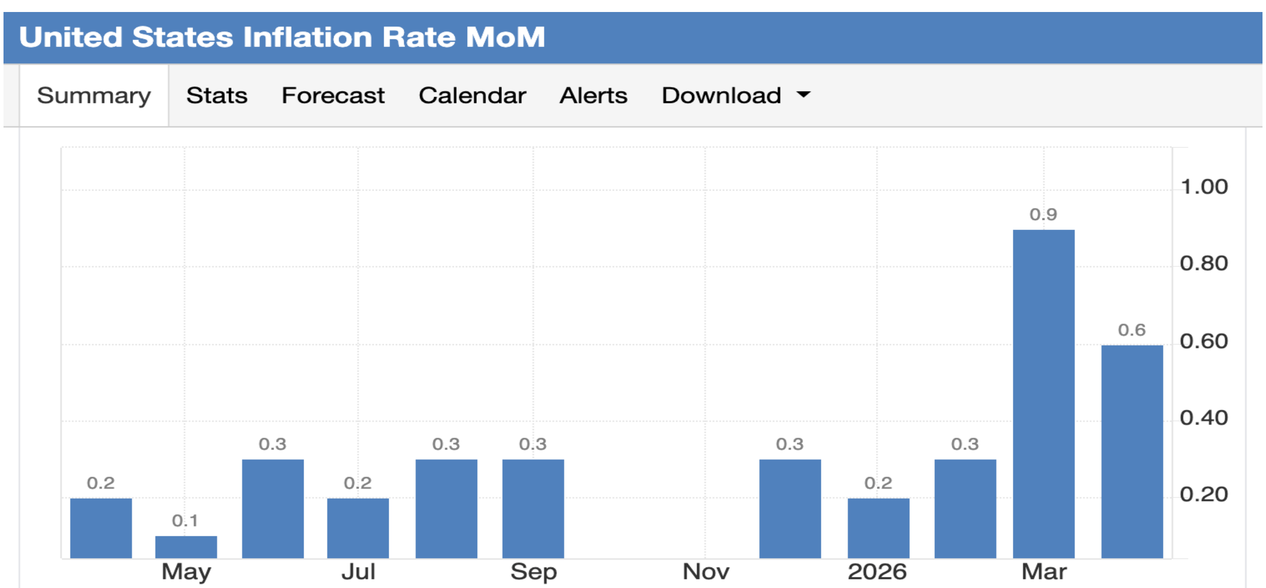
FCM Market Notes-May 15, 2026

The Fed And the Era of Non-Stop Stimulus

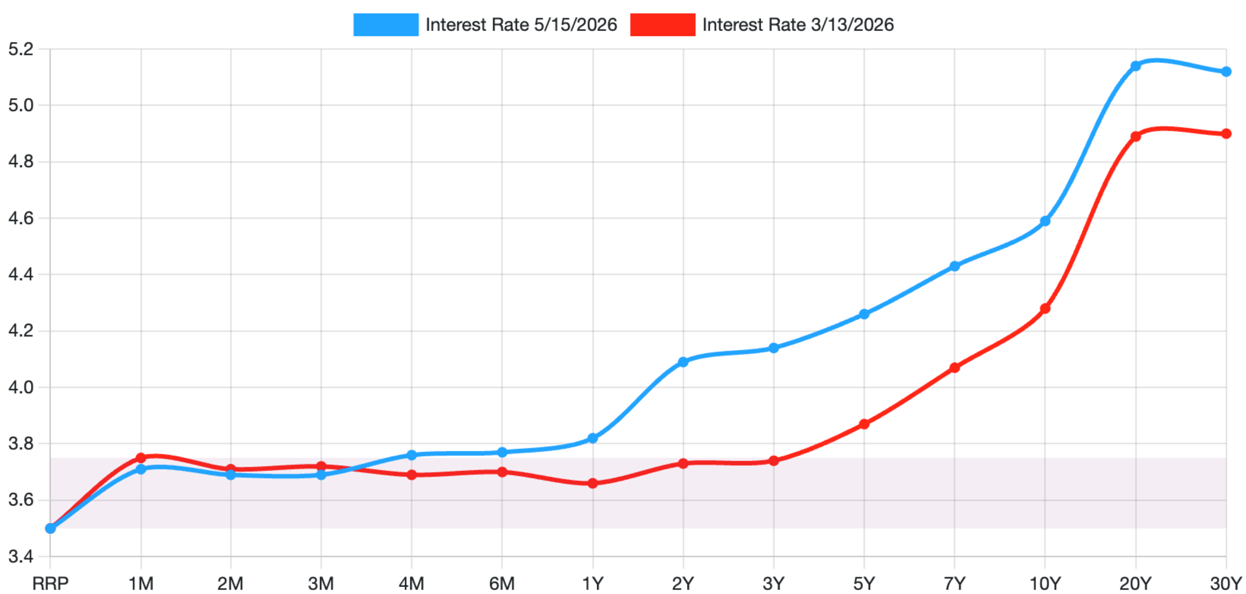
The markets welcome our new Fed Chair Kevin Warsh this week. You might have heard he has a near-term inflation problem. But the bigger worry should be the long run structural constraints in addressing it.

