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THE INVESTMENT COUNSELOR
SEPTEMBER 2026

THE WARSH ERA: LESS FED, MORE MARKET VOLATILITY

Randall L. Zaharia, CFA, CAIA®
Principal, Director of Fixed Income & Alternatives

A lot has changed in the financial markets over the last seven months, including the transition to the Warsh Federal Reserve era. When President Trump nominated Kevin Warsh to succeed Jerome Powell as Federal Reserve chair at the beginning of the year, there was wide anticipation that Warsh would be hawkish and narrowly focused, prioritizing inflation control and shrinking the Fed's direct intervention in the markets.

Reflecting this new era, in early September markets are pricing in one to two quarter-point (25 basis-point) increases to the Federal Funds Rate over the next 12 to 18 months. This would push the benchmark rate from its current 3.50%-3.75% target range up to or slightly above 4.00%. Notably, this is a complete reversal from the beginning of the year when the market anticipated rate cuts.

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A Different Kind of Fed

Since being sworn in mid-May, Chairman Warsh has overseen two Federal Open Market Committee (FOMC) meetings. At the late-July meeting, the Fed left interest rates unchanged, though three dissenting regional bank presidents, who favored an immediate rate hike, underscored growing market uncertainty surrounding future Fed policy.

Warsh's aim to minimize the Fed's market presence has begun, symbolically at least, with shorter FOMC press releases and his decision to omit his own interest rate projections for the Fed's "dot plot." Having served as a Fed governor from 2006 to 2011, Warsh supported initial emergency liquidity when markets locked up during the 2008 financial crisis but has long advocated against the central bank's expanding role and ongoing quantitative easing.

To revamp the Fed's approach, Warsh has established five task forces to reexamine core functions:

- **Communications** to evaluate policy signaling and what guidance the Fed conveys to the public.
- **Balance Sheet Policy** to assess the scale and long-term implications of the central bank's holdings.
- **Data** to improve the quality of the real economic signals the Fed relies upon to make policy decisions.
- **Productivity and Jobs** to consider the economic impact of transformative new technologies like AI.
- **Inflation Frameworks** to analyze drivers of inflation.

These structural changes could prove significant. For example, FOMC governors might begin utilizing real-time inflation data or adopting entirely new analytical frameworks for considering inflation. Ultimately, Warsh wants financial markets to independently assess economic and financial data rather than look to the Fed for guidance.

Broadening Geopolitical and Inflationary Risks

The shift toward a less interventionist Fed arrives just as inflation risks have broadened across several fronts. The 2026 conflict in the Middle East has created substantial energy market disruptions, with Iranian retaliation targeting Persian Gulf infrastructure and restricting shipping through the Strait of Hormuz. Consequently, oil prices spiked from under $70 per barrel to over $110 per barrel before settling in the $80 range. This volatility flowed directly to consumers, pushing national gasoline prices from under $3.00 per gallon early in the year to over $4.50 before moderating to just under $4.00.

Despite these spikes, the U.S. economy today is less vulnerable to energy shocks compared to the memorable 1970s shocks, thanks to strong domestic production and its

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net exporter status. As a result, economic growth has remained relatively steady, with GDP expanding by 2.0% in Q1 2026 and an estimated 1.5% in Q2, allowing the Fed to focus on inflation rather than employment.

Energy, however, is not the only inflationary pressure. High demand for semiconductor chips and heavy capital spending driven by AI data center buildouts and manufacturing reshoring have strained supply chains. Compounding these pressures is rapid U.S. Treasury debt issuance (over $1.5 trillion anticipated this fiscal year), which pushed the total national debt past $40 trillion in late August. Over time, this unprecedented fiscal expansion threatens to weaken the U.S. dollar, driving up import prices and adding another layer of sticky inflation.

While new AI technologies may eventually have a deflationary impact, the timing and extent of those productivity gains are difficult to predict. Ultimately, we are planning for persistent 3%+ inflation for the foreseeable future, rather than a quick return to lower pre-2020 levels.

Strategy Impacts for Bonds

What would persistent 3% or higher inflation mean for investors? In simple terms, we believe investors should try to avoid large swings in bond prices (given the risks for higher inflation and thus higher interest rates) while prioritizing attractive income. As such, we favor high-quality bonds that mature in roughly two to five years.

These intermediate-term bonds offer a key advantage in the current environment: because bond prices and interest rates move in opposite

"Ultimately, we are planning for persistent 3%+ inflation for the foreseeable future..."

directions, their prices are less sensitive to interest rate hikes than longer-dated bonds (what investors call having a shorter duration). This helps insulate portfolios if rates continue to rise. To illustrate the vulnerability of longer-duration bonds, yields on 10-year and 30-year U.S. Treasuries have increased substantially this year, from 4.15% and 4.85% to 4.65% and 5.20%, respectively, resulting in significant price declines.

Interest rates on shorter-term fixed-income securities remain attractive, with 6-month U.S. Treasury bills yielding around 3.95% and 2-year Treasury notes offering around 4.25%. By contrast, corporate bonds are currently offering very little extra yield compared to risk-free Treasuries, making them less appealing. If an investor is not paid to take on risk, the risk-free option of U.S. Treasury and agency securities makes the most sense.

In taxable accounts specifically, we are targeting tax-free yields near 3% by utilizing select callable municipal bonds (with calls typically arriving within two to six years) and adding some newer municipal bond issuers. In some cases, U.S. Treasury notes might make more sense than municipal bonds.

Our baseline expectation is the Fed will leave rates unchanged for at least the next six to twelve months. However, Chairman Warsh's presentation at the Jackson Hole conference at the end of August underscored concerns over inflation, meaning an interest rate hike by yearend is possible. We have shortened our average duration and taken a more defensive posture across bond portfolios, locking in yields at or above 4%, which appears to offer real returns going forward.

