

Federal Reserve Policy – What the Data Is Telling Us

The Federal Reserve sets the price of money, which nearly every asset and economic decision depends on. Guided by its mandate of maximum employment and roughly 2% inflation, it uses interest rates, its balance sheet, and, in the past, forward guidance to influence borrowing costs, spending, the dollar, and inflation expectations. In bonds, short-term yields track expected policy, while long-term yields also reflect inflation risk and Fed balance-sheet actions. In stocks, higher real rates lower valuations, especially for growth companies, and policy shapes the earnings outlook and the appeal of equities versus cash. Fed policy sets the cost and availability of credit, which shapes nearly every part of the economy, from mortgages and car loans to business investment and government borrowing costs. Tighter policy cools demand, slowing growth, hiring, and inflation, while easier policy stimulates spending, housing, and job creation.

On August 28, 2026, Federal Reserve Chairman Kevin Warsh gave his first major address as chairman at the Kansas City Fed's symposium in Jackson Hole, Wyoming. He argued that "forward guidance should be pulled back sharply in normal times." Stating "it was a crisis tool that outlived its purpose." He offered a set of principles instead of guidance. These include acting on trends in timely data rather than stale or isolated readings. He framed the whole section with the line "I stand here today committed to a discipline, not to a decision." He did mention about 30 distinct indicators and I count another 120 to which he alludes.

Executive Summary

Taken together, the 150 indicators, which we have charted, describe an economy that is **re-accelerating while inflation plateaus well above target**. The labor market has firmed from its late-2025 soft patch, business investment (especially AI/data-center capex) is booming, and corporate earnings are at record highs. Headline and core PCE inflation are stuck at or above 3%, producer prices are re-accelerating, and household inflation expectations are climbing again. Markets have responded: the Fed raised its target to a 4.00% upper band in September, the entire Treasury curve has sold off for seven straight months (10-year at 5.26%, 30-year at 5.62%), real yields are at cycle highs, and rates volatility (MOVE) has spiked to a 12-month high.

The soft spots are the consumer (although August Personal Spending was up 0.9%) and housing: sentiment is near lows, the saving rate has dropped to a 12-month low, retail sales fell in September, and higher mortgage rates are pushing housing activity down. The overall picture is a hot corporate/investment economy, a squeezed household sector, and a Fed leaning hawkish into rising long-end yields.

1. Price Stability

Headline and core PCE are stuck well above 2%. PCE inflation was 3.4% y/y in August, unchanged from July, above its 12-month average of 3.1% and well up from the 2.7% low of October 2025. Core PCE was 3.0%, up slightly from 2.98% but below both its May peak of 3.16% and the 3.3% consensus. Both measures peaked in May 2026, so the upswing that began in late 2025 has stalled rather than reversed.

Short-run momentum is cooling. The 6-month annualized rates carry the most encouraging signal. Headline PCE (6m ann.) has eased from a 4.70% May peak to 3.45%, and core PCE (6m ann.) has declined three straight months to 2.75%, down from a 3.89% peak. Core PCE rose 0.25% m/m in August, up from 0.13% in July and in line with its 0.25% average, roughly a 3% annualized pace: too fast but no longer accelerating.

CPI gives mixed signals. Headline CPI is 3.4% y/y, but core CPI has fallen three straight months to 2.4%, the low of the window, and core CPI on a 6-month annualized basis is down to 2.90% from 3.92%. However, both the headline (+0.4%) and core (+0.3%) m/m prints for August were above average. The gap between core CPI (2.4%) and core PCE (3.0%) suggests pressure in categories weighted more heavily in PCE (healthcare, financial services) rather than shelter.

The pipeline is the concern. PPI final demand accelerated to 5.4% y/y from 4.8%, and PPI ex food & energy climbed to 4.6% both above average and near their spring highs. The Q2 GDP price index, revised to 6.1% annualized from 6.4%, confirms how hot prices ran in the spring. With oil back above \$90 (see Commodities), producer-price pressure could feed into consumer prices in coming months and undo the recent cooling in the 6-month rates.

Takeaway: Inflation has plateaued at roughly 3.0–3.4% on PCE measures. Short-term momentum is easing, but producer prices and energy are warning signs. The case where price stability has been achieved is weak.

2. Underlying / Trend Inflation

The trend gauges disagree, which matters for judging persistence:

- **Dallas Fed trimmed-mean PCE** is the most reassuring: 2.28% y/y (below its 2.45% average) and 2.35% on a 6-month basis. Stripping out extreme price moves, underlying inflation is close to target.
- **Atlanta Fed sticky-price CPI** has fallen three straight months to 2.74%, the low of the window: slow-moving prices are gradually cooling.
- **Cleveland Fed median CPI** points the other way: 3.60% in September, up 0.23pp and well above its 3.21% average.

Takeaway: Trimmed-mean and sticky measures place core trend inflation around 2.3–2.7%, implying the high headline readings are driven by a narrow set of large price increases (energy and some

services) rather than broad-based inflation. The rise in median CPI is a reminder that this could still spread. On balance, trend inflation is lower than headline but not firmly anchored.

3. Inflation Expectations

Households are becoming more worried. University of Michigan 1-year expectations jumped 0.6% to 4.6%, near the May high of 4.8%, and the 5–10-year measure edged up to 3.4%. The NY Fed survey is calmer: 1-year expectations eased to 3.58% and 3-year to 3.19%, though both remain above average. Survey expectations sit well above the 2% target, and the Michigan data shows consumer mood is tied to price worries.

Markets remain anchored but are drifting up. 5-year breakeven is 2.37% (below average), 10-year breakeven 2.36%, and the 5y5y forward breakeven 2.33%, close to its 2.36% high. Inflation swaps tell the same story: the 1-year swap has recovered to 2.49% from a July low of 1.92% but sits far below its 3.42% April peak, and the 5y5y swap is 2.44% after three consecutive rises.

Takeaway: Long-term market expectations are anchored around 2.3–2.5%, so investors believe the Fed will ultimately deliver. But most measures have risen for two or three months in a row, and household expectations are elevated. Combined with the September hike, this is the kind of backdrop in which a central bank worries about credibility.

4. Maximum Employment

The labor market has firmed. Unemployment is 4.1%, the lowest of the window and down from a 4.5% peak in November 2025. U-6 underemployment fell to 7.7%, also a low.

Payrolls have bounced back. August nonfarm payrolls rose 162k after a weak 21k in July; private payrolls rose 127k. ADP's September report showed private hiring rebounding to 90k from 36k, above the 74.5k consensus. The 3-month average (71k) is above its 12-month average but still modest, and the window includes a sharp negative print in February 2026 (–156k), so the hiring trend has been uneven.

Claims point to a tight market. Initial claims are 197k and the 4-week average 202k, both below average. Continuing claims have fallen three months, running to 1.72mn, the lowest in the window, and the layoffs rate is 1.0%, also a low.

Labor supply is the soft spot. Participation (61.6%), prime-age participation (83.4%), and the employment-population ratio (59.1%) all sit below their 12-month averages, though each ticked up in August. Part of the fall in unemployment reflects fewer people looking for work rather than just stronger hiring. Quits (2.4%, six straight rises) are at a 12-month high, a sign of worker confidence, while job openings (7.08mn) slipped just below average and hires (3.6%) are in line with it. Recent-graduate unemployment has improved to 7.1% from 9.2% a year ago.

Wage signals disagree. Average hourly earnings growth has slowed to 3.1%, a 12-month low, while the Atlanta Fed wage tracker has risen three months running to 4.1%. The Employment Cost Index rose 0.9% q/q, the highest of the window. Unit labor costs are growing a modest 1.4% y/y, helped by strong productivity.

Takeaway: Employment is close to maximum: low unemployment, low claims, few layoffs. Wage growth is not clearly inflationary, but the mixed signals leave that question open.

5. Activity and the Consumer

Growth looks fine on the surface and strong underneath. Real GDP was revised up to 2.2% annualized in Q2 from 1.5%, after 2.5% in Q1, but private domestic final purchases, a cleaner read of domestic demand, rose 9.5%, the highest of the window. Inventories or trade likely dragged on the headline while underlying private demand was strong.

The consumer is spending but running down its cushion. Real personal consumption jumped 0.9% in August from 0.1% in July, far outpacing income growth of 0.2%, and the retail sales control group fell 0.12% in September, well below its 0.48% average. With spending outpacing income, the saving rate fell to 4.1% from 4.6%, the low of the window and below its 4.8% average, leaving households with a thinner cushion. Sentiment is poor: Conference Board confidence dropped 6.7 points to 81.9, a 12-month low after three straight declines, and University of Michigan sentiment fell 3.6 points to 48.1, near the May low of 44.8.

Businesses are more upbeat. ISM manufacturing is 54.6 and ISM services 55.4, both above 50 and above their averages. Industrial production has flattened (+0.02% in August).

Takeaway: Business activity is solid and investment is strong, but households are squeezed by inflation and higher rates. Consumer spending looks like the most likely source of any slowdown.

6. Business Capital Expenditure

This is the strongest section on the dashboard.

- Real equipment investment grew 12.6% annualized in Q2, the third straight rise and the high of the window.
- Intellectual-property investment grew 9.2%, above average though down from Q1's 15.6%.
- Core capital goods orders jumped 1.6% in August, pointing to more equipment spending ahead; shipments (+0.58%) and total durable goods orders (flat) were softer.
- **Data-center construction** reached a record \$75.2bn annualized in July, the eighth straight monthly rise and up about 53% from \$49.1bn a year earlier.
- Total private non-residential construction (\$755bn) is slightly below average, so outside data centers construction is flat to weaker.

- The electricity demand / utility output index is near its high, consistent with power-hungry AI infrastructure.

Takeaway: The investment cycle is being driven by AI and technology infrastructure and is broadening into equipment. This helps explain the strong GDP detail and resilient manufacturing, and it adds demand pressure while inflation remains elevated.

7. Corporate Profits and Market Internals

Profits are at records. National Income and Profits Account (NIPA) corporate profits grew 22.8% y/y in Q2, the third straight acceleration. S&P 500 trailing EPS is \$328 and forward EPS \$360 (up 11 and eight straight months respectively, both at their highs), and the net profit margin of 15.6% is also a record.

Valuations have actually fallen. The S&P 500 is at a record 7,710, yet the forward P/E has compressed to 21.3x from 26.3x in January. The rally is being driven by earnings, not by investors paying higher multiples.

Leadership is narrow. The Nasdaq 100 (30,567) and S&P information technology (7,317) are at record highs and still rising, while the equal-weight S&P fell 379 points in September. Most other sectors declined in September: consumer discretionary, staples, energy, financials, health care, industrials, materials, real estate, and utilities. Utilities (403, three straight declines) sit at the low of the window, and real estate and discretionary are below average, the sectors most sensitive to rates and consumer spending.

Volatility diverges. The VIX is still below average at 15.9, but the MOVE index jumped 31bp to 106.6, its highest in the window. Equity investors are calm; bond markets are not.

Takeaway: Record technology earnings are masking a narrower, rate-sensitive market underneath. The gap between equity and rates volatility is a risk if yields keep climbing.

