

Matt King 30 October 2025

# The blinkered Fed

- In a narrow technical sense, the FOMC was indeed hawkish
- But in the cessation of QT and through questions, it more broadly reconfirmed a reaction function at once deeply asymmetric and completely oblivious to asset price inflation
- This paves the way for a further melt-up in risk assets and havens and for more assets to exhibit the sort of exponential sawtooth boom-bust recently seen in gold

Markets' immediate reaction has been to see the FOMC meeting as hawkish – with simultaneous selling of bonds, gold, CHF and equities.

Given the narrowly technical terms which the Fed likes to frame its decisions, and relative to prior market pricing of a December cut being a 'done deal', this reaction is unsurprising.

But the longer-term driver of 'easy money' or debasement trades was never just a question of the timing of the next rate cut or two – but rather the question marks hanging over the Fed's broader policy framework, especially in the light of increasing political pressure from Trump.

In cutting, in ending QT and above all in Powell's consistent downplaying of bubble risks in markets, the Fed is effectively reconfirming a long-standing bias towards deeply asymmetric policymaking. Far from being hawkish, the Fed has effectively given a green light to a further melt-up in both risk and havens.

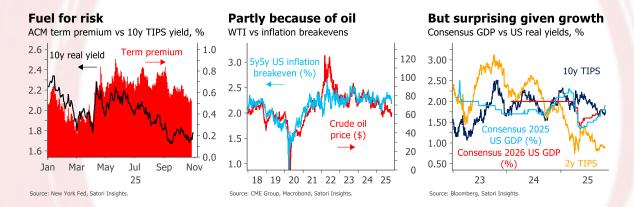
This piece examines the evidence that, both on rates and on QT, the Fed's narrow desire for 'technical' policymaking based on the real economy and money markets risks compromising their long-term credibility and contributing to financial instability.



### **Inefficient markets hypothesis**

The most striking feature of market moves in recent months has been the simultaneous rally in US real yields, risk and havens. Just as striking was the way all three reversed yesterday in response to Powell's so clearly pushing back against a December cut being a 'done deal'. It wasn't just that the dollar rallied; it was that gold, CHF and risk sold off.

Some of the prior yield rally has come thanks to the decline in oil prices – but it has felt like more than that. Term premia have also declined – albeit by much less than real yields – and USTs have outperformed vs swaps. As Powell noted, it looks especially incongruous when viewed against simultaneous rises in growth expectations. And as the unusual correlations make clear, it has felt at least like an expectation of easy money – if not of some form of outright yield curve control.



But even as he pushed back against near-term easing expectations, in reaffirming the Fed's narrowly technical focus on the balance between hopefully one-off inflation effects from tariffs and the evidence of a slowing labour market, Powell did little to dispel the bigger picture questions accumulating around the Fed's longer-term credibility. As the additional dissent helps make clear, the decision to cut rates with inflation above target, although defensible, is also contestable – especially with a base case of further tariff-driven increases ahead.

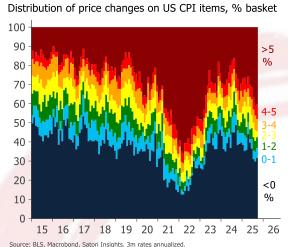
<sup>&</sup>lt;sup>2</sup> Acknowledged by Powell but also potentially quite long and drawn-out: see <u>A note on tariffs from the real world</u>, J. Cochrane, 26 Oct.



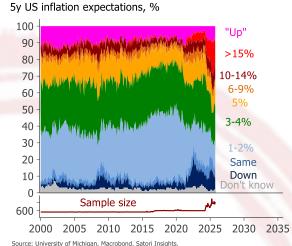
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<sup>&</sup>lt;sup>1</sup> Is the Fed's Inflation Target Still 2%?, C. Crook, Bloomberg, 29 Oct.

#### An unusual backdrop to rate cuts

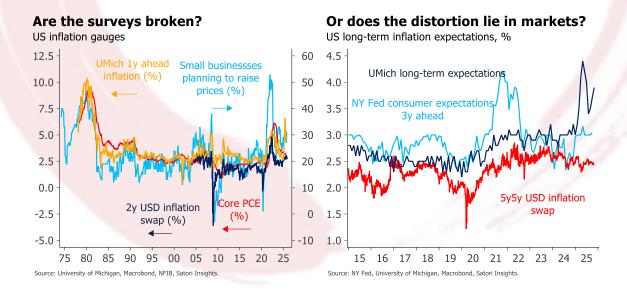


#### Even more so given expectations



The real question marks for most investors revolve not around the immediate rate outlook but around the Fed's interactions with markets – and with their persistent reluctance to acknowledge the impact their actions may be having on them.

