Main Events

ECB MEETING — 10.09
The European Central Bank is expected to raise rates by 25 bps, as telegraphed several times over the past weeks

US CPI — 11.09
The CPI report is expected to cement expectations that the Fed will raise rates the following week

US RETAIL SALES — 16.09
Retail sales are expected to rebound strongly following the unexpected contraction in the previous month

FOMC MEETING — 16.09
After Jackson Hole, a hike seems obvious, but under Warsh's watch, there's no telling exactly what might happen

Azimut Global Network

- Milan
- Abu Dhabi
- Austin
- Cairo
- Chicago
- Dubai
- Dublin
- Hong Kong
- Estoril
- Istanbul
- Lugano
- Luxembourg
- Mexico City
- Miami
- Monaco
- New York
- Santiago
- São Paulo
- Shanghai
- Singapore
- St Louis
- Sydney
- Taipei

JACKSON HOLE TAKEAWAYS

- **Warsh's remarks at Jackson Hole were widely interpreted as a pledge to raise rates in September, as inflation seems unlikely to slow anytime soon**
- **While Warsh clarified that interest rates will continue to be the Fed's primary monetary policy tool, he also added that the other unconventional tools—with a clear reference to the size of the balance sheet—should be used sparingly, if at all**
- **Any change in stance regarding the use of the balance sheet is likely to have a significant impact on market rates, far greater than that of a change in benchmark rates. But to gain clarity on this front, we will still have to wait a little longer**

With earnings season now behind us, the upcoming central bank meetings could be the next drivers of the market, particularly the Fed meeting.

Warsh's remarks at Jackson Hole did not differ substantially from previous statements made after FOMC meetings or during Congressional hearings. However, the emphasis was much stronger. In his remarks he pledged to rapidly restore price stability and stressed again that the Federal Reserve is solely responsible for having missed the 2% inflation target for over five years. In his words, the "responsibility for 65 months of sustained, elevated inflation sits squarely with the central bank." Immediately after, he added that at the Fed, "we must be confident that underlying inflation is moving to our objective, clearly and at sufficient speed. Otherwise, we have work to do" (emphasis ours).

Considering that underlying inflationary pressures appear to be intensifying for a variety of reasons—from the ongoing war in Iran to price pressures on tech components because of the race to AI—and given the strong emphasis in Warsh's speech, it seems very unlikely that the Fed will not follow through with an interest rate hike in September. We assume here that Warsh does not want a repeat of what happened back in July, when the market had prepared for a rate hike following similarly hawkish remarks during his first press conference as Fed chair but ultimately no action was taken. Otherwise, the consequences would likely be just as similar: a weaker dollar, a rise in long-term rates, and a growing risk of a loss of credibility.

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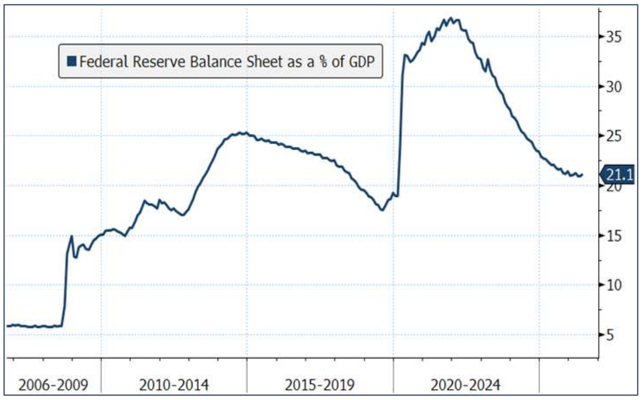
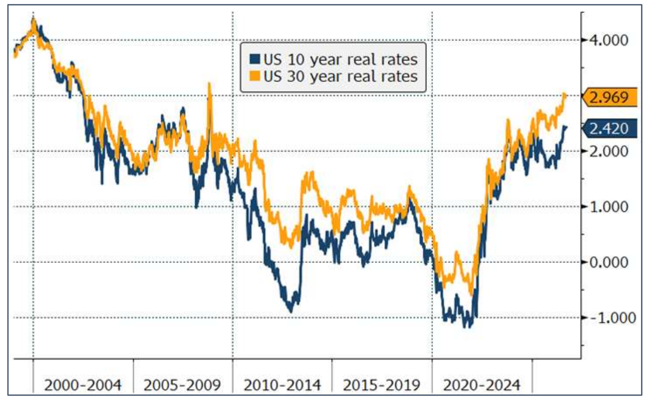


Source: Bloomberg



Source: Bloomberg

Further complicating matters for Warsh, Trump has also resumed his pressure on the Fed. In a post on Truth Social last Friday, he said that "The Fed Board, with its great new leader, must get smart - BE PATRIOTS for a change. High interest rates put the U.S.A. at a very unfair disadvantage, and I won't allow that to happen!" This misplaced interference gives Warsh an additional incentive to take action on rates, as otherwise concerns about a possible erosion of the Fed's independence could resurface.

