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Higher for Longer: Markets Navigate a New Era of Uncertainty (With Joe Brusuelas)

COLLIN MARTIN: I'm Collin Martin.

LIZ ANN SONDERS: And I'm Liz Ann Sonders.
COLLIN: And this is *On Investing*, an original podcast from Charles Schwab. Every week we analyze what's happening in the markets and discuss how it might affect your investments.

LIZ ANN: Hi, Collin, hope you had a good Memorial Day weekend. Hey, I wanted to follow up on something that you spoke about last week and in previous weeks, and that is a metric called the risk premium, and it's in the context of global bond yields, not just U.S. bond yields. And what we see the market is starting to price in, which is the hope for an end to the war in Iran at some point, hopefully soon. But talk a little bit more about that risk premium and how it's changed recently.

COLLIN: Yeah, we've seen it fluctuate a lot. I'm glad we're following up on this because I kind of mentioned it in previous episodes, but there's a lot of moving parts when we talk about what drives bond yields. And I think that's … we can kind of take a step back in that we have the fed funds rate, which is something we talk about that directly influences very short-term interest rates like Treasury bill yields. And then as you get further out and longer maturities like the 10-year Treasury, for example, its yield is influenced by expectations of Fed policy over the next 10 years. It's influenced by inflation expectations, growth expectations, geopolitical concerns, fiscal concerns, you name it.

So as you alluded to, there's this kind of generic risk premium. We call it the term premium. And one way to frame it is that it can be considered the extra compensation that investors require for holding longer-term bonds rather than just

rolling over short-term bonds or Treasury bills, because there's a lot of risks out there, and we don't know what's going to happen over the next 10 years or so. Now that term premium, which, full disclosure, it's hypothetical. It's theoretical. It's like model-based. But the model we look at has increased over the past handful of years. It bottomed at a negative number in 2020 but actually spent a lot of 2017 through 2023 in negative territory.

And I think there's a few reasons for that. And this … don't worry, I'm getting to my final point, Liz Ann.

LIZ ANN: That's all right.

COLLIN: I get very excited about these topics. Where we were versus where we are, and this ties in with a lot of things that you've been talking about. So think it's a really good topic. If we go back to a low-term premium environment that we had for basically this extended period prior to the past few years, there were two things that you can point to, I think, that kept that term premium relatively low. One is low, and then maybe more importantly, low and stable inflation, where we didn't really get inflation surprises. It was low. It was below the Federal Reserve's 2% target. So investors really weren't demanding higher yields to extend duration or to consider long-term bonds because inflation just really wasn't an issue.

And then I think a second reason is how the Fed went about its monetary policy, how the Federal Reserve went about its monetary policy, specifically with quantitative easing, or QE. When it purchased long-term Treasuries, it also purchased agency mortgage-backed securities, but that arguably pulled down the term premium and pulled down long-term yields as well, as the Fed was this big buyer. If we fast forward to today, inflation is … it's been high, but I think it's very uncertain.

There's … it's a cloudy outlook, and I don't think there's much clarity about where it's going to go over the next few years, you know, either directionally or in magnitude. And then also quantitative easing, or the idea that the Fed could be … you know, resume its asset purchases and buying Treasuries. That seems like a low likelihood, because with Kevin Warsh as the new chair of the Federal Reserve, he is notoriously not a fan of quantitative easing. So I think that that's been driving

long-term yields up, along with other things. Fed policy expectations have shifted. Inflation has picked up, as well, but I think this uncertainty premium is a key driver. And I think if I take another step back and think about "OK , well, what does the outlook look like over the next few months and years?" This might be the new environment we're in with a lot of uncertainty, especially around inflation and maybe we are in this, you know, quote-unquote "higher for longer" period where I

think a lot of market participants, because of the Federal Reserve holding near zero for so long, having a near-zero interest rate policy, I think that's behind us.

And I think maybe we're in this "higher for longer" period. Not that it needs to be exactly where it is, the Fed might tweak here and there, but I think that's a key reason. So even if we get some clarity or good news in the Middle East that can maybe bring energy prices down and maybe bring inflation expectations down, I'm not sure how much room there is for long-term yields to fall significantly because of that risk premium. So what do you think about all that?