Consider, for example, the increasingly stark mismatch between market- and survey-derived inflation expectations. As usual when there is divergence between markets and the real economy, the Fed's – and most economists' – presumption is usually that "markets must be right". But Powell's repeated assertions that inflation expectations remain firmly anchored at or near 2% seem increasingly at odds with the data.



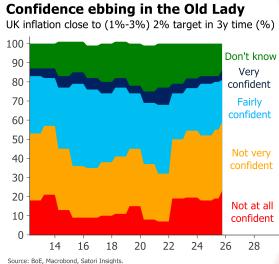
<sup>&</sup>lt;sup>3</sup> "I consider survey-based measures of inflation expectations unreliable, and the market-based measures that I watch have remained firmly anchored". *The Case for Cutting Now*, C. Waller, 17 Jul.



In this case we have some sympathy with the view that surveys may be unreliable: like everything else which has moved online, they seem to be becoming more extreme. But simply dismissing the surveys also ignores the possibility that markets themselves, from the level of real yields to the extreme valuations of risk assets, may be being distorted.

If there is one thing market participants agree on, it is that risk premia everywhere seem unusually compressed, and that markets are behaving oddly.<sup>4</sup> It seems short-sighted to dismiss out of hand, as Powell did,<sup>5</sup> that central banks may be playing a part in this. Even in jurisdictions where governments are not piling explicit pressure on central bank governors to out-dove one another, a willingness to overlook such evidence may be guiding central banks towards overly easy policy at the expense of declining credibility: look at the Bank of England.





### **Un-balanced** sheet policy

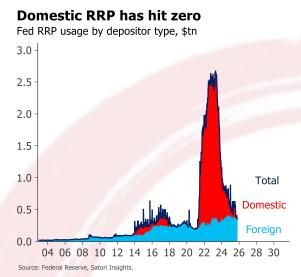
But if the case for rate cuts is contestable, it is when it comes to balance sheet policy and asset price inflation that we think the narrowness and asymmetry of the Fed's approach, coupled with a belief in the efficiency and primacy of markets, is most damaging.

Here too, it is perfectly easy on narrow technical grounds to explain the decision to abandon QT. With the buffer provided by domestic RRP having hit zero, ongoing QT has (finally!) been bringing down reserves, and has been amplified by recent increases in the Treasury General Account.

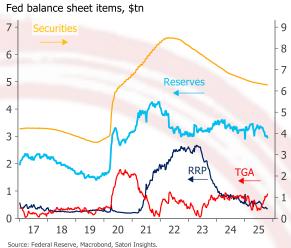
<sup>&</sup>lt;sup>5</sup> "We don't set asset prices: markets do." Powell's FOMC response to a question from Mike McKee, 29 Oct.



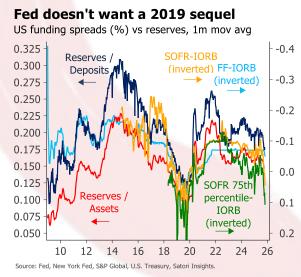
<sup>&</sup>lt;sup>4</sup> Replay: The limits of easy money, M. King, 23 Oct.



#### So TGA+QT have finally started to bite



This has led to spikes in money market rates, not only around month- and quarter-end but even intra-month, which the Fed finds unpleasantly reminiscent of 2019. They suggest that reserves have fallen to levels where the slope of demand has moved from being 'flat' (indicating an abundance that can be eroded without affecting market interest rates) to upward sloping (meaning that reserves are merely abundant and that further declines may cause market rates to spike). Stopping QT is, in the Fed's mind, a near risk-free way to reduce the likelihood of such spikes, with minimal downside.6



### **Even if the RDE metric has decoupled**

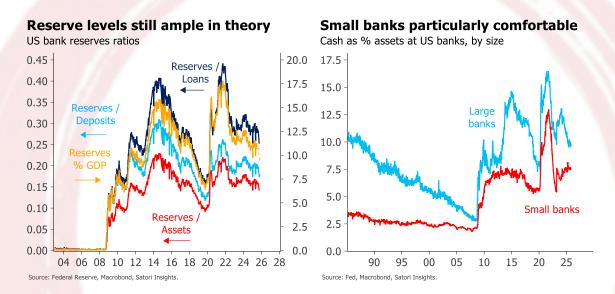


Source: New York Fed, Bloomberg, Satori Insights.
\*Fed Reserves Demand Elasticity metric designed to spike

<sup>&</sup>lt;sup>6</sup> As Bill Dudley puts it: "The Fed has unlimited capacity to expand its balance sheet, either by purchasing high-quality securities or by lending against them. In doing so, it provides bank with an assets - reserves - that has no liquidity, settlement or interest-rate risk. This makes the system more stable and monetary policy operationally simpler than in a scarce-reserves regime." The Fed's \$6 Trillion Balance Sheet Is About Right, Bloomberg, 28 Oct.



