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The Fed's Balancing Act for 2026 (With Claudia Sahn)

KATHY JONES: I'm Kathy Jones.

LIZ ANN SONDEERS: And I'm Liz Ann Sonders.

KATHY: And this is *On Investing*, an original podcast from Charles Schwab. Each week we analyze what's happening in the markets and discuss how it might affect your investments.

LIZ ANN: Well, hi, Kathy. So this is a big one. We have several significant announcements to start off this episode. The first, very exciting, that we have Claudia Sahn back on the show. Kathy did the interview. And the second, bigger, for me, sadder announcement is that you are taking a well-earned retirement soon.

KATHY: Yeah, that's right. Thanks, Liz Ann. And it has been so much fun doing this podcast with you that I almost didn't retire. But upon further reflection, I think it's time for me to step back and enjoy a little slower pace of life.

LIZ ANN: Well, I think we probably should do a show at some point on retirement and bring you on as a guest, Kathy, and tell us what you're doing in your retirement.

KATHY: OK, well let me figure out what I'm doing and then that will be fun. But yeah, this is my last interview for this show and I'm excited about it because we have a wonderful guest in Claudia Sahn. We'll push along for now and then next week we'll have a little bit longer conversation about it.

LIZ ANN: We sure will. So you will be back next week and it will be a special *On Investing* episode to feature you and have you reflect back on lessons learned over the years in this business over the decades. So this week isn't really goodbye. We will save that for next week.

KATHY: And we have another bit of good news, and that is that our friend and colleague, Collin Martin, will be taking over as co-host of this podcast. He is the managing director and the new head of fixed income research. He's been a good

friend and a colleague for, I want to say going on about 20 years, but I don't think I want to date either one of us, specifically.

But I think he's going to be terrific co-host with you and he's here with us now. So Collin, thank you for being here and thanks for taking over as the co-host of this podcast.

COLLIN MARTIN: Yeah, well, thank you both. I'm really excited at this opportunity. You know, I've joined as a guest before, but I'm really looking forward to co-hosting with you, Liz Ann, so thank you again. I think it's really exciting. The two of you have done a fantastic job, you know, building this podcast over the years, along with the fantastic podcast team you have, and I'm really hoping to just keep... keeping that momentum going.

But, but Kathy, really thank you to you, you know, Liz Ann, you said, you she was, you were sad to mention this news. I share that sentiment. It's, it's bittersweet. I won't date us anymore, but we've known each other for, we'll say 20 years, but I've worked with you at Schwab here for my whole Schwab career going on 14 years. And you've been just a fantastic leader, you know, for me and our team. You've been a fantastic mentor to me and others throughout Schwab and just a fantastic friend. I know me and the team are going to miss you. I know our clients at Schwab will miss you. Regular listeners of this podcast will miss you. And I just want to say thank you and we all wish you the best of luck in retirement.

KATHY: Thank you, Collin. Very kind words. Thank you. I appreciate it.

LIZ ANN: Well, as you start to wind things down, the market is maybe not cooperating by letting you depart with an incredible amount of calm, at least not in my world. As we're recording this, the prior day was a pretty ugly market day, and we're still digesting the aftermath of the Supreme Court ruling on tariffs going through the International Emergency Economic Powers Act, IEEPA and what the future looks like.

As we already know, President Trump the next day announced in the second step a move up to 15% across-the-board tariffs through Section 122, is also discussing other sections to use to get the tariffs across. There's a lot of focus on "Will there be refunds?" There have been companies already that have announced that they are filing lawsuits. So that's going to be a complicated process. And then yesterday, again, as we're taping this, we had an ugly day driven by a report that went viral.

The sell-off has been called the Citrini sell-off. And it's a report, kind of a big-picture report on AI and what the likelihood is of it being incredibly disruptive. And it was

written in memo form from the year 2028, talking about an incredibly high unemployment rate and the market being down 40%.