Short Term: It's Not Looking Great

This week's release of inflation numbers show a clearly deteriorating trend:



And markets are moving: Over the past month, the odds of a rate hike by the September meeting have gone from zero to 17%. That tightens liquidity conditions. The yield curve has steepened as well. This chart compares the treasury yield curve on Friday with a pre-Iran conflict level.



We view (most) bonds as a singularly poor investment in this environment. Especially anything over three months' maturity. And downward price acceleration occurred in bond land this week in the wake of the inflation data.

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This is the week the market gave up the ghost on rate cut hopes. No matter how the new Fed chair spins a narrative of AI producing a productivity boom, the near-term facts are now far too clear to produce policy ambiguity.

We may be seeing the beginning of risk assets reacting to the bond market's moves. In an environment of rising rates, we would expect gold to weaken (as more yield creates a more attractive alternative), small cap stocks to under-perform (given higher reliance on debt and lending to produce growth), and we would expect the dollar to rise. That template is now playing out.

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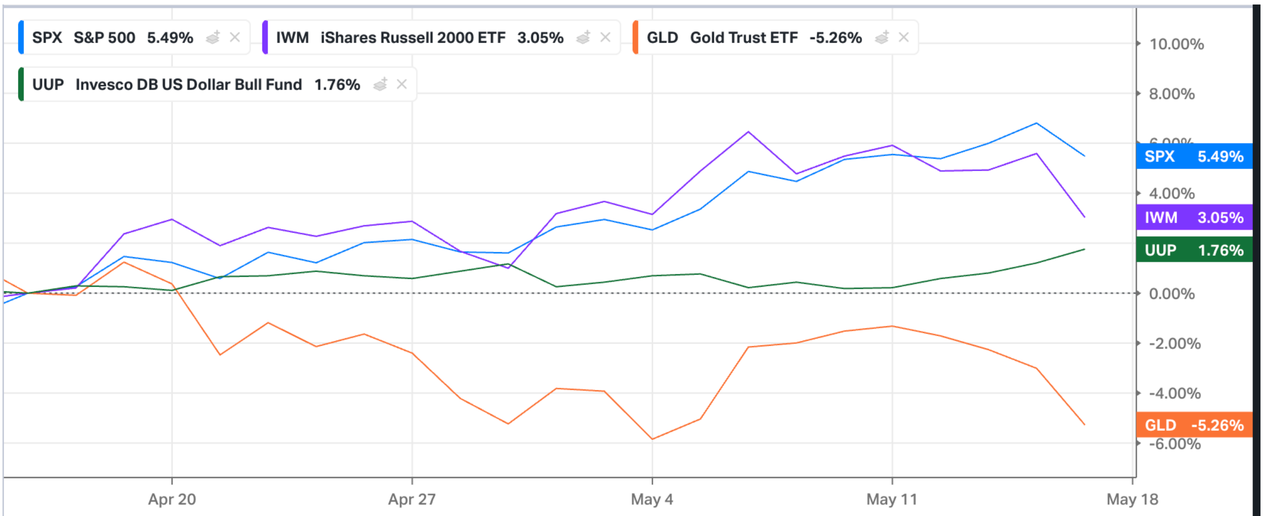

In sum, the market moves just emphasize the box that Warsh finds himself in on day one: he can't please his boss by dangling rate cuts and blowing up his credibility immediately, and an unambiguous hawkish approach risks cratering highly appreciated equity markets. Welcome aboard.

But The Longer Term Looks Worse

What we have described above is not a particularly unique or novel market cycle, even if choking off 20% of the world's oil is unprecedented. Something similar played out post-Covid and in many other cycles where inflation temporarily rose (and we could credibly pretend that 2% was a strict inflation target).

The bigger problem is the financial market's, and the economy's, reliance on stimulus that doesn't stop.

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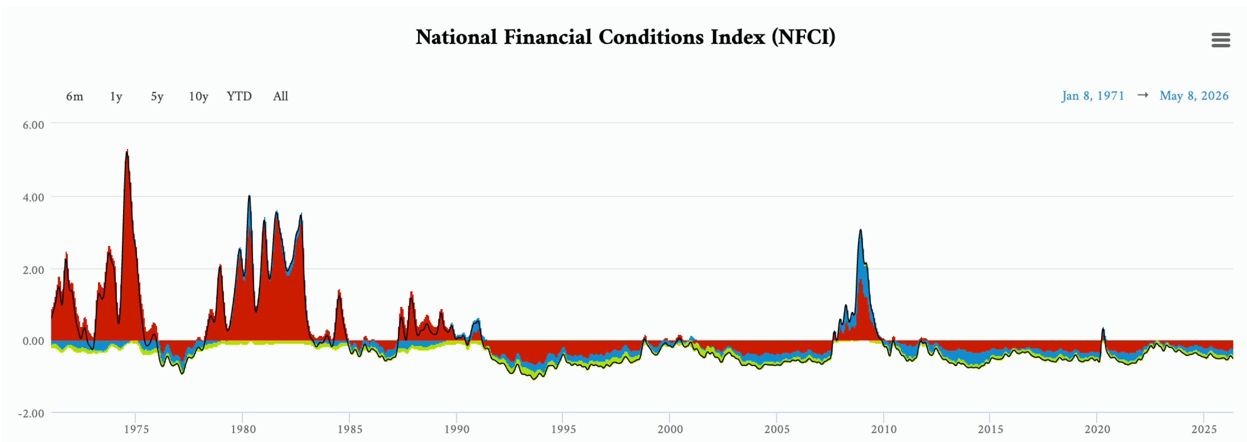
The Chicago Fed's financial conditions index was created to measure financial conditions across many different credit and asset markets, and it was created for a zero reading to be neutral, and a reading below zero to represent loose financial conditions.



