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## Federal Reserve Independence

**There has been substantial coverage in the media about the Federal Reserve losing its independence. The system is robust, and we see little reason for concern.** Some background is helpful. The Federal Reserve is a Public/Private hybrid system: On the Public side is the Board of Governors (members nominated by the President and confirmed by the Senate). On the Private/regional side are 12 Reserve Banks with local boards and bank participation. Policy is set at the nexus of the public and private sides at the Federal Open Market Committee (FOMC), which brings both together to set monetary policy. An appendix has been included at the end of this report for added detail about the four main components of the Federal Reserve.

**The structure of the Federal Reserve was established in 1913 with the explicit intent of spreading power and decision making.** The President of the New York Fed is always part of the FOMC, but the Board of Governors are commonly pulled from various parts of the country. Furthermore, the 12 regional Fed banks were incorporated to ensure that the remote areas of the country, and their distinctly different economies and business interests, received appropriate representation in the setting of monetary policy. The entire structure of the Federal Reserve was designed to ensure differing and competing viewpoints, and a robust decision-making process.

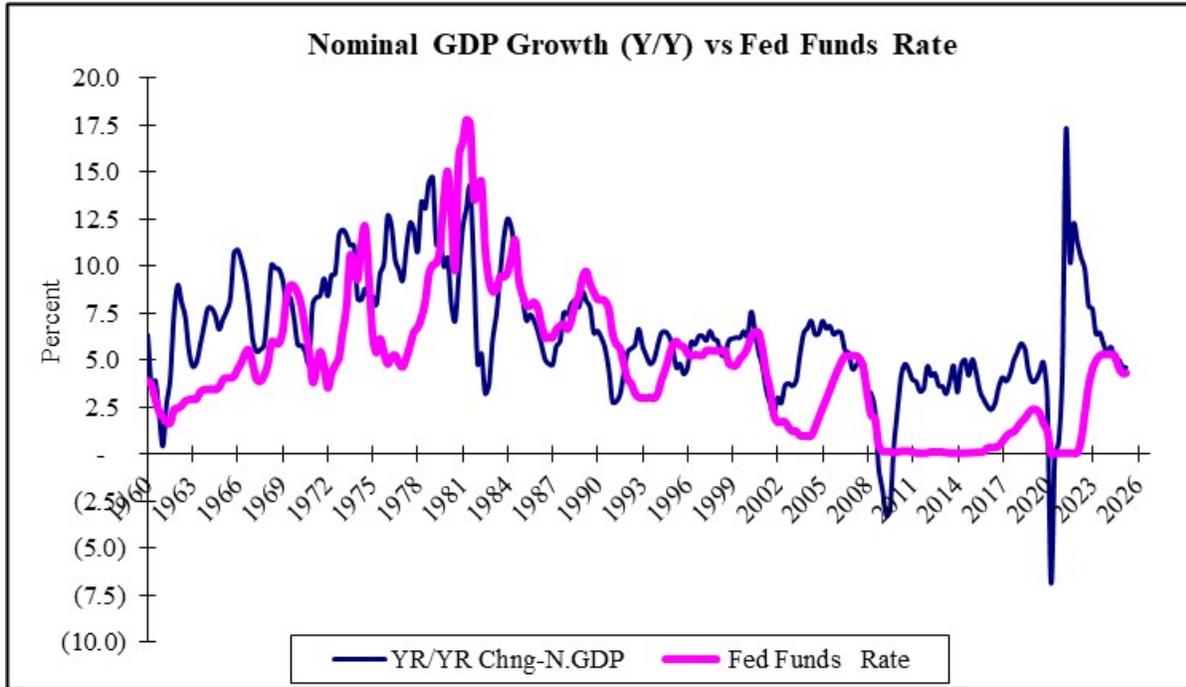
**Politics has always been part of the Federal Reserve's structure. How could it be otherwise since the President nominates all members of the Board of Governors?** For example, the media has lately been in high gear with criticism about President Trump's firing of Lisa Cook, a member of the Board of Governors. Cook was nominated by President Biden. But the firing of Lisa Cook, however the mortgage fraud charges develop, should be framed in the context of her controversial hiring. For example, Stanford University economist John Cochrane noted that her publication record is thin: "you will find essentially nothing [published] related to monetary policy, monetary effects on employment, interest rates, inflation, financial regulation or other traditional Fed topics." During her U.S. Senate confirmation process it was discussed that Cook's research focused on racial and gender inequality. So the question becomes whether Biden politicized the Fed by hiring Cook, or did Trump politicize the Fed by firing her. The answer is yes to both. And it has always been that way. But the system is designed where the members of the FOMC must discuss and professionally debate differing points of view before voting to set monetary policy. No one person holds the power to change policy. This system is not perfect, and mistakes are made. But, putting the partisan opinions aside, many would argue that it has worked reasonably well and will continue to do so.

