Key takeaways

- **Central banks remain focused on inflation:** The ECB has already raised rates, and stronger-than-expected U.S. jobs and inflation data have led the Fed to increase rates by 0.25%.
- **A Fed hike during an easing cycle is a bit unusual:** With policy rates already above the Fed's estimated long-term neutral range, further hikes could have uneven effects—especially if inflation is being driven by energy shocks and geopolitical factors outside the Fed's control.
- **AI investment is a key economic wildcard**: Data center and AI spending may support growth and productivity, but higher rates may do more damage to rate-sensitive sectors like housing than to the AI.

(Approximately 3-5 min. read)

Last week, the European Central Bank (ECB) increased short-term interest rates by 0.25% (25 basis points). The rate hike was unanimous amongst the ECB's Governing Council and was widely expected by markets. Meanwhile, both the U.S. Federal Reserve and the Bank of Japan (BoJ) are meeting this week.

0.25% rate hike by the U.S. Fed was mainly anticipated, but it was also a bit unusual, and perhaps dangerous, at least as far as the past generation of monetary policy goes.

Why was it anticipated? Because the U.S. has experienced both above-consensus job growth and above-consensus inflation. As a result, futures markets are pricing in three to four rate hikes in the next 12 months, but that could be too much at this point. **Rate increases tend to come in pairs when trying to influence economic liquidity.** One and done rarely happens; small, steady and several rate increases are the norm in a non-crisis economic environment.

But even one 0.25% rate hike would be unusual given that the Fed started cutting rates about two years ago. **Rate hikes, in the midst of an easing cycle, are unusual.** Moreover, Fed policymakers believe the long-term neutral federal funds rate is somewhere between 3% and 3.25%, which is below the current target of 3.75% to 4% after the rate increase.

Normally, or at least in the past generation, once the Fed starts cutting rates, it keeps cutting rates until rates have reached a long-term bottom. Going backward in time, that is what happened before and during COVID, before and during the Global Financial Crisis, as well as during the collapse of the first internet boom in 2000-02. All three of these episodes included a recession that the Fed felt it could alleviate. **For now, at least, a recession does not seem to be in the cards so the Fed is less worried about that. It's more worried about inflation.**

The last time the Fed raised rates during a general rate cutting cycle was in early 1997 under then-Chairman Greenspan, who justified the one-time 0.25% rate hike based on strong economic growth that he thought was due to a "wealth effect" from booming stock markets. Using a Keyneisan approach, the Fed was worried that low unemployment (then just above 5%) could stoke inflation even though it hadn't happened yet.

This same thing is playing out today. **The unemployment rate is 4.1%, the Atlanta Fed projects third quarter real GDP growth at 4.4%, investment in data centers is soaring, and inflation remains stubbornly high.** All of this is complicated by multiple wars. Energy prices have spiked because of the conflict in the Middle East while the Ukraine-Russia conflict has reduced global refining capacity. But, there is nothing the Fed can do about this and hiking rates during war-time is highly unusual.

Another important point is that in 1997, when Greenspan hiked rates, interest rates and the money supply were tied together because the Fed operated under a system of scarce reserves. Now, with abundant reserves, a rate hike will not directly influence the money supply in the same way. If rates rise, but the money supply grows, the rate hike will have less impact on inflation than investors (and the Fed) seem to think.

As Chairman Warsh pointed out in Jackson Hole, AI and the investment in data centers is a wild card. It could lift productivity growth, which would reduce inflation. But it could also be over-investment (like fiber optic investment during the late 1990s) that comes to an abrupt end.

One thing is for certain. The buildout of AI and data centers, which has been rapid, is not as rate-sensitive as the rest of the economy, which is not performing nearly as well. Housing in particular is very weak, and rate sensitive! **In other words, raising rates may not slow AI, but it could impact other areas of the economy.** When corporate earnings and employment are strong, investor confidence usually follows as well.

Source: First Trust, Economic Research Report, September 14, 2026

Sierra Roads Wealth Management Group at Morgan Stanley
Team Updates

If you know anyone who would benefit from the information in this newsletter, please feel free to connect them with us and/or forward it to them.

We are all around this week.

Please enjoy this week's commentaries and links to reports below. To read the full report of any of the excerpts below, feel free to reach out to us and request a copy of the full report.

September 17th, 2026

Global Investment Committee (GIC) Weekly
Distractions?

