Caron's Corner Transcript – 8.10.2026

A Higher Nominal Growth World Brings on Higher Volatility

- We believe there has been a shift higher in nominal growth levels, which supports earnings and keeps a tailwind in place for equities.
- However, the increase in nominal GDP will weigh on bond performance. Spreads may indeed remain tight, but duration will come under pressure.
- The jobs data for July surprised to the downside. Although there may be technical reasons for the weakness, it may deter the Fed from hiking rates at it's September FOMC meeting.
- In addition, reduced communication by the Fed could result in increased volatility across markets.

Jim Caron: Hello, this is Jim Caron, CIO of the Portfolio Solutions Group. Welcome to another edition of Caron's Corner powered by The BEAT, our asset allocation framework across Bonds, Equities, Alternatives, Taxes and short-term Transitional (cash) investing.

The title of this week's Caron's Corner is "Higher Nominal Growth World Brings on Higher Volatility." In essence, we are now in a higher nominal growth world and we need to adjust to that. This is a core theme for us. For example, the U.S. had been approximately in a 1.6% real growth and 2.0% inflation world, which gave us approximately 3.8% - 4.0% nominal growth scenarios. What we're doing today is shifting to a higher level of nominal growth. Specifically, first quarter nominal GDP came in at 6.1%. That's a pretty good number, a very strong number, and then second quarter GDP growth nominal growth came in at 7.9% based on the GDP deflator (if you use core PCE as your inflation measure then it was closer to 6.5%). Regardless, these are stronger figures and a tailwind for corporate earnings. Earnings performance has been strong in both the first and second quarters, which can be attributed to the effect of higher nominal growth driving actual dollar based earnings. This is a very key factor for us to focus on.

So now where does the Fed come in on all this and how do we correlate that? Well the Fed's evolving communication strategy is a cultural shift, which I do think will bring on higher volatility. Let's talk about the Fed's communication strategies and create a contrast of the pre-enhanced communication strategy, which is the period from say 1990 - 2007. Let's call that the Greenspan era. Then came the post-crisis environment, 2010 - 2026, where we had enhanced communication strategies introduced by Ben Bernanke post-crisis. The current transition to back to a less communicative approach is reminiscent of the pre-enhanced communication era, which may lead to increased volatility in both bond and equity markets. The current changes are aimed at restoring the Fed's independence. In my view, the Fed's focus should be exclusively on inflation and monetary policy rather than broader political issues, so reduced communication by the Fed could result in more volatility for bonds.

For example, if we look at the MOVE Index (which measures the implied bond volatility in the U.S. Treasury market), it averaged about 80 at the index level during the 2010 – 2026 enhanced communication period, compared to 100 (more volatility) in the pre-enhanced communication period from 1990 - 2007, implying a roughly 25% difference in volatility measures. With respect to equities, the VIX was around 18 on average in the pre-enhanced communication period and had risen to about 20 in the enhanced communication period, about a 12% increase. These changes may have valuation implications despite healthy earnings and broader market participation.

So what are the implications across asset classes? Let's talk about bond yields first. The implication for bond yields and duration management, that’s an important connection to make. Increased nominal GDP and associated inflation expectations versus the need for higher bond yields as higher yields are required to compensate for increased volatility. So while bond yields may rise, let's compare a ten-year Treasury yield implied by historical volatility levels from the MOVE index, which was roughly at about 5.5% five in the pre-enhanced communication period, and today, somewhere around 4.6% in the post-enhanced communication period. What I'm highlighting is a major difference in yields depending on the volatility that might be attributable to the bond markets. Also note that higher yields, if supported by strong nominal growth and positive fiscal and regulatory policy, may not necessarily harm equity markets. It depends why yields may be rising and that's really a key aspect. If it's from productive nominal growth, that's actually pretty good.

Onto inflation metrics and Fed policy outlook. The current inflation measurement is under reconsideration. The Fed is looking at metrics beyond just core PCE year-over-year. Alternative metrics have been mentioned that include trimmed mean and true deflation measures, which suggests that inflation could be closer to around 2.3% – 3.3%, somewhere in that neighborhood and not much higher. This recalibration of inflation metrics is central to the current debate regarding whether to hike rates. Some banks forecast cuts while others forecast hikes. There's a lot of differences of opinion out there, but I think there will not be a rate hike this year. It's a close call for me, but this is really going to depend on the inflation and jobs data coming through. The introduction of a new task force in the Fed to determine the best measure of inflation is a means to support a calibrated monetary policy approach. That should hopefully stem some of the volatility that comes in the markets.

Lets look at international markets and specifically emerging markets. When we think about international implications, higher U.S. yields have contributed to a more stable dollar than what we might otherwise have been, based on the weakness in the fiscal deficit metrics and debt to GDP, things like that. Higher yields have actually stabilized the dollar's decline on the equity side in emerging markets, and while the environment appears generally supportive, especially given the growth prospects related to AI and resource needs, a selective approach is still recommended for the emerging market space. I still expect dollar/yen to rise, meaning that the yen will continue to weaken. I believe this is a longer term trend. Yes, there will be interventions and every now and then in order to slow that weakness in the yen or appreciation of the dollar relative to the yen and avoid disorderly moves. This is a reason for our strategic overweight in Japanese equities, banks and certain industrial sectors. We think this is going to be very supportive of Japanese markets.

With respect to key takeaways and allocation preferences first let me say we continue to believe there has been a shift higher in nominal growth levels, which supports earnings and keeps a tailwind in place for equities. It's one of the reasons we remain overweight U.S. equities. On the flip side, the shift higher in nominal GDP will weigh on bond performance. Yes, spreads may remain tight, but the duration component of a bond returns will come under pressure. The monthly jobs data that we just recently had for July surprised to the downside, and although there may be many technical reasons for the weakness, it may throw cold water on the calls for the Fed to hike rates in September at their FOMC meeting. This will likely keep bond yields in a range with more of a focus now on the inflation data. Note that fixed income will still play a very important role in portfolios, but one needs to move toward active management, especially with respect to duration, versus passive management.

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