Weekly Commentary with Professor Jeremy J. Siegel



Tech Weakness Fuels Bond Rally and Value Rotation

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The Federal Reserve meeting last week was largely uneventful. The S&P 500 and the 10-year Treasury yield ending the trading session almost exactly where they stood before the Fed's announcements. Despite some disagreements within the Fed, there was virtually no forward guidance. The Fed is content to wait until December, particularly given the uncertainty surrounding the midterm elections, developments in Iran, and oil prices. A 50-basis-point increase remains possible if inflation pressures warrant it, although a more substantial deterioration in the AI sector and broader financial markets could change that calculation.

What is much more interesting is the continued rotation away from AI-related stocks and into value, accompanied by falling bond yields. The 10-year Treasury yield has declined from approximately 5.35% to 4.90%, with further declines accompanying weakness in the Nasdaq. I have been highlighting this relationship over the past several weeks. As enthusiasm for AI moderates, expectations for economic growth and capital spending adjust, putting downward pressure on interest rates and providing support for value stocks.

The uncertainty surrounding AI remains extraordinarily high, which means relatively small changes in sentiment can produce substantial movements in stock prices. But we need to maintain perspective. Even with the recent selling, the Nasdaq remains less than 10% below its all-time high. That is a pullback, not even a correction. Certainly, individual stocks have suffered much greater losses, but the broader technology market has not experienced anything approaching a bear market.

There are parallels to the market rotation that began in 2000, when technology stocks weakened, bond yields declined, and value stocks substantially outperformed. However, I want to emphasize that today's valuations are nowhere near the extremes of the technology bubble 25 years ago. I am not forecasting anything resembling the large-scale Nasdaq decline that followed. We could see a correction if sentiment continues to deteriorate, but I believe a genuine bear market would require much stronger evidence of declining AI spending, weaker demand for computing capacity, or a significant reassessment of the industry's growth prospects. We have not yet seen that evidence.

Turning to the midterm elections, prediction markets have shifted substantially toward the Democrats, with several previously secure Republican races becoming surprisingly competitive. Current probabilities suggest the Democrats could gain control of the Senate, potentially by a 53–47 margin, with the possibility of an even larger majority if the late momentum continues. But prediction markets are not certainties, and these elections remain fluid.

From an economic and market perspective, a Democratic Congress will not produce major legislative changes over the next two years. President Trump retains veto power, and much of his legislative agenda has already been enacted. Divided government would likely mean considerable gridlock, with major policy changes largely postponed until the 2028 presidential election. That election, rather than this year's midterms, will be a much more consequential political event for the longer-term direction of markets and economic policy.

There is growing political opposition to data centers, including proposals to restrict new construction in states such as Texas. My view is that enormous positive economic incentives associated with these projects will ultimately prevail. If one community rejects a data center, another will welcome the investment, jobs, and tax revenues. The greater risk to construction is not necessarily political opposition, but whether the underlying demand for AI-computing power justifies the spending. If that demand is there, I believe developers will find places to build.

My overall assessment remains constructive, although I expect continued volatility in the AI sector. The rotation toward value and the decline in bond yields are behaving much as history would suggest when enthusiasm for a dominant growth sector begins to cool. Investors should distinguish between a healthy reassessment of valuations and evidence of a fundamental deterioration in the economy. At this point, I see the former rather than the latter, and I believe the improving relative performance of value stocks is an important development that could continue.

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