

2 GRAY BEARDS | Week 174 Summary

May 2, 2026 | Fed Transition, QRA Preview & Global Central Banks

FED TRANSITION: POWELL OUT, WARSH IN

The episode opens with a brief FOMC debrief. Last week's meeting came in slightly more hawkish than expected, though Nick and Andy view the market reaction as overblown. More consequentially, Powell has signaled he will stay only until the administration's investigation clears — at which point he departs. Kevin Warsh is the incoming chair.

Nick's thesis on Warsh: take him at his word. Warsh has publicly stated the Fed's balance sheet is both too large and too duration-heavy. Nick's base case is that Warsh will seek to:

- Reduce the absolute size of the balance sheet
- Reduce its duration composition (i.e., shift holdings toward shorter maturities)
- Offset the resulting financial tightening with one or two rate cuts at the front end

The intended yield curve outcome: a bull steepening, where the 2s and 5s come down while the 30-year stays roughly anchored. This gives banks — the natural buyers of long duration — a steeper carry incentive without blowing up long-end rates.

Andy agrees with the direction but emphasizes the institutional complexity. He frames Warsh as a rational long-game player: someone who intends to run the Fed for eight years and won't compromise that tenure with an early rash move. The committee is split along several fault lines:

- The New York Fed / SOMA desk contingent cares intensely about reserve adequacy and will resist any absolute balance sheet reduction that risks a repo squeeze
- An inflation-hawkish bloc wants patience on rate cuts and is uncomfortable easing prematurely
- A structurally aware cohort agrees the balance sheet is mis-sized and mis-composed, and is open to reform

Andy's conclusion: Warsh's vision is right and the committee will ultimately fall in line — FOMC members historically don't fight a chair for a full four-year term, as obstruction tends to marginalize them — but the process takes time. Building consensus across these factions likely takes weeks of internal deliberation before any coordinated move.

On the possibility of a June rate cut: both dismiss it as unlikely. Markets are pricing 0% probability for June and July. If Warsh were to push for a June cut, he would need to simultaneously deliver aggressive balance sheet action to offset the easing signal — a coordination that Andy doesn't think is executable that quickly. The more probable path is a methodical consensus-building effort through Q3.

EARNINGS SEASON: STRONG NUMBERS, MIXED SIGNALS

Tech earnings dominated the week. The headline read is strong, but the per-stock detail is messier:

- Google: +12% — the clear standout
- Meta: -10%
- Microsoft: -3%
- Apple: +4%, Amazon: +2%

Strip out Google and the mega-cap tech cohort is essentially flat on earnings reaction. Andy's observation: forward earnings growth estimates are decelerating, though AI capex remains a powerful structural driver. NASDAQ earnings expectations are running at roughly 44% year-over-year growth (from ~710 EPS to ~1,180), which is a massive embedded assumption.

The more interesting tell is sector breadth. XLI (industrials), XLF (financials), and XLB (materials) are all lagging meaningfully. Earnings growth expectations are broadly strong across most sectors — pharmaceuticals being a notable exception — but the market isn't rewarding non-tech names for it. Nick's read: this is a pure tech-and-AI trade; everything else is being ignored regardless of fundamentals.

The bottom line on asset prices: after an incredible April rally, Nick and Andy are looking for consolidation or retracement rather than continuation. Multiple headwinds are converging — Warsh's balance sheet agenda pushing duration into the market, heavy corporate bond issuance from hyperscalers (Meta and others), and a significant IPO pipeline. None of that is friendly to further equity upside in the short run.

QRA PREVIEW: A NEAR-CERTAIN NON-EVENT WITH TWO TAIL RISKS

The Quarterly Refunding Announcement drops Wednesday at 8:31am. The base case, with roughly 98% probability, is no change. Auction sizes have been unchanged since the February 2024 QRA (which announced April 2024 increases); the Treasury has pre-signaled stability and has no reason to surprise.

The expected language evolution: Treasury will likely soften its guidance from "comfortable with several quarters of similar auction sizes" to something more hedged — "a few quarters" or "a quarter" — telegraphing that increases are eventually coming, without pulling the trigger now.

The two 1% tails, each requiring investor action:

- Bullish tail (1%): Treasury cuts auction sizes. This would be a deliberate asset-price support mechanism — stocks could rally 10%+ between now and the next election cycle, mortgage rates would ease, and DXY would likely break below 95. Andy considers this a real but low-probability political choice by the Bessent Treasury.
- Bearish tail (1%): Treasury signals imminent auction size increases. Bad for both bonds and stocks; a supply shock that tightens financial conditions across the curve.

Andy and Nick flag that QRA reactions are typically not instantaneous — there's usually a delay before markets reprice. If either tail materializes, they commit to alerting subscribers by email with specific positioning guidance.

GLOBAL CENTRAL BANKS: HIKES TELEGRAPHED, TIMING TBD

All major central banks met this week; none acted. The direction of travel is broadly toward rate hikes — the ECB, Bank of England, and Bank of Japan are all leaning that way — but each is waiting for cleaner timing. Markets had already discounted the pause, so disappointment was limited.

The notable exception was Japan's Ministry of Finance. The MOF conducted a real, forceful FX intervention at the ¥160 level — roughly \$34 billion deployed — and followed up the next day at even more aggressive levels. The motivation is structural: Asian economies are heavily exposed to dollar-denominated oil, and a weak yen amplifies those import costs sharply. They need ¥ stability; they got it, at least temporarily.

Andy's read on the durability: he doesn't expect markets to test the MOF aggressively in the near term, but also doesn't expect markets to credit them with a permanent repricing of fair value from ¥160 to ¥150. The likely outcome is a prolonged period of narrow range trading in ¥/\$ — similar to the pattern that prevailed before the intervention.

Nick raises the systemic question: if intervention becomes recurrent and scales up toward \$100 billion, Japan would need to sell assets (likely Treasuries) to fund it. At \$34 billion, it's manageable. At \$100 billion+, it starts to leak into global yields and, in turn, into equities. For now, Andy treats it as a watch item, not an active risk.

BOTTOM LINE

The structural narrative hasn't changed. Warsh's Fed — once he gets the committee aligned — means lower short rates, flat-to-higher long rates, and a bull steepening yield curve. That is a net headwind for asset prices in the short to medium term: more duration hitting the market, cap rates rising, equity multiples under pressure.

Near-term, after April's strong rally, the path of least resistance is sideways-to-lower. The combination of corporate bond issuance, upcoming IPO supply, and QRA uncertainty creates a ceiling. Watch Wednesday's QRA for the two tail scenarios, and watch for Warsh's first FOMC meeting as the key inflection point where his agenda either accelerates or encounters institutional friction.