SITUATION ANALYSIS

September 16, 2026

Fed increases policy rate for the first time in three years, with investors expecting more to come

Key takeaways

- The U.S. Federal Reserve (Fed) increased its policy interest rate to a range of 3.75%-4.00% in an attempt to bring down inflation.
- Kevin Warsh reiterated his commitment to return inflation to the Fed's 2% target in his third post-meeting press conference as Fed Chair, while the median Fed member survey projects an additional rate hike this year.
- Market prices reflect expectations for another rate hike this year and two more hikes next year amid rising oil prices.

The Federal Reserve increased its target federal funds interest rate by 0.25% to a range of 3.75%-4.00% at its September meeting, a decision investors generally expected. It was the first Fed rate hike in more than three years. The unanimous vote indicates new Fed Chair Kevin Warsh has successfully lobbied dissenting views on the committee, in contrast to the three dissents at the prior meeting. Ahead of the decision, investors expected a 90% chance of a rate increase. Rising oil prices this year drove rate hike expectations higher, in turn pushing both short- and long-term bond yields up. Investors now anticipate three additional rate hikes by mid-2027, including one more hike this year.

Kevin Warsh has taken a strong stance against inflation in his comments since assuming the chairmanship earlier this year. He has repeatedly noted the Fed's 2% inflation target as foundational to Fed credibility, highlighted his skepticism of forward guidance due to risks it can anchor policymakers' decisions despite changes in data, and established task forces to reevaluate Fed conduct relating to data, communication and balance sheet policy.

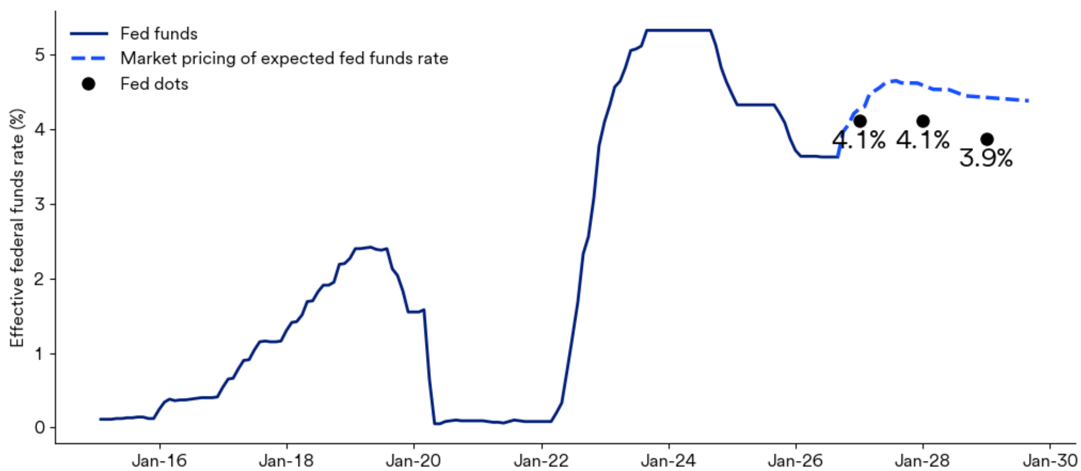
Warsh reiterated these themes during his press conference on September 16 and emphasized the importance of returning inflation to 2%. In recent speeches he has also highlighted the breadth of inflation, stating, "too many categories are still posting increases above 3%." He also refrained from submitting responses for the Fed's Summary of Economic Projections, viewing it as a form of forward guidance. The updated median Fed projections ex-Warsh show an additional rate hike this year, slightly stronger growth expectations in 2027 and stable inflation expectations next year compared to their previous projections in June, but a slight uptick in 2028 inflation expectations. The Fed's official policy statement remained largely unchanged since the last meeting, but new language highlighted, "domestic spending remained resilient."

Fed interest rate increases from 2022-2023 helped mitigate inflation over the past four years, but higher oil costs are again escalating near-term prices. The Core Personal Consumption Expenditures (PCE) Price Index accelerated from 3.0% in December 2025 to 3.3% in July 2026. West Texas Intermediate crude oil front month futures prices rose from near $57 per barrel at the beginning of the year to a peak of $113 in April. Prices fell before rising back above $100 in recent sessions. Higher energy prices have acted as the primary driver of rising rate hike expectations and Treasury bond yields. Longer-term inflation expectations remain well-anchored, with investors anticipating that rate hikes will eventually bring inflation under control.