8. Credit and Financial Conditions

High-grade credit is still tight but widening. The investment grade spread is 0.82% and BBB 1.00%, both now slightly above average after widening in September, and Credit Default Investment Grade widened 9bp to 59.0bp (above average), suggesting hedging is picking up.

The riskiest borrowers are under strain. The High Yield spread widened 48bp to 3.09%, above average, and the **CCC & lower spread** has widened five straight months to 9.98%, the high of the window and up from 5.95% in January. Leveraged loan prices (95.4) are near average and Credit Default Swap High Yield (106.8) is below average. This is the pattern expected from rising real rates: the weakest, floating-rate-heavy borrowers feel it first. Broad financial-conditions indices remain loose, with the Chicago Fed National Financial Conditions Index (−0.55) near its most accommodative level in the window.

Takeaway: Overall conditions are still loose, which partly explains why the Fed tightened, but stress is building at the lower-quality end of credit, and September's widening across HY and IG suggests it is starting to spread. It warrants close monitoring.

9. Bank Lending

The Senior Loan Officer Survey shows credit easing. Net tightening of C&I standards fell to 0% for large and medium firms and 1.8% for small firms, both lows of the window, while net demand for C&I loans turned positive at +3.6%, the highest. Consumer credit grew \$18.1bn in July, above average. Banks are willing to lend and borrowers are beginning to want credit, which supports the capex story.

Takeaway: Bank credit is flowing freely: standards are neutral and business loan demand has turned positive. That supports continued investment but works against the Fed: with bank lending easy and broad financial conditions loose, the September hike has yet to bite through the lending channel.

10. Money

Money growth is accelerating. M2 is \$23.28tn after seven straight monthly rises; M2 growth is 5.7% y/y, the high of the window and up from 3.8% in November. M1 has risen 11 straight months.

The Fed balance sheet has turned up. Total assets have grown to \$6.75tn from a \$6.55tn low in November; reserve balances are \$2.97tn and currency in circulation is at a high. Nominal GDP reached \$32.5tn in Q2, and velocity is flat at 1.41x, so money growth is not yet translating into faster spending.

Takeaway: With M2 growth near 6% and the balance sheet expanding, liquidity is growing rather than tightening, partly offsetting the rate hike and consistent with sticky inflation.

11. Rates, Treasuries, and the Dollar

The Fed hiked. The target upper bound rose 25bp to 4.00% in September. SOFR moved up to 3.88% and 3-month bills to 4.13%.

The yield curve has sold off sharply.

Tenor	Sep 30	Monthly change	Feb 2026 low
2-year	4.86%	+51bp	3.37%
5-year	5.05%	+55bp	3.50%
10-year	5.26%	+51bp	3.94%
30-year	5.62%	+37bp	4.61%

The 2- to 10-year yields have each risen seven straight months and are at their 2026 highs. The 2s10s curve has flattened to 41bp from 71bp in January as short-dated yields rise fastest, a classic reaction to a hawkish Fed.

Real yields are driving the move. The 10-year TIPS yield jumped 47bp to 2.90%, a high, while breakeven barely moved. Investors are demanding a higher real return, which tightens financial conditions through equity valuations, housing, and weaker credit.

The dollar is mixed. The DXY rose 1.8 to 101.2, a 12-month high, but the Fed's broad trade-weighted dollar dipped to 118.9, below average.

Takeaway: Rates are the market's main pressure point. A 5%+ 10-year yield, a 2.9% real yield and MOVE at its 2026 high are what is squeezing housing, utilities, real estate, and low-rated credit.

12. Commodities

Commodities are rallying broadly. The Bloomberg Commodity Index is at a high of 142.9, up about 33% from 107 last October, and the energy sub-index is at a high after three straight rises. **WTI crude is \$91.2, up \$5.5 in September and above its \$77.8 average** (April peak \$105). Copper is a record 665c/lb., consistent with AI and electrification demand. Corn and soybeans are at their highs; wheat pulled back but remains above average. **Gold is the exception at \$4,174, down \$263** on the month and well below its February peak of \$5,279, as expected when real yields rise.

Takeaway: Higher energy and food prices threaten the progress in the 6-month inflation rates and are consistent with the PPI acceleration. This is a key upside inflation risk for Q4.

13. Housing and Agriculture

Housing is the clearest casualty of higher rates. The 30-year mortgage rate jumped 37bp to 7.03%, the highest (up from 5.98% in February). NAHB builder sentiment plunged 6 points to 37, the low. Existing home sales (3.98mn) have fallen three straight months to a low, and housing starts (1.275mn) and permits (1.403mn) are below average and declining. New home sales rose to 684k, likely helped by builder incentives. Case-Shiller prices are up 2.5% y/y, a 12-month high, modest but accelerating for four months as low supply supports prices.

Farm finances are strong. Net farm income was a record \$162.6bn for 2025 and farm lending is rising. With grain prices rallying, the farm economy is in good shape.

Takeaway: Higher mortgage rates are shrinking housing activity; this is where the rate shock is showing up in the real economy first.

Overall Assessment

Theme	Signal
Inflation	Plateaued at ~3.0–3.4% (PCE); momentum cooling; PPI and oil are upside risks
Expectations	Long-term anchored at ~2.3–2.5%; household expectations rising
Labor	Near full employment, supply soft; wages mixed
Growth	Strong capex and private demand; weakening consumer
Markets	Record earnings, narrow tech leadership, rising bond volatility
Rates	Fed hiking; curve at highs; real yields driving the move
Stress points	Housing, widening HY/CCC credit, utilities/real estate, consumer confidence at a low

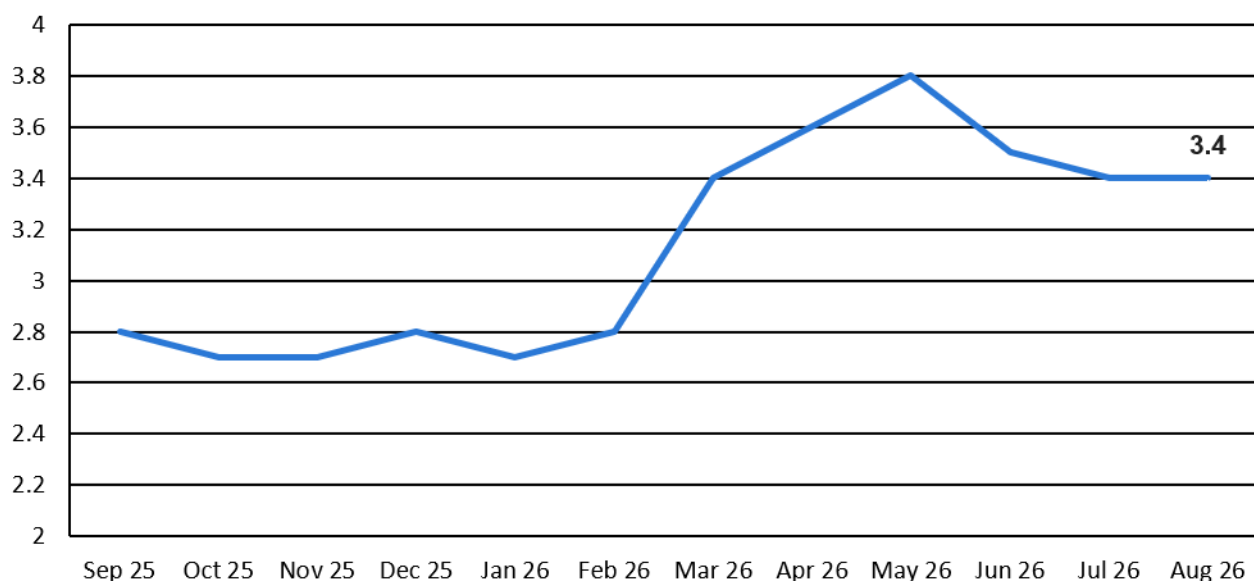
The dashboard supports a **hawkish-leaning policy stance**: both sides of the Fed's mandate argue against easing, with employment strong and inflation above target with upside risks. The main risks to that view are:

1. Consumer spending rolls over, as the retail and sentiment data suggest (although August Personal Income was up 0.9%)
2. Rising real yields tighten conditions faster than intended, as is already visible in housing and low-grade credit.
3. Equities, heavily dependent on technology earnings, are exposed if long-end yields keep rising.

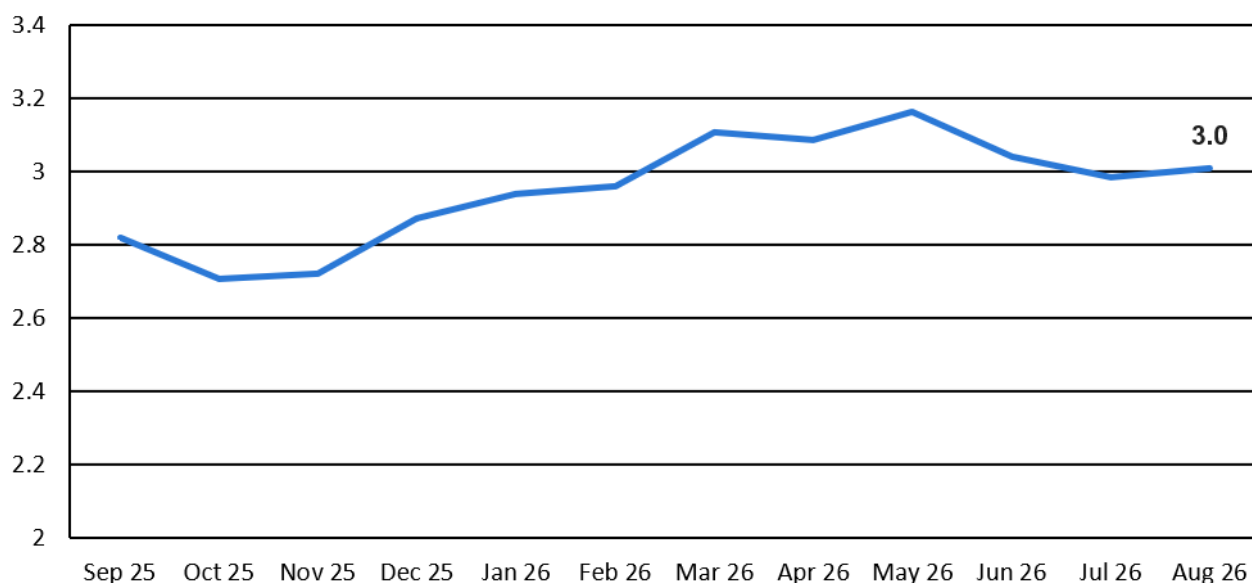
Source: KCM Eco Releases Monitor, Dashboard Charts sheet, Bloomberg data.

