THE point·

CIO
THE CIO GROUP

EPISODE 58

A Violent Adjustment to a Reactive, Pro-Cyclical Fed

By Steven Wieting, David Bailin and Malcolm Spittler

November 20, 2026

Summary

There are times when the timing of Fed policy is helpful to markets and times when it is not. At this moment, we are experiencing a major "air pocket" where the combination of AI fears and the Fed's determination to quell inflation have caused near term equity market panic.

What makes this moment more painful is Kevin Warsh's determination to attack energy inflation caused by the Iran War, now in its ninth month, and to convince Fed members that hot AI spending can be cooled by higher short term rates. In our view, the Fed had been "pro-cyclical" lowering rates even as AI spending boomed and is now being "reactive", multiplying market uncertainties.

In the short term, market volatility may rise further, and equity price weakness is likely to spread more broadly. Ironically, we think this may lead to an early 2027 buying opportunity, post the Fed meeting and a wave of tax-loss selling still ahead. However, if a rally ensues, we will remain vigilant, mindful that as the AI boom peaks and then declines, a more significant downturn may be ahead.

Summary Details

- The Fed's monetary responses to past crises, from sub-prime mortgages to the wild policy adjustments around the pandemic, have proven more reactive than "preventive." This means that the Fed has tended to be too late or too large in its responses to events.
- Most recently, the Fed emphasized the latest monthly CPI report that showed a temporary pass-through of higher energy costs. While Chair Kevin Warsh would not have encouraged tying short-term readings to Fed actions, that's exactly what FOMC participants have done.
- Their hawkish comments have pushed the US dollar up through levels breached during the "tariff liberation day" collapse of 2025. In turn, a stronger dollar has pushed gold down 31% from its January peak and caused short-term rates to surge.
- Where the US/Iran conflict is headed, and at what consequence to global commodity costs, is impossible to predict with confidence. But the fact remains, the Warsh Fed is significantly tying future US monetary policy to that war. The result is that even long-term US yields are on an "oil price rollercoaster."
- The Fed often tightens late in an investment-driven economic expansion. The Fed funds rate reached its peak levels in May of 2000 at the end of the internet boom and June of 2006 near the peak of the housing boom.

- While US monetary policy is not as misaligned as it was during those periods, we must again prepare for not just the Fed's next tightening move, but also the next case of "late recognition" that monetary policy is misaligned for the future.

In 2028 or sometime later, we foresee a period when US monetary policy will require major easing again. Given that timeframe, we are not tactically building large bond portfolios to take advantage of plunging rates as this could be a year or longer off.

The Bank of Nvidia and the Central Bank of the World

The world has been hyper-focused on Jensen Huang's AI economy. Huang's Nvidia has been much more than a semiconductor powerhouse. It has been a bank, providing capital for others to buy its chips. It has been a kingmaker, investing in companies that it considered strategic to its industry leadership. And it has been a political machine, seeking to optimize its global sales footprint with a special focus on sales of its products to China.

So strong was Nvidia's influence that when Huang stepped down, even Anthropic's hugely successful IPO could not bring the shine back to battered AI-related equities of every size. Even Saturday Night Live did not miss the public's interest in the story of the tech titan and the lady spy.

Chips and More Chips

As we suggested last week, Nvidia's products are not the problem. The firm's earnings and revenues rose 103% over the year through 3Q. Interim CEO Colette Kress announced an increase to the firm's revenue guidance for the coming year from 70% growth to 75% growth. She said key customers and suppliers – likely including the now public Anthropic - are "100% behind us."

Nonetheless, the tarnished story of one man's stewardship of the world's most important semiconductor designer is continuing to create market uncertainties that won't be resolved until key issues are tested. For example, Kress noted that Nvidia would be "more disciplined" and "rigorous" in its investments to support customer spending and AI startups. Perhaps Nvidia, the "central bank of AI," was too accommodative? Time will tell and the early voting is not positive.

While this unfolds, it is important for investors to still see *other* factors at work shaping the future of their investment portfolios.

