

The End of Fed Independence?

As we go to issue this update, President Donald Trump last night shared that he had no intention of firing Federal Reserve Chairman Jerome Powell. However, we believe this doesn't change the administration's utilization of unconventional methods to achieve their goals, nor does it change the fact that Powell's term will expire in May of next year. This may render Powell ineffective in the eyes of the administration, keeping his (and the Fed's) independence a point of concern for markets. We believe the facts have not changed: the Fed will have new leadership in 2026. Let the campaigning for the next Fed Chairman begin.

Bottom Line:

In an era where unconventional is becoming the new norm, Trump has once again taken to social media to voice his dissatisfaction with Powell's monetary policy actions. Despite his assertion that Powell should be fired, it is unlikely that Trump will remove Powell from his position before his term ends in May 2026. **However, we believe the suggestion of a "shadow chairman" should be taken seriously.** A "shadow chairman" refers to a Fed Chair nominee making public appearances and driving a narrative prior to confirmation. In our view, this so-called "shadow chairman" would be aligned with Trump's objectives and desired outcomes. If this were to happen, the market may focus as much, if not more, on commentary from the "shadow chairman" than what Powell communicates. This could potentially undermine Powell's influence on markets. While we do not agree with this approach, and respect the Fed's independence, it would not surprise us at all to see this play out. The administration has proven thus far an ability to follow through on policy objectives, regardless of the disruption.

With this in mind, we find it prudent to take the administration seriously in their ultimate goal to lower rates. Treasury Secretary Scott Bessent's focus on the 10-year yield raises the question of whether an era of unconventional monetary policy could become reality under a new Fed Chairman. Something to consider.

The administration likely won't have legal authority to remove Powell, but they may find another way (even if it is controversial) to achieve their goals through the "shadow

chairman.” This is likely to lead to increased market volatility and uncertainty. In assessing the developing situation, we find it helpful to review the inner workings of the Fed below.

First, let’s review the facts:

Fed interest rate policy is set by the Federal Open Market Committee (FOMC), which consists of twelve people: the seven members of the Fed’s Board of Governors, the President of the Federal Reserve Bank of New York, and an annually rotating group of four of the 11 remaining Regional Reserve Bank Presidents. The seven members of the Board of Governors, as well as the Chair, are nominated by the President and confirmed by the Senate. The Regional Reserve Bank Presidents are appointed by a search committee composed of non-government directors, insulating these seats from political pressures.

A full term on the Board of Governors is 14 years, where the Chair and Vice Chair of the Board serve a term of four years, which can be renewed by the President. After their four-year term in a leadership role is over, a Chair or Vice Chair can still serve out their remaining term as Governor, though historically this is rare. Note, also, that the Chair and Vice Chair of the FOMC (which differ from the Federal Reserve Board) are chosen by the FOMC, **not by the President**. The formal powers of the Chair, of either the Board or the FOMC, aren’t much greater than those of a regular Governor or Committee participant. The Chair presides over meetings and represents the Fed before Congress, but the authority vested in leadership stems from the historical power that the Board or the FOMC normally affords the Chair. If Trump were to replace Powell with a loyalist, the rest of the committee could still select somebody else to lead the FOMC. In addition, the Chairman of the FOMC does not unilaterally control monetary policy. Monetary policy decisions are voted on by all twelve voting members, and a simple majority is necessary to implement actions such as rate cuts. If Trump replaces Powell, either in the next few months or following Powell’s exit in May 2026, **his nominee will not be able to change policy on their own**. Still, it begs the question: Can Trump actually fire Powell?

The current answer is: it depends. In a 1935 case, *Humphrey’s Executor v. United States*, the Supreme Court unanimously ruled that the president couldn’t remove a member of the FTC who was protected from dismissal due to political differences. Since then, most had thought that the case had settled any question about the job security of Fed Governors, ensuring the independence of the Fed and monetary policy. The current administration, however, is testing whether the precedent set in *Humphrey’s Executor* will be upheld by the current Supreme Court. Two members of independent agencies, the National Labor Relations Board (NLRB) and the Merit Systems Protection Board (MSPB) were recently fired by the administration. A lower court has ruled those firings unlawful, the administration appealed, and the Supreme Court has decided to hear the appeal. If the Supreme Court rules in favor of the administration, this could open the

door for Trump pursue Powell, but still wouldn't guarantee legal authority to do so. The Supreme Court could still opt to treat the Federal Reserve as a separate case. We consider the chances of both cases being decided in Trump's favor to be relatively low, due to the absence of "just cause" for termination beyond mere political disagreement.

We also entertain the question: would Trump even want to actually fire Powell?

If Trump fires Powell, it could be harder to deflect the narrative around potential bad economic or market outcomes from tariff policies. In Trump's mind, it could be beneficial to maintain a scapegoat amid the volatility of the recent policy actions. Moreover, the firing of Powell himself could become a negative economic or market catalyst that further deteriorates confidence in the U.S. By keeping Powell in his position and continually pestering him on social media, Trump may aim to more easily divert negative attention away from himself without causing excess market turmoil.

So if he can't or won't get rid of Powell before next year, what are Trump's options?

We have examined the potential of a "shadow chairman" emerging sometime as early as this fall. In this situation, would markets listen to the current chairman or the individual set to lead just a few months later? Given the forward-looking nature of financial markets, we are inclined to believe the latter. Bessent floated the idea of a shadow chairman before Trump won the election. While there hasn't been anyone confirmed as a nomination candidate, initial commentary highlights Kevin Warsh as a potential top pick. Warsh was nominated to the Federal Reserve Board of Governors by President Bush and served on the Board from 2006 to 2011, leaving on his own accord after disagreeing with the Fed's continuation of Quantitative Easing (QE) following the Great Financial Crisis. Trump and Warsh have reportedly already spoken about being Powell's successor, though Warsh has notably advised against removing Powell prematurely. He and Trump are aligned on key issues, including the view that government spending is a large driver of inflation, and that "the president inherited a fiscal and economic and regulatory mess, and it's going to take a little digging out to be on a stronger platform for growth".

Trump likely won't be able to fire Powell or restructure the entire Federal Reserve to align with his directives, but we expect some controversial actions will be taken to assert pressure and influence monetary policy. A threat to Fed independence would likely upend markets and erode confidence in the U.S., but actions taken to align fiscal and monetary policy are clearly a goal of the administration that needs to be taken seriously.

One last consideration: Trump campaigned and won on the prospects of reducing inflation from the elevated levels seen post-COVID. With consensus indicating that high tariffs are inflationary, we are examining the administration's desire to lower rates (focusing on the 10-year) to facilitate lower borrowing costs for the \$5.7 trillion of debt maturing before July of this year. This is something else to keep on your radar.

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