Fed Chair Drama Ends With Warsh

The new Fed Chair nominee is named during a period of continued uncertainty over the Fed's independence.

What's Driving Markets

1. Trump nominates Warsh as next Federal Reserve chair: President Donald Trump announced his intention to nominate former Federal Reserve (Fed) Governor Kevin Warsh as the next Fed chair. Warsh previously served as Fed governor from 2006-2011, during which time he leaned hawkish. His more recent public comments have advocated for easier monetary policy, in line with Trump's demands, though he has long been a critic of Fed balance-sheet[1] policy.

The Fed held rates steady as expected at its January policy meeting, with Governors Miran and Waller dissenting in favor of a 25-basis-points (bp)[2] cut. Uncertainty around Fed independence intensified earlier this month following news that the Department of Justice subpoenaed the Fed as well as Chair Jerome Powell over renovation-related matters. The situation has spilled over into the Senate, where Sen. Thom Tillis, a senior Banking Committee member, has indicated plans to block Fed confirmations until the investigation is resolved.

Oral arguments from the case of Fed Governor Lisa Cook appear to lean toward her termination being overruled, though concerns about independence and governance persist. Despite near-term political noise, we continue to expect the Fed to cut rates this year as inflation drifts lower (**FIGURE 1**).

Insight from sub-adviser Wellington Management

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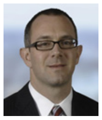

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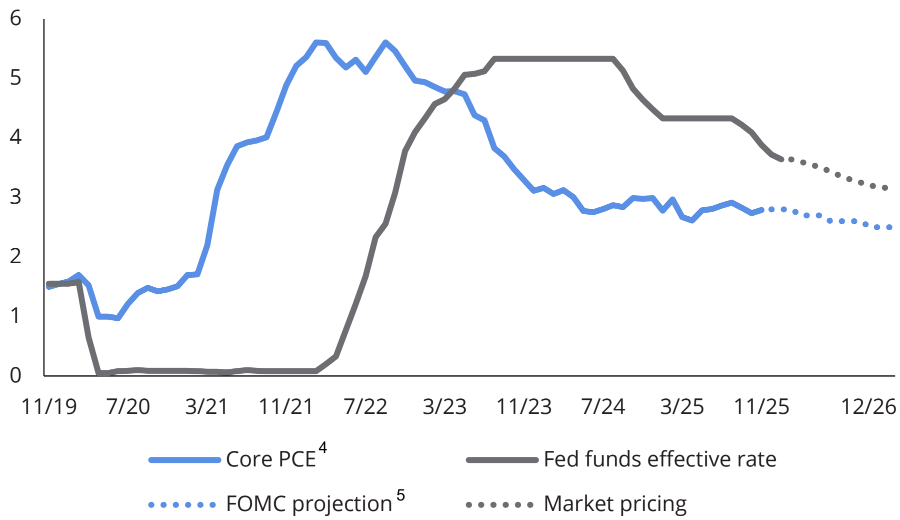
FIGURE 1
The Fed Is Expected to Continue Cutting Rates As Inflation Moderates
Inflation and Fed Funds Rate[3] (%, 2019-2026)



As of 1/21/26. Data Sources: Bloomberg, Bureau of Economic Analysis, Federal Reserve Board of Governors, Wellington Management, and Hartford Funds, 2/26.

2. World Economic Forum: Greenland emerged as a focal point at the World Economic Forum in Davos after President Trump sought to recalibrate earlier rhetoric around US intentions toward the territory. While he explicitly ruled out the use of military force to acquire Greenland, he simultaneously reaffirmed Greenland's strategic importance to US national security and introduced the concept of a "framework" agreement, signaling that Washington intends to pursue its objectives through sustained diplomatic and economic negotiations. This shift reduced the tail risk[6] of a direct US-NATO military confrontation but did little to resolve underlying tensions with European allies, particularly as the clarification was paired with renewed threats of tariffs should negotiations falter. As a result, the Greenland issue now appears set to evolve into a prolonged and complex bargaining process rather than a near-term geopolitical resolution.

