



## Economic Resilience, Fading Inflation Supporting Value Rotation

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The sharp retreat in oil prices has dramatically altered the market narrative. Just weeks ago, investors feared a renewed inflation shock from the conflict with Iran. Instead, crude has fallen back toward pre-conflict levels, Treasury yields have declined, and markets have begun rotating aggressively away from the large tech hyperscaler, the Magnificent Seven, that dominated recently and toward more cyclical and value-oriented sectors. In fact, Thursday marked one of the strongest relative performances of Value versus Growth in years, suggesting that investors are reassessing both valuations and the macro backdrop.

The economy itself continues to display remarkable resilience. Final first-quarter GDP was revised higher to roughly 1.5%, largely because of improved trade data, while estimates for second-quarter growth have converged around a healthy 2.5% (although a wider trade deficit reported later Friday may lower that figure by a couple of tenths). Although consumer spending was revised to be somewhat lower, overall activity remains solid. Weekly jobless claims have improved, durable goods orders have exceeded expectations, and labor market forecasts have strengthened. Just a few months ago, many economists believed payroll growth had settled into a new normal of 0 to 50,000 jobs per month. Now expectations have shifted back above 100,000, reflecting an economy that continues to create jobs at a surprisingly healthy pace.

The productivity story, however, deserves careful attention. Strong employment is unquestionably positive for workers, but rapid hiring also means productivity gains become harder to achieve. Producing more GDP with substantially more workers is fundamentally different from producing more output with the same workforce. The massive AI investment boom is boosting measured investment and GDP today, but the ultimate test is whether those investments translate into lower prices, higher productivity and better living standards for consumers. Economic welfare ultimately depends on consumption rather than investment alone. To wit, you cannot eat a datacenter that shows up in the investment component of GDP.

That question becomes particularly relevant as technology hardware prices move in an unusual direction. Traditionally, consumers receive greater computing power at the same price—or equivalent performance at a lower price. Today, however, memory shortages tied to AI infrastructure are pushing up the cost of many technology products without delivering corresponding improvements in underlying hardware performance. Markets are beginning to grapple with whether consumers will accept higher prices for devices such as iPhones whose principal change is more expensive memory rather than meaningfully improved functionality.

The outlook for inflation continues to improve. With crude oil falling and gasoline prices beginning to follow, headline inflation should receive meaningful relief over the coming months. The latest PCE inflation data were largely in line with expectations, while commodity prices broadly remain under pressure. Unless geopolitical tensions unexpectedly reignite and energy prices surge again, I believe the case for additional rate hikes has effectively disappeared this year. Lower energy prices simply work in the opposite direction of tighter monetary policy.

Looking ahead, I continue to believe monetary policy will gradually shift toward a more forward-looking framework. Rather than placing overwhelming emphasis on backward-looking year-over-year inflation statistics, policymakers are likely to pay increasing attention to real-time indicators, including commodity prices, financial conditions, labor market trends and money supply growth. M2 has accelerated modestly, but as long as productivity improves alongside economic growth, that increase need not become inflationary.

This week's employment report will therefore take on added importance. A payroll gain comfortably above 100,000 would reinforce the view that economic momentum remains healthy despite moderating inflation. Combined with declining energy prices and easing bond yields, that would represent an unusually constructive backdrop for equities.

The market itself appears to be undergoing an important internal rotation rather than entering a broad correction. After years of extraordinary leadership from the Magnificent Seven and technology stocks, investors are increasingly looking toward sectors that benefit from lower inflation, lower interest rates, and more attractive valuations. The long-term AI story remains compelling, but leadership within the equity market is rotating. That is typically a sign of a healthier bull market rather than a weaker one.

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Professor Jeremy Siegel is Senior Economist to WisdomTree. This material contains the current research and opinions of Professor Siegel, which are subject to change, and should not be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. The user of this information assumes the entire risk of any use made of the information provided herein. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.