Weekly Commentary with Professor Jeremy J. Siegel

Warsh's Communication Misstep Doesn't Change the Bigger Picture

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The market spent much of this week trying to interpret what Fed Chair Kevin Warsh meant rather than what he actually said and that was entirely avoidable. The decision to leave rates unchanged was defensible. What wasn't defensible was Warsh's lack of explanation. Markets don't require the Fed to promise its next move, but they do require a coherent framework. Warsh could have explained that the recent rise in oil prices is viewed as a temporary supply shock, that productivity gains continue to restrain underlying inflationary pressures, and that longer-term inflation expectations remain well anchored. Instead, he largely deferred to the market and offered little insight into the Fed's thinking. That left investors filling in the blanks themselves.

The debate over forward guidance is a legitimate one. Warsh has clearly signaled he prefers allowing markets to determine expectations rather than having the Fed pre-commit to future policy. There are reasonable arguments for that approach. But even without providing explicit forward guidance, central bankers still have an obligation to explain the economic framework behind their decisions. On that score, this press conference fell well short.

The market's reaction beneath the surface was equally important. During the five trading days ending last Wednesday, the Russell Growth Index suffered its worst relative performance versus the Russell Value Index in roughly four and a half years. That sounds dramatic, but I actually view it as a healthy development. For months I've argued the only area approaching bubble-like conditions was a narrow group of chip and related stocks. Removing some of the froth without damaging the broader market is constructive. Leadership broadening is exactly what durable bull markets should experience.

Importantly, recent market moves are not a wholesale rejection of artificial intelligence. We're already seeing significant dispersion within technology itself. Some AI leaders have stumbled while others continue to post extraordinary earnings and investment plans. Meta and Amazon, for example, have reacted very differently. That kind of differentiation reflects investors becoming more selective rather than abandoning technology stocks altogether. The AI revolution remains intact, but the market is beginning to distinguish between winners and losers instead of treating every AI-related company identically.

The economic data also deserve a more nuanced reading than the headline GDP number suggests. Second-quarter GDP came in at only 1.5%, disappointing many forecasters. But that weakness was largely driven by a surge in imports, itself a consequence of remarkably strong consumer demand. Consumption remains resilient, which is the far more important signal for the underlying economy. The St. Louis Fed's GDP tracker moved sharply lower ahead of the release and ultimately proved closer to the final outcome than many private forecasts, while Goldman Sachs remained near 2.5%. Now the early estimates for the third quarter are already diverging, with the St. Louis Fed opening near an eye-catching 5% growth rate. Whether that proves sustainable remains to be seen, but it illustrates that the economy still has considerable momentum.

The single most important variable remains oil. We hope the current pause does lead to a durable agreement. Earlier this summer, many analysts dramatically overestimated how high oil prices would move following the initial Middle East conflict and disruptions surrounding the Strait of Hormuz. That forecasting error has left many traders reluctant to build long positions today, fearing that any diplomatic breakthrough could quickly send crude prices sharply lower. But the opposite risk cannot be ignored. If the conflict persists and shipping disruptions continue, global inventories may prove thinner than many expect. Strategic reserves have already been drawn down in many countries. If oil moves decisively above $100 per barrel and gasoline prices return toward the $4.50 to $5.00 range, inflation expectations would rise and much of today's optimistic economic outlook would have to be reconsidered.

Conversely, if oil retreats back toward the $70 area as geopolitical tensions ease, the outlook brightens considerably. Consumer confidence has softened modestly in recent surveys, but much of that appears tied to energy costs and geopolitical uncertainty rather than deteriorating economic fundamentals. Lower oil prices would relieve inflation concerns, support household purchasing power, and likely reinforce the broadening leadership we're now seeing in equities.

For now, I remain encouraged. The recent rotation away from the market's most speculative leadership, while uncomfortable for some investors, strengthens rather than weakens the foundation of this bull market.

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