

Acronyms and Anachronisms

Report for the Week ending July 4, 2026

Dylan Smith

Key Takeaways

- **MONOLOGUE: Acronyms:** SCOTUS blocked Trump from firing Governor Cook, adding another pillar to Chairman Warsh's mission to restore Fed credibility. USMCA talks officially began, a tail risk for the US but existential for Canada.
- **MACRO:** June payrolls missed at 57k, but almost every other labor market indicator pointed to continued modest improvement. Wage growth is bifurcating between hot cyclical and AI-adjacent sectors and lagging large services industries.
- **MARKETS:** Yields rose, gold and the dollar shrugged, and tech led equities higher. Forward earnings growth estimates near 20% are sparking "earnings bubble" talk. In private credit, retail redemptions intensified.
- **MEMO: Anachronisms:** Warsh's data task force may be the most consequential of his five and the most under-appreciated by markets. Changes to how inflation is measured could shift the rate outlook meaningfully. A switch to market-based core PCE alone suggests policy is already easier than the Fed believes.

Monologue

Happy Fourth of July to those who celebrate, and happy Canada Day to everyone.

It was labor market data week. Headlines focused on the first nonfarm payrolls miss since February, but the totality of employment data was unambiguously positive. A July hike is probably not on the cards – unless the inflation data in a couple of weeks shows clear evidence of an acceleration in core prices – so we'll have to wait until September.

However, the way we think about this type of data in relation to the interest rate outlook may soon be **anachronistic**. Read this week's Memo to find out why.

First, though, we should address two important **acronyms** that dominated the news this week, and which have profound implications for the institutional underpinnings that support markets and macro.

SCOTUS: The Supreme Court of the United States blocked President Trump's attempt to force Governor Lisa Cook out of office. This added another pillar of support to Chairman Warsh's mission to restore the inflation-fighting credibility of the Federal Reserve. Markets may be tempted to read a hawkish tone into this news (the President can't eject voting members who are unsupportive of cuts). They would be wrong, at least in the medium-to-long term. As Warsh reminded us in his inaugural press conference as Chairman, a credible central bank does not have to maintain artificially tight policy to contain inflation expectations. He emphasized the same message on a panel this week at the ECB's annual confab in Sintra.

USMCA (CUSMA) talks officially began this week when the United States elected not to renew the agreement that replaced NAFTA in 2020. The US, Canada and Mexico will now begin the process of reviewing the agreement annually for the next ten years, unless a party withdraws or a new agreement is signed.

The fact that all three countries have their own acronym for the trade agreement is a minor annoyance to those of us writing for global audiences. But having separate terms for the deal for each country might actually be quite useful if we use them as shorthand to express the different weight it has for markets across borders.

In America, the **USMCA** represents a tail risk, albeit an important one. Compared to the shocking and arbitrary global "Liberation Day" tariff formulas, adjustments to, or even a collapse of, the largely tariff-free trade ensured under USMCA might seem like economic small potatoes. Indeed, part of the reason that tariffs have not had a larger effect on US inflation and growth is that trade with its two nearest and largest partners has stayed free and frictionless. Tariffing Mexican and Canadian imports (and absorbing counter-tariffs) could trigger a recession and further spike inflation. This appears too dear a price for even President Trump to pay to withdraw, but it is a tail risk that should not be ignored.

For Canada, **CUSMA** is existential. America is its largest customer by far. Canada is deeply integrated into continental value chains, and its financial markets are closely linked with Wall Street. But Canada does not have the size to absorb the shock of a loss of CUSMA cover without a severe recession, and it can't pivot to global markets fast enough to avoid profound economic damage.

As negotiations continue, we see an eventual renewal with modest (but potentially politically difficult) concessions from the smaller partners as the most likely outcome. Mexico and Canada have every incentive to stretch negotiations beyond the midterm elections in November, and possibly even to a new White House administration in 2029, so don't expect a resolution any time soon.

With that, enjoy this week's note.