Interestingly, subsequent to that, there was a rebuttal that came out from a different firm that's now equally going viral and it sort of takes the other side. So it's like we got the tail risks and opportunities on AI in back-to-back days with these reports. But that's the nature of the beast with how viral some of these things can go and it certainly had an impact on the market as we're taping this pre-open. It looks to be a bit of a recovery day, but my bottom line is I think the market is likely to continue to have these bouts of volatility. You're seeing incredible amount of churn and rotation under the surface.

The indexes have not had any significant weakness. The S&P 500's maximum drawdown at the index level is only 3% so far year-to-date, but the average member within the S&P has had a 12% drawdown. So that is correction territory. More extreme for the NASDAQ at the index level, NASDAQ hasn't had any more than a 6% drawdown, but the average member has had a 25% drawdown just on a year-to-date basis. And it's just happening through churn and rotation and all else equal, given what we know now, lots of qualifiers these days, I think that type of churn and rotation under the surface is going to persist. A little more calm in your world.

KATHY: For sure, the bond market continues to be very stable over the last couple of months. And I think it's still caught between these various forces. As you mentioned, there's the of the doomy outlook of "This is deflationary, it's going to kill the economy," and that is supportive of the bond market because people say, "Well, then I'll just be in bonds because rates will come down and there'll be deflation," and that's good for bonds.

And then you get the offset of the reality that we still have high inflation, that the Fed's not cutting rates, and now we have the prospect of potentially higher tariffs which lift prices. So I think the market's really caught in this kind of seesaw between the current fundamentals and whatever the future looks like, the uncertainty about the future.

But on the Citrini thing, look, doom sells, right? How many times over the years have we read the gloom and doom scenarios? And the truth is that occasionally really bad stuff does happen to the economy and to markets. And it's something certainly to not ignore.

On the other hand, a lot of times this is just a thought exercise that people go through. And the more you know about the potential tail risks, the more you can do to avoid them. So I'm not taking it too terribly seriously myself, just observing that

we're at a point where markets are very, very jittery about a number of things and chaotic policies are part of that and a very unstable geopolitical environment and you throw this in, and, you know, you're going to get some reaction. So for now, I'm just going to put that aside and I think that's what the bond market's doing. It's focused much more on incoming new Fed chair what his plans are whether he can implement them and that's part of the conversation that I had today with Claudia Sahm.

LIZ ANN: As I mentioned before, we do have Claudia on the show this week. This is actually her third appearance on our podcast, but for people who may be hearing her for the first time, why don't you introduce her, Kathy.

KATHY: Yeah, she's a former economist for the Federal Reserve, former economist for the White House Council of Economic Advisors. Claudia Sahm is now chief economist for New Century Advisors. She's a regular guest on Bloomberg News, CNBC, MSNBC, and many other places. She's the founder of her own advisory firm, Sahm Consulting, S-A-H-M, and you can keep up with her on her newsletter called Stay-at-Home Macro, which, by the way, matches up with the letters of her last name and you can subscribe to that for free at stayathomemacro.substack.com, and we'll link to it in the show notes.

Claudia and I had a good conversation about many, many topics that are pertinent today, including some of these AI-related, artificial intelligence-related topics such as LLMs, large language models, what the impact might be, so it does link into some of this concern that we're seeing about what the economic impact might be of some of this AI-related development.

Claudia, thanks for being here.

CLAUDIA SAHM: Thank you. Happy to be here today.

KATHY: So let's just jump into it, because there's so much going on right now to talk about, from what's going on in the economy, what's going on with Fed policy, what's going on globally with various policies. So I'm just going to start out where we sit today. Where do you think the Fed goes from here in terms of setting policy?

CLAUDIA: I think the Fed is going to be very deliberate with their next move. So... and that's really a good news story. We are seeing some signs of the labor market stabilizing, not quite as worrisome, though I mean, got to keep an eye on it. But we got some signs with the last jobs report and really the end of the year in general, the labor market data looked a little bit better. And so that takes some of the urgency out of needing to cut, to try to like, you know, get ahead of downside risks to the

labor market. So the fact that they went into a pause in January, I suspect that's where they're probably going to stay for a while.

