

A NEW ERA AT THE FED AND WHAT IT MEANS FOR YOUR PORTFOLIO

The bond market is sending a clear message: the era of cheap money may not return anytime soon.

Kevin Warsh has taken over as chair of the Federal Reserve, and fixed-income investors are already adjusting. The recent signals from the Treasury market matter for anyone with exposure to bonds, stocks, or other interest-rate-sensitive assets.

This is more than a routine policy shift. It reflects a reassessment of where interest rates may be headed, what is driving that direction, and why expectations have changed so quickly.

FROM CUTS TO HIKES: A SHARP REVERSAL

Three months ago, the prevailing view on Wall Street was straightforward: the Fed appeared likely to move toward lower rates. Markets were pricing in multiple rate cuts, and many investors positioned their portfolios accordingly. Longer-duration bonds, rate sensitive equities, and assets that benefit from lower borrowing costs all stood to gain.

THAT VIEW HAS CHANGED QUICKLY.

Today, markets are increasingly pricing in the possibility that the Fed could begin raising rates by December. Two-year Treasury yields, one of the market's clearest gauges of Fed policy expectations, recently rose to 4.14%, their highest level in more than a year. That puts the two-year yield nearly 40 basis points above the top end of the Fed's current benchmark rate range. Historically, that kind of gap suggests investors believe rate increases are more likely than rate cuts.

Longer-term yields have also moved higher. The 30-year Treasury yield briefly touched 5.2% in late May, a level last seen in 2007, before easing to 5.06%. These are not minor technical moves. They point to a meaningful shift in how investors view inflation, economic growth, and the direction of Federal Reserve policy.

THREE FORCES DRIVING THE SHIFT

The first is the inflationary effect of the conflict involving Iran. Energy prices, shipping costs, and supply chain pressures have risen, adding new stress to an inflation picture that was already difficult. For investors and policymakers, the conflict has pushed inflation risk back to the center of the conversation.

The second is the resilience of the U.S. economy. Consumer spending remains solid. The labor market has held up. Corporate earnings have been broadly stable. A strong economy is generally good news, but when inflation remains elevated, it gives the Fed less reason to cut rates.

The third is the investment boom tied to artificial intelligence. Capital continues to flow into AI-related sectors, supporting equity markets and broader economic momentum. That strength may make it harder for the Fed to justify easing policy, especially if asset prices remain firm and inflation pressures persist.

Together, these forces have increased concern that inflation could remain above the Fed's 2% target for longer than expected. That concern is now visible across the Treasury market.

WHO IS KEVIN WARSH, AND WHY DOES IT MATTER?

Kevin Warsh is not new to the Federal Reserve. He served as a Fed governor from 2006 to 2011, including during the financial crisis. He has long been associated with a more hawkish, inflation focused view of monetary policy.

Bond investors appear to believe Warsh will prioritize the Fed's credibility as an inflation fighter, even if that creates tension with President Trump's stated preference for lower interest rates. That tension matters because a Fed chair who appears to yield to political pressure can quickly lose credibility with the bond market.

For bond investors, a hawkish Fed chair arriving during a new inflation shock is significant. Current market conditions suggest rates could remain elevated for longer than previously expected and portfolios should be reviewed with that risk in mind.

WHAT THIS MEANS FOR YOUR PORTFOLIO

This is where market dynamics become practical financial planning.

If you hold significant exposure to longer-duration bonds, rising yields can create a headwind. Bond prices move inversely to yields, so the recent rise in long-term rates has reduced the value of existing longer-term bond holdings. The 30-year yield's brief move to 5.2% is a reminder of how quickly that math can affect portfolios.

Shorter-duration bonds and money market instruments may look more attractive in this environment. At 4.14%, two-year Treasuries offer meaningful yield with less duration risk than longer dated bonds. For the part of a portfolio focused on capital preservation or income with modest risk, shorter maturities may deserve renewed attention.

For equity investors, the picture is more nuanced. Higher rates often pressure valuations, especially for growth companies whose prices depend heavily on future earnings. But the same economic strength that is pushing rates higher is also supporting corporate profits. The impact will depend on the sectors you own, the debt levels of the companies in your portfolio, and whether AI-related momentum can continue to offset rate pressure.

The real economy also matters. Higher mortgage rates, tighter credit conditions, and higher borrowing costs for businesses may not affect portfolios immediately. But over time, they can shape corporate earnings, consumer behavior, and market sentiment.

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*“Liberty means
responsibility”*

- GEORGE BERNARD SHAW

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THE TAKEAWAY

The Treasury market is sending a signal worth taking seriously. The rate environment that shaped the post-pandemic recovery is giving way to a more complex and potentially more volatile period.

A new Fed chair with hawkish instincts, renewed inflation pressure tied to geopolitical conflict, and an economy that continues to outperform expectations have shifted interest-rate expectations in a matter of weeks.

None of this calls for panic. It does call for a review. If you have not recently reviewed how your portfolio is positioned for interest-rate risk, now may be a good time to do so. The recent moves in the Treasury market are not background noise. They may reflect how investors are currently interpreting future rate expectations. Let's make sure your financial plan is built to navigate it.

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