PRICE STABILITY

PCE price index, 12-month change (%)

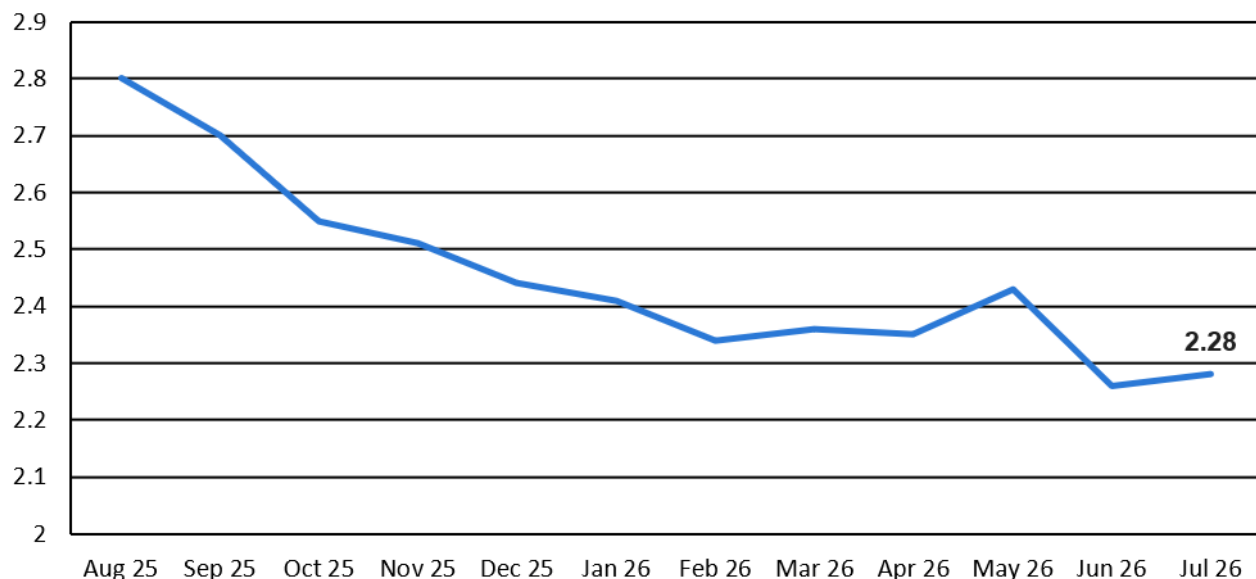


Core PCE price index, 12-month change (%)

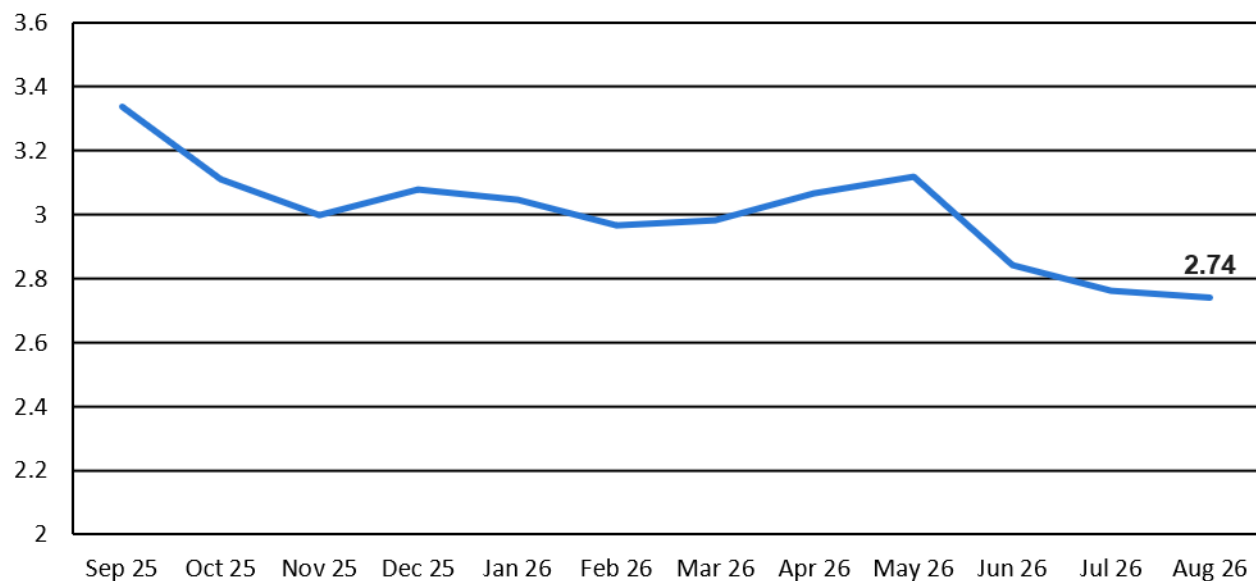


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Dallas Fed trimmed-mean PCE, 12-month (%)



Atlanta Fed sticky-price CPI, YoY (%)

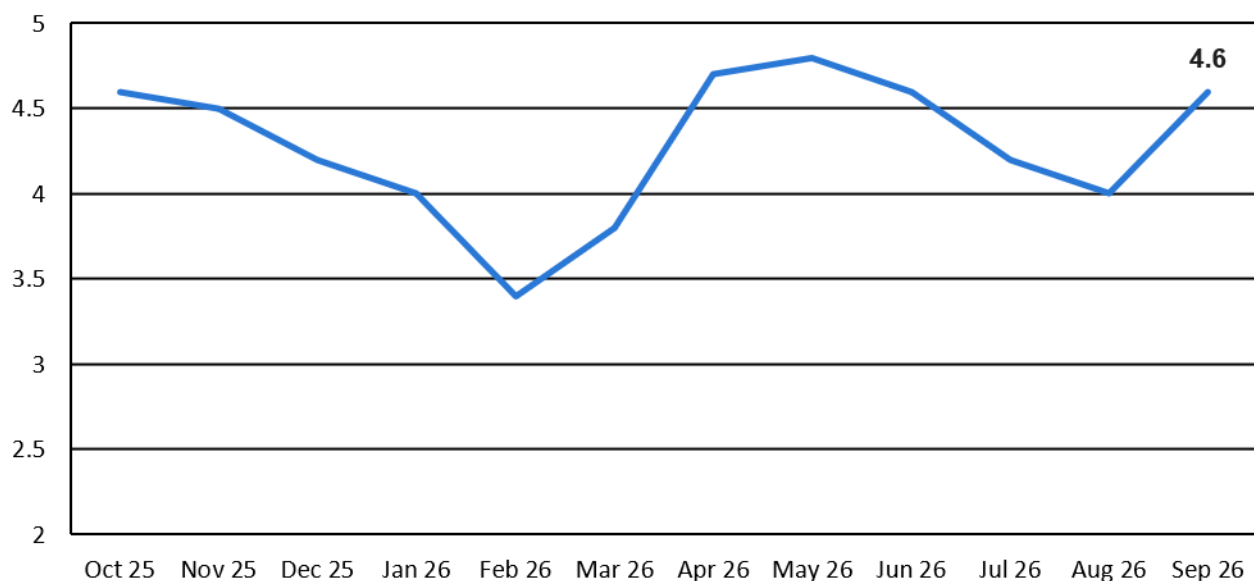


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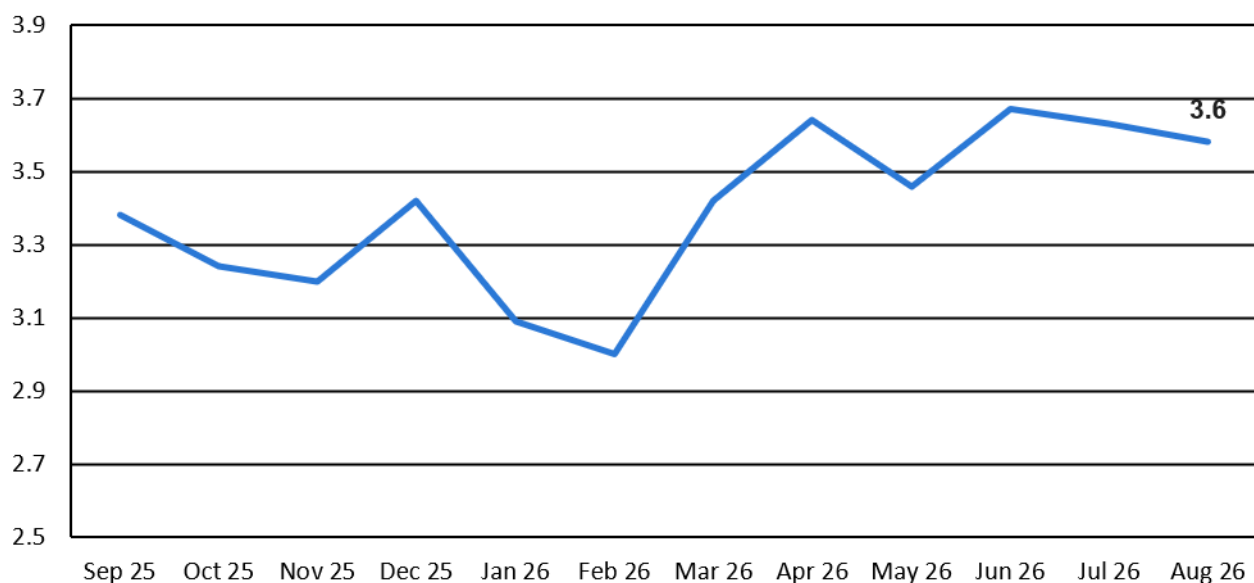
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INFLATION EXPECTATIONS

