A New ‘Warsh’ Cycle

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Key Takeaways

- Kevin Warsh’s early overhaul of Federal Reserve communication and policymaking suggests investors should prepare for a higher-for-longer rate environment with greater uncertainty around policy signals.
- As the Fed shifts away from forward guidance and incorporates more real-time economic data, fixed income markets could experience increased volatility, reinforcing the value of strategies that reduce duration risk.
- Investors seeking income without heightened interest rate sensitivity should consider zero-duration strategies such as USFR, AGZD and HYZD, which are designed to help navigate the new "Warsh" cycle.

On the domestic front, arguably one of the more notable events in 2026 has been the change in Federal Reserve leadership, ushering in a new era for how the U.S. central bank conducts monetary policy and how its actions are communicated to the public. For those investors who were expecting Kevin Warsh to be a ‘rubber stamp’ for rate cuts, they are finding out that the new Chair is putting his stamp on Fed policy in a totally different way.

It is important to recognize that there are two very distinct aspects to a new ‘Warsh’ cycle. Obviously, the most important part of the equation is what Warsh & Co. actually do with respect to the fed funds rate. The other avenue involves the five task forces that he has set-up to examine issues such as, forward guidance, the balance sheet and what data inputs should the policymakers be focusing on.

In terms of forward guidance, investors have already witnessed the Chairman’s plans where the goal is to essentially remove this form of communication to the markets. Some clear-cut examples were the scaled back, just the facts, Greenspan-esque, June FOMC policy statement as well as Warsh’s non-participation in the dot plot. The balance sheet question will take longer to resolve, but the examination of the data the Fed uses to set policy deserves some attention.

The Chairman referred to some of these economic releases as “echoes of history” and acknowledged their flaws…think notable revisions to prior months’ statistics (hello monthly jobs report). Warsh seems to have a preference for including ‘real-time’ data to the decision-making progress. In other words, economic data that doesn't necessarily go through the federal government's 'rinse' cycle. The bottom line here will probably be a policy input process that includes the usual suspects (monthly employment, CPI etc. reports) plus whatever 'real time' statistics the task force recommends.

In our opinion, the lack of forward guidance plus potential new data inputs raises the volatility quotient for the money and bond markets.

Back to the important part of the New 'Warsh' Cycle: where are rates headed? It has become increasingly apparent that the curtain has closed for rate cuts. According to the June dot plot, half of the Fed (Warsh not included) saw rate hikes as the next policy step, and even the Chair himself seemed committed to their 2% inflation target and to "fix" five years of misses on inflation. While our base case is for the FOMC to stay on hold for the remainder of 2026, if there's any tilt going forward, it's now for a potential rate hike.

Fixed Income Solutions for a New 'Warsh' Cycle

Against this new backdrop, we believe fixed income portfolios will need to be positioned for this "normal" elevated rate environment that could also come with heightened volatility. How can investors prepare their bond portfolios for this upcoming landscape?

WisdomTree offers three strategies that offer a path to income without the duration drag and volatility; the WisdomTree Floating Rate Treasury Fund (USFR), the WisdomTree Interest Rate Hedged U.S. Aggregate Bond Fund (AGZD), and the WisdomTree Interest Rate Hedged High Yield Bond Fund (HYZD). Think of them as all in the "zero-duration" suite, with varying exposures on the credit spectrum. All three are designed and seek to limit or mitigate interest rate risk and dampen volatility.

1. **USFR: Your Anchor**
   - 100% Treasury Floating Rate Notes
   - Floats with the Fed as rates may be higher for longer
   - Anchor allocation in any strategic fixed income portfolio
2. **AGZD: Core**
   - The Zero Duration Agg
   - Investment grade bonds without interest rate sensitivity
   - A smarter core bond allocation when the rate outlook is uncertain or tilted higher
3. **HYZD: Core-Plus**
   - Can be used for high yield income without the duration risk
   - Cash flow screen filters out the weakest issuers, only quality left behind
   - High yield without the 'junk'

Together, or in combination, these strategies give fixed income investors the flexibility to generate income, manage rate sensitivity and adapt as the new Fed regime continues to take shape.

Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

USFR: Securities with floating rates can be less sensitive to interest rate changes than securities with fixed interest rates, but may decline in value. Fixed income securities will normally decline in value as interest rates rise. The value of an investment in the Fund may change quickly and without warning in response to issuer or counterparty defaults and changes in the credit ratings of the Fund's portfolio investments. Due to the investment strategy of this Fund it may make higher capital gain distributions than other ETFs. The Fund invests in the securities included in, or representative of, its Index regardless of their investment merit, and the Fund does not attempt to outperform its Index.

AGZD: Fixed income investments are subject to interest rate risk; their value will normally decline as interest rates rise. The Fund seeks to mitigate interest rate risk by taking short positions in U.S. Treasuries (or futures providing exposure to U.S. Treasuries), but there is no guarantee this will be achieved. Derivative investments can be volatile and these investments may be less liquid than other securities, and more sensitive to the effects of varied economic conditions. Fixed income investments are also subject to credit risk, the risk that the issuer of a bond will fail to pay interest and principal in a timely manner, or that negative perceptions of the issuer's ability to make such payments will cause the price of that bond to decline. The Fund may engage in "short sale" transactions of U.S. Treasuries where losses may be exaggerated, potentially losing more money than the actual cost of the investment and the third party to the short sale may fail to honor its contract terms, causing a loss to the Fund. While the Fund attempts to limit credit and counterparty exposure, the value of an investment in the Fund may change quickly and without warning in response to issuer or counterparty defaults and changes in the credit ratings of the Fund's portfolio investments. Investing in mortgage- and asset-backed securities involves interest rate, credit, valuation, extension and liquidity risks and the risk that payments on the underlying assets are delayed, prepaid, subordinated or defaulted on. Due to the investment strategy of the Fund, it may make higher capital gain distributions than other ETFs. The Fund invests in the securities included in, or representative of, its Index regardless of their investment merit and the Fund does not attempt to outperform its Index.

HYZD: High-yield or "junk" bonds have lower credit ratings and involve a greater risk to principal. Fixed income investments are subject to interest rate risk; their value will normally decline as interest rates rise. The Fund seeks to mitigate interest rate risk by taking short positions in U.S. Treasuries (or futures providing exposure to U.S. Treasuries), but there is no guarantee this will be achieved. Derivative investments can be volatile and these investments may be less liquid than other securities, and more sensitive to the effects of varied economic conditions.

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