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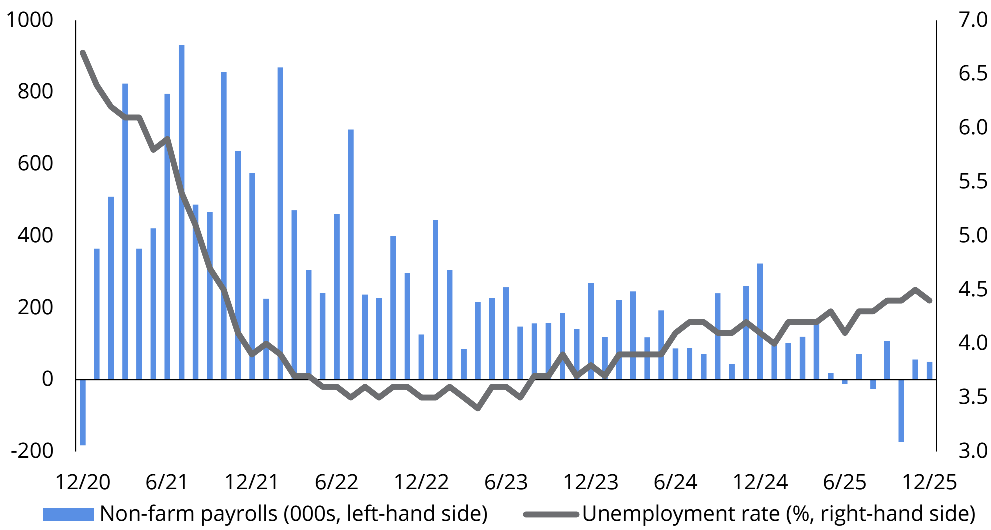
3. Mixed labor-market signals: The December jobs report suggested early signs of resumed tightening in labor-market capacity (**FIGURE 2**), reflecting the lagged effects of strong third-quarter 2025 growth (revised up to 4.4% annualized) and potentially reducing the likelihood of further Fed easing in the near term. Payroll gains were muted at 50,000, with downward revisions to prior months. However, the Household Survey[7] showed a stronger underlying picture, with 232,000 jobs added, pushing the unemployment rate down to 4.4%. Labor demand may improve over the next 3–6 months, just as restrictive immigration policy begins to constrain labor force growth, putting further downward pressure on the unemployment rate. Risks to this view include a more resilient labor force or technological shifts that weaken labor demand per unit of growth—but we think those dynamics are more likely to play out beyond early 2026.

FIGURE 2

Labor Markets May Be Tightening Up Again

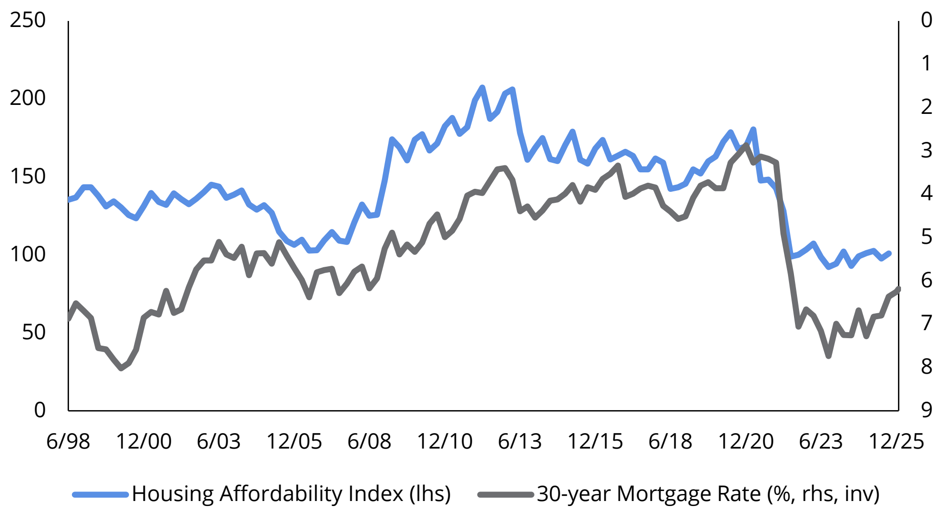


As of 12/31/25. Data Sources: Bloomberg, Bureau of Labor Statistics, Wellington Management, and Hartford Funds, 2/26.

4. Housing affordability initiatives: Early January saw two unexpected policy announcements aimed at housing affordability. On January 8, President Trump directed up to $200 billion of agency MBS[8] purchases through Fannie Mae and Freddie Mac under their Treasury-backed Preferred Stock Purchase Agreements.[9] The move tightened agency MBS spreads[10] by roughly 10 bps, though we see limited scope for further compression absent clarity on purchase pace and composition. While the program may modestly trim primary mortgage rates from recent ~6.15% levels (**FIGURE 3**), it may materially reduce prospects for GSE[11] IPOs[12] or conservatorship exit and comes against a backdrop of already full investor positioning. Hedging activity by the GSEs should render the program broadly rate-neutral, contrasting with the Fed's post-GFC approach. Separately, on January 7, the administration proposed banning institutional purchases of single-family homes. Given that large-scale operators represent only ~3% of the single-family rental market, we expect minimal impact on securitized products,[13] with any technical benefit from reduced issuance likely offset by lower liquidity. Both measures underscore a policy pivot toward affordability, but near-term market effects appear incremental rather than transformative.