LIZ ANN: Let me answer, Collin, in a slightly longer, with a slightly long-term perspective, and in the context of these secular eras that we often speak about and write about. So the so-called "Great Moderation" Era, and that was a term I think initially coined by Ben Bernanke, and it references the period, and different people have different starting points for when the Great Moderation period started, but somewhere in the mid-to-late 1990s.

And it carried until, call it the first year into the pandemic, first year and a half, until basically until the 2022 pandemic-related inflation spike. And it was an era, an aptly named Great Moderation because we had a fairly moderate backdrop in terms of inflation, generally disinflationary trends, but maybe more importantly, very little inflation volatility.
In turn, you had less economic volatility. You had longer cycles, fewer recessions, although the growth phases were not terribly robust. But you had a little bit more stability in terms of the economic cycle. It certainly was marked by a massive wave of globalization, especially starting in about 2001 when China joined the WTO.[1] That helped to bring that disinflation into the mix.

And from an investment standpoint, probably the most important characteristic of that, call it 25-ish-year era, was that bond yields and stock prices went in the same direction, which in turn meant that for most of that time, because bond yields and bond prices move in the opposite direction, you had an inverse relationship between bond prices and stock prices, ostensibly establishing that, you know, bonds are a great diversifier because they were not moving in sync. But back to the relationship between yields and stock prices, the reason why you had the relationship that you did almost the entire period, with the exception of a bit of an inflation spike in 2008, was because yields in that era and the Great Moderation era were generally keying more off of the growth side of the equation than the inflation side of the equation.

So if you have an environment where yields are going up because growth is improving, but you don't have the attendant concern about runaway inflation, that's kind of nirvana for equities. And vice versa, when yields were coming down, it was

generally reflecting a slower economic backdrop, not necessarily that inflation was being contained, and that was not as good for the equity market. The reason why I bring this up is that was a very distinct period. And in stark contrast to really what was the 30 years prior to that period, the period from the mid-'60s to about the mid-1990s. And there's no official word for that era. We've been calling it the "Temperamental Era." I'm not a former Fed chair, so I keep using it. It hasn't really caught on yet, but I'm going to keep using it, and maybe it'll catch on.

But that was the complete opposite era. There was more inflation volatility. There was more economic volatility. There was actually more geopolitical instability. There were disparate drivers of inflation. Everything from the energy crisis in the 1970s to poor monetary policy management. And that was an environment where nearly the entire 30-ish year span, the relationship between bond yields and stock prices was inverse because bond yields were generally keying more off of inflation than growth. So bond yields going up because inflation had been let out of the bag again, not necessarily because growth was improving, not a great backdrop for equities and vice versa.

Well, for what it's worth, we track everything from rolling one-month to rolling three-months to rolling one-year correlations between bond yields and stock prices and shorter-term on a one-month, on a three-month basis, we're back in that negative correlation territory, like we were for the bulk of that Temperamental Era, whether it's long lasting or not. And for our listeners, when we talk about a negative correlation, it means that in the case of a negative correlation between bond yields and stock prices, it means that if bond yields are going up, stock prices are going down and vice versa. When, of course, we talk about a positive correlation, it means whatever you're comparing, both of them are going up at the same time and vice versa.

But to me, it's something to keep an eye on because it may be more than just a short-term phenomenon, but to your point, Collin, it may be indicative of an environment that is different, higher for longer, Temperamental Era, the market and yields focusing more on inflation.

I also think, not that we talked much about Fed policy specifically or the fed funds rate, but I don't know about you. I'll pose this to you. My thinking is that for much of the past many years up until recently, as it relates to the Fed's 2% target, certainly during the bulk of the Great Moderation Era, you could almost think of that 2% target as the ceiling in a range that we bounced around in. Now I think at best, we probably should think of it as the floor in a range, maybe I would emphasize, at best, given, I think, limited likelihood that inflation gets down to 2% and just hangs around there. What are your thoughts on that kind of going from the ceiling to the floor?