And I, for one, am looking forward to the next cut being a good-news cut, if we've seen some real progress on inflation. I don't think we're... we're not there yet. And I think it probably is really into the middle of the year, maybe a little bit later before we can see really consistently inflation moving back to 2%. But I think that's...the Fed's in a place where they can hold and kind of wait to see some of that good news data, but always a watchful eye. They may pivot, things happen in the world, as we know. And I think they're certainly going to defend this labor market. Inflation is elevated, it's higher than they want it, but this is not the kind of inflation that you go after a recession to get the last bit down.

And they've consistently shown us in the last two of their kind of sets of easing, that it was the labor market that got them off the sidelines to cut. So I have a lot of confidence they'll step in if they need to with the labor market, but I actually think the past is one where they're patient, they hold, and then we get some good news cuts. Of course, there's a few things that are going to be happening at the Fed this year with a change in leadership. So I mean, things could go in a little different direction, but I honestly think the base case for the Fed is being patient, deliberate, and moving when we see that good news on inflation.

KATHY: Well, that sounds very central banker-ish, right? They like to be deliberate and fact-based and despite all the drama going on around the Fed. But I do want to pick up on your comments on the job market, because it seemed to me it's been a bit of a conundrum. It's kind of like been frozen for a while. So maybe a little bit of improvement, but not convincingly so. I don't feel like we can all say we're out of the woods in terms of unemployment.

On the other hand, it doesn't seem all that bad. Unemployment rate is low, hiring is low, but the supply of labor is low. If you're sitting in a seat at the Fed, how do you look at this? How do you make sense out of that with respect to the mandate they have?

CLAUDIA: More than ever, like really trying to grapple with the data. The thing that I'd underscore is just how unusual what is happening in the labor market is. And frankly, we've been seeing unusual things in the labor market since the pandemic. So this is not like a completely new... it's been shifting around, but you know, it's really tough to like rely on your models or your theory when you're in a space where it's like, "Yeah, we haven't seen this before."

And just to give one example of how this is so different, so over the past 2.5 years, the unemployment rate has gradually drifted up. It's been very slow, but is now a full percentage point off of its low after the pandemic recovery. You go back to World War II, that does not exist. Like, you don't see that size of an increase in the unemployment rate outside of a recession. Now what's been different here is it's been very gradual, right?

Like the recession indicator that's named after me, the Sahm Rule, the logic behind that is once you start seeing small increases up to a certain threshold of like a half a percentage point, then it really takes off. That hasn't happened. But they didn't reverse, they just, you know... so we've had this very gradual drift up in the unemployment rate, which I mean, frankly, probably comes from... we had a job full recovery. We had labor shortages early on. Probably the unemployment rate got pushed lower than was what's sustainable. So some of this is recalibrating, but it's also really unusual. And so you kind of look at this and it's like, "Well, there's a reason why we kept talking about recessions and like they didn't happen." That's good. And then I also look at it's like, "Well, maybe, maybe that's what a soft landing looks like." That's also a very unusual thing.

You know, we talk a lot about the Fed not acting soon enough, inflation getting out of hand in 2021 and 2022. And that is legitimate criticism. But inflation has come down a lot, and we didn't have a recession, which is also very unusual. So maybe that's what it looks like. So I think that's one where you have to just be really watching the data, looking at the patterns, trying to test out different hypotheses, having an open mind about what can happen with the labor market. So that's where I think I have a cautious optimism about where we're headed, that there'll be stabilization.

