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August's topic:
„Kevin Warsh and the markets' verdict"

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Kevin Warsh and the markets' verdict

– The global economy remains resilient and continues to benefit from the shift of liquidity into the real economy.
– The Fed remains in wait-and-see mode; Kevin Warsh's comments around the Fed's July rate decision could paradoxically increase pressure on the US central bank to raise its policy rate later this year.
– We are becoming gradually more cautious on risk exposure; corporate bonds continue to benefit from the supportive economic backdrop, while convertible bonds offer attractive asymmetry.

Overall economic situation

The global economy continues to benefit from the shift of financial-market liquidity into the real economy, driven by high fiscal deficits and the AI investment boom. This robust starting point has helped the global economy absorb the significant oil-price shock following the Iran conflict relatively well so far. Recent developments in the Middle East show, however, that this headwind is far from over. The downsides of this environment remain sticky inflation and increasingly restrictive central banks.

Recent developments: Fed remains in wait-and-see mode

— Economic activity in Europe and the US remains resilient despite volatile energy prices. The euro area grew at an annualised rate of 1.8% in the second quarter, following zero growth in the first quarter. The US economy expanded by just 1.5% over the same period. Private domestic final sales, a useful gauge of underlying demand in the economy, nevertheless grew by a strong 3.9%, supported by robust consumption and rising business investment. It is also encouraging that the investment upswing has now broadened beyond the technology sector. Overall, the data point to economic strength without clear overheating, buying the Fed time. It therefore left its policy rate unchanged in July.
— It was unusual that, even shortly before the Fed meeting at the end of July, futures markets were still pricing in more than a one-in-three chance of a rate rise. This is a direct consequence of Fed Chair Warsh's deliberate decision to dispense with forward guidance: heightened uncertainty right up to the meetings is therefore becoming the new reality. The rate decision itself was in line with expectations; however, the few concrete signals Warsh provided during the press conference were markedly less hawkish than expected.

➲ **On the radar: More pipelines bypassing Hormuz** (page 6)

Overview & outlook: Warsh and the markets' response

» **Bond investors demand greater compensation.**

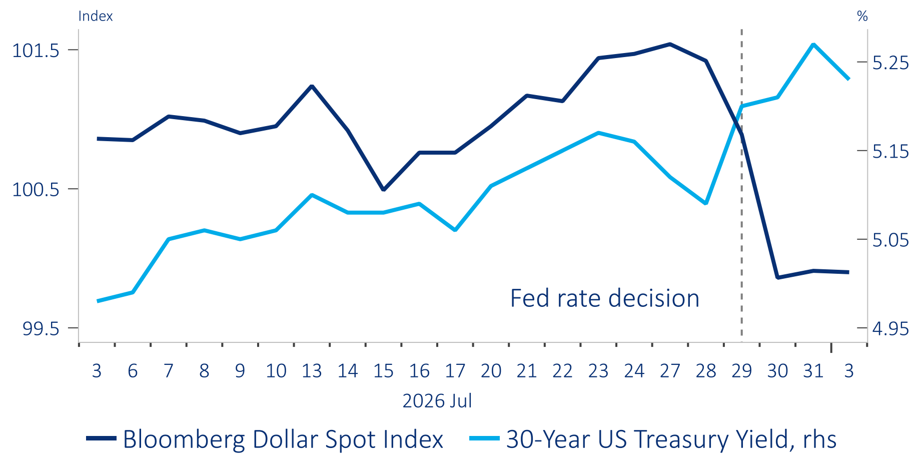
— Although Warsh confirmed the 2% inflation target, as measured by PCE inflation, he left open whether this benchmark would remain unchanged after the conclusion of the monetary-policy strategy review in early 2027. In principle, it makes sense to consider supplementary indicators such as the trimmed mean alongside traditional inflation measures in order to identify the underlying inflation trend more clearly. However, if it remains unclear what exactly the Fed will use as its benchmark from next year, this creates unnecessary uncertainty.

