

At the April meeting, the U.S. Federal Reserve Open Market Committee voted to keep the Fed funds rate steady at the current range of 3.50-3.75%. The vote was 8-4, the largest number of dissents in over 30 years, with only one wanting an actual quarter-point rate cut (Miran), but the other three not supporting inclusion of an easing bias in the official statement.

The formal statement was not changed by much in volume, but somewhat in content, and was still considered a bit dovish, as noted by the dissents. While economic activity was described as still expanding “at a solid pace,” inflation was noted as “remaining elevated,” based on the “recent increase in global energy prices.” Developments in the Middle East were “contributing to a high level of uncertainty about the economic outlook,” while the committee remains attentive to “both sides” of its dual mandate. Recent comments from FOMC members before the meeting, such as from Governor Barr, noted that current policy puts the committee in a “good place” while they “evaluate incoming data, the evolving forecast, and the balance of risks,” as Middle East conditions continue to add a strong element of uncertainty to the global economy.

CME Fed funds futures pegged the odds of no change at a rare 100%, being in a range of 95-100% since the March meeting, with any residual odds leaning toward a rate hike rather than a cut. In fact, after the recent oil price spike, odds of any cuts in 2026 have fallen to zero, with the only expected action now being a single cut in Dec. 2027. That would bring the Fed funds rate just above the ~3% level the Fed considers to be long-term ‘neutral,’ which is policy that’s perfectly in tune to conditions, neither loose nor tight, but a situation that has never seemed to last very long, if it is ever reached.

Economy. The official U.S. GDP growth figure for Q4-2025 was downgraded to 0.5%, which is old news and was no doubt pulled down by the government shutdown, some of the impacts of which were expected to reverse in Q1. The Atlanta Fed GDPNow Q1 estimate started the quarter at over 3% (near where some private sector estimates still lie), but has since declined to 1.2%, with deceleration in consumer spending as inflation stayed high and hindered by oil prices. Otherwise, non-residential fixed investment has taken on greater share with a renaissance in manufacturing, much of which is tied to cloud/AI infrastructure, while residential and government investment remain weaker (as are net exports). Of course, a key input is how long the Middle East disruption lasts, in terms of oil price spike duration and magnitude, which has carried over into other petroleum-related areas (directly into gasoline and jet fuel, but also secondary products like plastics, fertilizers, food, as well as semiconductor chip manufacturing inputs). A faster drift back to normal for oil lessens the chance of the second derivative of disruption, which is broader economic damage, and could pull GDP growth down by at least a few tenths from 2.0%-like trend growth. Markets know the bear case of high oil prices has been a catalyst for recessions historically, due to crowding out effects on spending elsewhere and the potential impact of physical supply constraints, if it comes to that.

Inflation. As of March, 12-month trailing CPI showed a rise of 3.3%, while core CPI ex-food and energy increased 2.6%. Core PCE for February continued to run above-target at 3.0%. Hopes for the slow deceleration were no doubt interrupted by the oil price surge in early March. The initial shock made its way through to headline inflation, but may take a few months to fully find its way into other goods and

services. Alternatively, a more permanent resolution in tensions could have a downward impact on the near-term monthly inflation rate of change. That's aside from continued normalization from last year's tariff hikes, with an uncertain future for any tariff workarounds and the complicated process of refunds. It's worth noting again that many consumers don't mentally make the distinction between rate of change, of starting and ending indexes used for CPI calculations, and overall price levels, which reflect building-block effects of prior inflation. The bad news is that price levels have tended to stay high once reached, and are a major source of current consumer aggravation. That's a potential political liability in a mid-term election year, with high current likelihood of a split Congress if current predictions play out. The Fed has taken the approach to 'look through' last year's tariff price increases and this year's oil shock, although they've at least been talking about cautiousness due to downplaying similar 'transitory' assumptions made during the pandemic six years ago to their peril.

Employment. The unemployment rate ending in March was 4.3%, having steadily risen from a low of 3.5% in early 2023, but not having sharply deteriorated lately. That's in contrast to more volatile payrolls reports showing the significant impacts of slower immigration, an aging labor force, and data revisions, but, at the same time, a pattern of moderate but cooling growth. Despite some mixed fears earlier in the year, labor hasn't weakened to the point of further Fed concern that could lead to a cutting bias, although Fed members continue to be on the lookout for signs.

Another wildcard has been the Senate confirmation of Kevin Warsh as new Fed Chair. Now that the DOJ case against current Chair Jerome Powell has been effectively closed (referred to the Fed inspector general), the only question is whether Powell will stay on as a governor for the last two years of his 14-year term. That matters for a vote count, as a Powell departure would open the door to another Presidential appointee, which could lean towards the dovish side. What to expect from Warsh? His past track record points to views that include a smaller Fed balance sheet (except for emergency powers mostly), lower bank reserves, reduced willingness to implement policies like quantitative easing (he voted for it in 2011, but continued to speak out about it as a bad idea), less communication and reliance on forward guidance (like the 'dot plot'), as well as a lesser role of the Fed into other policy objectives (political or social side). Taken alone, those have pointed to a perception that rates could sit a bit higher than they would under more accommodative Fed leadership, although recent comments point to more dovish leanings that made him a more attractive political fit.

All-in-all, financial markets have seemingly continued to assume a high likelihood of a sustained end to the Middle East conflict (in fact, the S&P 500 has moved in lockstep with prediction markets over some stretches). Despite the uncertainty, but perhaps also due to the unclear picture, the U.S. Treasury yield curve hasn't moved much this year, with the 10-year in a 4.0-4.5% range. As an important aside from geopolitical tensions, AI enthusiasm continues with S&P 500 earnings results for Q1 expected to continue growing strongly in the double-digits. The Federal Reserve again finds itself in a difficult position. Inflation, which was sticky from tariffs anyway and now higher again from oil, keeps policy member rate assumptions biased upward, with a desire to crush the remnants of inflationary pressures before they embed themselves in consumer future expectations (the 5-year/5-year forward expectations have moved from 2.0% to 2.3% in April). Any second phase of impact, which would include economic

damage, could be a tipping point that could outweigh inflation and push FOMC members to move in an easing direction. At this point, though, signs haven't proven negative enough for that to happen.

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Sources: CME Group, Federal Reserve Bank, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, Palouse Capital Management calculations.

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