As we approach mid-September and the historically weakest season for equities—in a midterm-election year no less—investor anxiety is understandable. This year's concerns are certainly formidable: rising rates, resurgent oil prices, currency volatility, a confusing policy backdrop and declining market breadth. But while our approach to crosscurrents is always to lean into prudent risk management, this time we're more sanguine, as markets have exhibited appropriate pricing discipline given the mix of headwinds and nearly unprecedented earnings. First consider the flushing out of equity market excesses, with the S&P 500's forward price/earnings (P/E) ratio now below 19.5. Credit spreads, meanwhile, have widened in response to surging AI capex. And critically, global bond markets appear to be repricing risks fairly, with around 3.5 Fed hikes signaled over the coming year, term premiums being restored and the neutral real rate reset. Focus on earnings and strategic asset allocation, adding to positions during meaningful weakness. Equity returns can still average 7% to 10% in the year ahead, as risks matter, but how they are priced matters more. **Consider** using stock and bond weakness to reload for long-term investing.

Also consider rebalancing fixed income toward strategic benchmarks and neutralizing tactical tilts, as we expect policy-related volatility to remain above average. In equities, add to equal-weighted index exposure or active stock selection. Financials, health care and some defensives fit the bill, along with select overweights to cloud-dominant hyperscalers. We still like non-semiconductor-oriented EM and Japan and prefer intermediate rates to credit, with added diversification from hedge funds, real assets, venture capital and growth equity.

Fixed Income Insight
Price-Insensitive Buyers' Exit Pressures Term Premiums

US investors are wringing their hands over higher US Treasury yields, with the two-year rate up 48 basis points in just month. While short-term inflation pressure is the immediate driver, government debt as a share of total borrowing and GDP is the longer-term issue. In the past decade, US government interest payments as a share of GDP have risen to around 3.5%, while corporate interest payments have plummeted to 0.5%. For the US government, and the Treasury in particular, rising rates boost financing costs and constrain fiscal flexibility. In many ways, this is the outcome of the Fed's post-Great Financial Crisis bargain that allowed corporations to refinance and lock in very low rates while the government grew more dependent on front-end issuance, which could now put the Fed and Treasury at odds. The current scenario, with corporations relatively insulated from rate hikes, favors our equity overweight in portfolios.

Source: Morgan Stanley – Global Investment Committee, The GIC Weekly, September 14, 2026

First Trust's Monday Morning Outlook
Rate hike likely, but unusual

Please use this link to read a special edition of First Trust's Economic Research Report:

Rate hike likely, but unusual

Source: First Trust, Economic Research Report, September 14, 2026

J.P. Morgan's U.S. Weekly Market Recap

This week in review
- Headline and core CPI rose 3.4%/2.4% y/y
- PPI rose 0.4% m/m

This week ahead
- FOMC meeting
- Retail sales

Last week, the European Central Bank (ECB) hiked interest rates by 25bps. The rate hike was unanimous amongst the ECB's Governing Council and was widely expected by markets, with all eyes now focused on whether they will deliver another rate hike in either of their two remaining meetings this year. Meanwhile, both the Fed and the Bank of Japan (BoJ) are scheduled to meet this week. While markets had expected that the BoJ would hike rates by 25bps, there wasn't as much certainty in the Fed's next move until Friday's CPI print showed hotter than expected core inflation. Markets are now pricing in a nearly 90% probability of a Fed rate hike on Wednesday.

Further out, markets are currently pricing in an additional three rate hikes from the ECB, three from the BoJ and three from the Fed by the summer of 2027. While the ECB, with resilient economic growth and elevated inflation from higher energy costs, and the BoJ, with strong wage growth and similar inflationary pressures, may continue on this path, we believe that the Fed will ultimately be less hawkish. Coupled with declining wage growth and receding tariff effects, inflation could quickly decelerate if hostilities with Iran cool after the midterm elections. If the Fed doesn't hike while other central banks do, short-term yield differentials narrow. This causes foreign currencies to strengthen against the U.S. dollar, which could be a tailwind for international equities due to the currency boost to earnings and returns and the capital rotation abroad that a weaker dollar causes.

Despite already strong EPS growth this year, international equity valuations remain at a 32% discount to the S&P 500 on a forward P/E basis. Throw in the potential currency pickup, and the case for adding international exposure to portfolios continues to be attractive.