I see that sentiment with many, not all of the Fed officials, but I also will agree that where we're at right now, this low-hire, low-fire environment, in addition with pretty solid growth in the economy, an economy that's expanding, right? These are not typically things that fit together. This doesn't feel like we're on the glide path, like this doesn't feel like a sustainable setup, like something is going to switch. Either hiring picks up because the economy has been growing or maybe the growth we've seen in the economy wasn't really there. Maybe some of this revises away or it just, it kind of, you know, sputters out and activity looks more like the low hiring. So there's just a lot of questions about which way this goes. So I think like kind of thinking in scenarios as opposed to getting too wedded to your, like, base case of what's happening is probably the right approach.

KATHY: One of the things that I think... I know you've written about quite a bit and you've talked about quite a bit that I think is important is this the quality of the data

we're getting, the quantity of the data we're getting, what's happening at the Bureau of Labor Statistics when we had a time period when nothing was getting done and they tried to make up for it and we've got these big revisions, which I know are... revisions happen because you get more information.

It feels like, though, we're in kind of a new Never Never Land in terms of the response rates to the surveys, questions about the quality of the data that we're getting and how the BLS is going to function and deal with that. Do you think members of the Fed who are using the data are now increasingly looking at other sources of information outside of the traditional labor market indicators or are they just relying on, you know, primarily on what we get from the BLS?

CLAUDIA: Right, so when I started at the Fed in 2007, pretty early in my careers on the staff's macro forecast, I likened the Fed to like a Hoover vacuum of data. Like that they just... we went out and we grabbed all this data and there's a lot that's, you know, processed internally and you really, in the discussions of Fed officials or even the research that comes out of the Fed, it's kind of the tip of the iceberg, right? In terms of what is actually looked at inside of the building.

And I will say in 2016, there were a whole set of kind of big data projects that were kicked off at the Fed. And I had the privilege to work on one that was looking at creating real-time retail sales indicators. And there was another at the time using the ADP data. That's a research the Fed's continued to work on. So the Fed's been in the business of getting all the data it possibly can. It's inference, like how do you interpret data? And you learn that data have different levels of quality and you need to understand how they're put together and you need to understand their weaknesses and their strengths.

And so I think really the people at the Fed have some of the best ability in the business to read the data. That doesn't mean that they always like have the right interpretation and the data certainly still have holes. But I think that's long been a view. "Go get all the information you can and see what you can do with it."

Now, it is the case, like the statistics that we have from the federal government, these are still the absolute best statistics. The US statistics are world class, right? Like that even with their flaws, even with under-investment in the statistics, that's still the place. But we can't be cavalier about that. Like, I am concerned that even in, like, the last year, the pace at which the statistics were degrading in terms of lower response rates, samples being cut for like the CPI because of budget constraints, because of the government shutdown, we missed a whole month of CPI and the unemployment rate. That hasn't happened again since those series started after World War II. So there's just been, there's a lot of pressure on the system. And then

there's also worries about, you know, interference. We had a Bureau of Labor Statistics Commissioner fired by the president.

So, it's been kind of a rough year for the data, but I do think they're still very high quality. And one thing that I think is so important is when we see these big revisions, there's a tendency to be like, "Oh, BLS, they're asleep at the wheel. They're making mistakes." And it's like, "No, we need to pay a lot of attention." When there are big revisions, what that usually means is something big is happening in the economy, and it's really hard to measure it in real time. And so then the revisions are actually us getting a more quality measure of it. So like we shouldn't go after the BLS and be like, "What are you doing, measuring...?" But we should be like, "What's going on in the economy?" And like really kind of go into that. But it's, but I understand why people... it's frustrating. Like, nobody likes revisions. You tell your story and then all of a sudden you find out, "Nope, that wasn't right."

KATHY: Well, it's not that the revisions weren't expected to some extent, either. I mean, most of us knew there would be revisions, just not the magnitude that we saw. But I do want to have you touch on something you came close to talking about, and that is this sort of, you know, interference, what's going, the changes going on at the Fed, et cetera.

