THE FED HIKES AGAINST THE WHITE HOUSE'S WISHES

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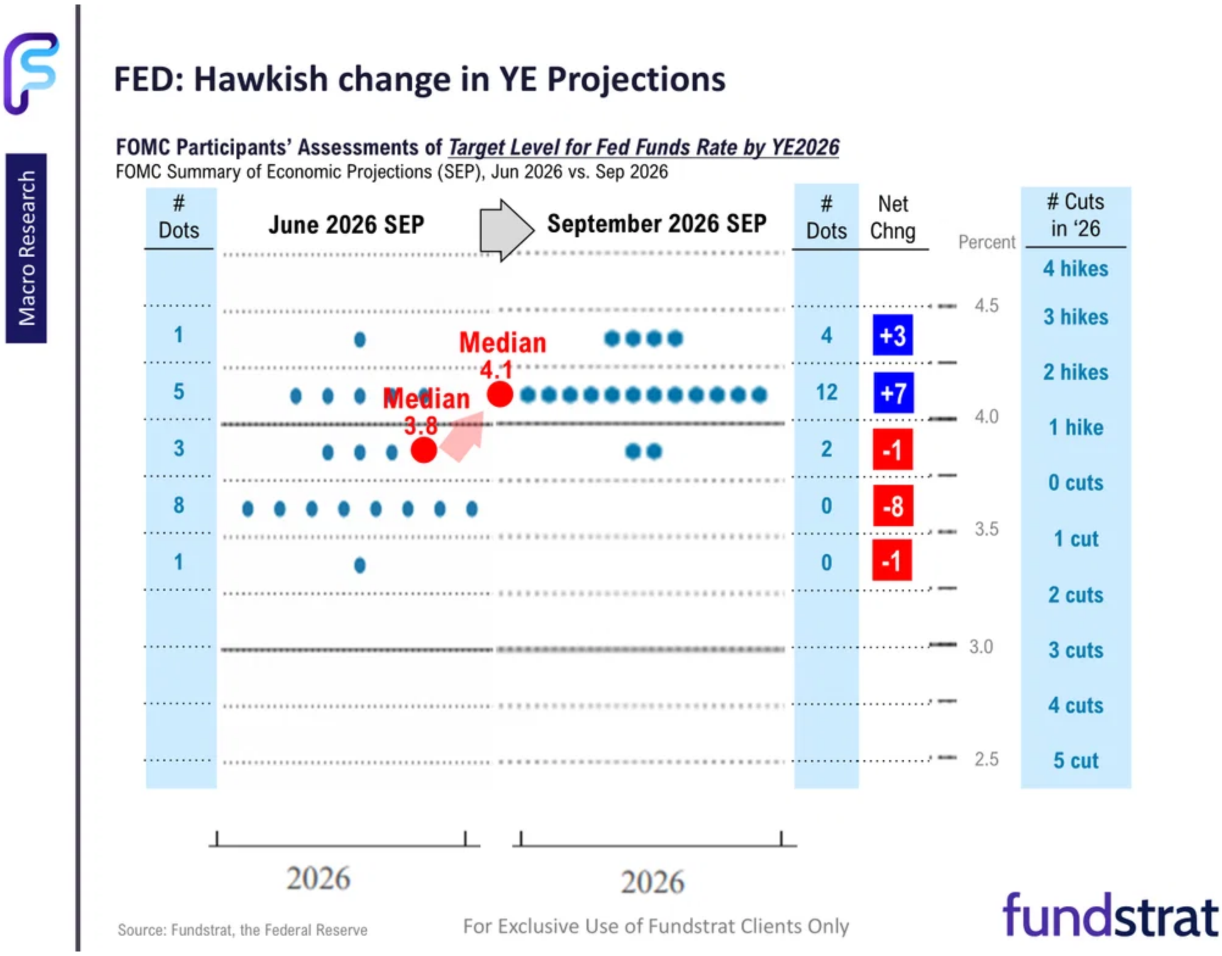
Most investors agree that an independent Federal Reserve is a good thing – good for markets, good for the economy, good for the U.S., and by extension, good for the world. There is, however, some disagreement about what Fed independence looks like in September 2026. Is it a rate hike? Or is it a pause?

