Investment Watch

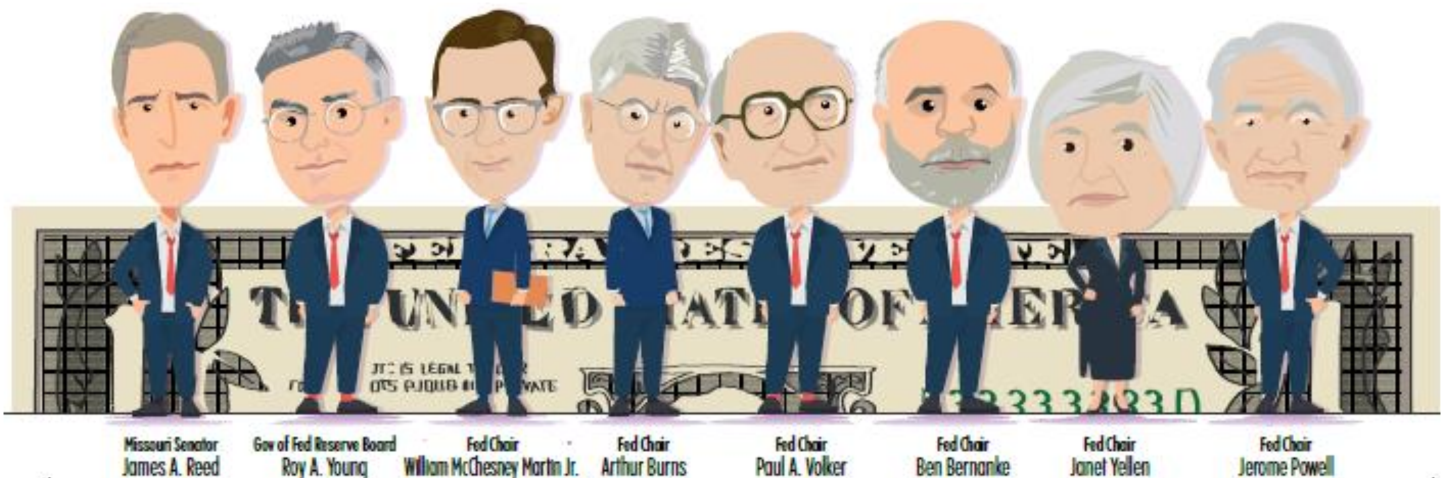
3rd Quarter, 2025

The Federal Reserve

At the top of every dollar bill you'll find the words "**Federal Reserve Note**". The Federal Reserve (the Fed) was created by Congress to address the economic crisis caused by bank runs in the 1900s. Think "*It's a Wonderful Life"* with Jimmy Stewart. The Fed is the US central bank system, a bank for banks, comprised of 12 separate reserve banks set up throughout the country. Missouri **Senator James A. Reed** was instrumental in creating the Fed with the passing of the Federal Reserve Act in 1913, not surprisingly 2 of the 12 reserve banks are located in Missouri—St. Louis and Kansas City.

Burns' friendship with President Nixon swayed him to not raise interest rates before the election in 1972. The suffering from this period of "Great Inflation" reinforced the necessity of a politically independent central bank. The Federal Reserve Reform Act of 1977 created the **Dual Mandate** pinpointing the goals of *price stability and maximum sustainable employment*.

Paul A. Volker took over as Fed Chair in 1979 with determination to provide *price stability* by breaking the inflation spiral that was undermining Americans' buying power. The Fed aggressively raised rates, even at the cost of recession, cementing the Fed's role as the guardian of *price stability* which lasted over the next 30 years.



1913 1927-30 1951-70 1970-78 1979-87 2006-14 2014-18 2018->

The Fed was established over 100 years ago with the narrow focus as the **"lender of last resort"** to stabilize the banking system and manage the money supply, but over the last century in response to fiscal crises, it has expanded and evolved into the leading institution for monetary policy, financial market stability, and emergency lending. The history of the Fed's crisis response:

- **1930s - Great Depression**

Under *Fed Chair Roy Young* the Fed was criticized for failing to provide liquidity to the banking system and its inaction was blamed for causing bank runs due to the lack of centralized power. Therefore, Congress though the Banking Act of 1935, centralized the Fed's power in Washington DC creating the Board of Governors, seven people including a Chairman appointed by the President and confirmed by the Senate.

- **1940s - WWII**

Fed Chair William McChesney Martin Jr. kept interest rates low to finance the war. The post-war economy boomed driven by pent-up demand, the GI bill, and rapid growth of new industries - the US *"golden age"* lasted 25-30 years. The Fed-Treasury Accord" solidified the Fed as an independent body responsible for managing the money supply and fostering economic stability.

- **1970s - Inflation Crisis**

Under *Fed Chair Arthur Burns* persistent inflation peaked at nearly 15% driven by government spending, OPEC oil embargoes, and underlying monetary policy.

- **2008 - Great Recession**

Fed Chair Ben Bernanke was faced with the Global Financial Crisis which jeopardized major US banks and threw the world into recession. The Fed teaming up with the Treasury Department with bank bailouts, massive lending and interest rate cuts to near zero prevented the collapse of the banking system. The Fed's power to influence not just banks but the entire financial markets reinforced the potency of the central bank.

- **2020 - Pandemic Crisis**

Fed Chair Jerome Powell met COVID-19 shutdowns head-on by directly supporting corporate lending, small business loans and expanding Quantitative Easing. The Fed backstopped much of the US economy which had ground to a halt. This massive stimulus cushioned the economy against fiscal damage, boosting the emergence from the pandemic with strong economic growth.

Today, the Fed's **Dual Mandate** is being tested due to low job numbers and sticky inflation. However, the US economy grew 3.9% in the 2nd quarter and is likely to record similar growth this quarter, twice the long-term trend. The US robust economy, with a mild 4.3% unemployment rate, exemplifies the Fed's dilemma.

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September 30, 2025

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