Dylan Smith

Founder and Chief Economist

Marginal Movers

Rising 🙌

- **The Fed's Balance Sheet:** [Beyond Reserves: The Federal Reserve's Balance Sheet and the Repo Market](#) — "We present a new constraint on the size of the Fed's balance sheet: repo market capacity. [...] We also demonstrate a novel complementarity between interest rate and balance sheet policies: higher policy rates expand repo capacity, allowing the central bank to operate with a smaller balance sheet." Food for thought for Chairman Warsh.

- **Inflation:** [Beyond energy prices: the ripple effects of Gulf supply disruptions](#) — Using scenario-based analyses, this blog shows that supply shortages can affect growth and inflation beyond the impact on global energy prices.

Falling 📉

- **Oil:** [Assessing risks to oil prices through options markets](#) — "options prices suggested that investors were concerned that oil prices would spike by more than they did."
 - **RCTs:** [The case against randomized controlled trials](#) — "Funders should consider allocating more resources to the collection of observational data. It may be much more cost-effective than the alternative."
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Macro Monitor

Payrolls break their streak

We were due a reality check from nonfarm payrolls. After three consecutive blowouts, the June report disappointed expectations for monthly jobs growth, coming in at 57k, half the consensus estimate (there was a cumulative 74k downward revision to the past two months too). On our preferred four-month trend, jobs growth is running at 130k per month, compared with -17k in December and 42k a year ago.

Nonfarm payrolls were not the only labor market data published this week. Almost all the other news pointed to a continuation of the modest improvement in the labor market we've been seeing for the past few months. The unemployment rate fell from 4.3% to 4.2%, initial unemployment claims are lower than at any point in the past three years, high-frequency employment data from Revelio and ADP are rising, job openings and hiring both rose, and layoffs fell. Niche leading indicators such as the share of people working part time for economic reasons and temp agency employment also moved in the right direction.

Meanwhile, wage growth dynamics continue to bifurcate. Cyclical industries and those connected to the AI infrastructure build are seeing strong wage growth. The three-month average wage for nonsupervisory employees is growing at an annualized rate of 7.1% in Utilities, 4.6% in Construction, and 11.4% in IT. The national

aggregate is being held back by tepid wage growth in large services industries, notably Education and Healthcare (0.8%).

[Chart NFP]

[Chart JOLTS]

Also noted

- The ISM manufacturing PMI for the US stayed in expansionary territory (53.3).
- Canadian GDP improved to +0.5% MoM in April after entering a "technical recession" in Q1. On a forward-looking basis, S&P Global's PMI for Canada's strained manufacturing sector improved to 53 points in June, indicating steady growth.

See the appendix for arcMacro proprietary Factors and the Key Macroeconomic Indicators tracking chart.

Market Monitor

Public markets

Trading was abbreviated by the holidays this week, and investors returned to their favorite themes after end-of-quarter liquidity volatility drove modest reversals in the past two weeks.

Longer-dated fixed income gave back a significant share of the gains made in the past two weeks, with five- and 10-year Treasury yields both rising by 11 basis points, steepening the yield curve in the process, leading a global updraft in interest rates. This fed through into cyclical equities – the small-cap Russell 2000 index declined by 0.5% – but both Gold (up by 1.4% to \$4,129 per ounce) and the US dollar (down by 0.5%) ignored the change in rates.

Technology and consumer-facing equities, meanwhile, forged ahead. The Nasdaq Composite index rose by 2.1%. Off the back of a strong earnings season in Q1, analysts are further upgrading their forecasts for Q2 and the rest of the year. At close to 20%, twelve-month ahead earnings growth estimates are at levels not seen since 2021, according the FT and Bloomberg.

This is prompting concerns over a potential "earnings bubble." High earnings mean a lower price/earnings (P/E) ratio. That makes valuations look more reasonable, potentially triggering another leg up in what is already a historic bull market. We've heard a lot about high stock prices. What if the denominator is the problem?

Private Markets

End-of-quarter regulatory filings from listed private credit funds have revealed that the retail redemption wave is as strong as ever – higher than in Q1 at most funds. Per [Bloomberg](#), redemption limits have "trapped" \$14 billion of investor capital (they got \$8.6 billion out).

