Weekly Commentary with Professor Jeremy J. Siegel

## Markets Betting on Tariff Relief But Impact Still Lurks

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Despite negative GDP growth in Q1 and global trade tensions, markets are showing surprising resilience. Investors are betting tariffs will not bite as hard as feared earlier in April and that deals will emerge to soften the blow.

First quarter GDP contracted, and while the drag from imports is the primary suspect, that explanation alone is insufficient. Imports must flow either into consumption or inventories, and with hours worked continuing to rise, the negative productivity implied by the data is jarring. It suggests something more puzzling beneath the surface—perhaps a one-off quirk in the way imports surged ahead of tariffs. We'll need more data to confirm whether this was simply a timing distortion, underreported inventory data, or the beginning of a troubling productivity trend.

The employment picture remained solid, with April's jobs report broadly in line with expectations after downward revisions to prior months. Hourly earnings came in soft, at 3.8% year-over-year, which some may interpret as lower inflation pressures. But without a corresponding rise in productivity, that wage deceleration is no cause for celebration.

Investors are looking past the impact of tariffs, which still haven't fully translated into higher consumer prices. That may change as pre-tariff inventory buffers thin out. Expect sticker shock to begin emerging by late May, particularly in categories most exposed to import costs. Yet oil price drops have not passed through to consumers either—WTI has fallen, but gasoline prices have barely budged as refiners shift from winter blends to summer and slowing the pass through in prices.

Meanwhile, the fall in the U.S. dollar—down nearly 10% year-to-date—is providing a powerful tailwind for multinational earnings. With 40-45% of S&P 500 revenues sourced abroad, that currency translation effect alone could cushion the impact of tariffs on corporate profits. This, alongside hopes of deal-making and eventual tariff de-escalation, is underpinning the market's recovery.

This is also a treacherous environment for short sellers where we could be one tweet away from a 3–5% upside spike. Volatility expectations, as measured by the VIX, have come down to the low 20s, suggesting the market sees no more than average risk ahead—an assumption that may be too sanguine given policy uncertainty.

The Federal Reserve meets this week, and while I continue to believe they should cut rates with the inverted yield curve structure, they will not. Inflation pressures remain muted, with both the PCE deflator and housing data showing softness. Rents are flat and other real-time housing indicators are showing declines. Powell is likely to offer little beyond platitudes about data dependency and policy patience.

History tells us stock markets tend to overreact to recessions. While earnings may drop if the economy turns south, the long-horizon value of equities should not fall 20–25%, as often happens. If investors finally look "beyond the valley into the mountain," the downside could be limited even in a mild recession.

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