



## Lack of Progress in Iran Triggers Oil Spike, Raises Correction Risk

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Lack of progress in the war with Iran and the hardline position taken by the new Supreme Leader, coupled with more missile strikes at or near oil facilities has send oil surging and stocks sinking. A correction in the market (greater than 10% down) is now much more likely. At this point, however, I do not see a recession or a bear market. If there is any news of a ceasefire, stocks will soar. The fundamentals of the economy are still very strong.

Markets face a complicated mix of signals. The payroll report came in dramatically weaker than expected, several standard deviations below forecasts, and prior months were revised downward. Taken together, the last two months essentially show zero payroll growth. Normally that type of data would signal a sharp slowdown in economic activity. Yet the rest of the economic evidence tells a very different story.

Retail sales for January came in roughly at expectations, and the February ISM reports—particularly the services index—were extremely strong, reaching multi-year highs. In other words, the real economy does not look weak at all. We are seeing stable, even rising GDP growth at the same time payroll growth has stalled. That combination points to one explanation that investors should not ignore: a sharp rise in productivity.

If firms are producing the same—or more—output with fewer workers, that is the classic definition of a productivity surge. The productivity data we received for the fourth quarter already hinted at this, with both the third and fourth quarter figures revised upward. If GDP holds firm in the first quarter despite stagnant employment, it would confirm that productivity growth has accelerated meaningfully. The obvious candidate driving that shift is the rapid adoption of artificial intelligence and automation technologies across industries.

What makes this payroll number particularly puzzling is that other labor indicators do not corroborate widespread weakness. Initial jobless claims remain within their normal range and are not signaling layoffs. Even the employment components of the ISM surveys remain relatively firm. Meanwhile, the Challenger layoff report actually showed a large decline in announced job cuts—from over 100,000 in January to roughly 48,000 in February. That does not suggest an economy suddenly shedding workers.

Some temporary factors may also be distorting the data. January was one of the coldest months in decades, which likely disrupted hiring in several industries. There were also sector-specific disruptions, including strikes in parts of the healthcare sector in California. But even adjusting for those factors, the larger narrative still points toward productivity improvements rather than a collapse in demand.

For equity investors, rising productivity is generally a very favorable development. If companies can produce the same output with fewer workers, margins rise—at least initially before competition erodes those gains. In the short run, that dynamic is strongly supportive for corporate profits.

At the same time, geopolitics is now dominating market sentiment. The conflict involving Iran and the resulting threats to energy infrastructure across the Middle East are pushing oil prices higher. The potential disruption of shipments through the Strait of Hormuz is particularly critical. If significant volumes of oil cannot pass through that corridor, prices will move above \$100 per barrel. Wholesale gasoline prices have already risen roughly 60 cents in just two weeks, which is highly visible to consumers and politically potent.

This situation introduces a classic supply shock. And that distinction matters for monetary policy. A supply-driven rise in energy prices is not something the Federal Reserve should respond to by tightening policy. When oil prices rise because of geopolitical disruption, the shock already slows economic activity by itself. Raising rates in response would simply compound the negative effects.

From a macroeconomic perspective, higher oil prices represent a relative price change. If the money supply is held steady, higher energy prices should be offset by lower prices elsewhere in the economy. The strong U.S. dollar reinforces that adjustment by reducing the cost of imports. As the dollar rises, imported goods and services become cheaper, helping offset part of the inflationary impulse coming from energy.

Despite the weak payroll report, the Federal Reserve is extremely unlikely to change policy at its next meeting. One data point—especially one contradicted by several other indicators—is not enough to shift the Fed’s stance. At the moment, the central bank appears locked into a “no change” posture. Markets briefly priced in more easing after the payroll number, but rising oil prices could quickly reverse those expectations if they feed into inflation expectations.

Looking ahead, I continue to believe the equilibrium for the federal funds rate should ultimately settle in the low-3% range, roughly 100 basis points below the 10-year Treasury yield. That spread has historically been a reasonable benchmark for neutral policy. Recently, however, the 10-year yield has moved higher, reflecting both geopolitical risk and diminished expectations for near-term rate cuts.

Another issue drawing attention is stress in private credit markets. There have been headlines about redemption pressure and rising concerns about loans to software companies and other technology firms. But so far, the data simply do not show widespread distress. Credit spreads have widened slightly, but the moves remain modest. With GDP growth still solid and corporate earnings holding up, the cash flows supporting credit markets remain strong.

In my view, the public markets continue to demonstrate their greatest advantage: price discovery. Private credit may appear stable partly because it lacks continuous pricing. Public markets, by contrast, instantly incorporate new information, which is why they can appear more volatile even when fundamentals are solid.

For investors, the key takeaway is that the payroll report likely tells us more about productivity than about recession risk. If the economy is producing more output with fewer workers, that supports margins and earnings growth in the near term. The bigger uncertainty lies in geopolitics and energy markets, not domestic demand.

In short, the economy today looks far more resilient than the headline payroll number suggests. If productivity gains continue and geopolitical tensions ease—even modestly—the market could be poised for a powerful rebound.

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