Weekly Commentary with Professor Jeremy J. Siegel

# Markets Taking U.S. Strike Well

6/16/2025

The U.S. strike on Iran over the weekend has added a modest premium to oil, and in the Sunday evening market, stocks opened only slightly lower. Any resolution to the crisis could send stocks to new all-time highs.

The market closed after a holiday-shortened week last week wrestling with a mixed tableau: a modestly hawkish Fed statement, softer housing data, and the ever-present tariff cloud. Equities have digested it all with remarkable poise, because the economy keeps grinding forward—second-quarter GDP is still tracking 3-4% percent—as firms are finding productivity offsets in artificial intelligence.

Chair Powell's press conference doubled the number of FOMC members penciling in no cuts for 2024, as Powell believes tariffs will lift prices. Treating a tax-induced price level jump as a reason to stay restrictive is simply bad economics. A 10% sales tax does not warrant monetary tightening; neither does a tariff schedule that is a tax on inputs. The Fed Funds Rate should already be almost 75-100 basis points lower—around 3.5%—to match the economy's true neutral rate.

Labor data is the canary in the coal mine. Initial claims have hovered just above 240k for three consecutive weeks; continuing claims keep edging higher as laid-off workers linger longer on the rolls. An interesting anecdote: the Fed itself is planning a 10% headcount reduction which—sounds like a productivity booster. Thousands of delayed government layoffs will hit the unemployment tallies in September. Chris Waller argued Friday morning for a potential July rate cut. Is he auditioning to be Powell's replacement? I agree with Waller, we're too far above the neutral rate with tariffs coming.

Housing delivered another weak print on starts, and shelter inflation—the whale that still drives 40% of core CPI—is rolling over. That deceleration will offset much of the tariff bump this summer. Barring an oil shock from worsening Iran conflict, core inflation will undershoot the Fed's new 3% PCE forecast, compelling at least two quarter-point cuts before year-end. The bond market sees it: term premiums remain subdued, and Europe is already easing. America's policy rate is now the global outlier.

Geopolitics is a wildcard, but the U.S. is far less exposed than it was in the 1970s. Even a brief closure of the Strait of Hormuz would not derail domestic growth—shale capacity and strategic reserves mute the blow. If the Fed interpreted such a spike as a permanent inflation impulse, that would be another policy error; if instead it focused on the likely demand hit, the path to cuts only steepens.

I maintain that investors should stay overweight equities versus bonds: a Fed Funds Rate sliding toward 3% re-anchors the discount rate and sustains multiples. Second, don't just chase the AI enablers at high multiples to earnings; real margin expansion could very well accrue to users of AI—banks, industrial, consumer-staples, mid-cap firms that are learning where they can cut costs, increase output and improve margins. Third, a steeper yield curve favors dividend-rich value stocks and defensives once the Fed finally pivots, while still giving cyclical exporters room to perform if tariffs plateau or fade rather than escalate.

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