MANAGING A CONCENTRATED STOCK POSITION

Elliott C. Hollingsworth
Director of Counseling

Strong market performance from industry leaders like Nvidia and Apple, alongside the public market debut of high-profile companies like SpaceX, has brought portfolio concentration top of mind for many investors. Whether a large position came from years of patient holding, an inheritance, founding a company, or equity compensation earned over a career, single-stock growth is often how meaningful wealth is built in the first place.

At the same time, holding onto an oversized position introduces a level of risk that can quietly compromise what might have taken decades to build. When one company makes up 20%, 40%, or more of your investment portfolio,

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your personal financial security becomes tied to the ongoing success of that single business.

Deciding how to handle that exposure is rarely simple, and it is almost never just a question of numbers.

Emotions and Tax Realities

Most people have a real, personal attachment to a concentrated holding. If you worked at the company, those shares represent hard work and conviction in the mission. If you inherited them, they can feel like a family heirloom you are responsible for stewarding. If you are a founder, the stock is closely tied to your own identity. Trimming shares can feel like betting against a company you believe in—or inviting regret if the price keeps climbing.

> *"When one holding dominates your balance sheet, company-specific vulnerabilities become your own."*

Alongside emotional loyalty, there is the tax bill to consider.

Selling a low-basis stock triggers federal capital gains taxes (up to 20%) plus the 3.8% Net Investment Income Tax for high earners. In California, where capital gains are taxed as ordinary income without preferential long-term capital gains rates, the state takes up to another 13.3%. An all-in tax hit near 37% makes holding onto the stock feel like the easiest path.

For investors whose primary goal is passing wealth to the next generation, holding taxable shares for life to receive a step-up in basis can eliminate capital gains for heirs. However, this strategy requires accepting company-specific market risk over what could be many years or decades.

Hesitating to sell because of taxes is completely understandable. However, while tax efficiency is critical, taxes should never be the sole driver of whether to hold or sell.

The Risk of Concentration

Every business faces headwinds it cannot control, no matter how strong its competitive position seems today. Leadership changes, shifting consumer behavior, new technology, societal changes, and regulatory pressure can all alter a company's trajectory quickly.

When one holding dominates your balance sheet, company-specific vulnerabilities become your own. Diversification does not eliminate market ups and downs, but it does reduce the impact that any single investment can have on your overall financial picture. While outsized growth in a single business may have built wealth, diversification is what ultimately protects it.

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Strategies for De-Risking

Managing a concentrated holding is not an all-or-nothing proposition. In most cases, the goal is to build a thoughtful, tax-aware plan to reduce risk over time.

A few practical approaches include:

Gradual Selling: Spreading sales across multiple tax years helps smooth out market volatility and can help prevent pushing your income into a higher tax bracket.

Tax-Loss Harvesting: If other investments within your broader portfolio have unrealized losses, those losses can be harvested to directly offset the capital gains realized from selling appreciated shares, making diversification substantially more tax-efficient.

Charitable Giving: Donating appreciated stock directly to a charity or Donor-Advised Fund (DAF) eliminates capital gains taxes and provides an immediate tax deduction. For larger holdings, a Charitable Remainder Trust (CRT) offers an additional layer of utility: the trust can sell the concentrated shares tax-free, reinvest 100% of the proceeds into a diversified portfolio, and pay you or your family an ongoing income stream before the remaining assets pass to charity.

Hedging Strategies: Options can sometimes protect against downside risk without an immediate sale, though they bring their own costs, tax nuances, and structural complexity. It is also worth noting that corporate insider policies generally prohibit active employees from hedging company shares, so this is typically only an option for investors no longer tied to the company.

Beyond these foundational approaches, other specialized

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strategies exist. Because every family's tax picture, cash needs, and estate goals are different, any strategy should be considered and developed collaboratively with your Investment Counselor, CPA, and estate attorney.

Finding the Right Balance

Like many financial planning decisions, there are exceptions to every rule. A concentrated position is not automatically a problem just because it crosses a specific percentage of a portfolio. If you have substantial assets outside the portfolio, reliable income streams, and low living expenses, holding a larger position might fit comfortably within your risk tolerance.

The key is to make sure the investment supports what you want your money to accomplish without exposing you to unnecessary risk.

Ultimately, managing a concentrated stock position is about protecting success. Thoughtful planning can help ensure your portfolio honors the achievements of the past while remaining resilient for the opportunities and challenges of tomorrow.

CELEBRATING OUR SUMMER INTERNS

This summer marked the eleventh year of our annual wealth management internship program. We were delighted to welcome rising college seniors Allison Erickson and Gyury Lee, who were selected from a competitive pool of applicants.

Our rotational program provides undergraduates with hands-on experience across all aspects of our firm, from securities analysis and investment counseling to compliance and operations. Both Allison and Gyury brought enthusiasm, curiosity, and fresh perspectives while completing meaningful projects.

Gyury Lee and Allison Erickson

Highlights included a capstone project where they presented a stock review and investment recommendation, which involved evaluating financial statements and conducting a discounted cash flow analysis to determine fair value. They also completed an in-depth quality rating analysis, assessing competitive advantages, long-term growth and profitability prospects, management strength, and balance sheet resilience to produce an overall quality score.

We are grateful to Allison and Gyury and wish them continued success in their final year of college and beyond.

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Randall L. Zaharia, CFA, CAIA®

Contact

177 East Colorado Blvd., Suite 550
Pasadena, CA 91105
T: 626.792.2228 | F: 626.792.2670
www.cliffordswan.com

Editor: Jennifer I. Maqueda
Designer: Megan A. Pantiskas