Finally, staying on hold in September would put Warsh in a very uncomfortable position, given that the Fed's next meeting is just one week before mid-term elections. Raising rates at that time would be politically impossible. The first viable opportunity to do so would then be at the December meeting, but the Fed cannot afford to wait until then if inflation shows no signs of subsiding, considering how strongly Warsh has emphasized the Fed's sole responsibility for delivering price stability and his reiterated promises to act forcefully and timely if necessary.

Two additional points from Warsh's remarks are worth highlighting.

The first one is that he made it clear that "short-term interest rates are the predominant tool to achieve the dual mandate" of the Federal Reserve. In previous remarks since becoming Fed chairman, Warsh had never clearly indicated how he intended to use the monetary tools at his disposal. In the past, he had been one of the most vocal advocates for reducing the Fed's balance sheet—contrary to the prevailing view among the governors that the Fed should maintain ample reserves—and, at the same time, for lowering interest rates to help Main Street. Since taking the helm of the Fed, he has repeatedly emphasized the need to tighten monetary policy, but refrained from indicating which tool should be used to achieve that aim. Given the stance he had previously advocated, the possibility that he might initially focus on downsizing the balance sheet while keeping rates steady could not have been ruled out. By now, instead, it is clear that interest rates remain the Fed's primary tool.

However, and this is the second takeaway, he also added that "unconventional policies to spur economic activity may suit genuine crises but should otherwise be used sparingly, if at all" (emphasis ours). The reference here is precisely to the use of the Fed's balance sheet as a monetary policy tool. The fact that he has taken such a firm stance even before hearing the conclusions of the task force on the balance sheet that he himself established, hints to the possibility that reducing the balance sheet is still one of his key objectives.

If he were to actually succeed in his endeavor, the implications might be far from trivial. When measured as a percentage of GDP rather than in absolute terms, the Fed's balance sheet has indeed already returned to levels similar to those seen before the pandemic and is not much higher than it was 15 years ago. A central bank's balance sheet can be viewed as a proxy for the liquidity available in the system. It forms the basis for the formation of capital available to the market. The fact that it is shrinking relative to GDP (and even more so when measured against the current size of the stock or bond markets) means that liquidity is becoming a relatively scarcer resource, even if the balance sheet is stable in absolute terms. Thinking about reducing it at a time when demand for capital is skyrocketing—both to finance chronic government deficits as well as massive investments in AI—could have unintended and undesirable consequences, in addition to the obvious one of pushing rates higher.

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All things considered, it seems that Warsh has cornered himself with his speech at Jackson Hole, and that a rate hike is the most likely outcome of the next Fed meeting. Ironically, by doing so, Warsh has created a clear expectation among market participants about the Fed's next move. How can this be defined if not precisely as forward guidance, the very practice he himself had vowed to dismantle?

That said, based on the evidence so far, we can't completely rule out the possibility that Warsh might, once again, blindside everyone next week. It's therefore definitely worth paying close attention to the upcoming meeting.

Waiting for the—arguably—most important event of all: when Warsh will finally reveal to the world what he intends to do with the Fed's balance sheet.

Asset Allocation View

	− (Under)	= (Neutral)	+ (Over)
Equity			
Developed Markets	Downgrade		
Emerging Markets	Downgrade		
Fixed Income			
Developed Markets Sovereign			Upgrade
Developed Markets Corporate		Downgrade	
Emerging Markets		Downgrade	
Commodities			
Currencies		*Commentary below*	

UNDER NEUTRAL OVER

Equity

Developed Markets

We have cut our recommendation on Developed Market equities to **Slightly Underweight**. Warsh's remarks at Jackson Hole suggest that the Fed might raise rates at least once, most likely in September. Rising nominal and real interest rates, unfavorable seasonality, and ever-present geopolitical risks all point to the need for greater caution. Furthermore, even another blockbuster earnings season failed to drive markets higher, reflecting how lofty expectations already were. In light of this, we prefer to take a more cautious stance for now, while continuing to believe that any meaningful correction should be viewed as a buying opportunity, as long as economic and earnings growth remain solid.