Admittedly it is a bit surprising that, even as market rates have been spiking higher, the Reserves Demand elasticity metric the Fed devised explicitly for the purpose has been showing reserves not only to be abundant but becoming more so. And reserves levels on most metrics remain some way above the thresholds that it was previously suggested might indicate tightness – particularly at the small banks which (after SVB) might be thought more vulnerable.<sup>7</sup>



An alternative – and we would argue better – approach might have been to continue with QT, conceivably at a slower pace, whilst announcing TOMO operations around potential stress points or reducing rates on the SRF (as JPM strategists have advocated).

But we think there is a bigger picture issue here which risks getting lost in the minutiae. Michelle Bowman's advocacy of a "Limited Footprint" for the Fed<sup>8</sup> seems to us very much a minority opinion. The majority is much closer to Dudley ("Why risk a repeat of the money-market turmoil of September 2019 when this is entirely unnecessary?"<sup>9</sup>), worrying about potential volatility and seeing next-to-no downside from a surfeit of liquidity. What harm can come from a little additional protection against negative outcomes? Powell seemed to echo this characterization yesterday.



<sup>&</sup>lt;sup>7</sup> For a potentially powerful counterargument – namely that large banks are instead the most important for short-term funding markets – see <u>US Banks and Global Liquidity</u>, R. Correa, W. Du & G. Liao, Minneapolis Fed, May 2024.

<sup>&</sup>lt;sup>8</sup> Thoughts on Monetary Policy Decisionmaking and Challenges Ahead, M. Bowman, 26 Sep.

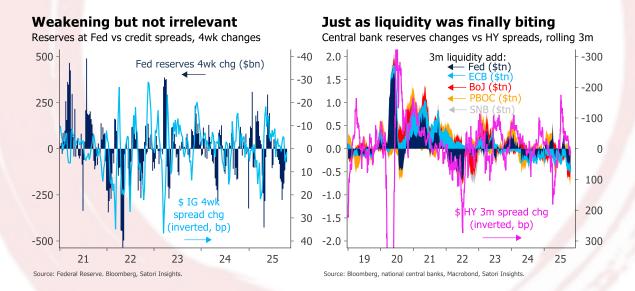
<sup>&</sup>lt;sup>9</sup> The Fed's \$6 Trillion Balance Sheet Is About Right, Bloomberg, 28 Oct.

It is exactly this asymmetric thinking, this refusal to acknowledge central banks' contribution to exuberant asset prices, which we think lies at the heart of so many economic and political controversies today – and which is ironically making its presence felt in some of the less conventional views of the potential replacements for Powell, even as they vie to out-dove one another on interest rates.

Perhaps the defining socio-economic feature of the last forty years is the way asset prices, debt levels and inequality have risen across most economies, even as growth, productivity and consumer price inflation have for the most part remained low. And yet downplaying the significance of asset price moves in general – at least until giddying price rises become giddying price falls – has been a hallmark of Fed policy for decades. As Powell's repeated ducking of questions about frothy market valuations helps demonstrate, the Fed seems likely to give us still more of the same.

### **Permission to party**

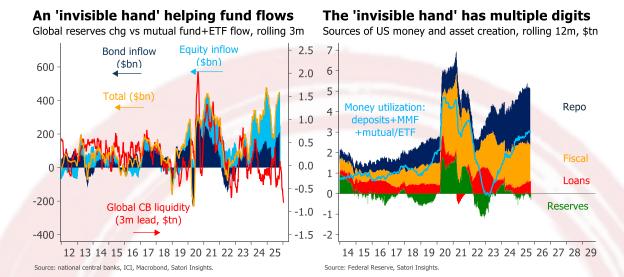
So what does this mean for investors?



The direct linkage between Fed and global central bank reserve changes and moves in risk assets has weakened in the past couple of years – but remains visible, particularly in credit and crypto. It is just that its short-term influence seems to have been overshadowed by an additional "invisible hand" pushing ever upwards – especially in equities and fund flows.<sup>10</sup>

<sup>&</sup>lt;sup>10</sup> Discussed in *Replay: The limits of easy money*, M. King, 23 Oct.





By ending QT and easing rates – even as financial conditions on some metrics are at their easiest since the extraordinary stimulus of late 2020 – the Fed seems likely to add to what many already consider 'froth' across multiple financial markets.

The main point here is not the direct linkages but the indirect signalling.

On our long-standing rules of thumb, the cessation of the Fed's \$20-30bn in net monthly reserves drain<sup>11</sup> is not by itself huge, equating to the removal of a force worth around - 0.5% per month on equities. The Fed's move also increases the likelihood of rate easing and QT reduction from other central banks, notably the ECB, and may at the margin provide stimulus for US loan growth and repo – even if in practice volumes have been influenced far more by structural and regulatory factors than by interest rates.

