CJ's Weekly Market Memo

The Economy

The most important development this week happened in a conference room, not on a trading floor. Kevin Warsh chaired his first FOMC meeting on Wednesday, and it confirmed what I wrote here on May 17: this is the most consequential change in Fed leadership in over a generation. The committee held rates as expected, but nearly everything around the decision shifted. The policy statement ran a mere 162 words, the shortest since 2007 outside one emergency cut in 2020. Warsh declined to submit his own dot to the Summary of Economic Projections, refused to sketch any reaction function for the press, and stood up five task forces to review how the Fed communicates, manages its balance sheet, and frames inflation.

Here is the part I do not think the market has fully digested. Warsh, in my reading, belongs to the Volcker school. He believes the money supply, not the level of the funds rate, is the root cause of inflation, and I expect him to manage the balance sheet and the growth of money far more aggressively than he micromanages a quarter point here or there on the overnight rate. The new task force on the balance sheet is the tell. Those of us who lived through the early 1980s recognize the pattern immediately. A generation of investors who have only known the Greenspan, Bernanke, Yellen, and Powell put may not, and that recognition gap is itself a source of near-term volatility.

The backdrop Warsh inherits is a cyclical economy that is reaccelerating, which is precisely why his hawkishness has teeth. Industrials traded to record highs this week and the Capital Goods group printed all-time highs, led by the physical buildout of the AI economy: cooling, backup power, electrical equipment, and grid contracting. Grid capacity is expanding at roughly 4% a year, the fastest pace in three decades, while battery and turbine production sit at multi-year highs. Freight volumes posted their largest three-month jump since early 2022, Canadian factory sales surged, and the labor data firmed across the board, with the New York Fed services employment index at its highest since 2022. The catch is on prices. Prices-received expectations spiked in the regional Fed surveys, and the FOMC's own risk weighting on core inflation moved to near historic highs. This is the PPI-to-PCE pipeline I have flagged for months, now showing up in the Fed's own forecast, which jumped to a 3.3% core reading for 2026.

A few crosscurrents are worth naming. Housing remains the soft spot, with May starts down 15% and multifamily cratering. I am also keeping an eye on the consumer, where student loan defaults are climbing fast. Roughly 9 million borrowers, close to one in five, are now in default following the return of collections and credit penalties, and only about 41% of outstanding balances are in normal repayment. That is not a crisis yet, but bad debt rising at this pace can become a real drag on spending before long, and it belongs on the watch list. Energy, mercifully, is cutting the other way. The agreement to end hostilities with Iran, announced June 14 with the Strait of Hormuz reopening, has pulled crude from roughly $80 back toward $76. My read on the politics is straightforward: President Trump appears willing to accept an outcome that some will characterize as a defeat in order to head off a far more serious worldwide economic disruption. Whatever one thinks of the diplomacy, lower oil is disinflationary at the margin, a genuine tailwind for the consumer, and it quietly takes pressure off the very inflation problem that worries the new Chair.

Current Market Technical Conditions

The tape's reaction to Warsh was violent and instructive. Wednesday's 1.21% decline was the worst debut for a Fed Chair since policy announcements began in 1994. The two-year yield posted its largest one-day jump in fourteen months, and fed funds futures pushed the first fully priced hike from March all the way out to October, now assigning a 40% chance to July. The dollar pressed to 52-week highs against the yen near 161, owing in good part to US real rates sitting well above those of the other major economies, a gap that is widening again. A stronger dollar is, in my experience, one of the more reliable lids on commodity prices, and it showed this week as gold, silver, and copper all sold off hard even with the cyclical economy running hot. That is a useful natural brake on the very inflation Warsh is fighting. Then, on Thursday, the market shook it off and rallied 1.08% in a tidy inside day. That resilience matters. It tells me the selling was a repricing of the rate path, not the onset of panic.

Leadership remains narrow and unmistakably AI-driven. Bespoke's AI Infrastructure basket is up roughly 84% on the year while its Implementation basket is down about 12%, a split that captures exactly where the money is going: into the picks and shovels of the buildout, not yet into the applications. The cleaner technical signal from the FOMC was a sharp rotation out of dividend payers. The highest-yielding names were hammered while the lowest and zero-yield names actually finished green. With cash and the front end of the curve now offering real return, the old argument that stocks have no alternative is finished for the time being.

One market-structure development bears watching by anyone who thinks about valuation discipline. SpaceX came public on June 12 in the largest IPO in history, and just four days later announced a $60 billion, all-stock acquisition of Cursor, the AI coding firm. Read that carefully. Anyone who read Adam Smith's The Money Game back in 1968 will recognize the move. Smith described how an operator with a high-multiple stock could buy real companies with his expensive paper, fold in their earnings, and let the rich multiple do the rest. Musk is reprising a version of that premise on a scale Smith never imagined, using a freshly public and richly valued balance sheet to expand well beyond rockets into AI software, all within days of the listing. It is the oldest tell there is, that at the speculative top of a wave paper becomes currency and ambition runs well ahead of cash flow. Bespoke's own work shows the cheapest names by price-to-sales have outperformed the most expensive over the past 20 years. My father taught me a discipline that still holds: the durable money is made buying sound businesses while they are cheap and out of favor, not chasing richly valued stories at the top of a wave.

A Prognostication for 2026

My near-term posture, covering the next three to four months, stays cautious, and this week reinforced it. A Fed that deliberately removes forward guidance widens the range of outcomes the market must price, which means higher risk premiums and more volatility at each meeting. Pair that with a hot economy and rising prices-received expectations, and the risk of an actual rate hike is real rather than theoretical. I expect a choppy, sideways-to-correcting summer while the market learns to read a guidance-light Warsh Fed.

None of that dents my longer-term optimism, which this week's data arguably strengthened. The Second Wave of the AI capital cycle is no longer a thesis on a page. It is showing up in hard production numbers for the grid, for turbines, and for batteries, in a pattern that most closely parallels the electrification of America from 1915 to 1940. Foreign capital continues to pour into US markets, over $1 trillion since late 2024, and the Iran de-escalation removes a meaningful tail risk on energy. The sound-money discipline Warsh represents, painful as it may feel in the moment, is among the healthiest things that could happen to the durability of this expansion.

As the infrastructure names grow expensive and the Fed keeps policy firm, I continue to expect leadership to broaden into value, cyclicals, and the cheaper corners of the market as we move through late 2026 and into 2027. That is where the next leg of opportunity is being seeded right now, while everyone is staring at the same handful of AI winners. Stay invested, stay diversified, and keep a little powder dry for the volatility a new Fed Chair is almost certain to hand us. The change underway is real, and the long-term investor who understands it will be well rewarded.

CJ Brott
Chairman Emeritus, Capital Ideas