> The Trump administration's proposed 10% cap on credit-card interest rates faces steep structural and legislative hurdles.

FIGURE 3
Housing Affordability Challenged by High Mortgage Rates



As of 12/31/25. An index above 100 indicates higher affordability, while below 100 indicates lower affordability. Data Sources: Bloomberg, National Association of Realtors, Bankrate, Wellington Management, and Hartford Funds, 2/26.

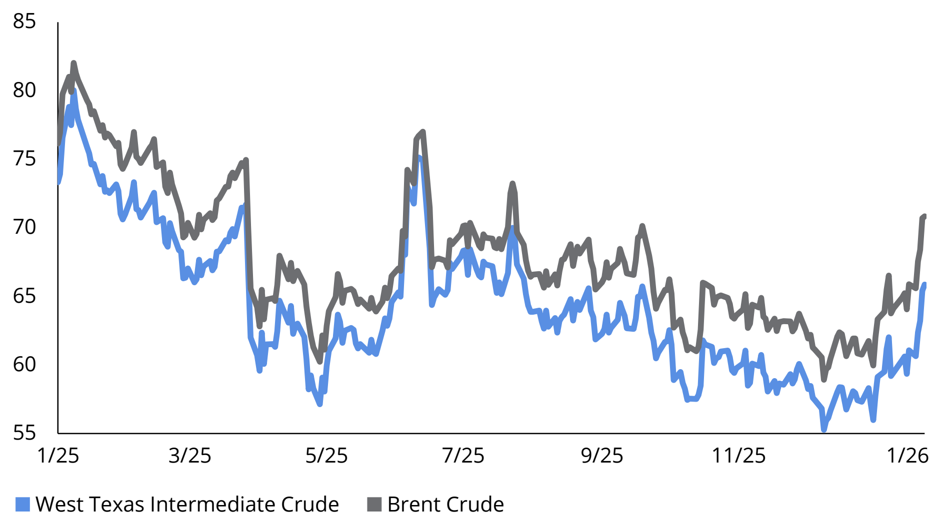
5. Credit-card interest-rate cap: The Trump administration's proposed 10% cap on credit-card interest rates faces steep structural and legislative hurdles. Implementing a federal cap would require congressional action to override state level usury laws, making passage highly unlikely, even as regulators could attempt to apply indirect pressure. If a cap were somehow enacted, banks and major card issuers would face substantial profitability losses and would likely try to offset the impact through higher fees or tighter credit lines—actions the administration may attempt to restrict. More broadly, the administration's stated affordability goals would be better served by easing regulatory burdens to encourage credit expansion rather than imposing restrictive caps. Alternative personal loan providers stand to gain volume in a world in which credit-card availability shrinks, whereas some models would be structurally unsustainable under a 10% ceiling.

What's Keeping Us Up at Night

1. **Fading US exceptionalism:** The Greenland episode highlights a potentially underappreciated vulnerability in US foreign policy: its reliance on external capital, especially from Europe. The European Union holds nearly $5 trillion (USD) in US risk assets excluding Treasuries and agencies, giving it significant leverage even absent outright asset sales. A shift in European investor behavior—such as reduced incremental allocations to US equities and credit, higher dollar-hedging costs, or a gradual buyers' strike—could weigh on valuations, increase risk premia,[14] and erode the wealth effect that underpins US consumer spending. These channels pose meaningful downside risks for US financial markets and the dollar over time, particularly in a scenario in which geopolitical frictions spill over into economic coercion rather than military conflict. Notably, these risks persist despite the modestly positive signaling out of Davos, underscoring that the market implications of the Greenland saga are far from resolved.

2. **Iran:** Geopolitical risk remains elevated as major unrest inside Iran coincides with an active military exchange between Iran and Israel, with both sides trading strikes and markets pricing a higher geopolitical risk premium (**FIGURE 4**). Oil prices have spiked following these escalations, reflecting concerns about potential disruption risks around the Strait of Hormuz, even if worst case scenarios remain low probability. While Iran retains meaningful proxy and missile capabilities, the broader worry is that any misstep could draw the US more directly into the conflict, raising the tail risk of a wider regional confrontation and keeping volatility elevated across energy markets and risk assets.