COLLIN: Well, unfortunately, I think that's right. I hope that doesn't continue. I'd love to see inflation get back down to 2% or so. But unfortunately, that's the reality of the situation right now, where we're now at five years and counting. I think the key point here is "and counting" of inflation being above the Fed's 2% target and now moving in the wrong direction. And I think that's important when we think about what that means for the outlook of Fed policy. You know, we always talk about it, but at the end of the day, we're not expecting any changes over the short run. So for the next handful of months, next few meetings, we expect the Fed to just hold rates steady.

The idea of rate cuts probably shouldn't be … they shouldn't be in our vocabulary right now, given inflation that's too high and moving in the wrong direction. But I also think the Fed wants to be cognizant of the short-term or potential short-term impact of what's going on in the Middle East, the energy-driven increase we're seeing as opposed to what they focus on: the more core inflation readings, which exclude volatile food and energy prices. So I think it's too soon to get too aggressive in terms of this move up we've seen in inflation with the Fed needing to act.

But it seems like it's going to be some time now before we see inflation get back to 2%. And, you know, kind of summing up everything we've talked about it doesn't seem likely that we're going to get back to that 2% as a ceiling era anytime soon given all the dynamics we've talked about. Let me go back to you real quickly on just the equity markets because we're talking about the correlations. And one thing I've noticed with Treasury yields, specifically the 10-year Treasury yield, it tends to ebb and flow at least directionally with news coming out of negotiations with Iran and the Strait.

And if there's good news where oil prices come down, Treasury yields tend to come down, the opposite tends to happen, and yields rise if the price of oil rises. But we're at this point where yields are still very elevated compared to where we were at the start of the conflict. And even though yields have elevated, the stocks are doing pretty well. It's a really strong year right now. And I'd say for the most part, they tend to be shrugging off those inflation concerns, at least for now, at least over the last few weeks.

LIZ ANN: Well, I think that that's in part due to the fact that, as I've been saying, there's a lot of short-attention-span money in the market right now. So I do agree with you. I think the market has largely priced an end to the conflict than an assumption, even if it's not imminent, that we get a bit of a retreat in yields and/or oil prices. That, in turn, means we probably have some risk to the extent things flare up again, or we start to see the ripple effects become more acute in terms of the closure of the Strait of Hormuz. And even if that were to open, how long it is going to take to bring both oil production and natural gas production, not to mention supply

chains getting unkinked, as it relates to so much else that goes through the Strait. But that's, you know, we're in a momentum-driven market right now, and the market is looking past some of those potential risks, but it's something we're paid for, is to be mindful of those.

COLLIN: So Liz Ann, let's get to the fun part of these podcasts. We do have a guest this week, so can you tell us who you are interviewing?

LIZ ANN: Sure, so thrilled to have Joe Brusuelas. He's a principal and chief economist for RSM. Joe is an award-winning economist with more than 20 years of experience analyzing U.S. monetary policy, labor markets, fiscal policy, international finance, economic indicators, and the condition of the U.S. consumer.
Joe is a member of the *Wall Street Journal*'s forecasting panel, regularly briefs members of Congress and other senior officials on the effects of federal policy. And he is a frequent guest on CNBC, NPR's Marketplace, Yahoo Finance, and contributes to the *Financial Times, The New York Times, The Wall Street Journal, The Washington Post*, Axios, and Politico. Before joining RSM in 2014, Joe spent four years as a senior economist at Bloomberg LP and the Bloomberg Briefs newsletter group, where he co-founded the award-winning *Bloomberg Economics Brief*.

Earlier in his career, Joe was a director at Moody's Analytics covering the U.S. and global economies for the Dismal Scientist website, and he served as chief economist at Merck Investments LLC and chief U.S. economist at IDEAglobal.

LIZ ANN: OK. Well, Joe, thanks so much for being here. Testament to what I know will be a fabulous conversation that we're going to have, you are now on for the second time on our podcast.

JOE BRUSUELAS: Well, thank you for having me on. That's really nice of you to do.