Source: J.P. Morgan Asset Management, Weekly Market Recap, September 14, 2026
Weekly Market Recap (jpmorgan.com)

BlackRock's Global Weekly Commentary
EM equities: back to overweight

Key Points

- We stay pro-risk despite higher rates. Strong fundamentals and AI scarcity support our U.S. equity overweight and return to an overweight in EM equities.
- Oil topped $100 and long-term yields remain near multi-decade highs, yet stocks are near records. We think higher rates and strong equities can coexist.
- The Fed, BoE and BoJ take center stage this week. Their rate decisions will keep global yields and currencies in focus as policy paths diverge.

Higher global rates are raising the hurdle for returns, but they have not knocked us off our pro-risk stance. Higher rates and strong equities need not be contradictory – what drives yields matters. When higher yields reflect stronger investment and growth, the resulting earnings strength can help offset a higher cost of capital. That explains why we maintain our U.S. equity and AI overweights. Our return to an overweight in EM equities offers another way to invest in the AI scarcity theme.

The bar for taking risk is rising as rates reset higher, making the durability of earnings more important. We think AI-related investment can support growth and profits even as the same investment boom absorbs capital, power and other scarce resources. EM equities now offer another place where earnings can clear that higher hurdle. The fundamental case has strengthened: earnings growth is exceptional even as valuations remain well below those in the U.S. See the chart. The tactical backdrop has improved too. We closed our previous overweight in EM equities in our Midyear Outlook in June as leverage concerns built, particularly in Korea. Korean equities subsequently experienced losses, and summer deleveraging has since eased those leverage concerns, supporting our return to overweight.

The numbers reinforce the case for returning to EM equities. Consensus expects headline earnings per share for the MSCI Emerging Markets Index to grow over 34% over the next 12 months versus about 20% for the MSCI USA Index. Yet EM equities trade at only 10 times forward earnings versus nearly 20 times for their U.S. counterparts. That is a 50% discount, with the EM multiple in the bottom 10% of its 20-year history. A weaker U.S. dollar could add support by easing financial conditions, supporting local currencies and encouraging foreign capital inflows. But our view does not depend on it. We see dollar weakness and stronger inflows as additional support rather than the foundation of our EM call.

EM at the center of AI scarcity
The headline EM rally masks very different sources of returns, but AI scarcity is one thread connecting them. South Korea and Taiwan sit at the heart of semiconductor, memory and hardware supply chains. Latin America, including Brazil, offers exposure to the resources and physical infrastructure needed for the AI buildout. These are different expressions of the AI scarcity theme that is an important part of our U.S. equity overweight. That overlap is deliberate and concentrates some of our equity exposure to the AI buildout. Over time, cheaper models and greater commoditization could shift where AI profits accrue. We therefore prefer to stay selective and dynamic rather than assume today's winners will remain tomorrow's.

We remain pro-risk, but see little room for complacency. We maintain our U.S. equity and AI overweights, return to an overweight in EM equities and downgrade short-term European government bonds to neutral. Two risks could challenge that stance. First, markets have absorbed the Middle East shock well, but Strait of Hormuz traffic remains severely constrained and scarcity has shifted downstream into refined products. Renewed energy pressure could keep inflation elevated just as the Fed faces a difficult policy choice. A hold despite persistent inflation and a tight labor market could test its credibility, with the term premium acting as a release valve as investors demand more compensation to hold long-term bonds. That could push long-end yields higher and raise the hurdle for equity returns. We stand ready to adjust as conditions change.

Bottom line: Strong fundamentals keep us pro-risk despite higher rates. Exceptional earnings growth, attractive valuations and a cleaner tactical backdrop support our U.S. and AI overweights and a return to an overweight in EM equities. But this is not an unqualified bullish call. A lot can still go wrong, and we stand ready to shift from risk-on if the signposts change.

Market backdrop
Markets are balancing mounting macro pressures against strong corporate fundamentals. Brent crude topped $100 a barrel for the first time since July after the U.S. and Iran traded fresh attacks, while new U.S. inflation data prompted markets to ramp up Fed rate hike expectations. Long-term government bond yields remain near multi-decade highs. Yet stocks remain close to record highs. We think strong earnings help explain that resilience: U.S. earnings expectations have continued to rise, giving equities a cushion against higher rates and energy prices and reinforcing our overweight in U.S. stocks.

Central banks take center stage this week, with the Federal Reserve, Bank of England and Bank of Japan all setting rates. Strong jobs and sticky inflation have sharply raised the market odds of a Fed hike, though we don't see one as a foregone conclusion. The BoE is expected to hold and the BoJ may need to normalize faster. We expect the decisions to keep global yields and currencies in focus.

Source: BlackRock Investment Institute, September 14, 2026
Click here for entire commentary including important disclosures

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