We can see that except for the 2008 financial crisis and a small blip post-Covid, financial conditions have been "loose" according to the indicator for the better part of 35 years. Having been a market participant for 30 years, this aligns with what we believe would be a consensus among investors that the Fed generally leans asymmetrically dovish over long periods of time.

That has led to great equity returns, stronger growth than would otherwise occur, and surprisingly little *measured* price appreciation (though most adults middle aged or over might feel quite differently in their lived experience).

Surely Chair Warsh will go to bed each night dreaming of joining the pantheon of great Fed giants who were able to boost asset prices and growth and err on the side of the doves when the outlook gets uncertain, all while getting away with few apparent inflationary consequences.

That's probably not going to happen.

Because the other part of that non-stop stimulus is coming for him. Most people understand we are running a budget deficit historically reserved for wars and emergencies on a quite regular and bipartisan basis. Very recently the amount of debt has exceeded the nation's economic output, and prior to that the interest on that debt began to exceed our defense spending and is rapidly outpacing other spending categories we consider non-discretionary as well.

The odds of the US addressing this politically are approximately zero.

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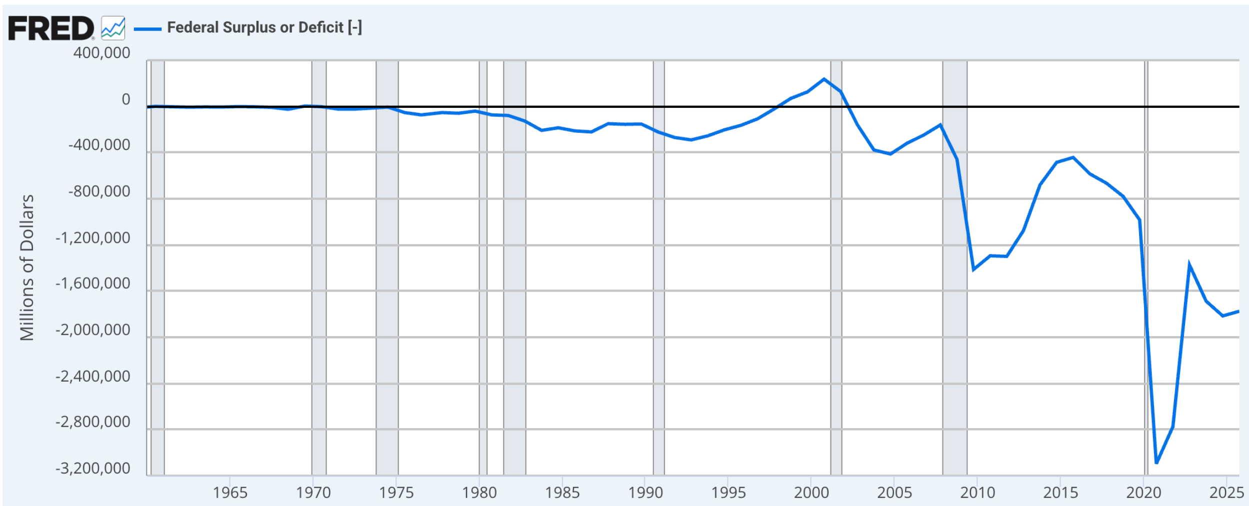

It's a favorite topic of market pundits to opine on when a crisis might be triggered by this inability to address the issue. We think of the situation more like friction: it limits policy options, forecloses the opportunity to respond to future emergencies, erodes foreign investor confidence and little by little reduces the Fed's ability to respond to slow growth with lower interest rates.

None of those dynamics can be measured but surely are in play.

Addressing one or both long-term stimulus dynamics comes with choices we are less and less suited to make. The increasing financialization of the economy and the concentration of wealth in a smaller percentage of the population makes keeping asset prices buoyant a more critical concern—not just politically but for overall economic growth.

Thus, the costs of addressing the issues rise, and the incentives for kicking cans down the road increase as well. Those twin dynamics suggest to us that shorter-term inflation could easily morph into longer-term inflation as the Fed gets more constrained in its policy options month after month.

James Barrineau, Chief Investment Officer

Fiduciary Capital Management LLC

1621 Central Ave

Cheyenne, WY 82001

Website: www.FiduciaryCM.com   Direct:

(914) 588-1978

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