LIZ ANN: My pleasure. So I want to start somewhat big picture. Rightly so, Bloomberg named you one of the best forecasters, specifically a bond forecaster, but we're in this very elevated period of uncertainty. In fact, I've been writing about it in the context of a different "un-" word, that being "unstable," maybe as a better descriptor than uncertain. I think "uncertain" is sort of generic, and it's always uncertain. But talk about how unique you think this environment is and how it … has anything changed in terms of the way you think about the interplay between markets and the economy, how you do your forecasting in light of some of these unique characteristics to this cycle?

JOE: OK, well, we are caught in an elevated level of uncertainty that is truly unique, right? You've got an economy that's engaged in a structural transformation driven by artificial intelligence. You know, that red-hot, non-residential investment that's

created an imbalance in growth is certainly something that we pay very close attention to. You know, it's one thing after another the last several years. For me, the big thing was that when we had the pandemic-era shock. It created what I call the regime change, a change that was going to shift us from a situation in which we had insufficient aggregate demand, insufficient aggregate supply, to where there was going to be a competition for liquidity and capital, featuring a rising cost of capital, higher inflation, and higher interest rates.

You know, the policy changes driven by the second Trump administration, whether it be tariffs or the decision to go to war in the Middle East, which has unleashed a historic supply shock, has made forecasting very difficult. What I'm saying is that level of uncertainty, the multiple shocks cascading through the economy, have accented the development of that split-screen economy we have, right? It's almost like we have an asset-based economy and a non-asset-based economy. If you like, we'll use the parlance of the K-shape. The upper spur is where the asset-based economy exists. If you live there, it's qualitatively and quantitatively different than the non-asset-based or the lower spur of the K, right?

And so right now, I've got a situation where 10% of the population is responsible for about half of consumption. Now, this isn't new. It's been going on now for 20 years. But it's evolved to a point where in that split screen you've got just different realities, right? I've got an economy that's largely going to grow between 1.5% and 2%. Let's say it's 1.7%, 1.8%. We're right at trend. Now as an economist that doesn't bother me. We're going at trend. Inflation is not going to be that bad. Unemployment's … we're at full unemployment as far as I'm concerned, right?

But we know that the imbalances in the economy are causing that inequality. And depending on who you're talking to, you're going to get radically different interpretation, which is why we have consumer confidence at a historic low, yet the unemployment rate's at 4.3%.

LIZ ANN: Let me pull on that thread a little bit as it relates to the K. I keep thinking back to the period in 2000 into 2001, and maybe not the common way that a lot of people are doing comps to that period as it relates to AI, which you touched on, and whether it's a bubble or not. But I think back to the recession that happened in 2001 and how mild an economic recession was, it was in large part because there were no major financial system imbalances.

I think what was a big contributor to that recession was the wealth effect because at that time into the peak in 2000, you had record equity ownership, households' exposure to equities was at an all-time high. Well, those metrics, to your point about being asset owners, are even more inflated now than they were then. So talk a little bit about the, call it chicken-and-egg sort of scenario, if there was something to

happen in the market, some sort of dislocation, a correction that turns into a bear market, would that be enough to cause serious problems in the economy by virtue of that wealth effect?

JOE: OK, so I think that's a fair comparison if maybe an inexact analogy. You know, the dot-com bubbles that we had were deflated because simply there wasn't the bandwidth to use the innovation that was brought forward, and there really weren't any earnings or profits, right? I can remember the Porsche Boxsters getting repossessed up and down the street, as those bubbles were deflated.

All right, here we have an imbalance. Now, I'm not necessarily convinced that what's going on in AI is a bubble. I think we've got an over-concentration of risk in elements of our equity markets, right? That has created what I call the four imbalances, right? You've got an imbalance in what I just described is that that overconcentration of risk. We've got an imbalance in terms of 10% of the households are responsible for 50% of the population. We have certainly debt dynamics that suggest a fiscal imbalance. And then, you know, we've got that imbalance in growth where it's the red hot, non-residential investment that's driving that.