FIGURE 4
Crude Oil Prices Spiked in Response to the Unrest in Iran
Oil Prices (US$/barrel, 1/8/25–1/30/26)



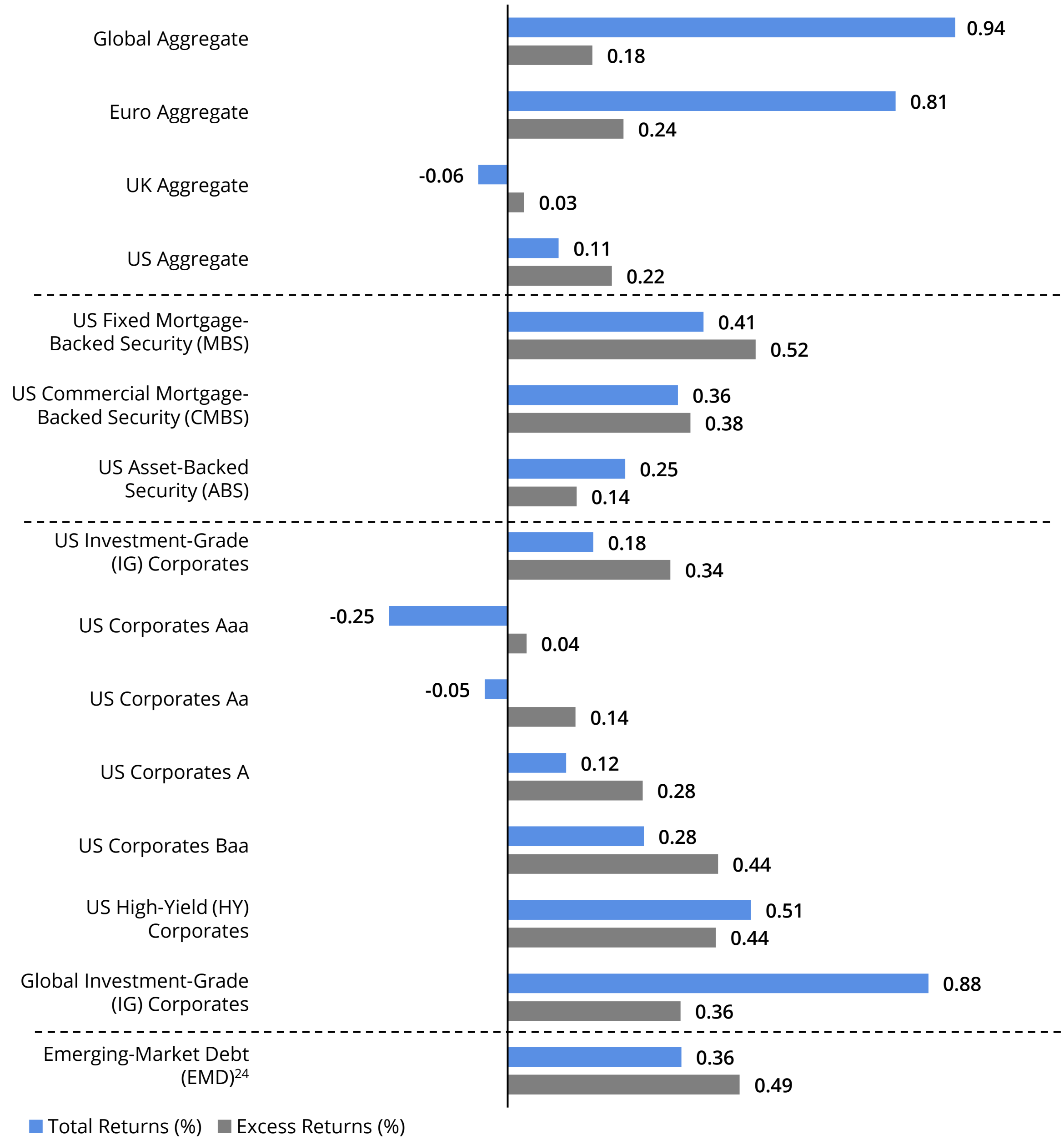
As of 1/30/26. Data Sources: Bloomberg, Wellington Management, and Hartford Funds, 2/26.

