



Another Shutdown? Markets Digest January Noise

1/26/2026

Dems have thrown a monkey wrench into what has looked like a done deal in the market. Threatening another shutdown, the prediction markets have moved from less than 10% to now over 70% that another shutdown will occur, which should impede the upward movement in the market.

Attention is also turning to the Fed leadership question, where the field has narrowed to what looks like a two-horse race between Warsh and Rieder. Importantly, markets view either outcome as benign. This has kept policy uncertainty contained, even as investors look ahead to the Fed's upcoming meeting. I expect uneventful: no new dot plot, no policy change, and a clear pause. The key point is that nothing in the incoming data since December has undermined the Fed's prior message. The economy remains strong, jobless claims are hovering near 200,000, and recession fears continue to recede.

The Supreme Court, however, again declined to rule on the tariff cases and has adjourned for several weeks, pushing the earliest possible decision into late February. While disappointing from a clarity standpoint, the delay does not materially alter the near-term growth or earnings outlook, and markets appear comfortable waiting. But with less than a week left in the month, I had hoped to get a resolution on at least one of these fronts.

Growth momentum remains the central story. The GDP Now estimates are tracking growth north of 5% for the fourth quarter, though that figure may be revised lower once one-off factors such as gold transfers are adjusted. Growth comfortably above 4% would be extraordinary, especially given modest employment gains. This divergence underscores what I see as the defining theme of 2026: a genuine productivity revival driven by technology. We are producing more output with fewer workers, precisely the kind of dynamic that supports higher real growth without reigniting inflation, but higher earnings growth for corporates.

Geopolitics briefly rattled markets during the week, including headlines around Greenland and renewed tariff rhetoric. Yet, as we see repeatedly, these episodes functioned more as bargaining tactics than as precursors to sustained trade wars. Europe's initial tough talk on retaliation raised eyebrows, but tensions quickly de-escalated. Trump's tariff rhetoric remains a background risk rather than a front-line macro threat.

Earnings season has reinforced this constructive backdrop. While individual stocks are seeing mixed responses largely on 2026 guidance uncertainties, the aggregate picture is reassuring. There is no evidence of deterioration in consumer spending or labor markets, and corporate profits are holding up well. Importantly, leadership within the equity market is broadening. Small-cap stocks and value stocks are meaningfully outperforming in 2026, marking one of the strongest relative runs for value since the growth-led bull market began several years ago. This rotation is consistent with my view that beneficiaries of artificial intelligence are primed to become consumers and users of AI, not just its producers.

In fixed income, credit fundamentals look solid, but total returns are constrained by duration risk. Spreads have compressed sharply, particularly in agency MBS, partly reflecting policy actions. Still, from a broader macro perspective, the bond market is simply moving back to a normal term structure. Historically, the 10-Year Treasury yield has averaged about 110 basis points above the fed funds rate. If the 10-year holds near 4¼%, that implies fed funds in the low 3% range over time—roughly two additional 25-basis-point cuts. I would only grow concerned on implications for the equity markets if the 10-Year were to move decisively above 5%, which could signal fiscal stress. We are not there.

Taken together, the past week reinforces my optimism for the year ahead. Growth is strong, productivity is improving, inflation is contained, and markets are broadening beyond last cycle's narrow leadership. While noise around policy and geopolitics will persist, the fundamental trajectory for both the economy and markets remains firmly positive.

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