We now have a nominee for the chair role for when Powell's term is up in May and presumably Kevin Warsh will get the nod. He's talked a lot about reducing the balance sheet and I have to admit that I have gone through this in my head seven ways to Sunday as to how it could be done and clearly anything could be done. But when I come down to it I'm like, "Well, what are we hoping to accomplish here? What are we aiming for?" And I sort of say, "Well, yeah, we can reduce the Fed's footprint, but that's going to give us more volatility in the short-term funding markets." And is that really what, is really that a worthwhile goal or not?

But I'd love to get your kind of take on the whole balance sheet discussion and where it's going and where you think it might go given that not everybody is on board, or everybody at the Fed apparently is on board with the idea.

CLAUDIA: You know, Kevin Warsh has... you know, his focus on the balance sheet. I mean, this really came from his time as a governor at the Fed. You know, he was critical of expansions of the balance sheet, particularly the quantitative easing, particularly as it went into the QE2. So like starting to, you know, try to support the economy, not just stabilize financial markets. And he really made a career from when he left the Fed of being critical of that policy.

To me, I've always thought of it as like he was critical of using the balance sheet in that moment. Like he felt, you know, the Fed had done enough, there should be, you know, fiscal authority should step in, as opposed to just this, like, the size of the balance sheet. It does go back to like, why do we have a larger balance sheet, right? Like, it wasn't just the Fed decided one day to do a balance sheet, they were at the zero lower bound, they couldn't lower interest rates, the economy was in a bad place, you know. So I think there's kind of the like, what are we even talking about?

But then it is, I find it difficult from his commentary to really have a sense of why are we doing... like the compelling story. And I think this is one where the over time, because the Fed needed tools when interest rates were already at zero, they chose to use the balance sheet as part of that toolkit. And then we've gone through two large recessions with the... after the Great Recession and then also in the pandemic. So the balance sheet is much larger, though it has shrunk some. Then they went into what they refer to as kind of the ample reserves. So the Fed just operates now with more reserves. And that meant they had to kind of change the way they get like the federal funds rate to what they said they want it to be. I mean, it's really into the operations, kind of the pipes and plumbing of the Fed's monetary policy.

And so they switched to this ample reserves, how to do monetary policy, we have a lot of reserves versus before the great financial crisis, they did scarce reserves. Now, a switch from where we are at ample reserves back to scarce reserves would almost be like the Fed shifting its 2% inflation target. It's not quite up there, like with being that kind of like foundational, but it's close.

This isn't like, "Oh, do we do 25 basis points or 50 basis points?" Like this is a foundational kind of like, "How do we do monetary policy?" So to move the committee, which, you know, the Fed just did a strategic review, right? And they affirmed the balance sheet, the ample reserves. So for Kevin Warsh to move the committee, and then it would require a majority of the Federal Open Market Committee to move towards, back towards scarce reserves, that is a multi-year project of winning over the committee. And frankly, they've spent a long time thinking about the balance sheet and what the tools are.

I mean, that may be an intention. And on the margin, might be able to... if they reduce some of the regulation, maybe they can do a little more shrinkage of the balance. We might see some, a little bit smaller balance sheet... that really to get the balance sheet way down to really get that financial footprint of the Fed down, I don't see how he's got a path to that and certainly not soon, right? It would take a lot of personnel changes on the FOMC to get to a place where they're going to go down that. And there's a lot of risks involved in it. So it's kind of like you got to really make the case that it's worth it.

KATHY: So Claudia, you mentioned QE, quantitative easing, and we've had a couple of rounds of it over the years, but some of our listeners maybe don't remember, weren't in the markets at the time, weren't paying attention. Can you just kind of walk us through what is QE, and 1 and 2, and how did that all play out?

CLAUDIA: Right, and I think this is really important when thinking about Kevin Warsh, because he was at the Fed as this was going on. And I wrote about this on my Substack, trying to kind of contextualize like him as a central banker, because he's been one. So we don't have to guess. We can go look at how he was then.