If we were to have a 20% or greater correction for whatever reason, let's say that we wake up one day and we realize that the refined product out of the Gulf is not sufficient to support the construction of semiconductor ships, right? Advanced technology. And Jensen Huang, the CEO of Nvidia, gets up one morning and says, "We can no longer meet our production goals and targets." We're going to have a big sell-off. There is some concern that the negative feedback loop into household spending, that wealth effect deflating, it would cause a problem. Now would it cause a systemic issue? No, it wouldn't. As a matter of fact, I think that the way the tech economy is evolving, the people who would be on the losing side of that equation would largely sell out to the people who are on the other side waiting with prodigious quantities of cash to buy them out at pennies on the dollar, right? It's how the market is supposed to work, meaning we would have, not a public bailout, but a private sector adjustment. Yeah, we could see a downturn in the economy quite sharply that might result in a recession. I remember that in 2000, 2001, I called it an inventory correction led by an increase in auto inventories.

And certainly, that could happen quite quickly, right, if you get a deflation of demand. You know, we've had this historic oil shock. I'm very optimistic that we've only seen a modest quantity of demand destruction that's almost all been down market and had occurred … and you know, I've got this research framework where I talk about the seven channels of demand destruction. We've only really seen it be in gasoline and consumer confidence. It has yet to spill over into demand for durable goods, which is where you'd expect to see it next.

LIZ ANN: So what triggers that spillover? Is it a time factor? Is it something that is more tied into just the complicated nature of supply chains? What defines what turns this into something that has not been calamitous by any means into something more significant? Do you put a timeframe on closure of the Strait of Hormuz and when that starts to trigger bigger problems?

JOE: We thought that we would need to see three to six months for it to translate into broad-based demand destruction, having to do with the existing level of barrels on the open water, inventories, strategic petroleum reserve, and then strategic adjustment in the big economies. The U.S. is producing more and exporting more, as is Canada, as is in places like Guyana, the decline in China's demand has been appreciated, if somewhat unexpected.

And then the savings amongst the upper middle class and the upper two quintiles, we thought would be sufficient to absorb it. You know, we weren't calling, and we still aren't calling, for a recession. We only increased our recession probability from 20% to 30% based on that shock over the next 12 months. We reduced our growth estimate from 2.4%—we thought we were going have a very strong year—to 1.7%, or just right around trend growth. So it's largely played out the way in which we thought, at least for now. Now, we, like a lot of economists and strategists, and I'm sure you tried to resist this temptation too, is to turn into a barrel counter. But unfortunately, it did seem to us that if we got through the end of June and we didn't see the war end, then we were going to all be on the clock with respect to a much more tighter energy scenario with respect to basic supply.

And that if we got to September, we would be, well, essentially we would have hit the floor. And at that point, some of the calls, say, like somebody like Jeff Curry, the former Goldman Sachs commodities head, about $150 per barrel or greater might come true. I'm more worried about refined product at this point, given the imbalances that we were just talking about. I mean, I really am afraid that one day Jensen Huang is going to appear on television one morning and talk about a more deeper supply shock that's now going to hit his business and that triggering a panic of sorts across equity markets that triggers in the household.

LIZ ANN: I couldn't agree with you more, and I find that there's not a wide-ranging conversation about this. I think most people that attempt to point to potential risks associated with the AI build out is the circularity of financing or maybe just the earnings expectation bar that gets us set a little bit too high, but there's much less discussion about the supply disruptions and everything that goes into the build out of AI.

JOE: You do a lot of television like I do, and we all go along to get along in the medium because you can start a panic if you're not careful, right? And in our in-

house, we all ask each other really difficult questions because there's billions of dollars at stake in revenues and in trading activity, right?

I was on a television show recently, and afterwards we were joking around, and I asked that question, I go, "What's the plan if Jensen gets up and does that? You're going to ask him the hard question?" And the guy was like, "Absolutely not." But that's the good thing about podcasts is we can have a little bit deeper, broader, more intense discussion.

LIZ ANN: Deeper, yeah.

JOE: Because you're not stuck in that medium … of 20 to 30 seconds.

LIZ ANN: Full sentence answers, full sentence questions. Yeah.

JOE: Yeah, right, right. We can think about the significant upside due to this transformative yet disruptive technology that will require all of us to simultaneously hold two contrasting ideas and arrive at synthesis that is AI. But also note the risks around where we're going with this, especially right now.

