policy, interest-rate decisions, and investment analysis by providing a detailed and consistent picture of the U.S. economy.

Stagflation is an economic cycle characterized by slow growth and a high unemployment rate accompanied by inflation. Economic policymakers find this combination particularly difficult to handle, as attempting to correct one of the factors can exacerbate another.

Inflation is a gradual loss of purchasing power, reflected in a broad rise in prices for goods and services over time.

Treasuries are government debt securities issued by the US Government. Treasury securities typically pay less interest than other securities in exchange for lower default or credit risk. With relatively low yields, income produced by Treasuries may be lower than the rate of inflation.

Treasury Bonds is represented by the Bloomberg US Treasury Index which measures the performance of the US Treasury bond market.

Treasury bond yields (or rates) are tracked by investors for many reasons. The yields are paid by the U.S. government as interest for borrowing money via selling the bond. The 10-year Treasury yield is closely watched as an indicator of broader investor confidence. Because Treasury bonds (along with bills and notes) carry the full backing of the U.S. government, they are viewed as one of the safest investments.

A Treasury bill (T-Bill) is a short-term U.S. government debt obligation backed by the Treasury Department with a maturity of one year or less. Treasury bills are usually sold in denominations of $1,000. However, some can reach a maximum denomination of $5 million in non-competitive bids. These securities are widely regarded as low-risk and secure investments.

When referring to being "overweight" or "underweight" relative to a market or asset class, RiverFront is referring to our current portfolios' weightings compared to the composite benchmarks for each portfolio.

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There are special risks associated with an investment in real estate, including credit risk, interest rate fluctuations and the impact of varied economic conditions. Distributions from REIT investments are taxed at the owner's tax bracket.