With the most private-markets focused asset manager stocks down by at least 25% this year (retail private credit specialist Blue Owl is down by more than 40%), it's fair to say that these dynamics are probably more-than priced in.

[Stock prices chart]

See the appendix for the market monitor table

Memo

The Biggest Change in How Interest Rates are Set Since the 1990s?

Bottom line: Fed Chair Kevin Warsh's data task force could introduce profound changes to how inflation and other key indicators are measured and analyzed, potentially changing the outlook for interest rates.

What it means for investors: Our benchmark inflation indicators may soon be out of date. Those who shift their understanding of which data matters and how it will drive interest rate decisions will have an edge in rate-sensitive assets.

The third task force, the one on data, will evaluate new information sources and consider methodological changes to improve data gathering, with the aim of giving policymakers more accurate, relevant, contemporaneous, and, perhaps most important, actionable information on the state of our economy.

I would be open minded if the task force and our own best thinking had recommendations how those official statistics can be brought up to a standard of, of our time using new analytic methods [...] bringing the best practices from the private sector and new analytical tools made possible by AI, so we can forge these into a fabric that gives us better real-time information.

In these quotes from his inaugural press conference last month, Fed Chairman Kevin Warsh defined the loose remit of the "data" task force that will review how the Federal Reserve collects and uses data for the monetary policy analysis that informs its interest rate decisions.

Of the five committees announced by the chairman, we think this may be the most consequential — and the most slept on by markets. Warsh may have ruled out a change in the 2% inflation rate that the Fed targets, but he did not rule out changing how that 2% is measured. This could have profound consequences for the interest rate outlook.

We will need more information on the precise terms of reference to draw any solid conclusions on what those consequences may be. We're not ready to opine on whether the committee's work may lead to higher or lower interest rates in the short or long term, but we will be watching closely.

At this point, it's worth highlighting how placing different weights on alternative inflation metrics can shift the outlook.

In testimony before his confirmation as Fed Chair, Warsh pointed to metrics of "underlying" inflation that strip out more volatile components as being a potential way to help the Fed avoid acting too slowly, as Warsh believes was the case in 2021/22. In our view, this is the type of recommendation markets are anticipating from the data task force, which would be small potatoes — the Fed already follows these types of indices closely.

[Trim chart]

Astute observers have pointed out that if the Fed only looked at measures of "underlying" inflation (e.g., trimmed mean, "supercore" services inflation), it would get even *further* behind the curve because it would miss the signal carried by faster-moving components. This is because a higher share of underlying inflation metrics

consist of components that are either heavily lagged, infrequently updated, or imputed from indirect sources.

[Chart-shares]

Rather than relying more heavily on these data, Warsh appears to be looking for ways to make them better by finding better sources and updating them in real time. His comments indicate a strong desire to update the suite of indicators the Fed studies and reduce its reliance on outdated information, or what he called "echoes of history."

We already have one imperfect measure of real-time inflation that improves on the Fed's current benchmark of core PCE inflation. It's called "market-based" Core PCE, and it simply excludes any components that are not directly measured by actual transactions — except for one major one: housing costs are still measured by asking owners what rents they think they would get, instead of using actual market rents.

The upshot is in the chart below. Market-based PCE moves more quickly (the 2021 spike would have been caught a month or two earlier). It's also structurally higher, implying that current interest rate policy is easier than the Federal Reserve thinks.

Of course, Warsh wants to go further than this by replacing imputed data rather than excluding it. But simply looking at this index is evidence enough for us to believe that the findings of the data group, in conjunction with the work of the other task forces, could represent the biggest shift in how monetary policy is conducted since inflation targeting was introduced in the 1990s. And this doesn't only apply to inflation.

[Real time PCE]

Appendix

Proprietary Factor and Regime Model and Key Indicators

![[Factors.png]]

![[Factor Regime Summary.png]]

![[Top_Indicators_Sheet.png]]

Disclosures

AI Declaration

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