LIZ ANN: I want to transition to inflation, but before I do that, maybe if you can, not that I'm asking for a sound bite here, because we just talked about the beauty of a podcast being not about sound bites, but when you think longer term about AI, often the questions that are posed to people are, you know, "Is this the greatest thing that's ever going to happen to our world?" Or "Is this the end of civilization as we know it? Is, you know, the unemployment rate going to 30%?" What do you think the impact is on inflation? Is AI more of a disinflationary force or an inflationary force? Maybe a little bit of both depending on your time period?

JOE: It's a bit dichotomous, isn't it? At first, it's likely to be more inflationary than deflationary. Witness the draw upon all sorts of different resources that now are feeding through to cause inflation to go higher. Over time, three to five years from now, maybe longer, we begin to reap the benefits that justify these very lofty equity valuations, where we see a rapid acceleration in productivity. OK, so there's your throw quote. You know, the increase in productivity that we've seen is really a function of late-era machine learning. We're not even really integrating the large language models into what we do. And so I'm quite confident we're going to have a productivity renaissance that will rival or better what we saw post-war, but it's going to come along with some disruption.

LIZ ANN: And that's the phase we're largely in. I want to stay on inflation, but let's bring up a topic that seems to have been pushed to maybe the further pages of the newspaper in light of the war in particular, but the notion of tariffs being a permanent tax. And I'm very aligned with what I know your views are, but I want

you to share with our listeners some of those views, especially around the increase in a price level.

And I talk about it in the context often of ... I'll say in front of a client audience that as a strategist, and I'm sure you as an economist on a month-to-month basis, we're living in the weeds of headline-versus-core inflation and Consumer Price Index versus Producer Price Index versus Personal Consumption Expenditures index. And the various versions of those and month-over-month changes and year-over-year changes. And I always say to people that the consumer doesn't think in those terms. They think of inflation as stuff is more expensive now than it was before, period. So talk about how tariffs work their way in and why it's important to think of them more as a tax than something that is more in line with the general way to think of inflation in rate-of-change terms.

JOE: OK, because tariffs cause a resetting upward of the price level. That once that happens, it doesn't go back. This is an inflation tax. We can talk about, "Well, it temporarily causes an increase in the price of tomatoes, but we'll substitute and we'll start growing more tomatoes domestically." Perhaps over time, not in the near term. But the fact is, in the near term, prices are going up, especially on durable goods that we have no domestic substitute for. Moreover, the way in which this episode evolved is really interesting because we haven't really seen the bulk of the increase in inflation due to tariffs because they haven't been passed through. One.

Two, if you remember last year, firms pulled forward a heavenly quotient of inventories that until just recently were exhausted, meaning new inventory accumulation is being attached to the higher prices that then get passed through, which is why at the outset I would tell people, if they were willing to listen, "Don't play the red-light, green-light game with this." It's not about the news cycle. That's a political construct. This is going to take two years for this to show up. And it will. And it is. It just happens to be beginning to show up at the same time as what the supply shock unleashed by the war.

LIZ ANN: So Joe, talk about the Fed's reaction function and how you think about the Fed under new chair, Kevin Warsh.

JOE: All right, so the Fed's reaction function is rightfully to look through the initial stage of the shock to identify where top line is bleeding into core and to methodically and systematically attempt to define any resetting of expectations higher. The big lesson we learned during the pandemic was to not discount one-year public resetting of inflation expectations higher. John Williams at New York Fed has done a great job of outlining why we shouldn't do that. And it appears Chris Waller is now beginning to look at that also in an interesting way. And we may need to hike rates to maintain the current level of pricing.

Notice I'm not saying price stability. If the European Central Bank lifts rates in June, it's to maintain price stability. We've been above 2% for the better part of, for more than five years now. So it's about trying to keep inflation between 3% and 3.5%, much less the 4.5% we're going to see when we get the May data in June.