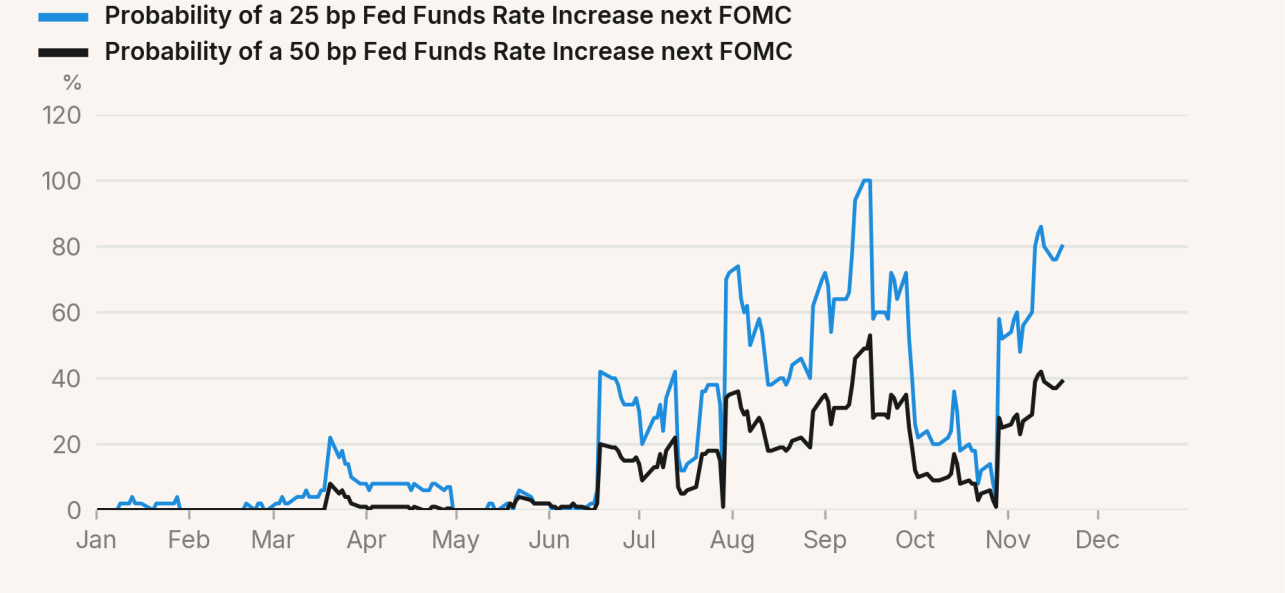
Kevin Warsh Looms Larger than Powell

The world of AI is dominated by the US, China and key suppliers in Asia. US equities have been the primary market beneficiary, with some gainers in Korea, Taiwan and Japan. Despite the Nvidia saga and a rapid, deep drop in AI-related asset prices this month, US equities have outperformed non-US regions, even those far-removed from AI in Europe and Latin America. That because the US dollar is surging on bets the Fed will tighten more aggressively.

Following the 0.4% increase in the October CPI and 0.3% increase in the core rate reported on November 10, markets have priced in a higher probability that the Fed will go further than a mere 25 basis point rate increase at the next FOMC meeting of December 9 (see Figure 1). Markets see a strong chance for a 50 basis point rate increase.

FIGURE 1

Implied Probability of 25 or 50 Basis Point Rate Hike at Next FOMC



SOURCE: CIO GROUP, HAVER ANALYTICS

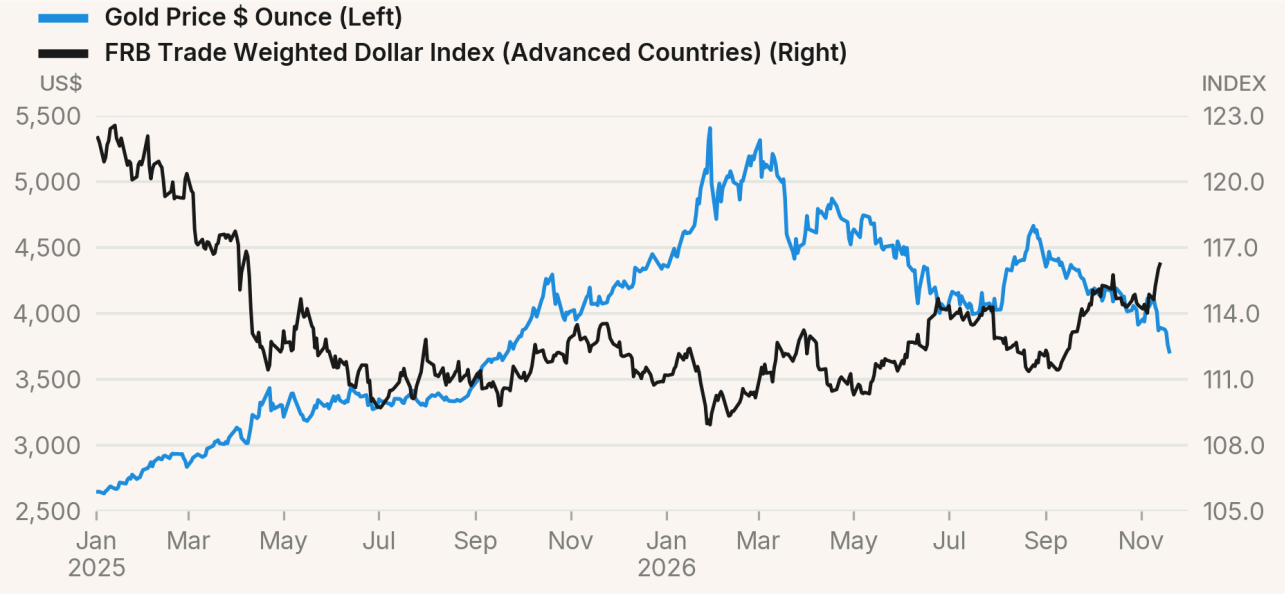
A Chorus of Lemmings?

