



Tariff Headwinds Manageable as AI and Earnings Drive Gains

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The U.S. economy is still proving resilient despite global tensions and trade barriers. The news of a 15% EU deal is very encouraging, and there were few other restrictions in the preliminary agreement. But investors should prepare for some economic drag as these tariffs take hold in the second half of the year. The cumulative inflation impact from tariffs is likely to be modest, perhaps 1.5% to 2% over two years, while the GDP drag remains limited and manageable.

The market has come to terms with this dynamic and continues to look ahead to more powerful, longer-term forces, particularly the ongoing AI. I think the market rightly assesses this will buoy productivity and earnings. In particular, the immediate expensing provision for capital equipment that came in the 'One Big Beautiful Bill' is a meaningful tailwind for corporate investment, counteracting some negative tariff effects.

Recent economic data remains trending well. Jobless claims fell below 220,000, signaling continued labor market steadiness, while the S&P Global PMIs revealed slightly soft manufacturing but better-than-expected service activity. On net, the forward momentum in economic activity remains intact.

Importantly, earnings season is not showing signs of a breakdown. While there is some cautious forward guidance, the tone has been far more constructive than feared. I'm encouraged by year-end earnings estimates, which remain stable or even modestly positive. I continue to believe we are in a healthy bull market with no signs of internal deterioration.

Turning to the Federal Reserve, while I do not expect a rate cut this week, it's clear the bias is shifting toward easing. Inflation readings remain slightly softer than expected, which supports the case for eventual cuts. Chair Powell's relationship with President Trump is obviously strained but stable. Trump may be benefitting politically from keeping Powell in place, using him as a scapegoat should economic conditions deteriorate. This is one reason I suggested last week Powell should resign so Trump would fully own the economic conditions. Powell appears to have implicitly signaled that cuts are on the way, perhaps at the September meeting. The Fed has often used the Jackson Hole Symposium in August as a time to discuss big policy pivots, and this August could be a useful time to signal this shift lower in rates.

One area that deserves more analytical attention is the rising presence of stablecoins on U.S. liquidity and the money supply. These digital dollar instruments, now totaling \$250–270 billion in aggregate, function in many ways like other bank deposits and should arguably be included in M2. While they currently represent just 1% of the \$25 trillion money supply, their transactional role and potential growth could meaningfully impact liquidity measures in the coming years. As more payments move outside the traditional banking system, our definition of money must evolve to reflect this reality.

From a valuation perspective, some argue markets are expensive. When measuring forward P/E ratios, we are increasingly pricing in next year's earnings, which are supported by strong productivity trends and expanding technology adoption. The 2025–2026 EPS outlook is solid, and while earnings might come down from lofty year ahead outlooks, I continue to see upside in equities.

This week, the Fed is on a dovish hold, and we should see payroll gains around 100k, maybe 1 tick up in the unemployment rate and an advanced GDP for the second quarter of around 2.6 %, which gives us a 1% average gain for the first half. Early projections for the second half are 1.5% GDP growth, depending on how the consumer reacts to the tariff increases.

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