U. Michigan 1-year inflation expectations (%)

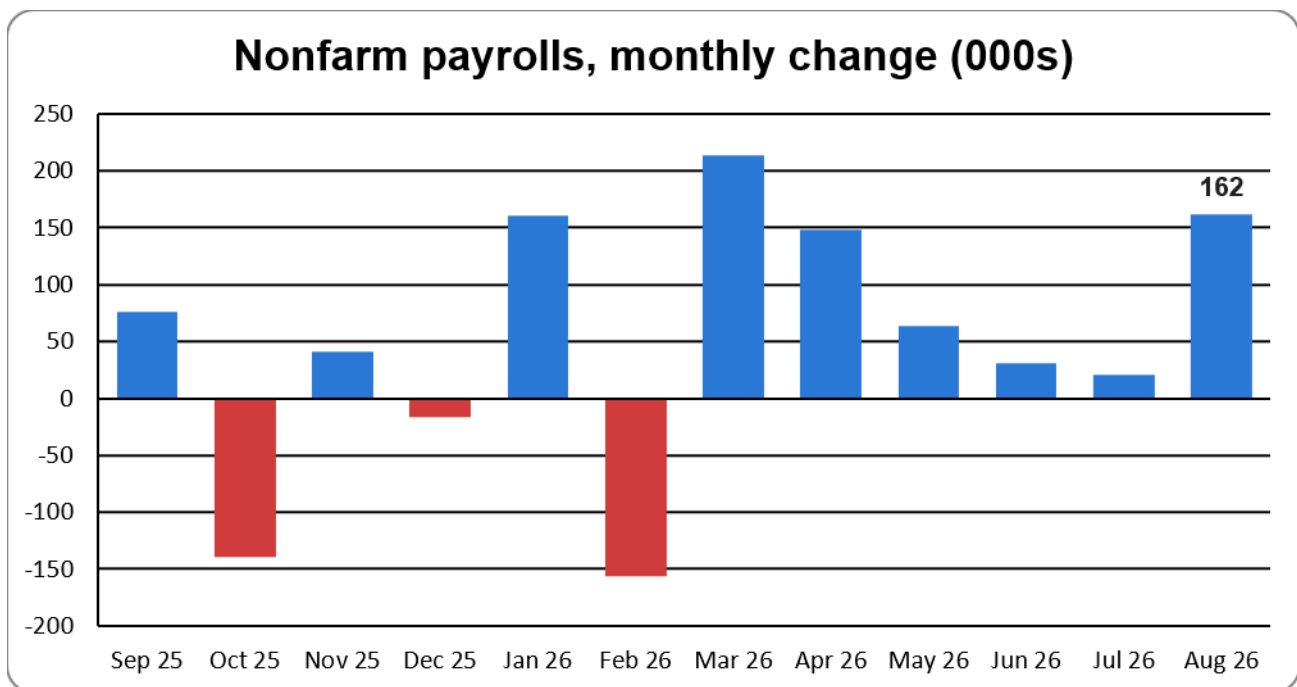
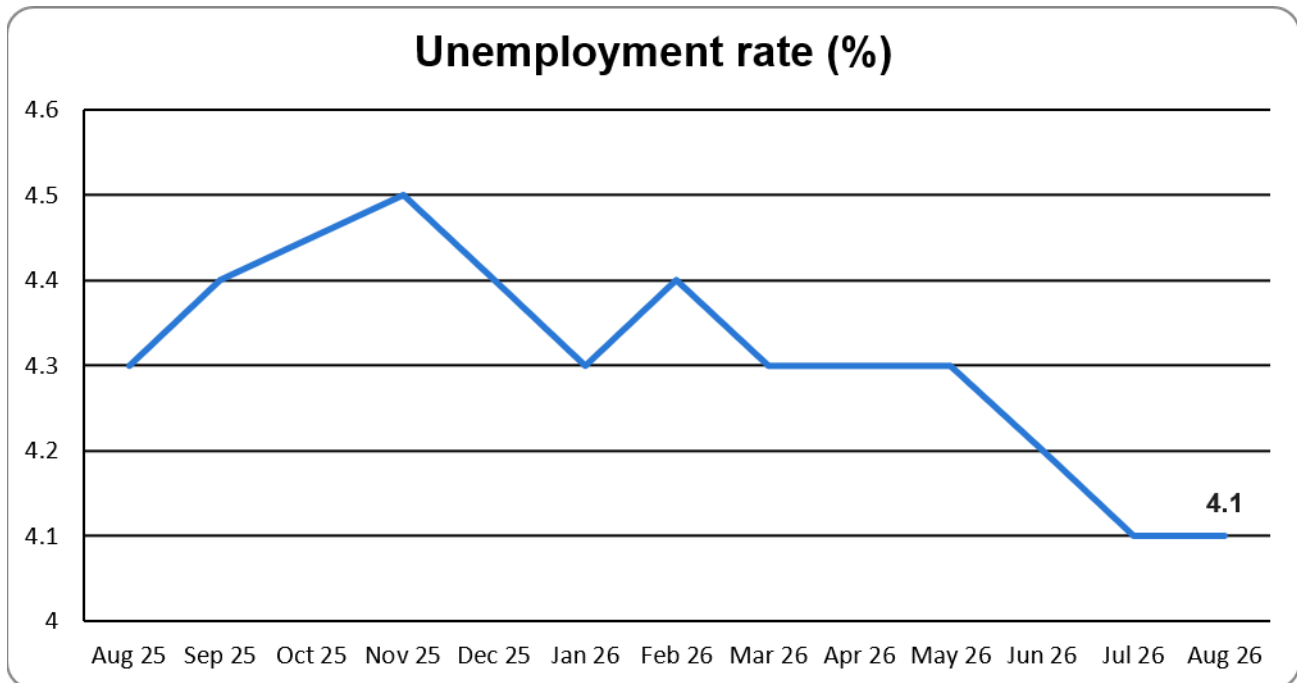


NY Fed SCE, 1-year ahead (%)



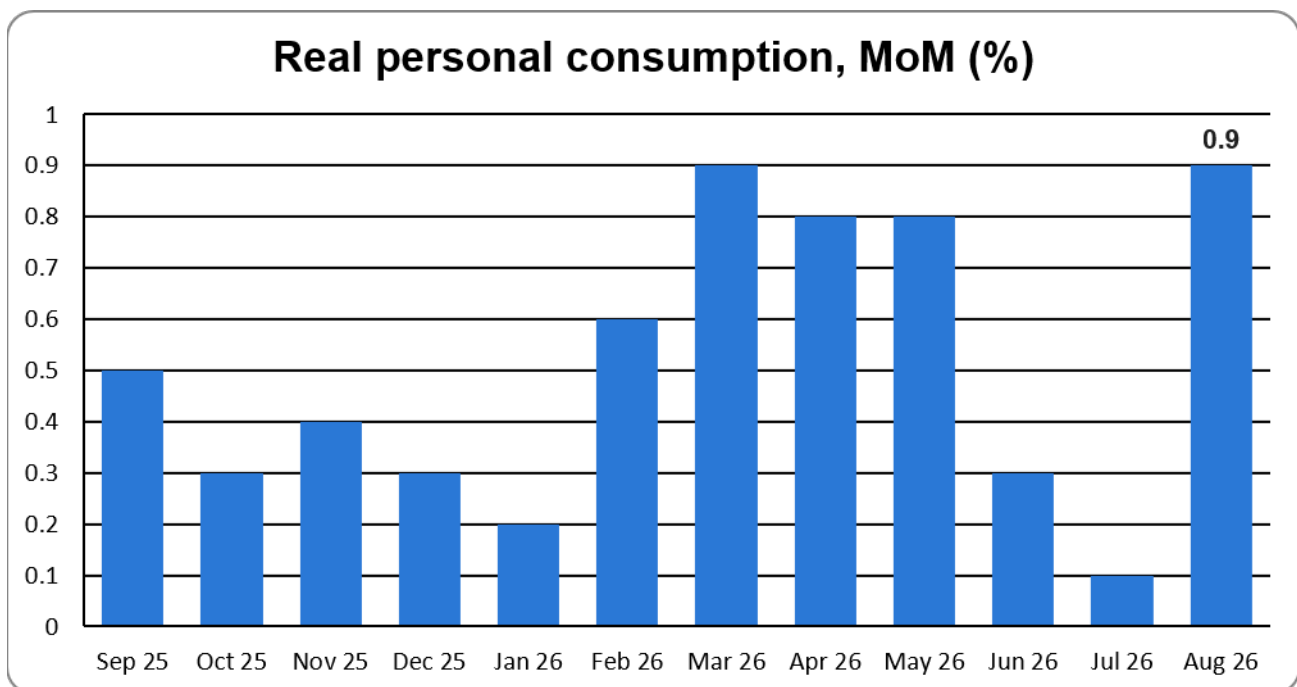
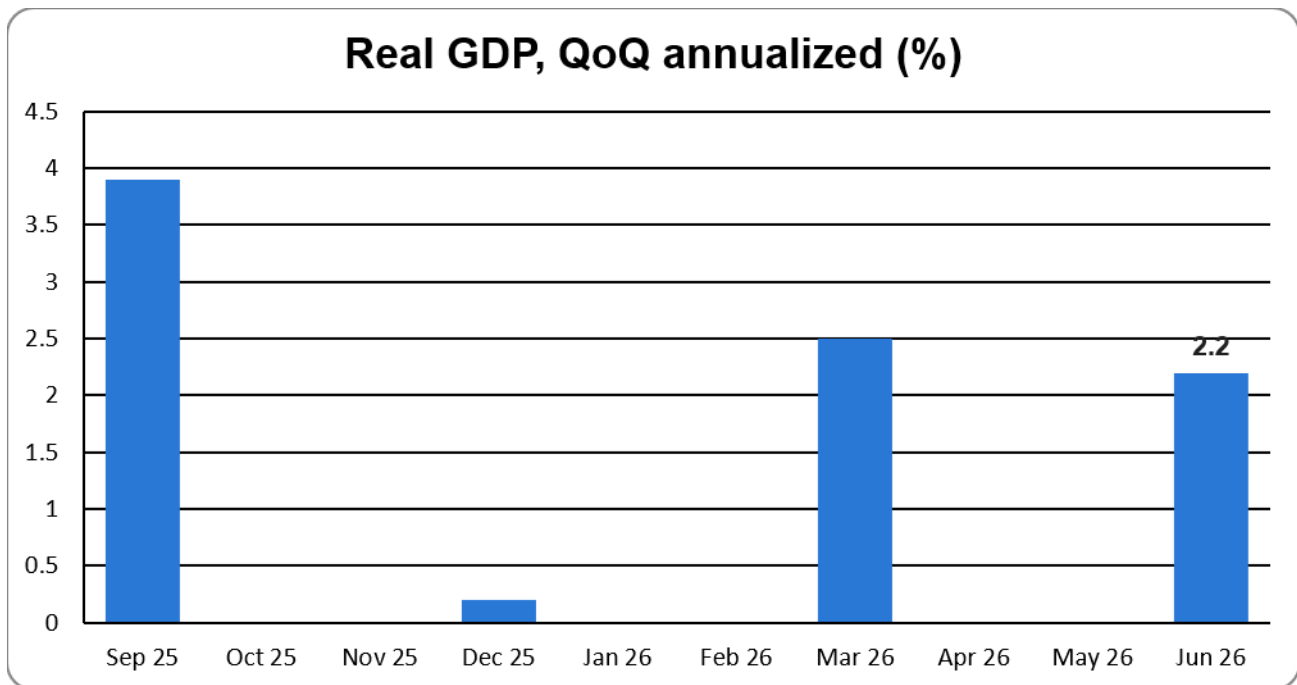
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MAXIMUM EMPLOYMENT