But what the quantitative easing, and this is the expansion of the balance sheet, but it was done when the federal funds rate was already at zero. So this was in response to the global financial crisis in 2008, the Great Recession, they took the funds rate to zero, but the economy was still a mess and frankly, financial markets were still a mess, too. So then the Fed was like "What do we do?" And they decided to do these purchases of long-term assets. So going out, buying Treasuries, buying mortgage-backed securities with the idea of like also trying to get interest rates down. So give some stimulus to the economy.

The first round, what was quantitative easing 1, that... also, financial markets were still kind of rough at that point, too. So it had like a... it was both for supporting the economy, but getting the markets like, you know, all functioning and good. But by 2010, they had finished that initial purchases and the Fed was like, "Well, now what do we do?" Because the economy... the unemployment rate was almost 10%. Inflation was well below 2%. And there was a lot of concern that the Fed needed to do something.

And where they landed was doing Quantitative Easing 2. So, a second round of purchases and that when they put that in place in November of 2010, Kevin Warsh was not in favor of it. And he spoke a lot then about why he disagreed with doing that. And not much after QE2, he left the Fed and was critical of that and he explained in public his criticism of it. And the Fed did go on to do a third round of QE3 a little bit later in the recovery. So that was kind of the period.... and they did also quantitative easing, these kind of balance sheet expansions during the pandemic period as well. So it's a tool the Fed, you know, added to the alphabet soup of jargon from the Fed, but it really is important to me. I really do like to go back when we have this discussion about the size of the balance sheet. It's like, well, let's talk about why the balance sheet is the size it is. Because that's really... it goes back to like, "What does the Fed do to help support the economy or should the Fed, right?" There is an argument, this is what Kevin Warsh makes, that maybe it's a time where the Fed needs to step back and let fiscal authorities step in. So like these are really big, important questions. The Fed... and it's pretty interesting. He was there,

but he was very much outside of consensus in his view then and he continues to be so, but maybe coming back, you know, with new resources, fresh look, maybe he kind of shifts the thinking some but these are big questions for the Fed.

And my question back to Kevin Warsh is, "OK, you don't want to do a balance sheet expansion if we're at the zero lower bound, we're in a crisis. Well, what do you do?" Or really is it still that the Fed just should not do anything, which is a little like... that's not a comfortable position in my mind, because, you know we're not close to the zero lower bound right now, but we could end up back there again.

So it's like, if you don't like the tool the Fed's been using, that's OK. I mean, no tools are perfect, but like, what's your better idea? And that's the piece where I just haven't been able to find him engage on. But when you're in charge, you're going to have to engage on that, because people are going to look to you for solutions.

KATHY: Right, and you've been in those meetings as part of the staff, right? Where say, you know, you're a governor and you come in and this is a topic for a conversation. Your staff is going to produce a lot of research on this and probably it's already, as you said, produced a lot of research, so you basically have to convince the staff that everything that they've been doing is wrong so that they can convince the voting member that it's wrong. I mean, that's a huge task, as you say.

CLAUDIA: Yeah, I mean, the chair does have more resources at his or her disposal, right? So as a governor, Kevin Warsh had criticized using the balance sheet, but he had a more limited amount of resources as governor. As the chair, the staff reports to the chair, right? So he really has hundreds of economists he can set loose on these questions and have a lot of input in terms of staff analysis.

And there's probably some other levers in setting the agenda. One of the things the chair is of, you know, a key, you know, leader and is like, what are they going to talk about at the FOMC meeting? How are they going to frame up the vote? So like there, there is a lot of influence, but at the end of the day, like the Fed, it really is the day to drive what's happening in the world drive. Like it's just, so I don't, it'll be interesting, but you know, Warsh was, he was there, like he knows. This is how the Fed works. So he probably has some ideas about how to move the ball forward and we'll see. And I'm hoping that some of the rhetoric from his quote unquote campaign to be Fed chair is just that. rhetoric, but it'll be interesting. Like he has some ideas about how to change things.

KATHY: Fed watching is very interesting these days, definitely.

CLAUDIA: Sadly.

