Weekly Commentary with Professor Jeremy J. Siegel

2025 Outlook: Moderated Returns, A Rotation Possible

Monday, 12/23/2024

Last week's market volatility was not surprising for readers of these commentaries, as I anticipated a jarring adjustment to readouts from the Fed Dot Plot that suggested less rate cuts in 2025. While this final Fed meeting of the year recalibrated market expectations, it largely confirmed what we anticipated in recent months: the Fed remains on track for a cautious rate cut path with inflation trending down.

Last week's inflation data delivered a welcome reprieve from a string of disappointing inflation reports. Both the core and overall PCE came in one tenth below consensus. Coupled with a decline in jobless claims, which settled right in the middle of the sweet range of 200,000 to 240,000, the market had reason to cheer on Friday.

Despite all the hoopla about a turn up of inflation, overall commodity prices have not moved at all in 2024, either broad indexes or oil. While inflation is not fully behind us, these figures bolster the case for a gradually cooling economy rather than a sharp downturn.

The U.S. 10-year yield, which crossed 4.5%, remains a global standout. It is welcome that we finally have a yield curve with a positive slope. The normal term structure of interest rates could suggest the 10-year nominal bond at 100 basis points above the Fed Funds, which would currently imply a 5.3% 10-year yield. This adjustment is likely to continue normalizing with more Fed cuts and some pressure higher on the long end of the curve.

These elevated rate levels explain the ongoing strength of the dollar, which has neared parity with the euro in recent weeks. While this makes U.S. bonds increasingly attractive, it also exerts pressure on foreign economies that struggle to match the returns offered by U.S. sovereign debt. Nevertheless, a strong dollar, coupled with potential tax cuts and regulatory relief under a pro-business administration, continues to draw capital into U.S. markets.

The equity market, however, to date shows no signs yet of a definitive rotation from "growth" to "value". After years of growth stock dominance, led by the so-called "Magnificent Seven," we may see a shift in 2025. The Fed's "hawkish pause" triggered a pullback in momentum-driven names, with Tesla, in particular, facing notable profit-taking.

I expect broader market gains in 2025 to be more modest than 2023 or 2024, with the S&P 500 likely delivering returns in the 0-10% range, and a dip can't be ruled out. Growth sectors may face headwinds from rising rates, and I can see a case where they are down 10%, while small-cap and value stocks, especially those tied to domestic production, could see a relative boost and have returns from 5-15%. However, all 12-month predictions come with a large standard error.

While oil prices stabilized, gold continues its ascent, reflecting international tensions and investors hedging against uncertainty. This divergence within the commodity space underlines mixed signals about global economic health. The Bloomberg Commodity Index's flat trajectory aligns with broader disinflationary pressures, yet gold's strength suggests lingering anxieties about geopolitical risks and monetary stability.

Rotation into undervalued sectors and regions may define the year, but it is too early to make the call while the AI narrative remains intact. No one knows when the rotation will occur. I continue to emphasize diversification and watch signs for the rotation. Further rate cuts from the Fed are one likely catalyst, particularly for small cap stocks that are more reliant on borrowing at short-term rates, but small stocks have potential tax and regulatory tailwinds. A better read on Trump's tariff and immigration policies will take place in the coming months, and DJT must have at least one eye on the stock market! Happy holidays to all and we will be back to you at the beginning of January.

Please see the WisdomTree Glossary for definitions of terms.

Past performance is not indicative of future results. You cannot invest in an index.
Professor Jeremy Siegel is Senior Economist to WisdomTree. This material contains the current research and opinions of Professor Siegel, which are subject to change, and should not be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. The user of this information assumes the entire risk of any use made of the information provided herein. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.