Investment Implications for Consideration

While the below positions have been static for some time, it's a reflection on how drawn out the current cycle has been due to the underlying strength of the economy.

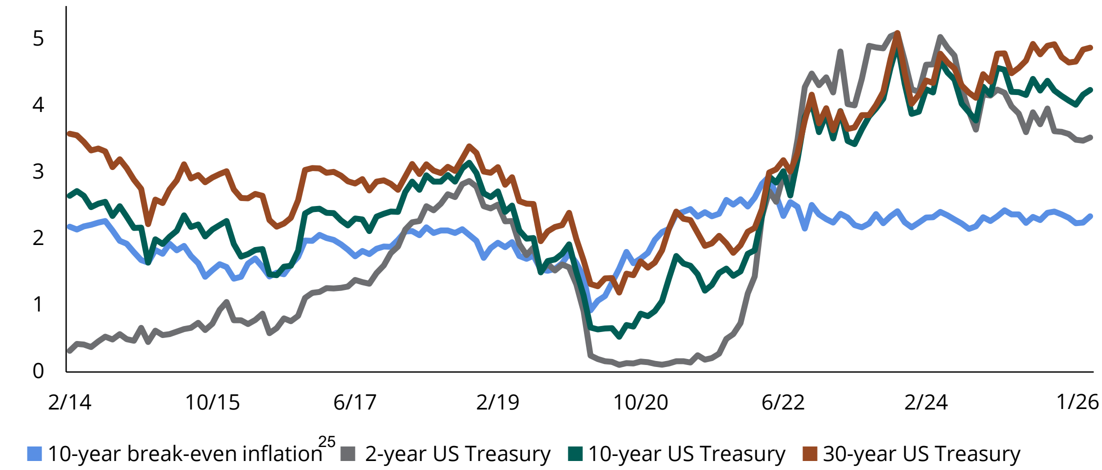
- **Recession risks remain modest—but not negligible**. At the same time, tariffs could reinforce inflationary pressures. In this environment, we continue to favor high-quality total-return strategies that are less constrained by benchmarks—particularly for participants seeking to diversify away from US-dollar assets. These strategies may include:
  - Global sovereign and currency strategies that tend to shine in these environments by capitalizing on diverging growth and inflation dynamics, uncoordinated central-bank policies, and the ongoing trend toward deglobalization. Alternatives to US Treasuries, such as European, Australian, and Japanese government bonds, along with select currencies, may help strengthen portfolio resilience.
  - "Go anywhere" strategies[15] may be well-positioned for late-cycle investing, with the flexibility to rotate across sectors and geographies as dislocations emerge. We currently favor holding more duration[16] to help offset credit risk and see opportunities in international markets (such as global convertible bonds and global high yield) to build a more balanced return profile.
- **Core Bond/Core Bond Plus/Intermediate bond positions**[17] **remain compelling**, with attractive all-in yields and a macro backdrop in which recession and growth risks could outweigh inflation over the medium term. Intermediate government/credit or short-duration strategies can serve as a potentially more risk-balanced way to add high-quality ballast to portfolios. While recent economic data points to cooling conditions, we're not yet ready to extend duration meaningfully given current valuations and the shape of the yield curve.[18]
  - Agency MBS valuations look attractive relative to investment-grade credit. Supportive supply-demand dynamics—driven in part by deregulatory initiatives—continue to provide a favorable tailwind.
  - We remain cautious on the long end of the curve, holding off on re-entering until valuations and curve structure become more compelling.
- **Short-duration bonds remain attractive** in an environment where inflation may be re-accelerating and the path for interest rates is uncertain. The economy is in transition, absorbing the effects of higher tariffs, shifting fiscal policy, and evolving labor market dynamics—factors that could produce mixed and volatile data through year-end.
  - Short-term bonds[19] still offer attractive all-in yields with less interest-rate risk. Put simply, investors are getting paid to stay cautious in a volatile environment.
  - Even with a rate cut expected by year-end, front-end strategies remain appealing. Cuts to overnight rates can steepen the front end of the curve, creating a favorable setup for total-return potential.
- **Higher-yielding credit remains potentially appealing**, with US and global high yield[20] offering close to 7% yield to worst[21] despite tight spreads. We remain cautiously optimistic that higher-yielding credit (including leveraged loans[22]) will continue to perform well for the remainder of the year but emphasize the importance of selective positioning amid ongoing uncertainty around tariffs and fiscal policy.
  - Active management and careful issuer selection may be key in navigating this environment.
  - Cyclical sectors and subordinated structures[23] offer limited compensation for their elevated risk, warranting a more cautious approach.