KATHY: Yeah, but I do want to shift gears a little bit because there's a question I really wanted to ask you about. There's this whole debate about productivity right now. Some of it centers on AI and how enthusiastic some people are about it and what the consequences of this technology will be. And we've had some pretty good productivity numbers before AI is really a thing, right?

I would say, in my estimation, it's hard to say AI is having a big impact yet on productivity. But what do you think about why we're here with the productivity numbers that we have, which seem to be pretty good? And do you have a view on AI and other technologies and what it might mean going forward?

CLAUDIA: Right, so one does always have to be really careful with like a quarter of productivity growth. It can be pretty noisy, but it is the case through the third quarter of last year, labor productivity was running at about 2% during the cycle. So starting at the end of 2019 up to that point, kind of averaging 2%, which was about 0.5% higher than it was in the prior cycle. So after the Great Recession 0.5% on underlying growth, that is a big deal, right? So that's, that's really important. and, and, and I fully, I agree with you. think very little of that is about AI, particularly the AI we're talking about with like chat and different kinds of LLMs, right. Like I do think there's been, there's other AI, but there's certainly some automation.

There's a few, I think probably leading candidates. One, as I talked about before, in the labor market recovery, we actually ended with labor shortages for a period. And so that really was an incentive for businesses to put more automation in place. Because we've seen productivity gains in the service sector, which is not like a place we usually see it, which is very much in line with businesses trying to find ways to save on labor. Because labor was costly, labor was scarce. So there's that.

We also saw a period of just an immense amount of movement in the labor market. So right now it's all about, it's low-hire, low-fire, and people aren't quitting. But there in kind of the early years of the recovery, we saw a massive amount of churn. And then what that can do, particularly if workers then stay on the job, is you've matched people better to their jobs, and then they gain some tenure. And so this could be the piece that right now we have an economy that like output is growing.

We're not adding more workers, but it could be we're able to kind of get more out of the workers we have because they've got more skills, they've got more tenure. You know, so like there's a... but that can't go on forever, but that could be part of the piece. I think there are things that have happened in this recovery and then expansion that gave us the extra lift on productivity. And so we certainly have seen more business investment, not just with the data centers more recently, but in this whole cycle, we've seen more business investment. And that really stands out

relative to, say, after the Great Recession, where we just did not have a lot of investment. And that business investment is such that, it's like the gift that keeps on giving because you're like creating the tools, the equipment that then make the workers more productive.

So like it adds to GDP when you do the investment and then it adds to GDP later because it's helping with the productivity piece. So I think there's a lot to be said for why productivity is somewhat higher. And then AI does have the potential and I'm going to think cautiously optimistic. I think it may just take a lot longer to have the wide, kind of economy-wide effects, but I could be wrong. I mean, that's a big debate about exactly how quickly the AI is going to affect labor markets and the economy. But I don't think much of it is in the aggregate data yet.

KATHY: Yeah, it's the... you know, maybe overestimating in the short run and underestimating in the long run, but we just don't know what the long run looks like. So I'm going to wrap it up with a question here. So, people like me have to do these forecasts all the time and update them for the economy. And it's only February and yet now I'm already trying to figure out, "Do we need to revise the numbers again?"

But when I look into the rest of the economy, we're getting some fiscal stimulus from the tax cuts and other incentives. We have an economy that's humming along at a real growth rate of 2% to 2.5%, which is clearly pretty close to potential in real terms. And we've got, you know... well, I would say it is not apparent to me that interest rates are hurting the economy in any way. So we have a policy that's at least neutral if not helping the economy. And so I look at all this and I say, "You know, the Fed is still expected to cut rates later in the year, but is there a case that maybe there's no rate changes here?" Maybe if these numbers continue as they do, we're just on hold for the entirety of 2026.