**The controversial Stephen Miran, chair of the Council of Economic Advisors for the Trump administration, will not be a permanent member of the Fed's Board of Governors.** Miran has gained a great deal of attention because of a paper he wrote that was subsequently referred to in the media as the somewhat sinister sounding “Mar-a-Lago Accord.” That paper contained many controversial ideas, most of which centered on trade issues. Miran, for example, argued that the dollar is too strong and that it has hampered the U.S.’s trade competitiveness. He suggested that there should be a meeting of the major nations like occurred at the 1985 Plaza Accord to weaken the dollar. Forget the fact that this is a very old and contested argument, it’s not going to happen. His other ideas like a “user fee” on foreign holdings of U.S. treasury securities is also not going to happen. The paper was widely criticized and attracted so much negative attention that the White House keeps it hidden in the basement like President Trump’s bad second grade report card (just kidding). In August President Trump nominated Miran to temporarily fill the Fed chair made vacant by the resignation of Adriana Kugler. Her term expires on January 31, 2026 and Miran would hold the seat only until then, and he will have to discuss his ideas with his new colleagues on the Fed’s Board of Governors. Interestingly, Miran just today submitted his opening statement to the U.S. Senate, which must approve him. Not surprisingly he suddenly sounds very conventional: “In my view, the most important job of the central bank is to prevent depressions and hyperinflations. Independence of monetary policy is a critical element for its success.”

**The Fed’s “duel mandate,” assigned by Congress, requires the Federal Reserve to conduct monetary policy to achieve two goals: maximum employment and stable prices. This is where politics hits the wall.** The spike in inflation during the pandemic was caused by policy failure. This is now clear. The Fed’s mission, made more complicated by Trump’s opaque tariff policies, is to get inflation down below 2%. Everyone agrees on that, although some, including us, think even lower is better. The Fed is a machine with its compass set by Congress. Mistakes happen. But the Fed has no choice but to set policies that will get inflation down.

**The futures market indicates a 95% chance that the Fed Funds rate (the overnight bank lending rate) will be cut 0.25% by the FOMC at the next meeting on September 17<sup>th</sup>.** Is this expectation based on politics? No. The Fed wants spending growth to be high enough to keep business humming, but not too fast so as to fuel inflation. Unfortunately, future spending growth is not simply determined by the Fed’s policies and the availability of money and credit. It’s also a function of people’s fears, and their desire to hold cash rather than spend it. This is not reliably knowable. Hence, in the chart below, you can see that changes in the Fed Funds rate are typically following, and in reaction to, changes in spending. Since the inflationary spike in spending in 2021, nominal GDP growth has decelerated rapidly. The Fed is left in uncertainty as to whether spending continues on a downward path or starts to rebound. The futures markets apparently think spending *growth* will continue to slow, and the Fed will *follow* that spending path downward with lower

rates. We hope so because a continuing slowdown in spending is necessary to ensure that inflation, the great destroyer of business and markets, goes lower.



**On the issue of the dollar’s reserve status, we see no other serious alternative.** There have been many attempts made by the so-called BRICS countries to reduce their dependence on the USD. To some extent these efforts have been, and will continue to be successful. One way they can do this is to accumulate gold reserves. The problem here is that only about 3500 tonnes of gold are mined each year. China, for example, only has 2299 tonnes of gold reserves, and India has 880 tonnes, versus the U.S.’s 8133 tonnes of gold. It is very difficult for these countries to accumulate gold without pushing prices much higher. More importantly, reserve currency status reflects the human desire for safety and liquidity. The Chinese or Russian or South African governments may very much want to have their currency be used as a “reserve.” The problem is the Chinese people themselves do not trust their own Communist government. Chinese with money not only send their children to study in the U.S., they utilize many clever means to transfer their wealth out of China to purchase U.S. real estate, stocks, bonds and other assets. They do this because they trust the U.S. Constitution and system will be a relatively safe haven for their “reserves.” Does the U.S. government periodically do stupid things to shake this status? You bet. The Trump administration has said many things that are counterproductive. But the U.S. foundation is very large and very firm.

## Appendix - Federal Reserve Organization

The Federal Reserve can be viewed by four primary components:

1. **Board of Governors (Washington, D.C.)**  
 Role: The main governing body. Oversees the entire Federal Reserve System.  
 Composition: 7 members, appointed by the President and confirmed by the Senate. Each serves a 14-year term.  
 Leadership: One Governor is appointed as Chair (currently Jerome Powell, as of 2025) and another as Vice Chair, for renewable 4-year terms.
  
2. **Twelve Regional Federal Reserve Banks**  
 Location: Spread across major U.S. cities (e.g., New York, Chicago, San Francisco).  
 Role: The operational arms of the Fed, serving their districts.  
 Functions: Provide financial services to banks and the U.S. Treasury (e.g., check clearing, electronic payments, distributing currency and coin).  
 Conduct regional economic research.  
 Supervise commercial banks within their districts.  
 Governance: Each bank has a president and a board of directors (mix of bankers, business leaders, and public representatives).
  
3. **Federal Open Market Committee (FOMC)**  
 Role: Sets monetary policy, specifically interest rates and open market operations (buying/selling U.S. Treasury securities).  
 Composition: 7 members of the Board of Governors. President of the Federal Reserve Bank of New York.  
 4 other Reserve Bank presidents, rotating annually.  
 Meetings: Usually 8 times per year.
  
4. **Member Banks**  
 Who they are: Private commercial banks that hold stock in their regional Federal Reserve Bank.  
 Role: Provide input and receive services, but they don't "own" the Fed in the traditional sense — the Fed is a public institution with private participation.



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