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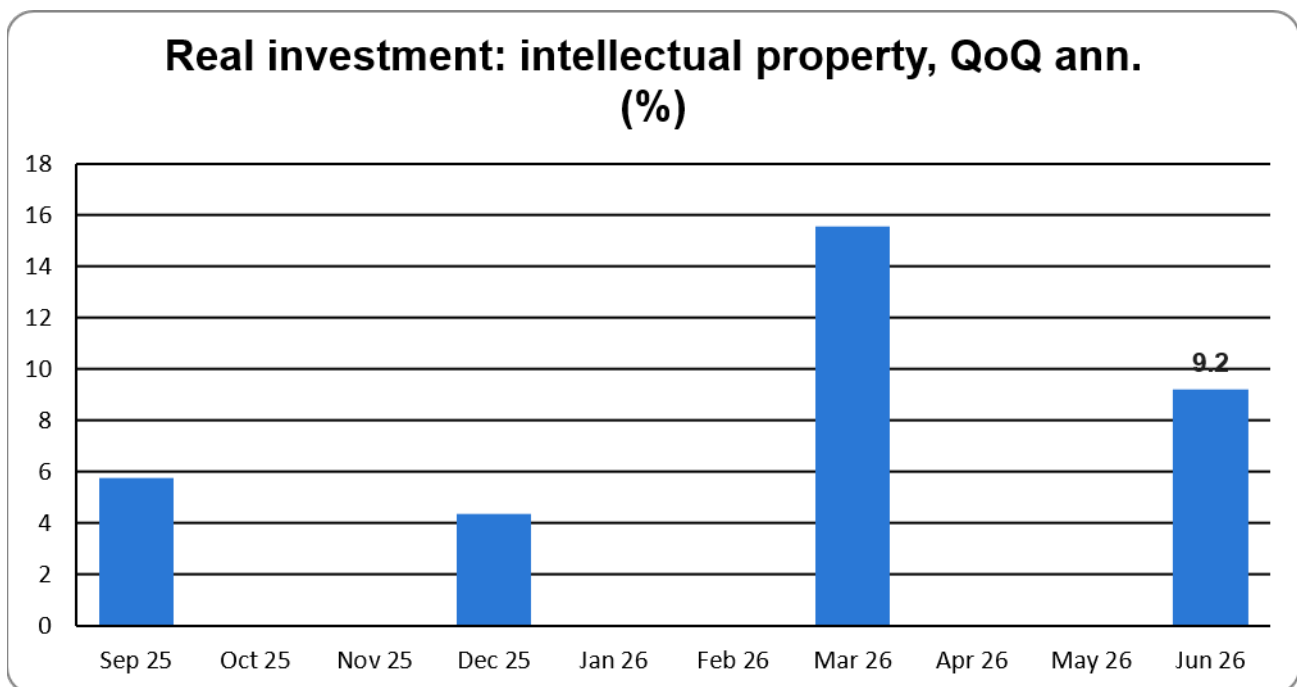
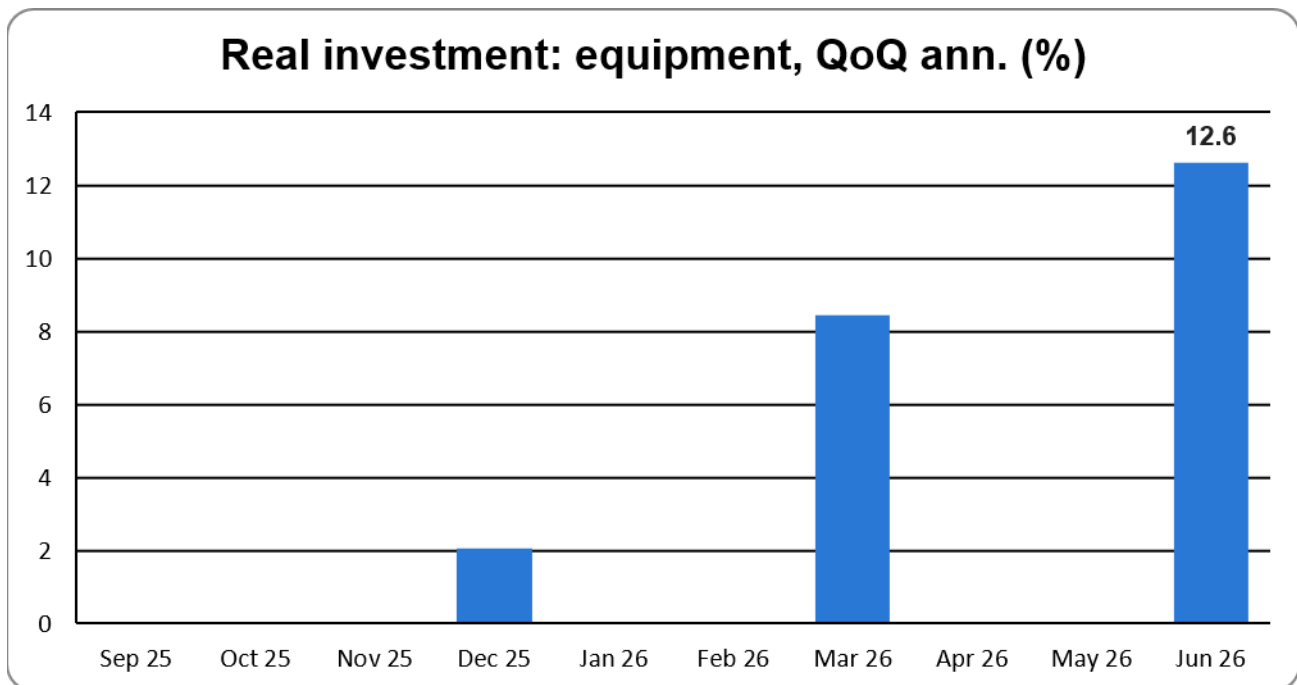
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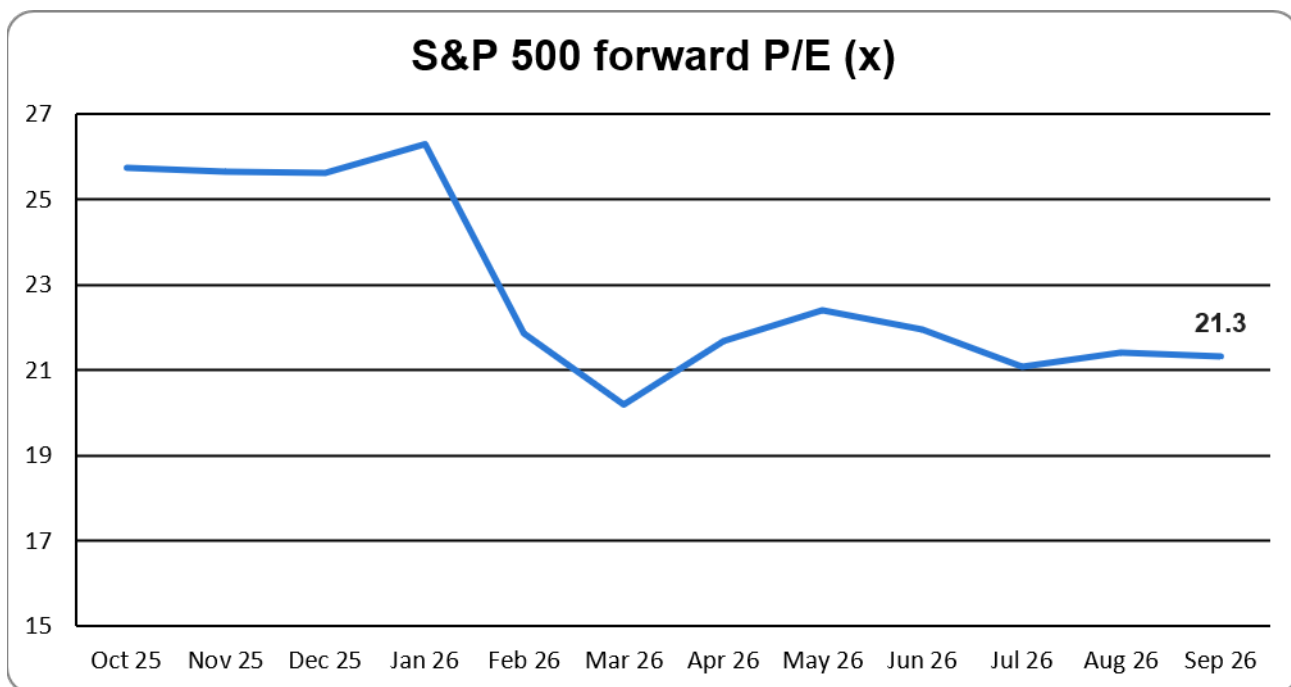
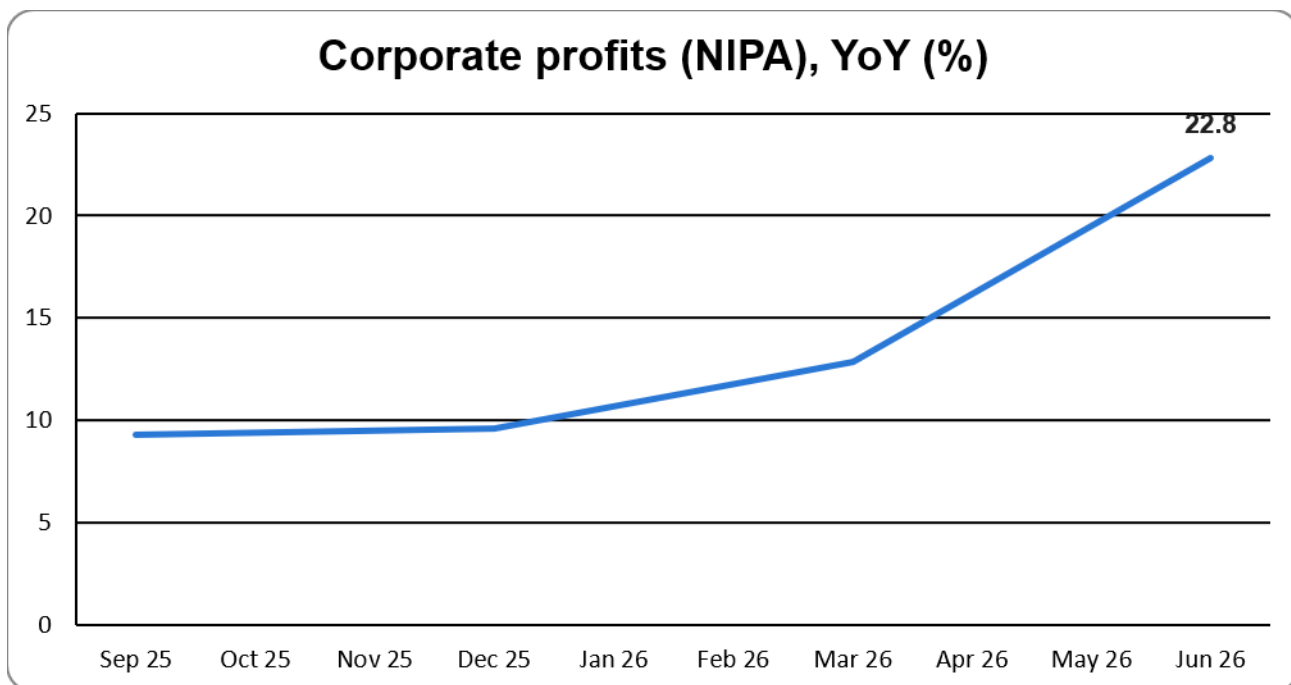
BUSINESS CAPITAL EXPENDITURE