FIGURE 5: Monthly Fixed-Income Sector Total and Excess Returns



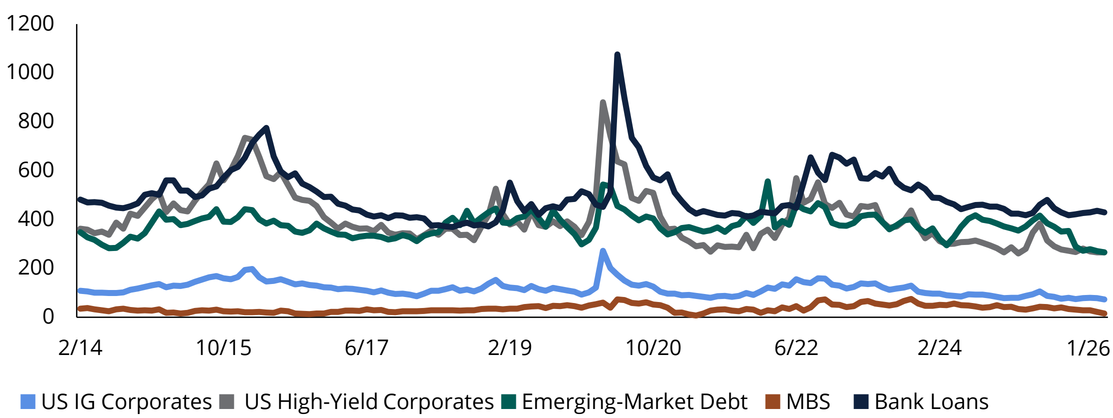
Monthly data as of 1/31/26. **Past performance does not guarantee future results**. Excess returns are defined as investment returns from a security or portfolio that exceed a benchmark or index with a similar level of risk. Indices are unmanaged and not available for direct investment. See last page for representative index definitions. Data Sources: Bloomberg and Wellington Management, 2/26.

FIGURE 6: US Yields (%)



As of 1/31/26. Data Sources: Bloomberg, Wellington Management, and Hartford Funds, 2/26.

FIGURE 7: Fixed-Income Spreads (basis points)



As of 1/31/26. **Past performance does not guarantee future results.** Indices are unmanaged and not available for direct investment. Please see last page for representative index definitions. Data Sources: Bloomberg, JP Morgan, Morningstar LSTA, and Wellington Management, 2/26.

To learn more about opportunities in fixed income, please talk to your financial professional.

[1] The Federal Reserve's balance sheet is a weekly report of its assets—primarily US Treasury securities and mortgage-backed securities (MBS)—and liabilities, such as bank reserves and currency in circulation. It acts as a tool for implementing monetary policy and maintaining financial stability, often expanded via quantitative easing to inject liquidity into the economy or shrunk via tightening.

[2] A basis point is a unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security.

[3] The federal funds rate is the target interest rate set by the Federal Reserve (FOMC), at which banks lend excess cash reserves to each other overnight to meet reserve requirements.

[4] PCE (Personal Consumption Expenditures) measures the price changes for a wide range of goods and services purchased by consumers, including durable goods (e.g., cars), non-durable goods (e.g., food), and services (e.g., healthcare). The Federal Reserve uses the PCE price index to measure inflation because it adapts quickly to changes in consumer spending patterns and covers a broad range of expenses.

[5] The Federal Open Market Committee (FOMC) is the 7-member Board of Governors and five Federal Reserve Bank presidents who meet eight times yearly to set US monetary policy, primarily by targeting the federal funds rate and conducting open market operations. It is the main Federal Reserve body for promoting maximum employment and price stability.

[6] Tail risk is the probability of rare, extreme, and unexpected financial losses that occur far from the average expected outcome. These occurrences represent market crashes or crises where traditional risk management models fail.

[7] The household survey is produced by the US Bureau of Labor Statistics and is designed to measure the labor-force status of the civilian noninstitutional population with demographic detail. The national unemployment rate is the best-known statistic produced from the household survey. The survey also provides a measure of employed people, one that includes agricultural workers and the self-employed. A representative sample of US households provides the information for the household survey.

[8] Agency Mortgage-Backed Securities (MBS) are investment pools of residential mortgages guaranteed by US government agencies or government-sponsored enterprises (GSEs)—specifically Fannie Mae, Freddie Mac, and Ginnie Mae. These securities offer high credit quality and safety from default, as the government guarantees the principal and interest payments.