Federal Reserve balance sheet and market liquidity

The Fed stopped shrinking its bond holdings and began buying short-term Treasury bills in December 2025 to ensure ample banking system reserves and to keep short-term interest rates near its policy rate. The Fed's bond holdings stand near $6.6 trillion today after peaking near $9 trillion in 2022. The Fed reduced its regular purchases this year, and holdings have barely grown since Warsh became chair. Expanding the balance sheet by purchasing Treasury bills can result in improved market liquidity by absorbing a portion of incremental supply. Liquidity, the money readily available to purchase goods, services and financial assets, can also cushion markets against unforeseen financial market shocks, and liquidity measures remain constructive. Warsh has expressed reservations about its long-run efficacy and questioned its appropriateness as a policy tool, forming a task force to explore the topic.

Market pricing of the expected path of the federal funds rate

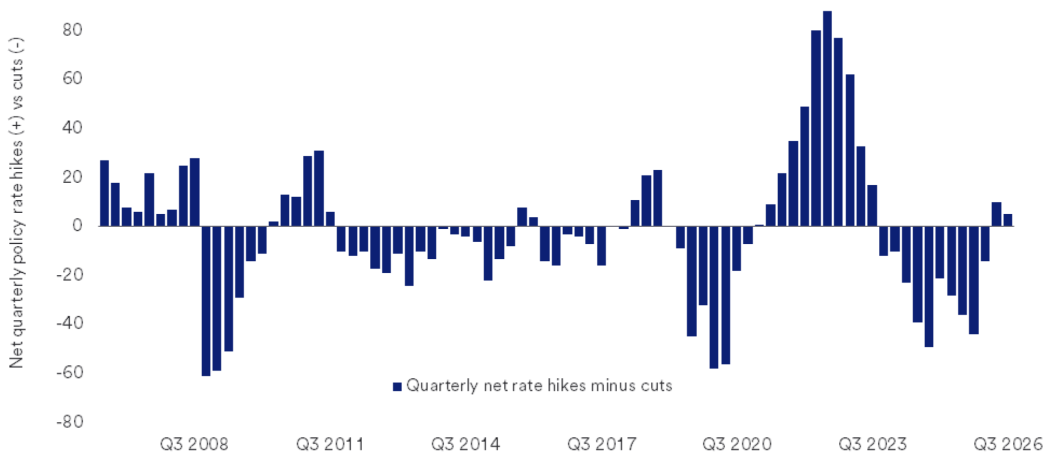


Sources: U.S. Bank Asset Management Group Research, Federal Reserve, Bloomberg, 1/1/2015-9/16/2026.

Two-year Treasury yields rose 0.08% to 4.74% today as expectations for additional rate hikes solidified. Ten-year Treasury yields rose 0.02% to 5.02% versus the prior day's close. Large stocks, represented by the S&P 500, and small stocks, represented by the Russell 2000, fell 0.5%.

Central banks across the globe eased policy in 2025, but many have begun increasing rates this year in response to rising energy prices. The European Central Bank and Bank of Japan both increased rates in 2026 with more expected, while investors also anticipate hikes from the Bank of England and Bank of Canada this year.

Global net central bank rate hikes (net hikes minus cuts), quarterly



Sources: U.S. Bank Asset Management Group Research, FactSet, 4/1/2006-9/16/2026.

Maintaining a constructive outlook amid market uncertainty

We maintain a constructive outlook for diversified portfolios and see opportunities in growth-oriented allocations including U.S. stocks, global infrastructure and structured credit. While higher energy costs risk increasing inflation and dampening economic activity, consumer spending and corporate earnings growth remain resilient, with fiscal support in the form of lower corporate and individual taxes and recent tariff rebates. Diversified portfolios spanning a variety of allocations can help limit the impact of price swings on individual assets. We will keep you informed as new data arrives and as we update our assessment of market conditions.

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