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Fed Poised to Cut Rates as Economy Slows

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I'm joined in Invest by Anne Walsh, Managing Partner of Guggenheim Partners and the Chief Investment Officer of Guggenheim Partners Investment Management, which oversees more than \$350 billion in assets. Anne, thanks for being here.

Anne Walsh: Hi Julie, nice to be here.

How did you think about the shutdown? How do you think about government functionality as it relates to investing?

Anne Walsh: So we've certainly seen now a record setting government shutdown. But we saw the second longest during the Trump 1.0 administration. And I think this fiscal policy, and political disruption is really one for the playbooks for the rest of the Trump administration. And the volatility ride, I think, will continue from that perspective. Having said that, I think that we are through some portion of some of the volatility that we saw earlier in the year. I like to think of the Trump administration of having four policy pillars. In no particular order: trade and tariffs, which continues; deregulation, which is sort of going on in the background right now, with the great pomp and circumstance to begin with DOGE, but really kind of now playing around in the background; tax policy, which is one of the elements that's actually got some certainty to it now because of the One Big Beautiful Bill passage, and I think that's

going to create some tailwinds into 2026; and then, ultimately, the immigration policy, or I tend to prefer to call it reverse immigration. So we're seeing all of this play out and I think that's going to continue.

Is this an underappreciated risk by the market? Do you think that the political golf in this country is an underappreciated risk by the market?

Anne Walsh: Well, I think we have to sort of separate markets from politics and policy and obviously even the real economy. They have combined effect, but they're operating in almost a siloed fashion. The disparity, or the, you know, discourse with regard to policy and politics, that's going to continue and that's going to create headline volatility. But I think the market is looking through that, whether you're talking about fixed income markets or you're looking at equity markets in particular, you're looking at Fed policy. Markets are considering a whole lot more factors and they're looking at the fundamentals separate from the narrative that we see at the headline level.

Let's talk about some of those fundamentals then and let's start with the Federal Reserve. Former Fed vice chair Lael Brainard today talked about the challenge that is right now before the Fed. So I want you to listen to what she had to say and then we'll talk about it. What do you think is going to happen here with rates?

Anne Walsh: So, we're at kind of a delicate time because we have had the government shutdown. We don't have the usual data sources for the Fed to point to, and they like to claim to be data dependent. Having said so, they also look very much at anecdotal evidence and in particular the Fed's Beige Book which seems to indicate a slowing down of the economy to a level that I consider more equilibrium. And if we're in more of an equilibrium, which is a sub 2 percent real rate of growth, then I'm looking at real rates of interest that should be lower. The neutral rate should be lower. And so let's just assume the neutral rates at 3 percent level. So for the Fed to continue to cut rates to 3 percent, they have some

more cutting to do. I'm of the camp that I believe that they actually will cut in December. Because I look at that Fed beige book. And it seems to indicate a lot more slowing and fraying around the edges. In particular, one area that we've watched all year long and we'll continue to watch, is sort of what I call the bifurcated economy. There's really two speeds that are happening in the U.S. economy. One is the lower end consumer and the small business market, and the other is the high end consumer and the larger companies with access to capital and the ability to, you know, particularly benefit from the AI trade, for example. And so as a result, we've had this two speed economy. And the Beige Book really represents this broader level of the economy, and it's really becoming much more sluggish. And so as a result, I think ultimately the Fed will say neutral, probably lower than it is now, probably closer to 3 percent. And, you know, the idea of actually cutting rates makes sense. And I still also contend that we're going to see more rate cutting in 2026 as well.

And you think that the sluggishness in the economy will take care of the inflation issue, because that hasn't gone away.

Anne Walsh: Right. Well, one of the other elements about this bifurcated economy, of course, is that portions of the economy that are particularly sensitive to interest rates. So the interest-sensitive parts of the economy are also slowing down, housing, in particular, and the cost of housing is actually declining, although that's not much reported. The last CPI number—the one that we actually got to see—seemed to finally indicate the owner equivalent rent portion of CPI had finally started to move down and I think that's going to make a big difference. So while I believe that the rate of disinflation has slowed, the trend is still towards more disinflation which will then also be supportive of further rate cuts.

We are going to get a change in leadership at the Fed next year. Who do you think is the best choice to lead the FOMC next? Are you concerned about the White House leaning on that person when it comes to policy decisions?