For the past 19 months, President Trump has made no secret of what he thinks the Fed should do. Before today's meeting, he had dialed up the volume on his view with this all-caps Sept. 4 social-media post: "LOWER THE RATE OR I'LL STOP TRADING WITH COUNTRIES WITH WHICH WE HAVE A DEFICIT."

The debate on Fed independence is likely going to intensify in the coming weeks and months because on Wednesday, the Federal Open Market Committee voted for a 25 basis-point hike from a range of 3.5-3.75% to 3.75%-4%, making it look like Fed Chair Kevin Warsh had defied the president who appointed him.

Markets had interpreted the most recent PPI and CPI inflation prints, released just last week, quite hawkishly. Consider that on Sept. 4, Fed funds futures trading implied that the market was pricing the odds of a Sept. 16 hike at 59.4%. This had risen to 72.4% on Sept. 10, the day that the latest PPI numbers were released. On Sept. 11, the odds surged to almost 90% in the wake of CPI numbers, and by Monday, they had broken through that 90% threshold.

Thus, today's rate decision is yet another in a long line of decisions that were largely anticipated before they were announced. Yet, the S&P 500 declined 0.5% afterward, possibly due to the Fed penciling in at least another hike this year, as shown by the Summary of Economic Projections dot plot below. This sign that the Fed is “serious about this” was almost certainly to the dismay of those hoping for a "one and done" hike.



What’s more interesting than the hike itself is the fact that this FOMC vote was unanimous, unlike the previous ones. Fundstrat Washington Policy Strategy Tom Block told us after the presser that "I think the unanimous vote shows a lot of behind-the-scenes work to get the united decision." The decidedly hawkish shift arguably reflects the committee's increased impatience about the battle against inflation. Repeatedly, Fed Chair Warsh expressed the committee's desire for a "timelier" return to the 2% inflation target.

It is apparent that the voting members felt comfortable enough about the strength of the economy to indulge in some impatience. With regard to the economy, the Fed chair said FOMC members expressed an "attitude of optimism," and Warsh himself views the economy as having strengthened since the July 29 FOMC. Importantly, the SEP also showed that members largely anticipate that unemployment will likely remain at an acceptable 4.1% level through 2027. On the surface, this could be seen as a bullish sign for stocks.

The downside, of course, is that this left the FOMC with little immediate impetus to cut rates or even hold. Instead, members decided that the "predominant" focus of their efforts (as Warsh put it) should be on the price stability side of their dual mandate, not the labor-market side.

As Head of Research Tom Lee pointed out later, all of this is arguably quite a vote of confidence in the economy. The SEP can easily be interpreted as evidence that the members believe that the economy is strong enough to handle even a 50 bps increase.

Does this latest hike represent a Fed transition to a restrictive rate policy? Beyond acknowledging that it "removed a dose of accommodation," Warsh wasn't biting. Follow-up questions had the chair asserting that debates about a hypothetical neutral rate are pragmatically unhelpful, even if interesting to academics.

Investors reacted negatively to the day's events at the Federal Reserve. The S&P 500 briefly dipped as much as 1.3% after the 2 p.m. announcement before partially recovering to close the day down 0.5%. The VIX briefly spiked 16% to 18.9 before settling slightly (it ended the day up nearly 3%). For Head of Technical Strategy Mark Newton, this represents a potential buying opportunity for equity investors. Though he sees the possibility of a short-term pull back later this week, Newton remarked that "I think the risk/reward looks favorable for positioning for a rally." Lee is largely in alignment, viewing the post-FOMC declines as a market "overreaction."

So to return to the question of Fed independence: Warsh deflected on questions from reporters seeking to elicit a comment about his relationship with President Trump. He also chose not to answer questions about Trump's likely reaction to the Fed's decision.

The chair has previously expressed a strong belief in the need for Fed independence. To him that means "we [the Fed] stay in our lane." Extending the analogy, he asserted that "independence is a two-way street." He thus refused to comment on Trump's previously mentioned trade-related threat, and he also demurred on an invitation to provide his views on the potential impact of AI on any aspect of the economy, including inflation.

Even after today, it still remains important for the Fed to avoid even the appearance of political motivation. The midterm elections are coming up on Nov. 3, and the next FOMC meeting is scheduled for Oct. 27-28. With either a hike or a cut right before a pivotal election both likely to provide fodder for critics looking for an opening, Block had this parting observation: "My guess is that part of today's unanimous decision is an acknowledgement that increases a week before the election is likely not in the cards."

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