Caron’s Corner Transcript – 2.17.2026

It Will All Come Out in the Warsh

- Kevin Warsh has been nominated to be the next Fed Chairman, eliciting a number of questions.
- For example, is Warsh a hawk or a dove; will he lower rates, inflation, and/or the balance sheet…?
- While all valid, I think the most important question that needs to be addressed is: Why was Warsh selected?
- If this were just about interest rate policy, then a more dovish candidate could have been selected.
- But Warsh is notably obscure about being a hawk or a dove, so it’s not solely about rate policy.
- So then what is it? Let’s get into it!

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.

“It Will All Come Out in the Warsh.” Kevin Warsh had been nominated to be the next Fed chairman and there will be many questions about this. Is he a hawk or a dove? Will he lower rates, inflation and the balance sheet? All valid questions. But I think it misses the most important question, which is why was Warsh selected in the first place? To be sure, if it were just about interest rate policy, then a more dovish candidate could have been selected. Warsh is notably obscure about being a hawk or a dove, so it's not solely about rate policy. Then what is it? Let's get into it!

Well, I think it's about changing the culture at the Fed and getting the Fed back to their mission. Since the Great Financial Crisis (2008/2009), the Fed increased its regulatory oversight of the financial system, and rightly so. But the problem with regulators is knowing when to stop, and it is believed their regulatory process had become too cumbersome. For example, opaque stress tests are too far reaching, such that it is viewed to impede the lending to the real economy, according to Lisa Bowman, who's the acting vice chair of supervision at the Fed. She said that the Fed had also become too political in its regulatory practices by Fed governors that led to debunking many segments of the economy. You can see it for yourself, she published on the Fed's website.

Warsh was selected to change this culture and return the Fed back to its mission, which is to control the money supply through interest rate policy. Now the Fed's dual mandate of full employment and price stability will remain unchanged, but don't confuse the mandate with the mission. The mission is clear and shouldn't be conflated with other political goals. The Fed's mission is not about controlling the money supply through owning assets, an important distinction where the balance sheet comes in. There's a lot of talk about the balance sheet and interest rate policy under a potential Warsh Fed. Warsh had been critical about the use of the Fed's balance sheet because he believes the balance sheet policy, while necessary at the height of the GFC, overstayed its usefulness for too long. And this creates two risks. The first one is that it inflated asset prices. That, in turn, created inequality between the asset owner class and the majority of the non asset owner class. This then creates affordability issues in that asset owners can leverage and borrow against the assets they own to buy say, a house, which makes a home price rise and less affordable to the non-asset owner class. And this again is just one example. The second is that a large balance sheet dampens the market's feedback to bad political policy. In other words, politicians. If a politician has bad policy, a large balance sheet may support asset prices such that it would not provide negative feedback and that feedback would be dampened. So that's another risk.

With this in mind as a foundation, let's make the connection between balance sheet policy and monetary policy. A large balance sheet is viewed as easy policy because it inflates asset prices, lowers bond yields and eases financial conditions. A small balance sheet is viewed as tighter policy because it does the opposite. Thus, if Warsh shrinks the Fed's balance sheet, then he is *de facto* tightening and in order to offset this tightening, he can ease policy rates. Or he may raise rates more slowly if the situation calls for it. Now this does not make Warsh a dove. His rate policy needs to be seen collectively with his balance sheet policy.

So what does this mean for markets? Is Warsh bullish or bearish? A question I'm often asked for those who like to get right to the bottom line, and my answer is “yes,” he can be both bullish and bearish. Clearly this is the wrong question. The right question is how will the Fed's policy reaction function work under a Warsh Fed? I go back to my statement on the Fed's mission to control money supply with interest rate policy, and this is very, very key, while also maintaining its dual mandate. Now this may mean if equities rally, but evidence of higher productivity for example keeps inflation low, then the Fed may be slower to increase interest rates. But if there's evidence of rising inflation then the Fed may be faster to raise interest rates.

The mission is money supply and its velocity, the product of which is inflation. Fed policy may react faster at times to avoid residual lags that come as a result of many of the Fed's models. Notable errors on this front were observed under the Powell Fed. But look, we're not going to judge here because maybe the Fed was too slow to cut rates at times, and maybe it was not fast enough to hike. Clearly this is not an exact science, and it's easy to judge with the benefit of hindsight. I'm just trying to explain how the Fed may operate led by Warsh. That said, if I had to color it one way, I'd say Warsh is more sympathetic to supply-side economic policies. That is more productive private sector growth policies than demand side policies, which is less productive public sector growth policies. But one thing for certain, Warsh does not believe Fed policy should greatly influence asset prices, which is why his objective will be to shrink the balance sheet.

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