[9] A Preferred Stock Purchase Agreement (SPA) is a legal contract detailing the terms, conditions, purchase price, and number of shares for a private company's sale of preferred stock to investors, often used in venture capital financings. It binds the issuer and investor, establishing representations, warranties, and closing conditions.

[10] Spreads are the difference in yields between two fixed-income securities with the same maturity, but originating from different investment sectors.

[11] GSE most commonly refers to a Government-Sponsored Enterprise, which is a type of financial-services corporation created by the US Congress to enhance the flow of credit to specific sectors of the economy, particularly housing and agriculture. Examples of GSE's include: Freddie Mac (Federal Home Loan Mortgage Corpiration), Fannie Mae (Federal National Mortgage Association), and Farmer Mac (Federal Agrecultural Mortgage Corporation).

[12] An Initial Public Offering (IPO) is the process where a private company first sells shares to the public to raise capital, increase liquidity, and enhance prestige.

[13] Securitized products are income-generating bonds backed by pools of loans—such as mortgages, auto loans, or credit-card debt—that transform illiquid assets into tradable securities. These instruments offer diversification and higher yields than traditional bonds, with risks including prepayment, credit, and interest-rate volatility.

[14] Risk premia represent the additional return expected or required by investors for holding risky assets over risk-free assets, such as government bonds. These premiums compensate for uncertainty and potential losses.

[15] Go-anywhere strategies are typically benchmark-agnostic and not bound by limits on exposure by sector, quality, currency, or country. Whereas traditional core-bond-plus strategies generally have flexibility to invest across the fixed-income landscape, they generally have upper limits on the amount that can be invested in securities rated below-investment-grade, domiciled outside the US, non-US-dollar-denominated, or reside in a particular sector (e.g., emerging markets).

[16] Duration is a measure of the sensitivity of an investment's price to nominal interest-rate movement.

[17] Core/core plus strategies typically invest in a baseline of investment-grade bonds such as government, corporate, and securitized debt. Core-plus funds can take that baseline and add additional sectors such as corporate high-yield, emerging-market debt, or non-US currency exposures to enhance returns.

[18] The yield curve is a line that plots interest rates of bonds having equal credit quality but differing maturity dates; its slope is used to forecast the state of the economy and interest-rate changes.

[19] Short-term bonds are debt securities issued by governments or corporations that mature quickly, usually within one to four years, offering investors periodic interest payments and return of principal; they are popular for their lower interest-rate risk, making them a relatively stable option for short-to-medium-term financial goals and preserving capital, with ultra-short bonds maturing in under a year acting as cash equivalents.

[20] High-yield (HY) securities, or "junk bonds," are rated below-investment-grade because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities.

[21] Yield to worst is the minimum yield that can be received on a bond assuming the issuer doesn't default on any of its payments.

[22] Leveraged loans are high-yield, senior secured debt instruments extended to companies with significant existing debt or poor credit histories. Typically used for mergers, acquisitions, or recapitalizations, these risky loans feature floating interest rates and are often syndicated to investors to manage default risk.

[23] Subordination refers to a lower priority level of debt or securities. Subordinated debt ranks below senior debt in terms of claims on assets and earnings. This means that in the event of a default or liquidation, subordinated debt holders are paid after senior debt holders. Subordinated debt is often considered riskier because it has a lower claim on assets, but it typically offers higher interest rates to compensate for this increased risk.

[24] Emerging-market debt (EMD) are debt instruments issued by developing countries. These bonds tend to offer higher yields than Treasuries or corporate bonds in the US. Emerging-market issues tend to carry higher risks than domestic debt instruments.

[25] The break-even inflation rate is a measurement that aims to predict the effects of inflation on certain investments, by analyzing known market inflation rates from recent years. It can be calculated by comparing the yield of an inflation-based bond (such as Treasury Inflation-Protected Securities, or TIPS) with a nominal bond of the same maturity period. The difference represents the break-even inflation rate, or the rate that inflation would have to be for an investor to "break even"—or earn the same return—between purchasing TIPS or nominal Treasuries.

