



Money Growth and Oil Renew Inflation Risks

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The market remains remarkably resilient, but I have expressed a more cautious outlook in the near term as rising oil prices and a renewed pickup in money growth complicate the inflation outlook. The latest CPI report was modestly better than expected on the core, and shelter inflation still appears to be moving in the right direction, but I do not think investors should take too much comfort from a single favorable print collected before the full energy shock has filtered through. The failure of talks this week only accentuates this point.

The key issue now is that higher oil, higher diesel, and higher fertilizer costs are likely to work their way into freight, shipping, airfares, and a broad range of goods prices over the next two to three months. At the same time, weekly deposit data suggest money growth may be turning higher again. That combination is exactly what the Fed does not want to see.

There is risk that the next move in rates could be up rather than down. I am not calling for a hike as the base case, but the odds are no longer negligible. A month ago, the market was still anchored on eventual easing. Now the policy debate is more difficult.

If the economy were clearly rolling over, the Fed could look through an energy shock. But that is not what the data are showing. Jobless claims have risen only into the middle of a still-benign range, consumer spending has held up, and tax refunds have provided an offset to some of the hit from higher gasoline prices. As long as demand stays firm, the Fed has to take seriously the risk that a temporary commodity spike becomes more broadly embedded.

The bond market is sending a similar message. Even after the softer-than-expected CPI details, the early rally in the 10-year Treasury quickly faded. That tells me investors understand the bigger problem: the inflation data are backward looking, while oil is a live shock still moving through the system. With the 10-Year around 4.30%, the market is not pricing much easing, and rightly so. If inflation pressures persist, long rates will struggle to move materially lower. In that environment, bonds are not providing the clean diversification investors had hoped for.

That has important portfolio implications. Commodities remain one of the clearest hedges against this type of inflation surprise, and real assets generally should continue to hold up better than nominal fixed income if the pressure persists. I still like real estate and other real asset-based exposures.

The more important point is that we are not yet reliving the money-supply explosion of 2020 through 2022. Back then, we had two years of the most extraordinary monetary expansion in modern history. Right now, it is a one-month acceleration and that is just an early warning, not a replay. But an early warning matters when energy costs are rising at the same time.

The market's bounce has the look of a low-volume rally driven more by short covering. Traders do not want to stay short into the possibility of a favorable geopolitical deal, and that alone can fuel sharp snapbacks. But unless we get a meaningful de-escalation that takes oil decisively lower, I suspect equities remain mostly rangebound in the near term. If oil were pushed back toward the low 80s, the inflation scare would ease substantially, and the market could quickly regain momentum. If instead oil remains elevated near current levels, the inflation pass-through will become much harder for both the Fed and investors to ignore.

My long-run optimism on equities has not changed. There are still good underlying forces in this market, and if we get a favorable resolution on the energy front, stocks can move to new highs. The economy remains strong enough to prevent quick easing, yet vulnerable enough to feel the cost shock. That is an awkward mix. For now, I think the most likely outcome is a sell-off as a result of the failure of the Iran-U.S. talks and then a choppy, sideways market while investors wait for clarity on oil, inflation transmission, and whether the Fed is forced to rethink the direction of its next move.

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