Caron's Corner Transcript – 7.20.2026

There's a New Sheriff in Town: Culture Change at the Fed

- New Chairman Kevin Warsh will review data and look to change inputs to the Fed's large-scale, macroeconomic model used to determine its policy reaction function.

- Warsh is questioning traditional metrics like Core PCE YoY as the Fed's most favored inflation measure, preferring more real time and "better" data sources.

- This suggests that the Fed may look at shorter term time frames to evaluate more real time data.

- By definition, this means the market may react with more volatility to data prints and rely less on smoothing.

- Bonds? Short-term rate volatility may rise, but longer-term could be more stable as long as the new Fed approach reduces longer-dated inflation risk premia.

- Equities? It is currently indeterminable how this will impact valuations. Stable future cashflows would imply higher valuations/lower risk premia … and vice versa.

Jim Caron: Hello, this is Jim Caron, CIO of the Portfolio Solutions Group. Welcome to another edition of Caron's Corner powered by The BEAT, our asset allocation framework across Bonds, Equities, Alternatives, Taxes and short-term Transitional (cash) investing.

In this edition we're going to focus on the Fed: there's a new sheriff in town, a culture change at the Fed. New Chairman Kevin Warsh's message is that the Fed has a measurement problem when it comes to economic data and inputs to their policy decision making process. As such, he intends to overhaul the process through the use of task forces. Warsh made some comments at a recent meeting of central bankers and what I thought was the most interesting was this panel discussion and a question asked to him by Sara Eisen, the host from CNBC. She asked Warsh what is his favorite economic indicator that drives your policy decisions? Warsh's response was very interesting and I quote: "With the data task force, my hope is that in 9-12 months we will be using new technologies to better understand what's happening in the real economy in a contemporaneous, real time way, that positions central bankers to make better decisions and not rely solely on government agencies to provide data with mismeasurement problems, surveys that are no longer relevant and every leading business we know are using new data sources to make better decisions. So my favorite data is upon us."

This is the new head of the Fed basically saying that he has issues with the economic data and how it's being used in their decision making process. This is a very powerful statement and what it really means is that the Fed under Warsh is going to overhaul the way that they're looking at markets. The next question asked to Warsh was what is your least favorite economic indicator? And his answer was amazing. He said, "The conventional wisdom we hear from time to time tells us nothing. Monetary policy works with long and variable lags, as we know in many of these indicators are echoes of history. We need indicators that when we look out our window today, so that when the Fed make judgments, when we next convene, they are as close to real time as possible." Basically his response was he doesn't have a favorite economic indicator and that the highly credentialed experts, the conventional wisdom that we hear from time to time, is really not informing the Fed or even the markets as much as that they had in the past. So this is a very important issue for us to all contemplate and think about what this means.

What are my key takeaways from all this? Warsh through his task force, will have a data review and look to change the inputs to the Fed's large scale macroeconomic model, which is called the FRB (Federal Reserve Board) U.S. model that is used to determine the Fed's policy reaction function. The other point is that Warsh is questioning the traditional metrics like core PCE year-over-year as the most favored inflation measure by the Fed and prefers more real time and “better” data sources as he would say. This suggests that the Fed may look at shorter term time frames to evaluate more real time data. Now that makes sense. If the markets or the economy is moving in a higher frequency way due to all this new technology, why are we using slower moving year-over-year economic data to measure it? So by definition, this means that the market may react more, meaning volatility, to data prints and rely less on smoothing. Now it's hard to say for sure, but speculating this may be the case.

Now for bonds, this implies that shorter term rate volatility may rise, but longer term rate volatility could be more stable as long as the potentially new approach by the Fed works to reduce longer dated inflation risk premia. In other words, let the front end do the hard work to keep back end rates stable and inflation risks low. At least that's the plan. The impact on equity asset prices? Well, it's undetermined what this will do to in terms of valuations. But stable cash flows in the future would imply higher valuations and lower risk premia and vice versa. So if inflation is kept in check and interest rates are kept more in check, then this could mean a positive for equities in the longer run.

So this is a culture change at the Fed. Now what's also happening here is that Warsh is introducing supply-side economics and he's going to put an emphasis on the supply-side economic indicators rather than demand-side indicators that the Fed has traditionally relied on. In the current macro framework, as I mentioned, the Fed typically looked at demand-side indicators more heavily than supply-side. Demand side indicators have to do with consumer spending, business investment, credit creation, fiscal stimulus, wealth effects and housing demand. Supply-side indicators would be more labor force growth, productivity growth, capacity expansion, labor force participation, supply chains and housing supply. Just as an example, demand-side indicators are typically easier to measure and this is what I think Warsh is really getting at, something he may want to change. The Fed may start to incorporate the harder-to-measure supply-side indicators.

What are the differences? Demand-side indicators are mostly observed through transactions, data coming from spending, sales and prices. It's easier to revise these and benchmark revisions. It can reflect current economic activity. Supply-side data is often inferred, rather than directly observed, and the data often relies on estimates of capacity or potential, which are hard to measure and are subject to large measurement uncertainty. It also does reflect the underlying economic potential. So all of these things are harder to measure, but what I believe Warsh thinks is that these are actually more impactful to the current economic situation. And this is what he's going to derive the inputs to the Fed's policy models to determine the Fed's policy reaction function, meaning how they may move interest rates up or down.

I think this is nuanced, and I want to spend some time on this and explain my views, because I think these two quotes by Kevin Warsh at the central bank meetings on what do you believe is your best economic indicator and your least favorite economic indicator. The answers that he gave were pretty substantial. And it really tells us the direction that the Fed is likely heading. This is all going to be revealed as the meetings go on and as the task force does its work. It's going to be a six to twelve month process, but I think we in the markets need to be aware of the changes that are taking place. So I wanted to give this update in terms of my thinking as we head into the July 28-29 FOMC policy meeting. Thank you.

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