Representative indices from Figure 5:
Global Aggregate is represented by the Bloomberg Global Aggregate Bond Index, which is a broad-based measure of the global IG fixed-rate debt markets. **Euro Aggregate** is represented by the Bloomberg Global Aggregate Bond Index - European Euro, which includes fixed-rate, IG Euro denominated bonds. **UK Aggregate** is represented by the Bloomberg Global Aggregate Bond Index - United Kingdom, includes fixed-rate, IG sterling-denominated bonds. **US Aggregate** is represented by the Bloomberg US Aggregate Bond Index, which is composed of securities that cover the US IG fixed-rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. **US Fixed MBS** is represented by the Bloomberg US MBS Index, which tracks fixed-rate agency mortgage backed passthrough securities guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). **US CMBS** is represented by the Bloomberg CMBS ERISA Eligible Index, which measures the performance of IG commercial mortgage-backed securities, which are classes of securities that represent interests in pools of commercial mortgages. The index includes only CMBS that are Employee Retirement Income Security Act of 1974. **US ABS** is represented by the Bloomberg Asset-Backed Securities Index, which is the ABS component of the Bloomberg US Aggregate Index. It has three subsectors: credit and charge cards, autos, and utility. **US IG Corporates** is represented by the Bloomberg US Corporate Bond Index, which measures the performance of US dollar-denominated, IG corporate bonds issued by industrial, utility, and financial companies. **US Corporates Aaa** is represented by the Bloomberg Aaa Corporate Bond Index, which is designed to measure the performance of IG corporate bonds that have a credit rating of Aaa. **US Corporates Aa** is represented by the Bloomberg Aa Corporate Bond Index which is designed to measure the performance of IG corporate bonds that have a credit rating of Aa. **US Corporates A** is represented by the Bloomberg A Corporate Index, which is designed to measure the performance of IG corporate bonds that have a credit rating of A. **US Corporates Baa** is represented by the Bloomberg Baa Corporate Bond Index, which is designed to measure the performance of IG corporate bonds that have a credit rating of Baa. **US High-Yield Corporates** is represented by the Bloomberg US Corporate High Yield Bond Index, which measures the performance of US dollar-denominated, below-IG corporate bonds issued by industrial, utility, and financial companies. **Global IG Corporates** is represented by the Bloomberg Global Credit - Corporate Bond Index, which is an unmanaged index considered representative of fixed rate, non-IG debt of companies in the US, developed markets, and emerging markets. **Emerging-Market Debt** is represented by the Bloomberg Emerging Markets Hard Currency Bond Index, which includes USD-denominated debt from sovereign, quasi-sovereign, and corporate EM issuers.

Representative indices from Figure 7:
US IG Corporates are represented by the Bloomberg US Corporate Bond Index, which measures the performance of US dollar-denominated, IG corporate bonds issued by industrial, utility, and financial companies. **US High-Yield Corporates** are represented by the Bloomberg US Corporate High Yield Bond Index, which measures the performance of US dollar-denominated, below-IG corporate bonds issued by industrial, utility, and financial companies. **Emerging-Market Debt** is represented by the J.P. Morgan EMBI Global Diversified Index, a broad-based, unmanaged index which tracks liquid, US dollar emerging-market fixed- and floating-rate debt instruments issued by sovereign and quasi-sovereign entities. **MBS** is represented by the Bloomberg US MBS Index, which tracks fixed-rate agency mortgage backed passthrough securities guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). **Bank Loans** are represented by the Morningstar/LSTA US Leveraged Loan Index, which is a market-value-weighted index that is designed to measure the performance of the US leveraged loan market based upon market weightings, spreads, and interest payments.

Important Risks: Investing involves risk, including the possible loss of principal. • Fixed income security risks include credit, liquidity, call, duration, and interest-rate risk. As interest rates rise, bond prices generally fall. • Investments in high-yield ("junk") bonds involve greater risk of price volatility, illiquidity, and default than higher-rated debt securities. • Mortgage-related and asset-backed securities' risks include credit, interest-rate, prepayment, and extension risk. The value of the underlying real estate of real estate related securities may go down due to various factors, including but not limited to strength of the economy, amount of new construction, laws and regulations, costs of real estate, availability of mortgages, and changes in interest rates. • Loans can be difficult to value and less liquid than other types of debt instruments; they are also subject to nonpayment, collateral, bankruptcy, default, extension, prepayment and insolvency risks. • Foreign investments may be more volatile and less liquid than US investments and are subject to the risk of currency fluctuations and adverse political, economic and regulatory developments. These risks may be greater, and include additional risks, for investments in emerging markets. • The risks associated with mortgage-related and asset-backed securities as well as collateralized loan obligations (CLOs) include credit, interest-rate, prepayment, liquidity, default, and extension risk. • Diversification does not ensure a profit or protect against a loss in declining markets.

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