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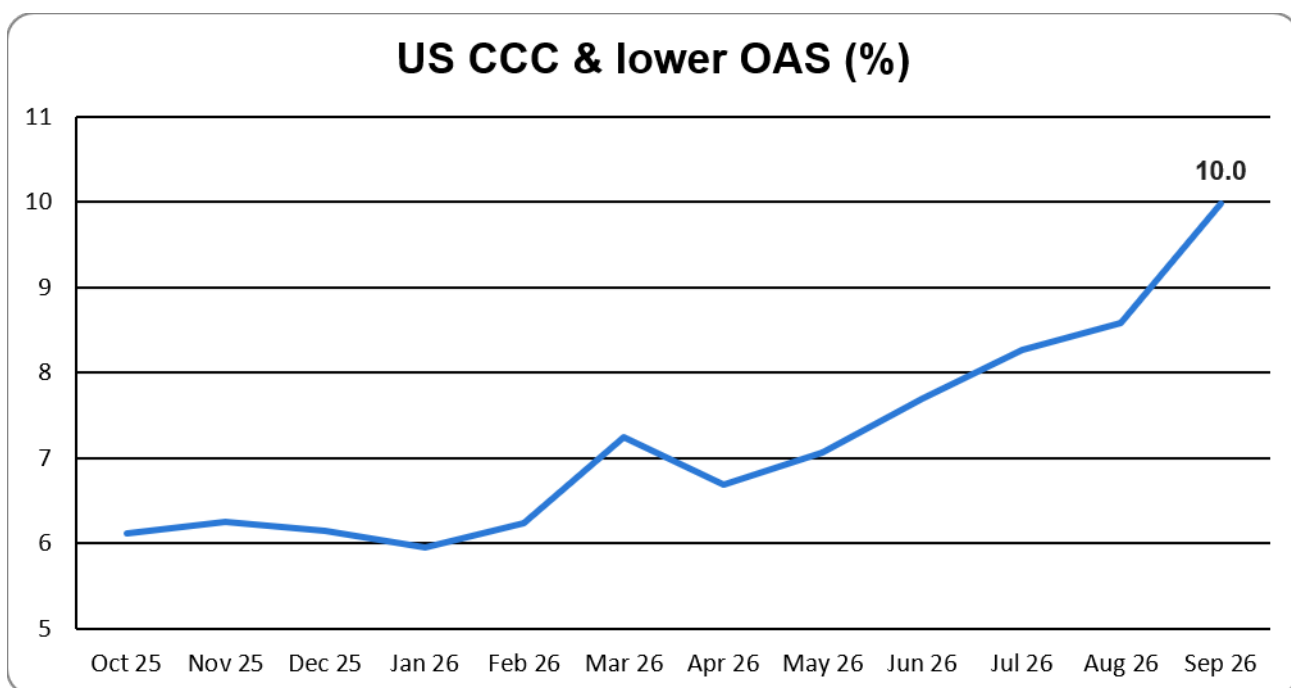
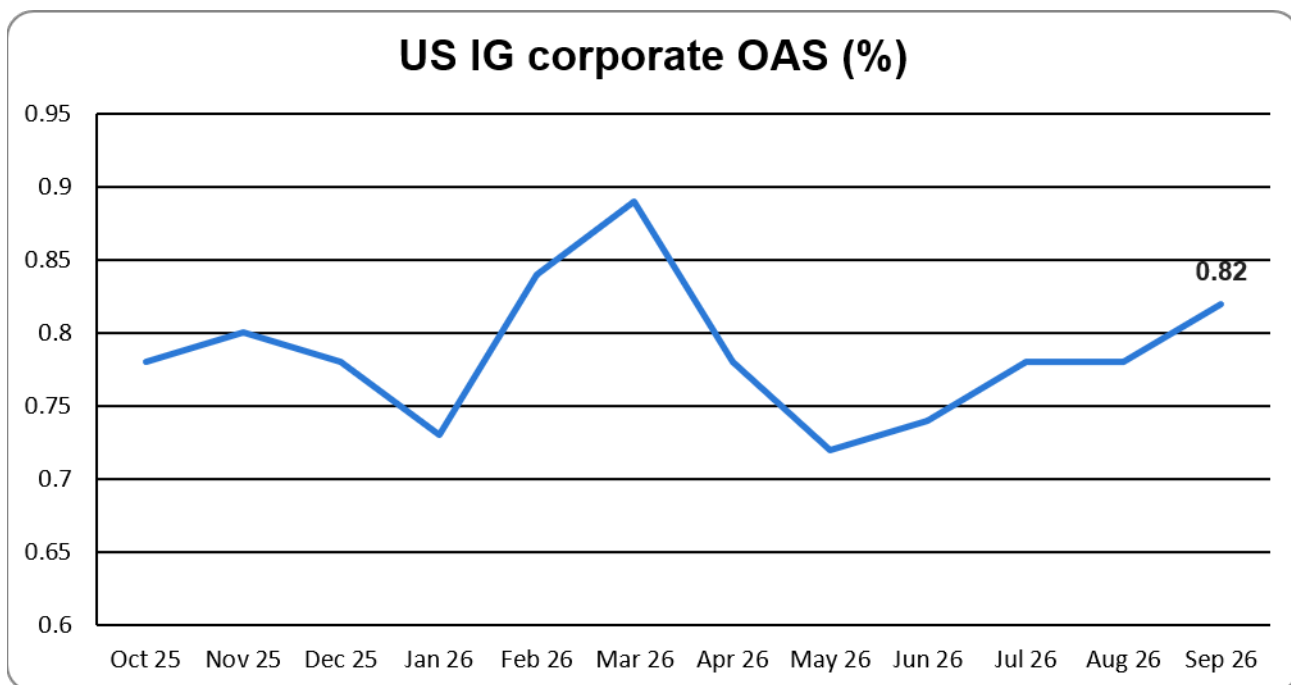
CORPORATE PROFITS AND MARKET INTERNALS



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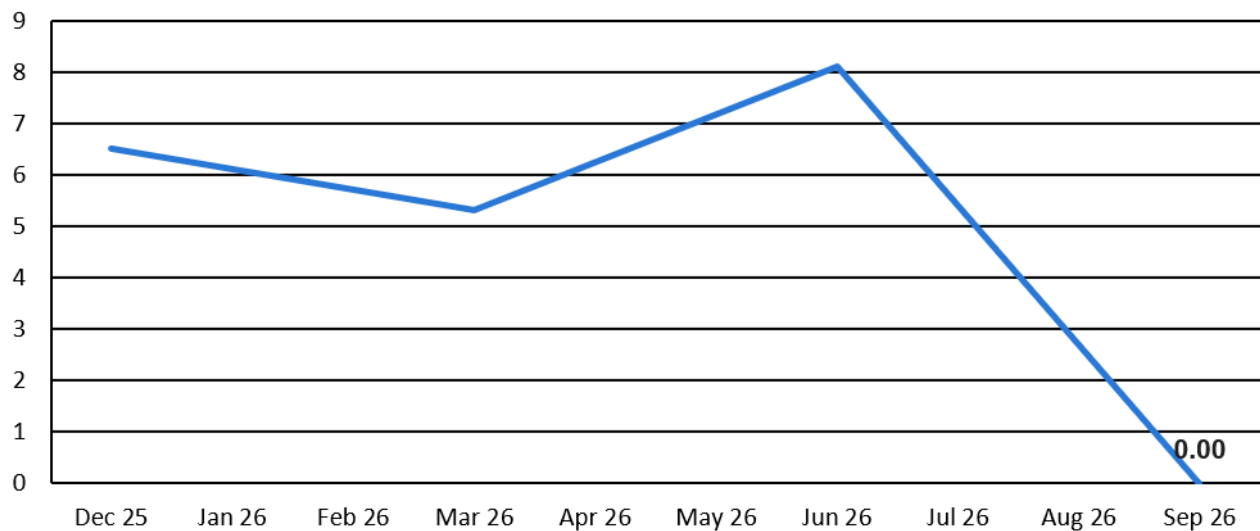
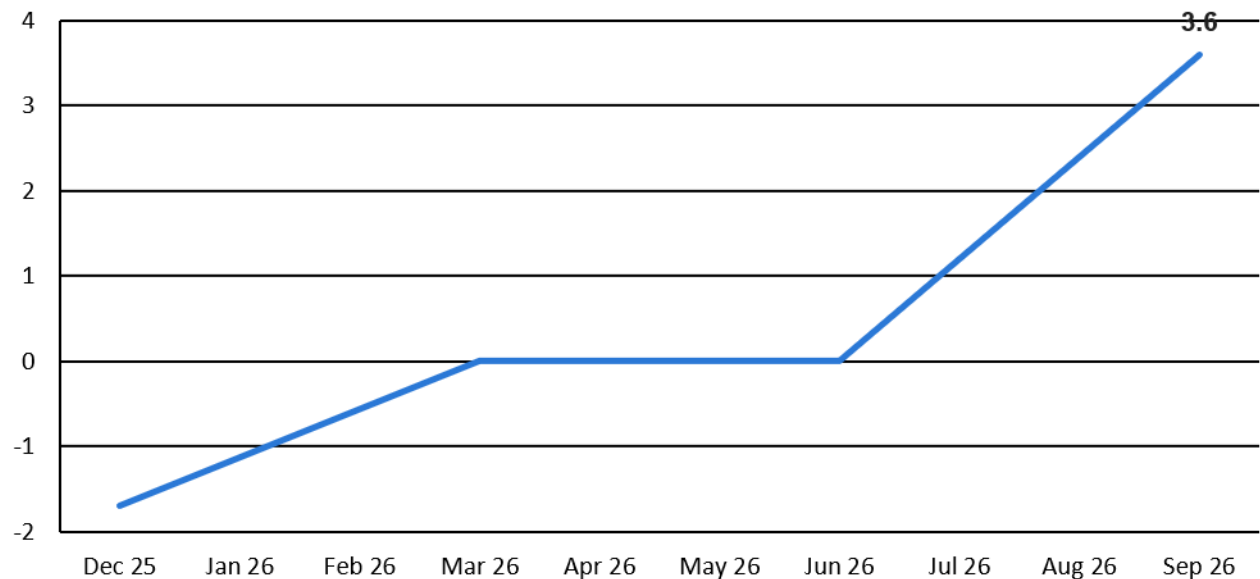
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CREDIT AND FINANCIAL CONDITIONS