Feeling quite sure their forecasts will prove correct, over the past few days, a “peanut gallery” of Fed speakers said they see a series of US rate increases over the winter months. Fed Governor Chris Waller noted that the Fed should tighten and signal an additional rate hike in January. Failing this “you have to go 50 in December …and get it done.” Such statements come just three weeks after the Fed chose to forgo raising interest rates at its policy meeting. Warsh’s Kool-aid appears to be becoming more popular.

The Fed Hawks pushed the US dollar through levels breached during the “tariff liberation day” collapse of 2025. Fed tightening expectations have pushed up US 2-year note yields 30 basis points within November. This helped push gold down 31% from its January peak (see figure 2).

FIGURE 2

US Trade Weighted Dollar Index vs Gold Price



SOURCE: CIO GROUP, HAVER ANALYTICS

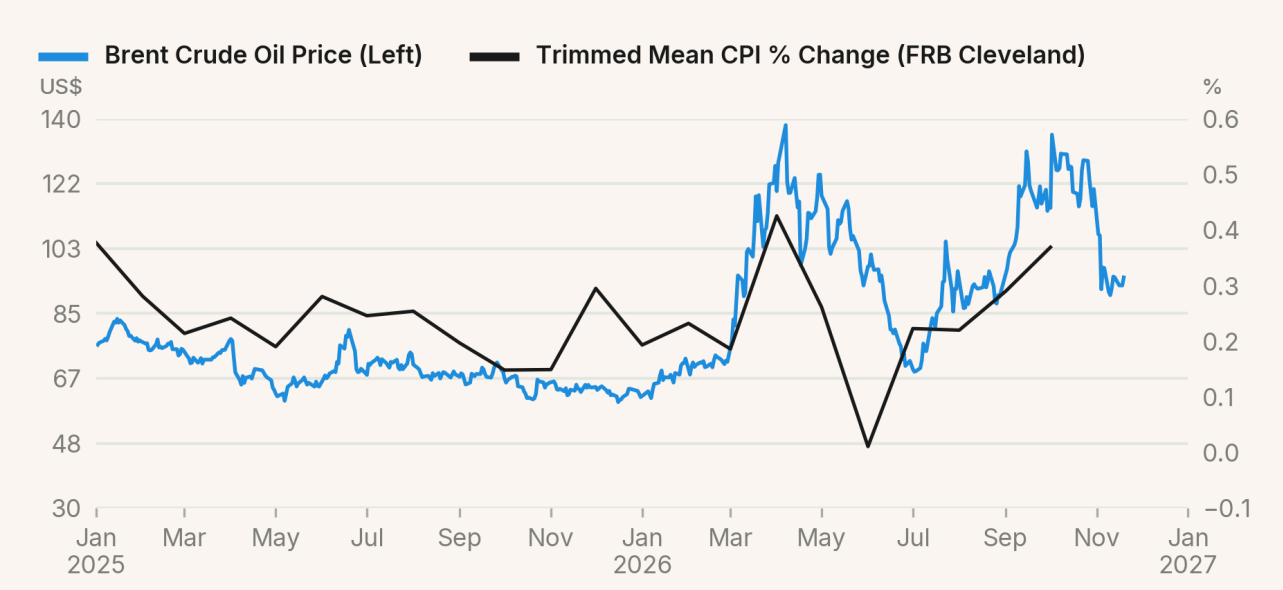
Not Better Late Than Never: Oil Prices Down, Rates Up Nonetheless

The October CPI report was preceded by a massive resurgence in global energy costs as the Iran conflict resumed in the summer. Yet, the report was also notable for pervasive increases outside of energy commodities. Some of this was random, including movements in medical costs that vacillate monthly. But after two months of surging fuel prices, transportation services costs jumped 0.8% in the month. In addition, surging shipping costs – driven in part by wildly higher insurance pricing - pushed up the cost of food.