— Warsh also suggested that bond markets had already done part of the Fed's monetary tightening for it. We had suspected that the sharp rise in real yields might give Warsh and the Federal Open Market Committee a reason to hold off on a rate increase for the time being. Asked whether the rise in bond-market yields was not in fact signalling the need for a rate increase, Warsh pointed to the resilient economy as the reason for higher nominal and real yields.

— However, the rise in long-term yields can also be explained by a higher term premium. The abandonment of forward guidance and the deteriorating US fiscal outlook are increasing uncertainty, prompting investors to demand greater compensation at the long end of the yield curve. The rise in yields therefore reflects not only a strong economy, but also greater uncertainty about the course of monetary policy and fiscal sustainability.

— Warsh wants the markets to speak for themselves – and they have responded clearly: long-dated US Treasuries and the US dollar came under pressure during and after the press conference. The 30-year Treasury yield rose to its highest level since 2007, accompanied by higher inflation expectations. Paradoxically, Warsh's comments and the subsequent market reaction could increase pressure on the Fed to raise rates later this year after all, in order to reinforce its credibility in fighting inflation.

Chart: The market reaction sends a clear message



Sources: Bloomberg, Macrobond, Fisch Asset Management

Positioning: Prioritise quality, harness asymmetry

» AI bonds offer opportunities, but selectivity remains crucial.

— Government bonds remain under pressure globally, as a solid economy and rising public debt create structural upward pressure on yields. In the US, neither the increased issuance of T-bills by the Treasury nor the Fed's Reserve Management Purchases focused on shorter maturities have been able to prevent yields from rising at the long end of the curve.

— Corporate bonds remain attractive relative to government bonds. While high deficits and rising interest costs weigh on government bond markets, companies continue to offer solid fundamentals and carry. Additional opportunities are emerging in AI bonds issued by highly rated hyperscalers: heavy new supply has widened spreads, even though many issuers retain strong credit quality. Selectivity remains crucial, however, as not all companies are equally well placed to absorb the sharp rise in investment spending.

– Following the recent consolidation, uptrends in equity markets remain intact; our indicators also continue to signal "risk-on". A gradual reduction in risk exposure nevertheless appears appropriate. Even now, there is a case for shifting direct equity holdings into asymmetric asset classes such as convertible bonds. More substantial risk reductions are not warranted unless important technical support levels are breached.

– On gold, we remain neutral in the short term but constructive over the medium term. The Chinese central bank accelerated its gold purchases significantly in June and again provided net liquidity in July. If this impulse persists, gold should benefit with a lag. Structurally, gold is also supported by the reallocation of reserves by China and other central banks into the metal as they seek to reduce their dependence on the US dollar.

Return drivers	US	Europe	Japan	Asia ex-Japan	LatAm	CEEMEA
Equities	o	o	o	o	+	o
Gov. Bonds	o	o	o			
Credit IG *(Spreads)*	o	o		o	+	o
Credit HY *(Spreads)*	+	+		-	+	o
Total return						
Convertibles	o	o	-	+		
Credit IG	o	o		+	+	+
Credit HY	+	+		o	+	+

	PrecMet	InduMet	Energy
Commodities	o	+	o

Key:

++	Strong positive market
+	Positive market
o	Neutral
-	Negative market
--	Strong negative market

Notes regarding the table: The table summarises the model results for the total returns of convertible bonds and credit investment grade and high yield, which are a function of the listed return drivers. Changes from the prior month are indicated with ↓ or ↑, i.e. "O ↓" means that the output has weakened from a prior value of + or ++. The methodology for calculating model outputs, and how the various pieces fit together to form the big picture, is explained here. Within government bonds, we take German Bunds into account for Europe.

Cross asset class preferences

This table combines top-down views with bottom-up analysis at the portfolio level.