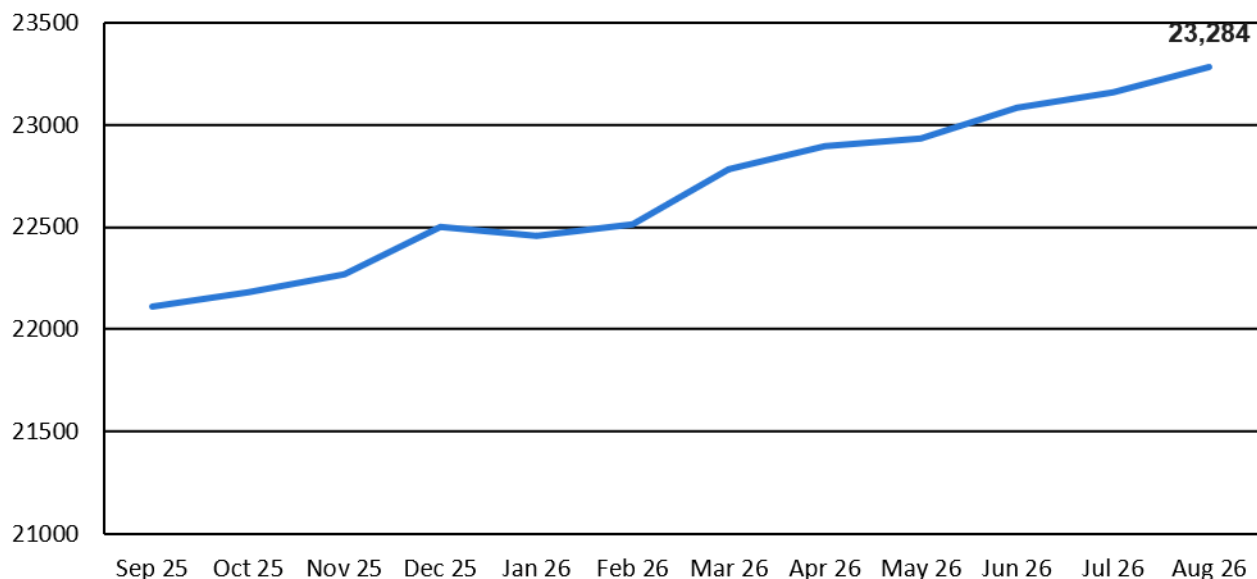
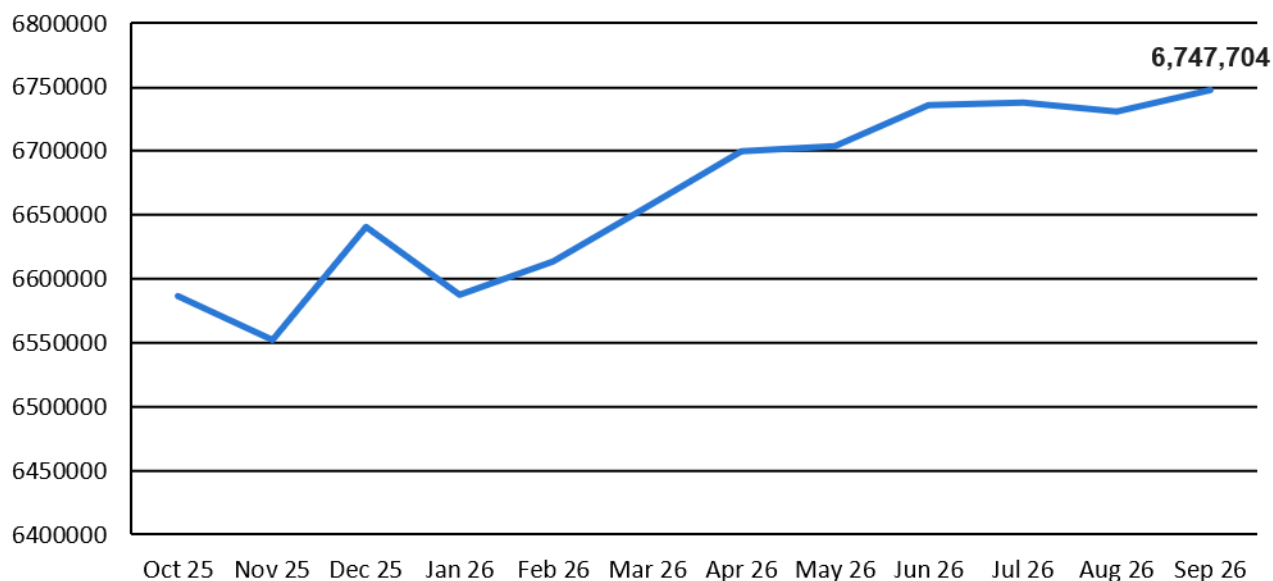


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**SLOOS: net % tightening C&I standards,
large/medium (%)****SLOOS: net % reporting stronger C&I demand (%)**

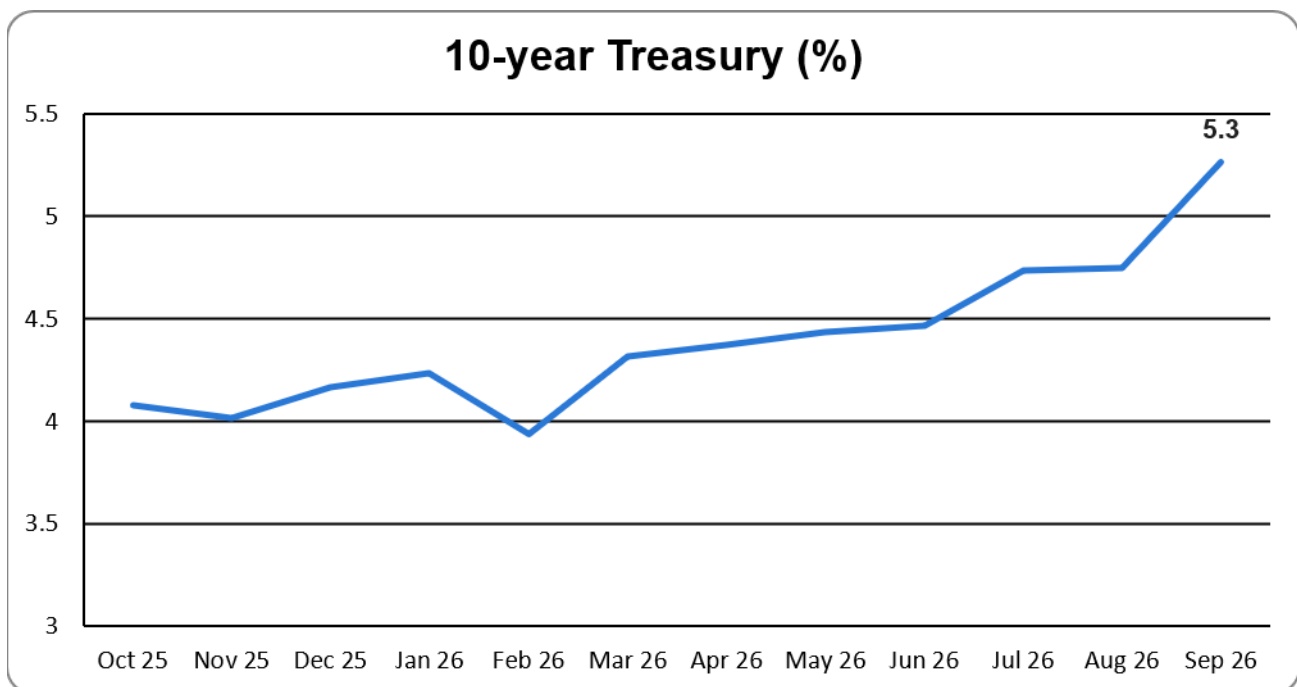
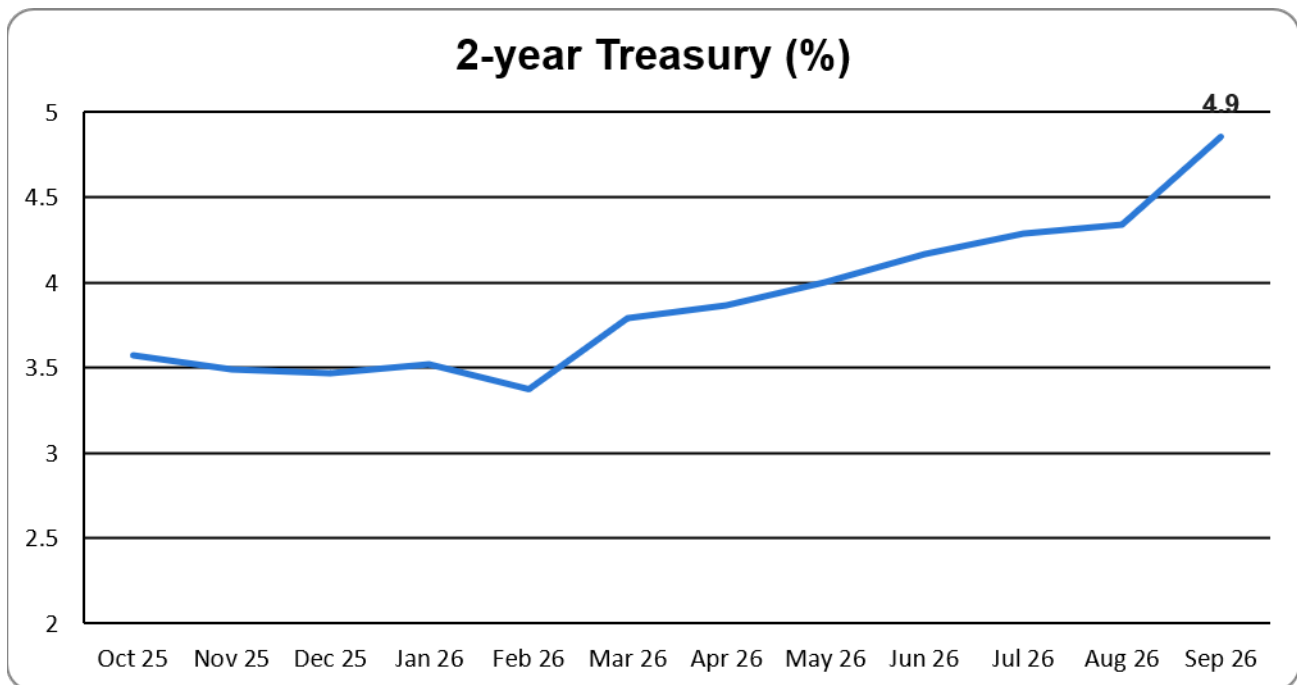
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M2 money stock (\$bn)**Federal Reserve total assets (\$mm)**