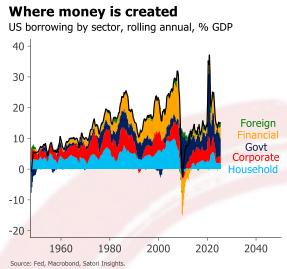
But the biggest force driving markets over the past couple of years has not been an unusual amount of money or credit creation relative to history so much as a disproportionate willingness on the part of investors to rotate the money created towards risk, most obviously in the form of equities, mutual funds and ETFs. Since 2022 almost no major investment sector has seen outflows.

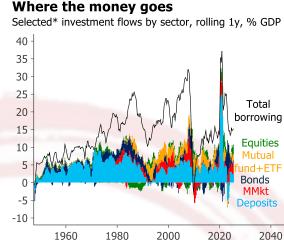
<sup>&</sup>lt;sup>12</sup> If anything, what stands out most on the credit creation side is the low volume of borrowing by households and corporates, with the total driven disproportionately by fiscal borrowing and the financial sector.



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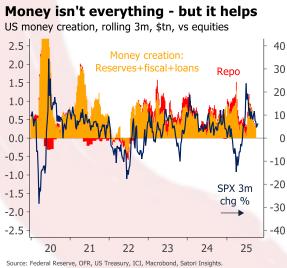
<sup>&</sup>lt;sup>11</sup> Before the influence of any changes in TGA and RRP.

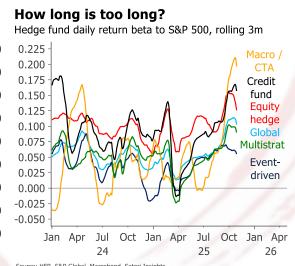




Source: Fed, Macrobond, Satori Insights.
\*Financial sector holdings largely excluded, for bond investments in particular.

In its narrow technical emphasis on avoiding money market spikes and on the outlook for CPI and unemployment, the Fed is effectively acknowledging that it will do nothing to stand in the way of a further melt-up in multiple markets – but would still be there to mop up if things went wrong and started to affect the real economy. A more concerned Fed might at least have made some mention of potentially tightening banks' countercyclical buffers, currently set at zero. As it is, ongoing fiscal stimulus and bank deregulation seem likely to continue providing the punch; the only question is how much investors are able to drink before they pass out.



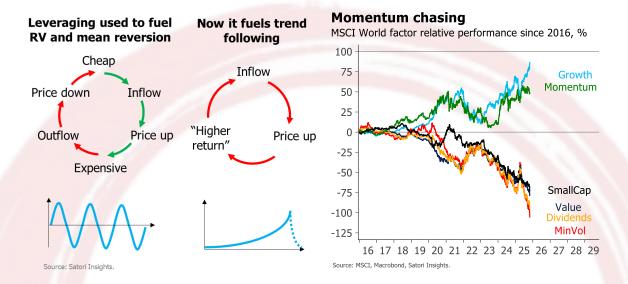


## Recipe for exponential sawteeth

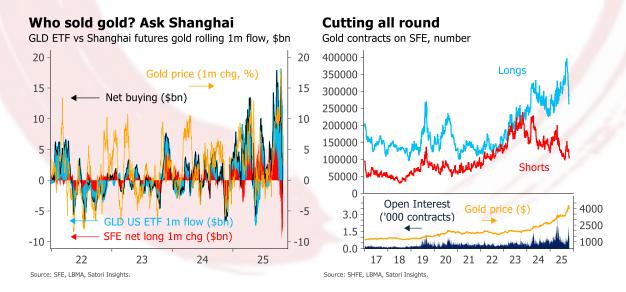
Beyond giving permission for a generalized melt-up, we think such a stance does more to encourage momentum-trading and herding than is widely recognized. Both leveraged and unleveraged investors alike have been forced away from value and mean reversion and



towards trend-following. It shows both in relative performance and in markets' price patterns.



The recent price action in gold has provided an archetypal example: an exponential rally with minimal volatility driven largely by FOMO, followed by an abrupt and ugly decline when momentum reverses. In gold, as it happens, we think the combination of intact underlying drivers and position cutting in China point to the rally resuming. And indeed our general preference remains for havens rather than risk assets. But the implication of a blinkered Fed – even before it becomes more politically biased – is that we should anticipate similar price action in more assets – and not always with a happy ending.

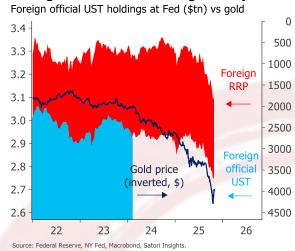


<sup>&</sup>lt;sup>13</sup> Though the accumulation of ETF longs outside China remains concerning and may need to be flushed out first. See our daily <u>UST-USD capital flight charts</u> for regular updates.



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### Foreign official UST selling to stay



### Lower vol, higher vol of vol