Mr. Warsh, very interesting fellow. Very dovish if the GOP's in charge, very hawkish if they're not. While I like Kevin Warsh, he comes off as the perfect candidate to be the Fed circa 1995, a product of the think tank, Washington think-tank circuit. Someone who's memorized his lines. Even his ad libs look like they're too well rehearsed. There are times I'm somewhat concerned that if we have a financial crisis, that the depth's not there. He'll have to rely on the staff because his first instinct I think is actually to hike rates. As we saw him carefully outline on the way into the most giant deflationary shock since the Great Depression, which most many economists will just never forgive him for.

And well I'm going to take his tenure with an open mind, I am a man of a certain age who was not quite yet senior on the desk during his era at the Fed, so I had to read every single thing he wrote and spoke. And I think I've got a real good sense of who this fellow is. He's going to have to do some heavy lifting to persuade the other members of the Fed to sign off on his view. My open and honest estimation is he's in the minority right now. And my sense is that, if he voted honestly, he would probably dissent, but he won't.

LIZ ANN: All right, so now let's talk markets a little bit, and you recently flagged the growing divergence between what's going on in my side of the world, which is the equity side of things, and the risk being priced into forward-rate markets. So you're someone that watches both. So talk a little bit about that disconnect, and if it's even a valid question, which market is right?

JOE: Yeah, I think probably we ought not to get to which one's right. I'll always take the bond market and the currency markets …

LIZ ANN: Yeah, no, me too. I'm an equity market person. I think the bond market is generally much more rational than the equity market.

JOE: Yeah, right, the equity market. The equity market's decoupled from the real economy. It's far less sensitive to what goes on because of the confidence in the tech community, that they really are responsible for the next revolution in economic and financial affairs. And I tend to agree with them.

LIZ ANN: Hey, I want to ask one final question. You've spent your career championing the middle market as the backbone of the U.S. economy. So these are mid-sized companies. What message are you getting from that part of our economy that maybe getting obscured by the message coming out of an index like the S&P

500®, or if you want to be more specific, the mega-cap leaders? And is it … I'm hoping it's a somewhat positive message. I do my best these days with so much to worry about to try to finish our conversation somewhat optimistic note.

JOE: OK, so it's growing, but there's been a significant consolidation in that market space over the past 20 years.

LIZ ANN: More to come?

JOE: The survivors have gotten … yeah, more to come. The middle market's far better off than the small-business community, where it's just been carnage and it's not stopping, and the small-business community's shrinking, right? The survivors in the middle market via venture capital, private equity, private credit, private markets have gotten much bigger. So what we're going to have to do is clarify the rules of the road. Because right now, the bigger you are, the greater capital depth that you have, the more likely it is you're going to succeed. But these companies don't want to go public. They want to stay private.

So we're going to have to make sure we don't overdo it with over-regulation of private equity, private credit, and private markets, that there's going, they're going to continue to play a dynamic, useful, and forceful role in the growth of the American economy. And those middle market companies are going to get a lot more important as we lose the dynamic properties that we often associate with small business. You know, if you go to Washington, and unfortunately I've had to go Washington way too much over last 20 years. We say that we just give lip service to those small businesses. They've for the most part disappeared. They've been absorbed. So we're going to want to make sure we retain that dynamic role that competition plays, that innovation plays.

Right now we're in a position where this innovation is being driven by the large companies. And that's good, right? That's a very good thing. But there will be a point which we hit diminishing returns, that we have the inevitable stock market correction, right? Not crash. Correction. And then we're going to depend on those mid-sized firms to drive hiring and innovation as we capitalize on this long period of dynamism and technological development so that we set the stage for that steady state equilibrium, right, that we all crave. Less volatility, better growth, better productivity, better rising living standard for all.

LIZ ANN: Perfect ending. Absolutely perfect. I couldn't have scripted it better myself if I tried, Joe. Thank you so much for coming on again. There's a reason why you are a repeat guest and absolutely appreciate your time. So thanks for joining us.

JOE: Thank you. It was a real honor, and I love the fact that we're sort of like salt and pepper, that I can talk economics and finance and you can talk equities, right? No, it's a really nice compliment, and it's fun to be on with the real pro.

LIZ ANN: Oh thank you very much. Right back at you.