	Most preferred	Least preferred
Convertible Bonds	– IT (AI beneficiaries) – Semiconductor (AI-related) – Healthcare – CBs with high convexity – Bond-like CBs with quality credits and attractive yields – Balanced deep investment grade Chinese tech with high convexity	– Consumer discretionary – Unprofitable, early stage, expensively valued IT and biotech – Weak credit quality and/or liquidity – Cryptocurrency-related names
Global IG Corporates	– Financial services, banking – BBB- & BB-rated bonds – EUR-denominated issues	– Technology & electronics – A-rated bonds
Global Corporates	– Healthcare, financial services – Developed markets – BBB-rated bonds	– Technology & electronics, transportation – Emerging Markets – A-, B- & CCC-rated bonds
Global High Yield	– Telecommunications – Basic industry – Retail	– Financial services – Utilities – Insurance
Emerging Markets – Defensive	– LatAm (Mexico, Brazil), Eastern Europe, Saudi Arabia – Utilities, energy	– Asia (Hong Kong) – Industrials
Emerging Markets – Dynamic	– LatAm (Mexico, Brazil, Colombia), Eastern Europe – High-yield bonds – Utilities, consumer goods	– Asia IG (China, Hong Kong) – A-rated bonds – Maturities > 15 years

Note: Preferred sectors/regions may differ between asset classes owing to respective performance drivers. In particular, equity exposure is the key performance driver for convertible bonds and is not relevant for corporate bonds.

On the radar: More pipelines bypassing Hormuz

Oil prices rose again in July following renewed attacks and counterstrikes between the US and Iran. Tanker traffic through the Strait of Hormuz remains negligible as a result. At the same time, the oil-volatility index OVX also moved higher. At its current level, the options market is, in simplified terms, pricing in a range of approximately plus or minus 18% over the coming month. Near-term uncertainty therefore remains considerable, even though mediation talks under way since the beginning of August have raised hopes of de-escalation.

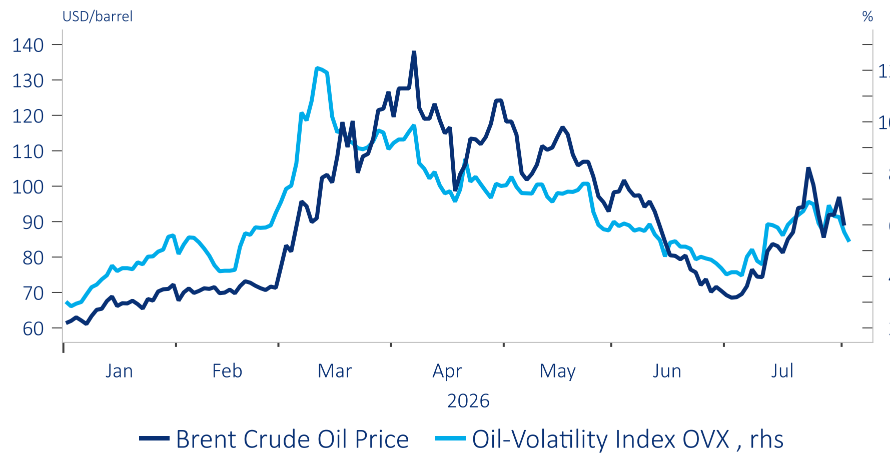
» Pipelines are becoming a medium-term hedge.

Over the medium term, however, there is a hedge that many investors may not yet have on their radar: additional pipelines that allow crude oil from the Persian Gulf to bypass the Strait of Hormuz.

Goldman Sachs examined seven potential pipeline projects in a recently published study[1]. Two are already under construction, one in the United Arab Emirates and one in Iraq. Under the base case, more than 45% of the Gulf states' existing exports could be shielded from a potential closure of the Strait of Hormuz by the end of 2027, rising to more than 60% by the end of 2028. The historical median of around two and a half years shows that pipeline construction can proceed comparatively quickly.

The expansion should materially reduce dependence on the most important chokepoint in global oil trade and could lower the geopolitical risk premium embedded in oil prices over the long term. This increases the likelihood that oil prices will move back towards pre-war levels over the medium term.

Chart: Uncertainty in the oil market remains elevated in the short term



Sources: Macrobond, Fisch Asset Management

1 Goldman Sachs Global Investment Research, Oil Comment: Gulf Exports: Short-Term Uncertainty, Long-Term Pipeline Hedge, 12 July 2026.

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