



## Fed Signals A Dovish Tilt and Market Rotation

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The Fed delivered what I would describe as a dovish version of the “hawkish cut” and the market’s reaction since then has confirmed that interpretation. Chair Powell did not pre-commit to additional easing, but almost everything surrounding the decision—his tone on inflation, his acknowledgment of labor market softness, and an underappreciated shift on the balance sheet—tilted clearly in a more accommodative direction. Equity markets heard that message immediately, with the S&P 500 and Dow moving to new highs and market leadership began to subtly change.

What I consider the surprising headline of this meeting is the effective end of quantitative tightening and a sooner-than-expected resumption on buying bills to create reserves. The Fed’s decision to begin buying Treasury bills, roughly \$40 billion per month, may be framed as a technical reserve-management operation rather than QE, but in practice it halts QT and adds liquidity at the margin. For markets that have been quietly worried about reserve scarcity and funding stress, this was a very important signal. The Fed is once again erring on the side of ample liquidity, and that has historically been supportive for risk assets.

Even more important was Powell’s conceptual shift on inflation. For months I’ve argued that tariffs represent a one-time price-level adjustment, not a persistent inflationary force. This was the first press conference where the Fed chair echoed that view so explicitly. Powell emphasized that inflation pressures are concentrated in tariff-affected goods rather than services, and that much of that impulse is already behind us. He repeatedly referenced TIPS break evens as evidence that inflation expectations remain well anchored. That matters enormously. When the Fed stops treating every price shock as the beginning of a new inflation regime, the bar for restrictive policy falls.

The labor market discussion was striking. Powell essentially acknowledged that payroll data have been overstated by roughly 60,000 jobs per month due to distortions in the birth-death model. If you take that seriously, the last three months of reported job gains are effectively negative. That aligns with what I’ve been calling the “no-hire, no-fire” economy—firms are reluctant to lay off workers, but they are not adding aggressively either. The Fed is forecasting unemployment around 4.4–4.5%, and we are beginning to see early signs consistent with that path. Jobless claims jumped sharply the day after the meeting, reminding us how volatile the data can be, but that is a series we now need to watch carefully for confirmation rather than noise.

Putting these pieces together—the end of QT, a softer inflation framework, and growing recognition of labor market cooling—the direction for short-term rates remains clear. I continue to believe the Fed funds rate belongs in the low 3s, with roughly a 100-basis-point spread to the 10-Year Treasury. With the 10-Year hovering around 4.1–4.3%, that implies another 50 basis points of easing ahead. The timing will be data-dependent, but the destination has not changed.

Importantly, investors should not assume that Fed cuts automatically translate into a sustained rally in long-dated Treasuries. If the economy avoids recession, and that remains my base case, 10-year yields are unlikely to hold below 4% for long, if they reach that level. The benefit of easing will be concentrated at the front end of the curve, relieving pressure on households, banks, and businesses tied directly to short-term rates. A normalizing yield curve driven by lower short rates, rather than collapsing long rates, is actually a healthy backdrop for equities.

Also, since the meeting: we are seeing signs of market rotation. While the S&P and Dow have pushed to new highs, the NASDAQ has lagged, and some high-profile AI names have stumbled. Oracle’s earnings were solid, but not spectacular, and the stock was punished due to fears on its spending and debt loads. The bar for AI-linked mega-caps is now extraordinarily high. This does not signal a collapse in those stocks, but it does argue for more caution.

This could be the long-anticipated broadening of the market, with non-Magnificent-7 and non-tech sectors beginning to benefit from lower rates and improving margins. That is a healthy development and one I expect to persist into next year.

There are still near-term risks that markets will have to navigate. A Supreme Court ruling on tariffs could arrive before year-end, and betting markets still suggest meaningful odds that existing tariffs are curtailed or restructured. That does not mean tariffs disappear, far from it, but even partial relief could have a significant impact on margins for many companies that have been pricing in worst-case outcomes, but also uncertainty. At the same time, the risk of another government shutdown early next year cannot be dismissed in late January.

On inflation, the news continues to improve. Gasoline prices recently hit multi-year lows, oil remains well below \$60, and forward-looking inflation expectations continue to drift down.

Finally, on AI, I remain optimistic but realistic. Some recent forecasts show limited earnings impact next year, with more meaningful benefits showing up in 2027 and beyond. That can be interpreted in two ways: either AI is overhyped, or companies have yet to fully embrace tools that will eventually prove transformative. The competition for AI models and bringing costs down could lead to this rotation: beneficiaries being firms that use AI to cut costs, raise productivity, and expand margins—not just those selling the infrastructure.

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