COLLIN: Well, Liz Ann, as always, it's time to look ahead at what we'll be watching over the next week. So what is it that you think investors should be watching for over the next week?

LIZ ANN: Yeah, one thing I would pay attention to is we get a couple of different PMIs. So PMIs are Purchasing Managers Indexes. Those are basically the generic term for these surveys that are done. One every month is done by ISM. The other is done by S&P Global. And they're really surveying both the manufacturing and the services side of the economy, many, many companies, about the health of the business. And there's an overall index measure. There are new orders components, employment components, prices paid components, so you get a nice flavor of what's going on in the economy. And what's been interesting and something that we anticipated would potentially happen is we're seeing a little bit of convergence between what's going on in the manufacturing side of the economy and what's going on in the services side where some of these services PMIs have actually been deteriorating a little bit. They're still in expansion territory but they've been easing back.

Yet at the same time, these manufacturing readings have actually been improving. In fact, four months ago, we saw a move out of what would be considered recession territory for manufacturing back into expansion territory. So that's what I'll keep on my radar, is just the differential between what's going on in the services side and the manufacturing side, because we'll get both ISM version and S&P Global version. We also get the Job Opening and Labor Turnover Survey. It's another way to look at the health of the labor market. We get job openings. We get the quits rate. One thing always of note with that survey when it comes out is it lags all other labor market surveys by a full month. So just be mindful of that. It's not really apples-to-apples compared to a lot of other more timely data.

We also get the Challenger job cuts. There's a lot of sensitivity right now to whether we're seeing any kind of deterioration in the labor market. And we also get productivity statistics and unit labor costs. And then we have the big one at the end of the week, which is payrolls, which I'll toss it back to you. I'm guessing that might also be on your radar, but anything else?

COLLIN: That's the one that I'll be paying attention to because, as I normally do, I kind of want to see, "OK, how does this flow into our outlook for the bond market

and Federal Reserve policy?" We know inflation is too high and rising. So I'm interested to seeing the evolution of the labor market right now. It's been pretty stable. I know you and Kevin talk about this a lot. There's a lot of moving parts when we look at the jobs report.

One thing that I tend to focus on is the unemployment rate, which has been very, very stable. I think we're at 22 straight months where it's been between 4% and 4.5%. And it looks like consensus expectations are pointing to having it hold at 4.3%. So that would mark the 23rd straight month. That is remarkably consistent, holding in a tight range. That's generally a good thing. We are going to look at the actual non-farm payroll gains. In the last month, we got the first back-to-back month of gains since May of 2025. So hopefully we'll get a third month of gains there, which will be good. And that's going to be really important, I think, for the Fed because …

If inflation's rising and the labor market is stabilizing or stable, that makes it harder for the Fed, I think, to act in terms of hiking rates. If we start to see a strengthening of the labor market, which is not really what we've been seeing, we've seen it kind of level off, but a strengthening, then maybe you start to see the idea of a potential rate hike, given the inflationary pressures, but we're not there yet. And then as you mentioned, I love looking at the ISM, the manufacturing and the services sector.

One thing that I'm paying attention to that you made it very clear, it's always good to look under the surface. And for manufacturing, what we've seen is one of the drivers there, supplier deliveries has been boosting that index a little bit. Other sub-factors have as well. But usually that's a good thing. That usually means demand is outstripping supply, and that's kind of resulting in slower deliveries. Right now it's mostly due to supply constraints given the closure of the strait. we'll want to look under the surface there. But I think for me, it's mostly going to be all that jobs data that you had mentioned.

So that's it for us this week. Thank you all for listening. As a reminder, you can always keep up with us in real time on social media. I'm @CollinMartinCS on X and LinkedIn. That's Collin with two L's, and CS is for Charles Schwab.

LIZ ANN: I'm @LizAnnSonders on X and LinkedIn. Make sure you are following the real me, still have a lot of imposters. And you can always read all of our written reports—they typically have lots of visuals, charts and graphs—at schwab.com/learn. And if you've enjoyed the show, please consider leaving 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. We will be back with a new episode next week.

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[1] World Trade Organization.