Anne Walsh: Well, a few ways to look at the selection process. One, I think that the panel of nominees that are being considered are all pretty well qualified to be Fed chair. I have my particular favorites.

Do you want to tell us who they are?

Anne Walsh: Well, you know, I actually happen to be a big fan of Kevin Warsh. And I would be biased because he's more of a monetarist and I do believe money supply still matters. But Miki Bowman's amazing, and maybe more of a dark horse is Kevin Hassett, and then I'm a big fan of Chris Waller as well. So we have a good selection of potential candidates. And notice I sort of pick more of the economist background personalities if you will. Having said so, I believe ultimately, it's not the first time we've seen political pressure put on Fed Chairs. We go back to Nixon, we go back to Lyndon Johnson. There's a long history of presidents trying to put pressure on the Fed chair. And strong Fed Chairs are important. Independence is important. But let's remember the Fed is also subject to congressional oversight—so not fully independent from policy oversight. They have two mandates. The dual mandate of stable employment and stable prices is still part of what they're obligated to work towards and engineer. Having said all of that, no matter what happens, I think we are looking at a more dovish Fed composition. And that means we're back to my concept of and belief in a much lower neutral rate going forward, which should be helpful for the interest-sensitive part of the economy, the lower end consumer to some level, for example, along with in 2026, some tailwinds that we're going to have, particularly the One Big Beautiful Bill. There's some tax benefits in there that will also be rather stimulative. So I think all of this keeps us out of any kind of recession risk, but it lends us to more of a neutral policy.

How are you thinking about this whole bubble question and how to strategically invest in AI right now?

Anne Walsh: So I'm a big fan of technology in the long run, and I believe artificial intelligence will ultimately be a technological game changer. But it has to play out. We're still in early innings. The huge amount of investment that's being undertaken right now is in what, you know, the blocking and tackling. The chips, the infrastructure buildout, the data centers, and ultimately the power needed to power all of this into the future. The applications, the work streams, the usage of AI has to broaden out into the entire economy. And that's going to take some time. So in the long run, I'm very positive. In the short run, in terms of just equity valuations, you know, the question is are we in a bubble? And I think if you look back to it, the number one comparison timeframe, which was the internet bubble in the late 1990s, you were looking at valuations that were so extreme because you didn't really have any earnings. Now you have earnings. And I think the risk or the concern is, are we going to now pile on quite a bit of debt to build out the infrastructure for artificial intelligence into the future? And I think that's something to watch. But I don't believe that we're there at this point in time. I think there's more for this market to run and I think technology will continue to drive a lot of stock market performance.

So on the corporate lending side, you don't yet see that sort of reach for risk in terms of this buildout?

What kind of warning signs would you be looking for?

Anne Walsh: So I get asked this question a lot, particularly with regard to private credit, which is where are we in the cycle. And what I say is there's cyclical risk and then there's structural. And cyclical risk is what happens late cycle in the economy when the economy slows down. There's more bankruptcies due to businesses failing. Usually recessionary pressures. We're late cycle, but we're not really there in a recessionary environment. Structural happens when you end up with too much lending to overleveraged entities. And you also end up with weakened covenants. Investor protections go away. And when you get a few headlines like, you know, like tricolor, for example, or first brands, you get

people questioning, are we having structural risk or is this still cyclical? And I would say it's still more a little bit cyclical, as those particular companies tend to start to have problems late cycle. But we don't have what I consider to be at this point in time, a structural widespread risk, and I'll say yet. But that's what I would look for and what I look for in the future.

And you have a great analogy to explain at these cyclical times when people reach more for risk.

Anne Walsh: Well, I think actually what ends up happening is people don't examine where the collateral is, what the underlying value is. And my analogy, it's a little rough, but you can take a Tiffany's box and it's beautiful and it's gorgeous and they put a pretty bow on it. But if you fill it with dirt, there's no diamond ring inside, it's just a box with dirt in it. And I think that's what lenders and investors have to be aware of is, know what you're investing in. And do more than just look at the outside and assume that everything is okay. Really do the diligence. Select your asset manager carefully and you know that they're doing their diligence.

What do you do when you're not doing this? What do you do to relax?

Anne Walsh: Well, I read a lot, and actually, I do get to play some golf. So I get to spend time with my family and we're all golfers. And it's a good way to come together and enjoy a beautiful afternoon. So yes, there actually is, from time to time, some downtime.