CLAUDIA: I think it's possible. I do think if inflation starts to move down more, not necessarily all the way to 2%, but start to move in that direction, I think they would cut. I think my base case is for, you know, two 25 basis-point cuts this year, which I think is pretty close to consensus in thinking. I don't think it's like big cuts in play. But I still think that the funds rate probably is a little elevated. But if we don't see the progress on inflation, I think they'd be very happy to hold where they're at. So, the Fed's probably not going to be the center of all of our attention when we think about what's happening with the economy, which is how they like it. They don't want to be at the center of attention.

KATHY: Yeah, that is probably... would be music to their ears right now to not be the center of attention of the financial markets. So, well, Claudia, thank you so much. It's

just an honor having you on for the third time here and really appreciate you taking the time and sharing your thoughts with us.

CLAUDIA: Well, thank you. I so very much appreciate it and good luck with everything in retirement. I'm so excited for you. And you've been a real inspiration for all of us in the field that try to get out and talk about the economy and markets, what's happening. So thank you.

KATHY: Thank you.

LIZ ANN: So Kathy, you're not actually retired yet. So I still get to ask you what is on your radar for the next week or so.

KATHY: You know, the next, as we're taping this, we're still waiting for the Producer Price Index data, that's always... any inflation data is important these days, but that's something we'll be keeping a close eye on. And then as we get into the following week, we're going to be looking at all the employment numbers again. So here we go again, trying to handicap where the jobs numbers are going to be coming out. We've got ADP figures, we'll get the whole host of job numbers. So that's going to be really important.

The other thing is that the Fed will release its Beige Book, which is kind of in preparation for these meetings. So we'll get to see what they were talking about and looking at before the last meeting. And then of course, just a lot of Fed speak that we've got tons and tons of Fed speakers out there getting a real range of opinions, which I think is very interesting. And they're a little less filtered, a little more salty these days than they used to be, which I appreciate, because it's good to hear very frank opinions about the various topics that are confronting the Fed. What about you, Liz Ann? What are you watching?

LIZ ANN: I'm glad you mentioned that about Fed speakers. I agree. I think it provides maybe more of a base level of confidence that there is not going to be any true meaningful threat to the independence of the Fed, given that we have seen a lot of diversity in opinions and it's not just showing up in the various speeches, but we've had more dissents recently. We have a wider array of dots on the so-called dots plot, which is individual members' expectations for where the Fed funds rate is going to be. We see it in a broader array in terms of economic projections. So I think we can rest on that a little bit as a sign that individual members are feeling emboldened to express their views and that not everybody is aligned in one direction.

The other thing is, you mentioned the labor market data, which is obviously important. And I think the next jobs report actually, again, comes on a Friday because we've had skips. We had the last report was released on a Wednesday. So we're trying to get back in the normal flow of things. But we also have Challenger layoff announcements. And I think that should be a little bit more front-and-center on the radar screen.

And then I'll also be focused on the ISM, which is the Institute for Supply Management, manufacturing and services indexes because we did see a recent pop back up into expansion territory for the ISM manufacturing index and everybody's wondering whether that is a sign of a new improving trend or whether that was maybe a one-time blip, so we'll have to see. And we also had a little bit weaker reading on services. So a bit of convergence that happened with the last month's worth of readings.

And then given that the most recent prior to the upcoming release of retail sales was weaker than expected, I'll have that on my radar, too. And then we also got a whole bunch of housing data.

So that's it for us this week. Thanks for listening. As a reminder, you can always keep up with us in real time on social media. I'm @LizAnnSonders on X and linked in don't follow one of my imposters, please follow me.

KATHY: And I'm @KathyJones on X and LinkedIn, and that's Kathy with a K. And you can always read all of our written reports, including lots of charts and graphs at Schwab.com slash Learn.

LIZ ANN: And if you've enjoyed the show, we would be so grateful if you would leave us a review on Apple Podcasts, a rating on Spotify, or feedback wherever you listen. And please tell a friend or more about the show. And we will be back with a very special episode next week. You do not want to miss that one.

KATHY: For important disclosures, see the show notes, or visit schwab.com/OnInvesting, where you can also find the transcript.