US	Europe	Japan
= (Neutral)	+ (Over)	= (Neutral)

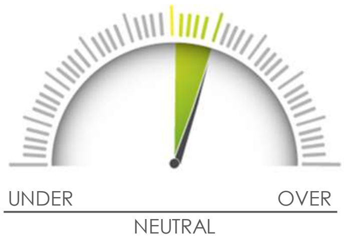
Emerging Markets

Likewise, we lowered our recommendation on Emerging Market equities to **Slightly Underweight**. The same factors—both positive and negative—mentioned above also apply here. Adding to the reasons for caution, the dollar could strengthen if the Fed raises rates, and a strong dollar has always been a headwind for emerging markets. On the positive side, emerging markets continue to trade at a significant discount relative to developed markets.

Asia ex-Japan	EEMEA	LATAM
= (Neutral)	= (Neutral)	= (Neutral)

Fixed Income

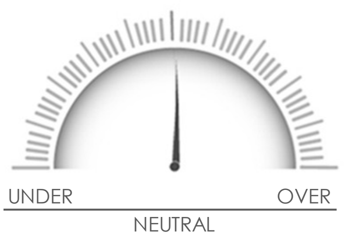
Developed Markets Sovereign



We have upgraded our recommendation on Developed Market sovereign bonds to **Slightly Overweight**. Although several factors explain and underpin the recent rise in market rates—geopolitical risks, underlying inflationary pressures, growing concerns about fiscal indiscipline, and poor communication from politicians and policymakers—the level reached by interest rates is seen as increasingly attractive. This is not only because higher rates already incorporate a risk premium that covers a significant portion of these risks, but also because, in the event of adverse developments, the negative correlation between risk-free and risky assets is likely to return, thereby serving as an effective tool for portfolio hedging.

EU Core	=	**EU Periphery**	=	**US Treasury**	=	**Japanese JGB**	=

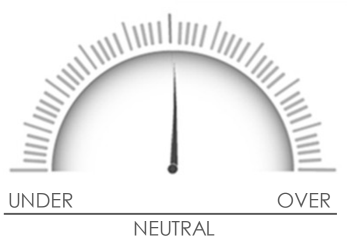
Developed Markets Corporate



We have downgraded our recommendation on Developed Market corporate bonds to **Neutral**. Although the hunt for yield continues, fueled by ample liquidity, spreads have now reached extremely narrow levels and no longer adequately compensate for the implied credit risk. Given that the risk-free rate accounts for an ever-increasing portion of a corporate bond's total yield—particularly for investment-grade bonds—we prefer to adopt a more cautious stance and lower our exposure to Neutral. Within credit, we continue to prefer investment-grade bonds over high-yield.

IG Europe	+	**IG US**	+	**HY Europe**	−	**HY US**	−

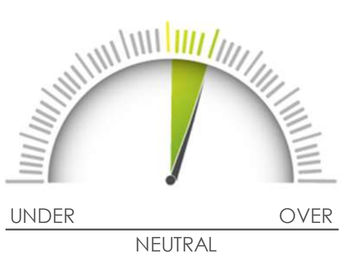
Emerging Markets



Similarly, we reduced our recommendation on Emerging Markets Debt to **Neutral**. In addition to the reasons already outlined for developed market corporate bonds, another factor comes into play for emerging market debt: the dollar could strengthen if the Fed raises rates—increasingly likely following Warsh's speech at Jackson Hole—and emerging market debt tends to underperform during periods of dollar strength.

Local Currency	=	**Hard Currency IG**	=	**Hard Currency HY**	=

Commodities



We have maintained our **Slightly Overweight** recommendation for commodities. We have temporarily turned more cautious on precious metals given the risk that the Federal Reserve may raise interest rates following Warsh's speech at Jackson Hole, as a stronger dollar could lead to short-term pullbacks, although the long-term bull case remains intact. We have no such concern on industrial metals—particularly rare earths—as their shortages are set to worsen in the coming years due to their increasing adoption in various strategic sectors, such as the development of artificial intelligence, the space race, military applications, and energy production.

Precious	=	**Energy**	=	**Industrial**	+	**Agricultural**	+

Currencies

We have again upgraded our recommendation on the **US Dollar** to **Neutral**. The recent weakness in the greenback could be reversed if the Federal Reserve raises interest rates in September, a scenario that has become increasingly likely following Warsh's comments at Jackson Hole.

Similarly, we have downgraded our recommendation on the **Euro** to **Neutral** as well. This is not only related to the upgrade of the US dollar to Neutral, but also to the fact that investors may become increasingly cautious toward Europe due to the approaching French elections in early 2027.

The recommendation on the **Chinese Renminbi** remains **Neutral**.

The outlook for other **emerging market currencies** has been lowered to **Neutral** as well, due to the risk of a stronger dollar.

Euro	=	**USD**	=	**CNY**	=	**Other EM**	=