As figure 3 shows, the late summer/fall resumption of hostilities with Iran caused global energy costs to rebound toward levels reached just after Iran's closure of the Strait of Hormuz in March. This made the "breadth" of US inflation widen in ways Fed policymakers are particularly sensitive to.

FIGURE 3

US "Trimmed Mean" CPI Measure (Excludes Outlier Components) vs Brent Crude Oil



SOURCE: CIO GROUP, HAVER ANALYTICS

Watch Those Barrel Prices, Kevin!

Yet, crude oil has subsequently fallen 21% in November-to-date. With this, CIO Group forecasts a 0.2% decline in the CPI for November. That report will be released just a day after the FOMC next meets on December 9.

Sadly, Geopolitics and the Fed Are Aligning

Where the US/Iran conflict is headed, and at what consequence to global commodity costs, is impossible to predict with confidence. But the fact remains, new Fed Chair Warsh is significantly tying future US monetary policy to it. This leaves even long-term US yields on the "oil price rollercoaster."

In a period of "well anchored" inflation expectations, with the Fed delivering stable low inflation for a long period, supply shocks can be "looked through" as "transitory." Warsh's critique of the Fed's performance since 2020 doesn't stomach this now. This leaves US monetary policy less predictable and on balance, less accommodative going forward.

When to Remove the Punchbowl? (Not When We Are All Drunk)

For both macroeconomic policymaking and portfolio management, hindsight often seems genius. Criticism of real-time management seems "cheap." Still, the Fed's monetary responses to past crises, from sub-prime mortgages to the wild policy adjustments around the pandemic, have proven more reactive than "preventive."

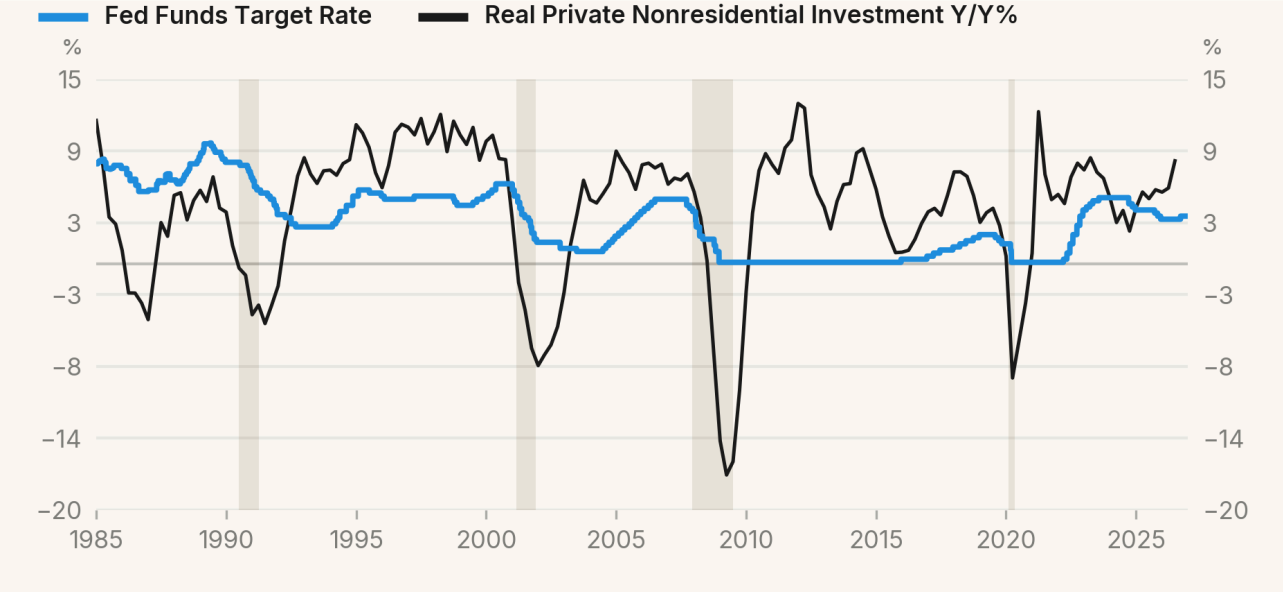
The focus on the latest CPI is not something Chair Kevin Warsh would encourage, yet it is the focus of FOMC participants nonetheless. So, is it fair for us to point to the Fed's reactive bias when inflation is running above target? Wouldn't the "right" monetary policy be tighter? Absent all other factors, we can answer affirmatively. Yet, it is important to see the full economic cycle in context.

