Weekly Commentary with Professor Jeremy J. Siegel

Tariff Turbulence Raises Recession Odds

4/7/2025

Markets faced more volatility as Trump's aggressive tariff measures injected both economic and political uncertainty into the system. While the latest employment data revealed a robust labor market heading into this turbulence, warning signs are beginning to emerge, suggesting a sharp deterioration in economic momentum should these tariffs remain in place.

In my view, these are self-inflicted wounds—policy errors that threaten to cloud the signals the Federal Reserve relies on, particularly in its inflation assessments. But with money supply growth still running well below historical norms and ample room to maneuver, I believe the Fed should move to cut rates—and it should do so even at risk of inflationary pressure.

The futures markets now price in roughly three rate cuts by year-end. I think the real signal to watch isn't inflation anymore but employment. Claims data remains stable for now, but loan demand is faltering. Money supply growth of 4%—down from double-digit increases in the pandemic years—is simply too low versus the 5.5% rate I'd like to see consistent with 2-2.5% real growth and 2-3% inflation. The Fed should act to support demand, especially as the inflation signal becomes increasingly distorted by tariffs, which are supply-side price shocks, not demand-driven ones the Fed can impact.

Late Sunday night, when this letter is being written, we have just entered a bear market on the S&P 500 according to the futures market. But we must keep perspective: even in the event of a sharp earnings decline, the market's long-term value proposition remains. A 20x P/E multiple implies only 10% of a stock's value comes from its next two years of earnings. History shows that markets overreact, particularly to earnings contractions. If earnings are wiped out for two years and return to trend thereafter, stocks should fall 10%, not 30%—but that's not how the market behaves in the short term.

And that overreaction may create opportunity. At a 20x P/E, stocks still offer a 5% real return. Compare that to the 10-year TIPS yield of 1.7%—the equity risk premium is right around the historical average at 3.3%. That spread justifies holding equities for long-term investors, even amid short-term turmoil. Treasuries can cushion portfolios temporarily, but they remain a poor long-term hedge against inflation and structural deficits.

Dividend-paying stocks are gaining favor again, buoyed by falling interest rates and relative valuation appeal. Investors now face a choice: a 4% Treasury yield with no growth, or a 3% dividend yield on a stock with the potential to grow alongside inflation over time. For those whose dividends have remained stable across economic cycles, these stocks could prove particularly resilient. However, a heightened recession risk raises vulnerability for economically sensitive dividend payers, so a focus on quality dividend payers and diversification is key.

I see the potential for a sharp rebound in risk assets if political pressure forces an off-ramp on tariffs. The President could easily reverse course and declare victory after some concessions—he's done it before, and markets have responded with vigor. Should that happen, the oversold sectors, especially high-beta stocks, would likely lead the rebound. Unfortunately, in the short run, the administration appears to have dug in.

Ultimately, I urge investors to stay the course. Stocks remain the best long-term hedge against inflation and provide the best returns of any asset class. While this volatile period may challenge even seasoned investors, it's critical not to overreact. Reducing equity exposure today risks missing a sudden 2,000-point rally on the Dow driven by a single tweet. The conundrum of volatility versus long-term value is not new—it has defined markets for over two centuries. Maintain discipline, diversify smartly, and let the fundamentals prevail.

Please see the WisdomTree Glossary for definitions of terms and indexes.