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How can investors navigate uncertainty at the Fed?



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The Trump administration's attempts to check the US Federal Reserve's powers risk unsettling markets and fanning inflation. We think investors can respond by doubling down on diversification (including beyond the US) and considering assets ranging from inflation-protected bonds to consumer and utility stocks.

Key takeaways

- The Department of Justice's criminal probe into Jay Powell highlights rising political pressure on the Fed as Donald Trump pushes for much lower interest rates and a weaker dollar, but with inflation still at 3%, sharp rate cuts appear unlikely for now.
- Political pressure on the Fed risks denting confidence in US assets and could lead to a moderately higher inflation environment with mixed implications across equities, bonds and currencies.
- In our view, investors should diversify globally and favour inflation resilient assets – like gold, European bonds, real assets, defensive sectors and private markets.



HOW CAN INVESTORS NAVIGATE UNCERTAINTY AT THE FED?

US Federal Reserve chair Jay Powell called the Department of Justice's criminal investigation an "unprecedented attempt" to undermine the independence of the world's most important central bank. Only a handful of governments in other countries have pursued criminal action against their top monetary policymaker, and almost all of these have been emerging markets. But perhaps in the context of the relentless criticism of Mr Powell by the US president, this move is unsurprising. According to Donald Trump's past pronouncements, it is clear he not only wants to check the power of the Fed but also use it as another toolkit to steer the economy. In practice, he would like lower interest rates and a weaker US dollar, to reduce the cost of the country's exports and support domestic growth.

In a way, he has already achieved one of these aims – at least in part. The US dollar has shed around 10% against major currencies over the past two years.

But interest rates are a different matter. The Fed has lowered interest rates three times since September 2025, and the benchmark rate now stands at 3.50 to 3.75%. But Mr Trump wants to see further cuts, saying he would like interest rates that befit the US's status as the "world's best credit".

In effect, this could mean rates similar to Switzerland, where the Swiss National Bank's key level is often at or near 0%. While we expect another 25 basis points cut by the Fed by mid-2026, we don't anticipate rates close to 0% anytime soon because the US's current sticky inflation would make it unfeasible. Although Mr Powell appears to be standing firm on resisting political pressure for now, the risk is that when his term ends in May, he is replaced with a more dovish chair, more willing to comply with Mr Trump's request to lower rates. An announcement on who will be the nominee to replace Mr Powell is likely soon.

Given the current US inflation of 3%, any sharp lowering in rates by the Fed could lead to a steepening in the US yield curve, with a pricing down in the short end and a much higher inflation term premium at the long end.

Implications for inflation and markets: potentially higher inflation and a flight to safety

The risk for Mr Trump is that his goal of exerting pressure on the Fed to lower rates backfires. Perceived political interference in monetary policy could lead markets to begin pricing in more political risk to compensate for the uncertainty. The likely resulting higher borrowing costs for US government bonds would actually make it harder for the Trump administration to achieve its goal to lower interest rates.

Experience shows in other parts of the world that when central bank independence is undermined, inflation expectations can become untethered. In short, a key risk from greater political interference in the Fed would be higher inflation.

In the short term, a lowering in interest rates might be positive for equities. But in the longer run, we see one of three potential scenarios playing out:

- **Worst-case scenario: surge in inflation.** We would expect a loss of confidence in US assets. The US dollar and US Treasuries could start to lose their safe-haven status. Equity flows could start to decline as consumers and companies struggle with inflation, while foreign investors return to their local markets. Gold and defensive currencies such as the Swiss franc would likely benefit.
- **Moderate scenario:** the Fed keeps better control over inflation, although it remains above target. This scenario would probably be positive for equities but negative for bonds. A moderately weaker US dollar would support emerging market equities and bonds. Emerging markets have exhibited, as a complex, increased discipline in fiscal and monetary policy over the last decade.

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- **Wild card AI scenario:** a productivity boost enables growth without inflation. In this scenario, which seems to have materialised, at least in 2025, higher goods price inflation is offset by productivity increases and lower wage pressure. Neutral interest rate rises would limit the scope for aggressive interest rate cuts.

Of these three, we think the moderate scenario is most likely. Consumer price inflation in the US is entering a sixth consecutive year of overshooting the Fed's 2% target, making us think it will hover around 3% in the year

ahead. Delayed and protracted tariff effects are likely to continue lifting goods prices in the first half of 2026.

But the reassuring news from the market's perspective is that the current betting market favourites to be the next Fed chair, former Fed governor Kevin Warsh and Blackrock fixed income chief Rick Rieder, are considered relatively moderate candidates. That may further lower the possibility of future Fed policy leading to runaway inflation.

Where to focus amid inflationary risks

Given an environment of moderate inflation and threats to the Fed's credibility, we think strategies focused on global diversification are key, with less US and US dollar concentration. We also hold a preference for higher quality European bonds given the region's sound fiscal policy. We like gold as a hedge against geopolitical risk and equities due to their robust performance in the face of moderate inflation.

We see four areas where investors can focus in this environment:

- 1. Inflation-protected government bonds:** US Treasury inflation-protected securities adjust their interest and repayment amounts to inflation, helping to offset inflation-related declines in value.
- 2. Real assets and commodities:** Real estate investment trusts and commodities such as copper and metals protect against price increases, as prices tend to rise with inflation. However, considering the tension surrounding Venezuela and Iran reflects a more assertive US policy, we think

oil and gas prices could remain under pressure, making an active policy key.

- 3. Companies in the consumer staples or utilities sector:** Such businesses can pass on price increases to consumers, helping their profits grow generally in line with inflation.
- 4. Private equity and infrastructure:** These asset classes are attractive as their values often rise with inflation. In addition, many private market investments are regionally anchored and not US dollar-denominated, reducing currency risk. Private assets are also less responsive to short-term market volatility and offer an illiquidity premium that can generate additional returns during inflationary periods.

In summary, we think political pressure and the absence of further signs of a slowdown in the rate of price increases may increasingly test the Fed's commitment to its inflation mandate. Investors should prepare for US inflation to linger longer than markets expect.

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Investing involves risk. The value of an investment and the income from it may fall as well as rise and investors might not get back the full amount invested.

Past performance does not predict future returns. If the currency in which the past performance is displayed differs from the currency of the country in which the investor resides, then the investor should be aware that due to the exchange rate fluctuations the performance shown may be higher or lower if converted into the investor's local currency.

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