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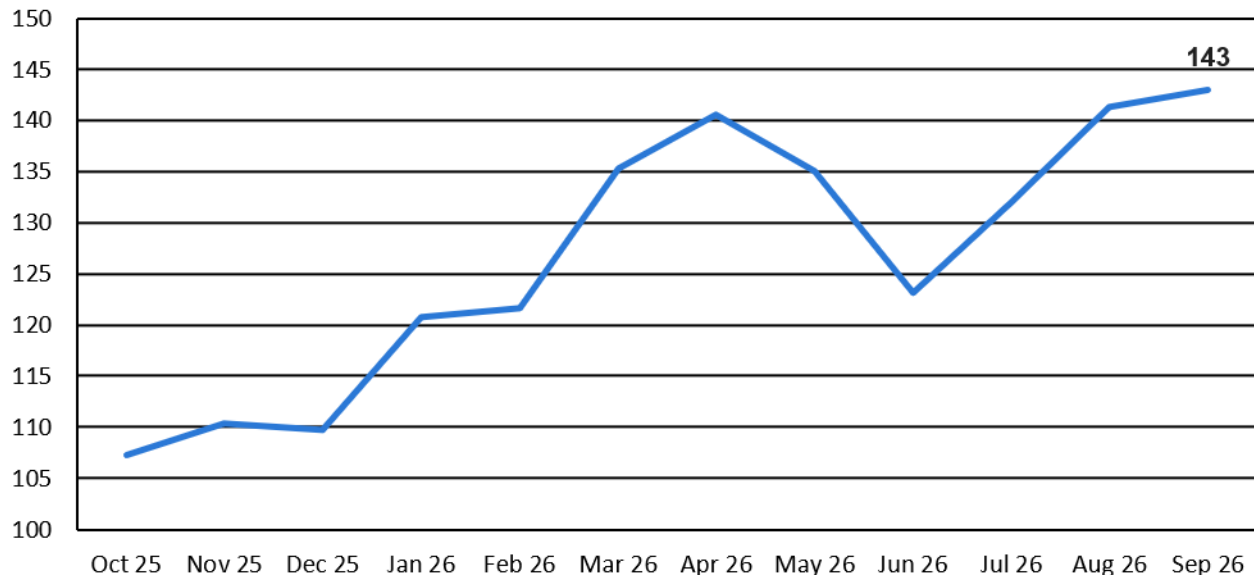
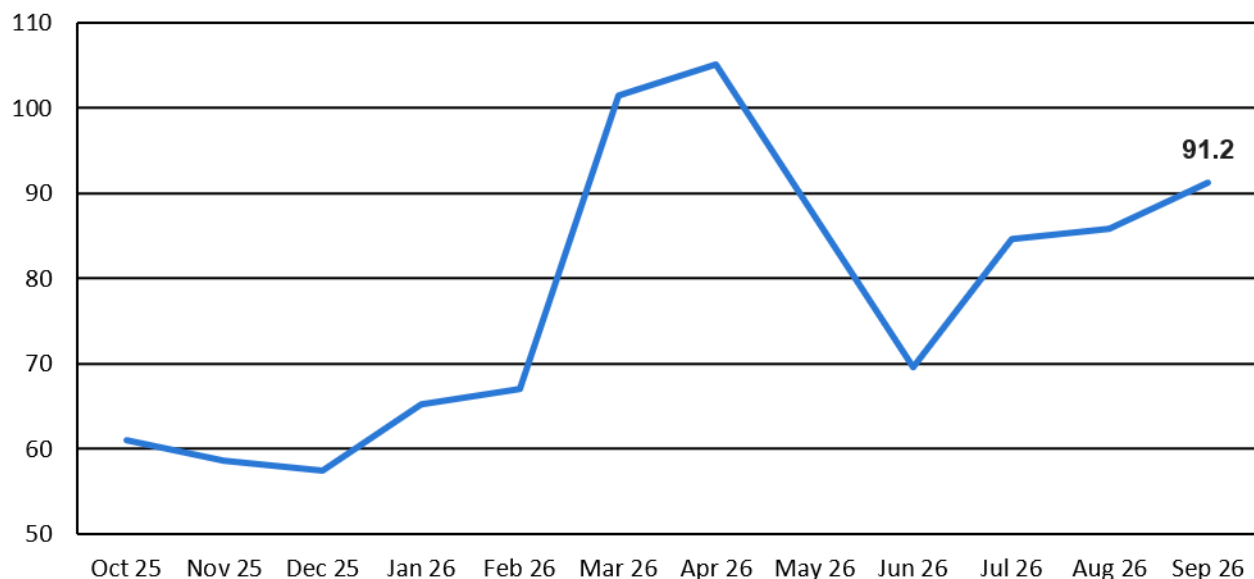
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TREASURY BONDS

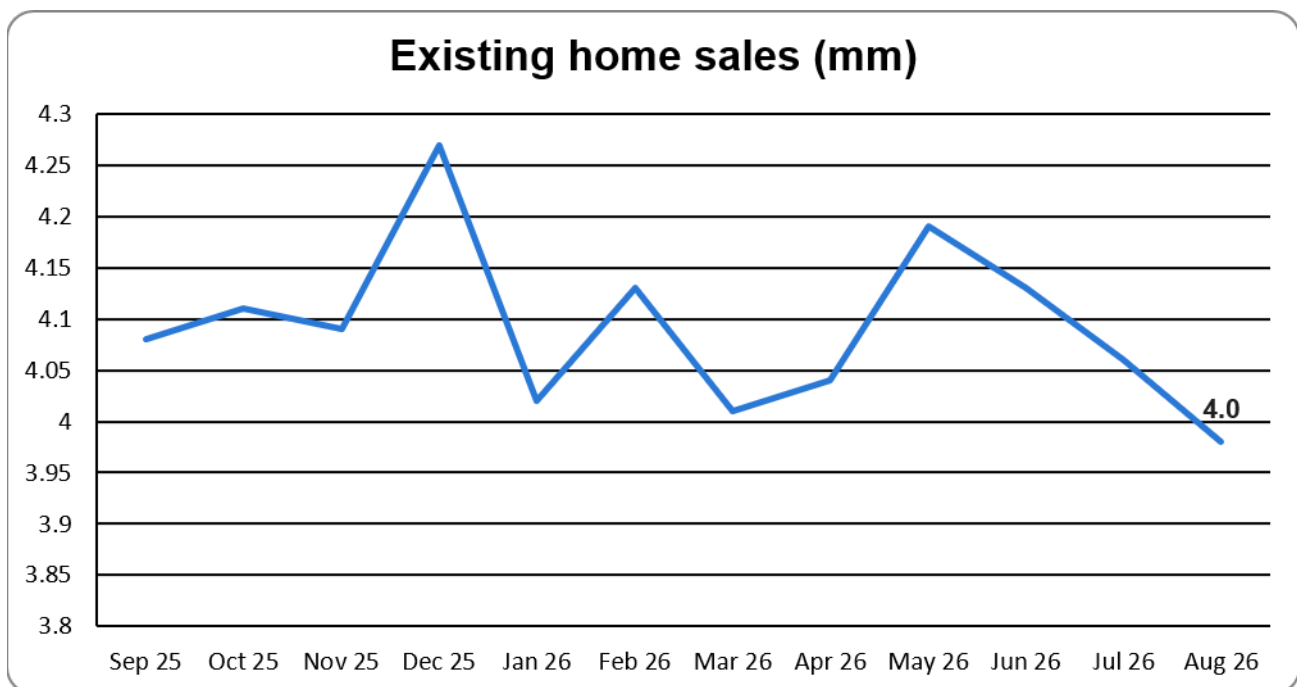
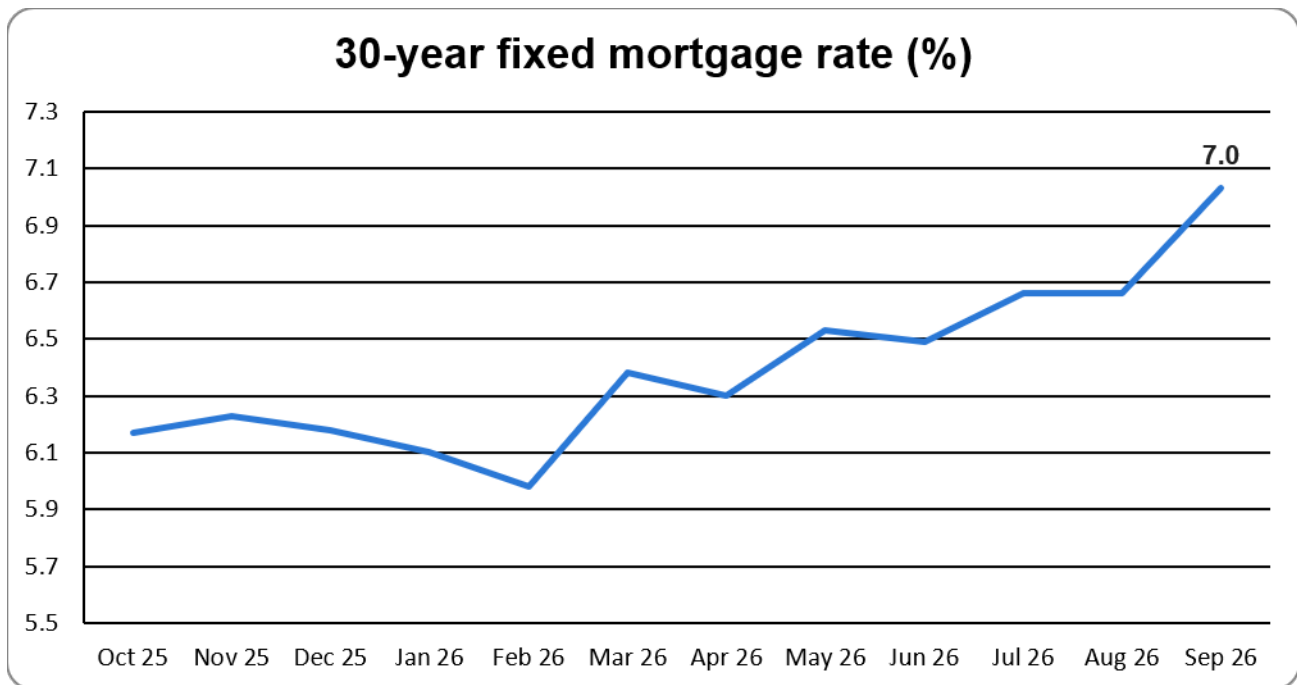


Takeaway: Rates are the market's main pressure point. A 5%+ 10-year yield, and a 2.9% real yield are what is squeezing housing, utilities, real estate, and low-rated credit.

The 2s10s curve has flattened to 41bp from 71bp in January as short-dated yields rise fastest, a classic reaction to a hawkish Fed.

Bloomberg Commodity Index (idx)**WTI crude (\$/bbl)**

Commodities are rallying broadly. The Bloomberg Commodity Index is at a high of 142.9, up about 33% from 107 last October, and the energy sub-index is at a high after three straight rises. **WTI crude is \$91.2, up \$5.5 in September and above its \$77.8 average** (April peak \$105).



Housing is the clearest casualty of higher rates. The 30-year mortgage rate jumped 37bp to 7.03%, the highest (up from 5.98% in February). NAHB builder sentiment plunged 6 points to 37, the low. Existing home sales (3.98mn) have fallen three straight months to a low, and housing starts (1.275mn) and permits (1.403mn) are below average and declining.

RECOMMENDATIONS:

1. Stay with KCM BlueBloods, Quality Equities Built for Turbulence

In equities, quality means exactly what KCM's BlueBloods strategy was designed to deliver: large-cap, U.S.-based multinationals with durable competitive advantages, diversified global revenue streams, fortress balance sheets, and the pricing power to navigate inflationary environments without permanent margin destruction. These are not speculative positions dependent on a specific macroeconomic outcome. They are businesses that have survived recessions, wars, inflation cycles, and policy reversals across decades, and have compounded shareholder wealth through all of them.

2. Stick with High-Quality Bonds, Ballast, Income, and Optionality

In fixed income, quality means staying with investment-grade bonds, Treasuries, and high-grade corporates and municipals, rather than reaching for yield in the parts of the credit market most vulnerable to sudden spread widening like Private Credit, high-quality bonds, by contrast, retain their role as portfolio ballast. Even when yields are volatile, investment-grade fixed income provides income, capital preservation, and the liquidity to rebalance opportunistically when equity markets overshoot to the downside.

Thank you for your trust.

Jay Kellett

Founder & CEO

Referrals are always welcomed!

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