The Fed's October 28-29 minutes were filled with comments about the increase in inflation being driven by the AI infrastructure boom which has spilled over to increased costs for consumer electronics, consuming scarce resources like electric power. The boom in AI investment began in 4Q 2023. Yet prior to the Fed's September 2026 rate hike – the first of a new cycle – the Fed cut its key policy rate by 175 basis points over that time.

As figure 4 shows, the Fed is often tightening late in an economic expansion driven by investment booms. The Fed funds rate reached its peak levels in May of 2000 at the end of the internet boom and June of 2006 near the peak of the housing boom. Both periods fell just before a recessionary investment bust that was years in the making.

FIGURE 4

Real Non-Residential Investment Spending Y/Y% vs Fed funds Rate Target



SOURCE: CIO GROUP, HAVER ANALYTICS

The Right Portfolio Response at the Right Time

We can be grateful that the Fed took strong measures to correct its excessively easy policy in 2022-2023. Without those steps, just partially unwound, the present policy setting now might require even more difficult adjustment. Yet we also see signs that the Fed may be significantly restrictive again once the AI investment boom fades.

While just a hypothesis for now, in 2028 or sometime later, we foresee a period when US monetary policy will require major easing again. Given the timeframe we suggest, we are not tactically building large bond portfolios to take advantage of plunging rates as this could be a year or longer off. Yet, we will be strongly disposed to reallocate toward a sizeable overweight in longer-duration US Treasuries and other assets that would benefit from Fed easing when the time is appropriate (“Everyone Hates Bonds. That’s a Mistake.”).

There is another aspect on the conduct of monetary policy that is critical for investors to understand. It manifests as stronger equity returns in periods when the Fed is hiking rates rather than cutting. Quite simply, the growth environment that convinces the Fed to hike is more conducive to positive equity returns than the environment that drives reactive rate cuts (see figure 5).

FIGURE 5

What's Worse for Equity Returns than Rate Hikes? Cuts

	Total-return, % ann. since 1988	Years in regime
Fed cutting	–1.7	11.1
Fed hiking	8.3	9.9
On hold	19.8	20.8

Regime = direction of the Fed funds target; a cycle runs from the first move of 0.25 pt or more to the last before a reversal. Years in regime count all cycles since 1985; returns use cycles from 1988. Includes the 25 bp hike of 2026-09-17.

SOURCE: CIO GROUP, HAVER ANALYTICS

Conclusion: Buyer Beware

For 55 years, the US dollar has effectively served as the world's reserve currency, backed merely by the Fed's credibility, rather than claims on gold. Deflated by the CPI, the "internal value" of the dollar is worth just 12% of its August 1971 level. (This was when President Nixon shocked the world, terminating convertibility of dollars for gold).

Despite this, the dollar has held more value than any other fiat currency of significant scale. Russian President Putin last year was sure to note the dollar as a key U.S. strategic advantage. With this in mind, we should certainly understand that maintaining the dollar's preeminence comes with costs.

Today, the Fed is working to maintain domestic price stability, which should contribute to US strength in the world. How it will do this is a tactical question.

A look at the Fed's record of the past forty years – since correcting the mistakes of the first decade of fiat currency management – suggests a reactive, pro-cyclical bias. This means we must prepare for not just the Fed's next tightening move, but also the next case of "late recognition" that monetary policy is misaligned for the future.

Important Information

This material has been prepared by CIO Capital Group, LLC (“CIO Group”) for informational purposes only and does not constitute investment advice or an offer to buy or sell any security or the solicitation of an offer to buy any security or investment advisory service. All opinions are subject to change without notice. Past performance is not indicative of future results. Investment returns may vary significantly over time. Indexes are unmanaged, are not available for direct investment, and do not reflect the deduction of fees or expenses. This material has been prepared without regard to the specific investment objectives, financial situation, or particular needs of any individual investor.

CIO Group believes that the information obtained from third party sources contained herein is reliable, but no representation or warranty is made regarding its accuracy or completeness. CIO Group accepts no responsibility or liability (including for indirect, consequential, or incidental damages) for any error, omission, or inaccuracy in such information and for results obtained from its use.

Certain information contained herein constitutes ‘forward-looking statements’ which are based on current expectations, estimates, projections, and beliefs. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially. Any forecasts, projections, estimates, or market expectations are based on current assumption and should not be considered guarantees of future events or investment results.

References to portfolio positioning, asset allocation, sectors, or investment strategies reflect CIO Group's views as of the date of publication and should not be interpreted as recommendations to purchase or sell any particular security or investment strategy.

CIO Group is an investment adviser registered with the SEC. Copyright ©2026 CIO Group. All rights reserved.