Composition Wealth

From The CIO's Desk

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Caught in the Spotlight

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This past week, President Trump announced his intention to remove Lisa Cook as Governor of the Federal Reserve. We aren't taking a stance on the decision to fire Governor Cook or its legality. Still, we wanted to offer our perspective on concerns some investors have expressed regarding the potential for reduced central bank independence and how that could influence markets.

Federal Open Market Committee Structure

To provide some background, let's start by reviewing the makeup of the Federal Reserve's policy-setting body, the Federal Open Market Committee (FOMC). The FOMC comprises nineteen members: twelve presidents from each of the regional Federal Reserve Banks and seven members of the Board of Governors. The regional presidents are nominated by the board of directors of their local Federal Reserve Bank and then appointed concurrently every five years by the Board of Governors. All twelve regional bank presidents' terms are up for renewal in February 2026. The seven governors comprising the Board of Governors are appointed by the President and confirmed by the Senate. Governors are given a 14-year term. At any given FOMC meeting, only twelve of the nineteen members are given a vote, with five of the twelve regional Fed presidents voting on a rotating basis (with the New York Fed president always retaining a vote).

When President Trump announced his intention to fire Governor Cook, concerns around Fed independence arose for two reasons. First, given the President's stated opinion that interest rates should be lower, there was consideration that the President is taking action to try to assemble more governors who favor his view on interest rate policy. Second, since the regional Fed presidents are up for reappointment this coming February, adding more governors appointed by the President has caused some to speculate whether the Board of Governors might elect to overturn a recommendation for a regional Fed president that has more hawkish (prefers higher rates) views.

Assessing Fed Independence

We have a great deal of respect and appreciation for the independence of the Federal Reserve. Changes to the composition of the FOMC are understandably worrisome; however, there are several reasons why we believe it's premature to make conjectures on whether there will be material changes to the FOMC's composition. First, the construct of the Federal Reserve was wisely devised, as the President has no direct authority over naming regional Fed presidents. Even if the Board of Governors were to be aligned with the President on a specific monetary policy agenda, the regional Fed board of directors would still need to nominate bank presidents who adhered to that perspective. Second, the President only has the authority to nominate a member of the Board of Governors. That individual must still obtain approval from the Senate, as an added check and balance in the process. Finally, FOMC members are rooted in economic backgrounds. Given their technical training and understanding of the impacts associated with monetary policy, it would be an extraordinary circumstance for the broader FOMC committee to compromise its informed perspective and credibility to cater to the views of those outside the Fed.

If one wanted to assume that these controls are not fully effective in maintaining Fed independence, then let's contemplate the outcomes and ramifications. First, it's important to consider the context in which we sit with current monetary policy. The current economic picture is not clear, and we are at a natural inflection where there are valid reasons to support why the Fed should/should not lower interest rates. The labor market is currently softening, where a preemptive rate cut is not illogical. Alternatively, tariffs add uncertainty around price stability, and holding off for additional data may be equally prudent. Therefore, at this point in time, it's not unreasonable to have differing opinions and divergent views across the FOMC given the current point in the economic cycle. The limited movement in bond yields in recent weeks, despite increased political rhetoric around the Fed, serves as an affirmation from the market that future rate cuts are not necessarily inappropriate.

If the FOMC's actions were to go too far, an overly accommodative monetary policy would likely lead to higher inflation. We would expect the market to respond by requiring higher long-term Treasury yields. This would serve as a negative feedback loop to policymakers in several ways. First, higher long-term yields go against the President's policy objective of lowering federal interest costs. Second, Treasury Secretary Bessent has publicly stated he tracks the 10-year Treasury yield as a measure of the market's conviction in policy. If we saw long-term rates, such as the 10-year Treasury, move higher, this would provide a signal from markets that policies have gone too far and are no longer prudent. In addition, lower mortgage rates are another stated priority for the Trump administration, as it views a strong housing market as positive for the economy. Since mortgage rates are based on 10-year Treasury yields, being too aggressive with policy and creating a negative reaction in long-dated yields would impair borrowing costs for homeowners and impact the housing market. Furthermore, overstimulating the economy with too low rates could lead to a weaker U.S. dollar and a higher risk premium on U.S. assets. All of these outcomes would have undesirable consequences for multiple Trump administration priorities. This natural feedback loop between markets and the economy serves as an added check, helping to ensure policy does not become too exaggerated.

CONCLUSION

Increasing concerns around the Federal Reserve and its independence have sparked understandable angst among investors. Hypothesizing what might happen can be premature, as various checks and balances are in place to ensure the Federal Reserve's independence. In addition, we believe the feedback mechanism between markets and the economy provides an added safeguard to inform policymakers when policies have unintended consequences that can impact other policy priorities.

We recognize that public statements from the Executive Branch around the Federal Reserve create concern and uncertainty for some investors. We are actively following and considering any developments as we assess the likely outcomes and risks ahead for markets and the economy.