



2025 Economic & Market Outlook Closing the Curtain

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Key Takeaways

- + Despite a visibly “cooler” labor market, the underlying fundamentals of the U.S. economy remain resilient, warding off recession fears.
- + Although the Federal Reserve resumed rate cuts at the September FOMC meeting, and policy is still skewed toward additional easing, Chairman Powell acknowledged that monetary policy remains data-dependent and “not on a pre-set course.”
- + The Treasury 10-Year yield is expected to remain at an elevated, “normal” level with heightened headline and data dependency producing continued volatility.
- + We believe the bond portfolio decision-making process could benefit from taking an active-passive barbell approach from a solution standpoint.
- + We remain constructive on global equities, with keen interest in U.S. small caps and our multi-year bullish call on Japan. The primary risk in stocks is to the upside, where a runaway market decides to run more.

The Macro Backdrop

Job Growth Not What We Thought

There is little question that the key economic storyline of Q3 was the fact that new job creation was not anywhere near as solid as the markets and, perhaps more importantly, the Fed believed. Indeed, while the headline number for monthly nonfarm payrolls has revealed definitive cooling, it was the rather sizeable downward revision to the May and June tallies that really stood out. In fact, as of this writing, the June payroll number actually contracted, the first monthly negative showing since 2020.

That being said, it is interesting to note that the unemployment rate still stands in the historically low 4%'s, and weekly jobless claims remain in non-recessionary territory. These developments have given rise to the saying that the U.S. labor market setting is in a “no-hire, no-fire zone.”

In terms of the underlying economy, the consumer has remained stalwart, continuing to provide solid contributions, as underscored by the recently better-than-expected monthly Retail Sales report. As a result, economist projections for Q3 real GDP are coming in anywhere from +2.0% to +3.0%, after the second quarter rebound in growth of +3.8%.

While the impact of tariffs and a cooling in new job creation need to be watched closely, it has become more apparent that the U.S. economy may be able to avoid investors' post-Liberation Day worst fears, i.e., an outright recession.

Inflation: Searching for Tariff-Induced Inflation

The “other shoe” the markets have been waiting to see drop is whether tariff-induced inflation will rear its ugly head. Thus far, there has been no surge in price pressures, but there have been signs that the spring bout of disinflation may now be over.

After coming in as low as +2.8% as recently as May, core CPI has since rebounded to +3.1%, while the Fed’s preferred core PCE gauge has also risen 0.3 pp to +2.9%. Although neither of these inflation readings should necessarily be deemed as worrisome, they are moving further away from the Fed’s +2% target.

Where should investors look to see if tariffs are playing a role in future price pressures? The goods component. Service-related inflation has managed to stay relatively calm, which is good news. However, according to recent CPI data from the goods side of the ledger, prior unchanged or negative monthly readings earlier in the year are now on the plus side, albeit remaining somewhat modest. Going forward, any tariff-related price increases would be more likely to show up in the goods sector of the economy, while services could be more neutral on overall inflation trends.

“Tariff-driven price pressures may resurface in goods, but the Fed’s 2% target remains elusive.”

The potential challenge going forward will be to see if the markets can look through any tariff-induced increases to inflation and focus instead on underlying demand pressures. In addition, as Fed Chair Powell recently stated, another key factor to consider is whether any potential increase in prices will be short-lived or have more of a persistent impact.

Either way, the Fed’s 2% target continues to be elusive.

Fed Policy: Rate Cuts Resume

As was widely expected, the Federal Open Market Committee (FOMC) implemented a 25-basis-point (bp) rate cut at the September FOMC meeting, bringing the new Fed Funds trading range down to 4%–4.25%. With the resumption of rate cuts now officially “in the books,” the more pertinent question is: what will the Fed have in store for the markets for the remainder of this year and 2026? Remember, it was exactly a year ago that Powell & Co. embarked on this rate-cut cycle and followed their first rate cut in September 2024 with two more easing moves to finish off the year. Will history repeat itself here in 2025? That’s what inquiring minds want to know.

There's no doubt the tilt will be for further rate cuts, as the voting members have consistently stated that, prior to this latest easing move, monetary policy had been modestly/mildly restrictive. Based upon economic data at this point, there doesn't seem to be a need to go into an "accommodative phase" for policy just yet, but perhaps just get back to "neutral," a point Chairman Powell emphasized at the FOMC presser.

The key question going forward is: what is a "neutral" rate? If you believe it lies in the area of 3.50%, then investors could expect to see two additional quarter-point rate cuts forthcoming. Two more rate cuts could come at each of the remaining FOMC meetings this year, or perhaps Powell & Co. may want to take a more deliberate approach and utilize an "every other" meeting approach to wait out the labor market/inflation data.

Bottom line: With Fed policy remaining highly data-dependent at this stage of the game, getting policy to neutral is a good starting point. If the upcoming employment data doesn't improve or gets worse in the months ahead, the voting members will more than likely front-load their rate cuts and get them in before year-end...then on to 2026.

"The Fed is steering policy back toward 'neutral,' with further cuts hinging on labor and inflation data."

Searching for GeoAlpha

The flurry of tariff headlines has slowly—but steadily—receded. While there are still lingering uncertainties around particular levies, they are predominantly niche and far less substantive than the ones announced on the infamous "Liberation Day." For markets, this places the peak of tariff uncertainty squarely in the rearview mirror. They are still there. But they are largely known and being mitigated by U.S. businesses. The current Federal government shutdown is largely noise for investors. It does not affect the ability of the government to pay its debts and is likely to be resolved before too much damage is done to the U.S. economic outlook.

From a geopolitical perspective, there has been little change in the outlook. The war in Ukraine continues with the Trump administration moving to put additional pressure on the primary revenue source of the Russian Federation—oil. Under traditional circumstances, this would be highly positive for oil. That has not been the case, as the market remains well-supplied, and OPEC+ (which awkwardly includes Russia) is pledging to raise output in the coming months. On the domestic front, the U.S. government has increasingly made strategic investments in industries deemed necessary from a national security perspective. This—like tariff policy—will continue to be a hallmark of the administration's push for onshoring production, and more announcements are likely in the coming months.

There are certainly going to be further headlines related to policy going forward. The Supreme Court is going to hear arguments on whether or not the current tariffs are illegal in early November, and that could cause some noise around the outlooks for various policies. But it will be just that—noise. Tariffs are already in the system, and companies have adapted. When it comes to the outlook, it is important to do just that—look out. Tariffs are behind, not in front, and that should not be ignored.

“Tariff uncertainty has peaked; the real risks now lie in policy noise, not systemic shocks.”

Equities: Rate Relief vs. Rich Valuations

In the U.S., the stock market will need optimistic themes to sustain its ruthless run off the April 8 “Tariff Tantrum” lows.

One possibility: a mortgage refinancing boomlet. With average mortgage rates falling to 6 3/8ths, the Mortgage Bankers Association Refinance Index has already started to pop. Also, last month’s Conference Board survey witnessed the “plan to buy a home” question leap to a four-month high. We imagine another large slug of Americans will join them if rates fall below 6%.

Rate-driven optimism should not be relegated to residential property; it has the potential to cross over into commercial, manifesting in REIT outperformance.

In the COVID-19 and post-COVID-19 era, the real estate sector has almost always outperformed the S&P 500 when bond yields have fallen. However, the 10-Year T-note yield has declined from 4.58% on May 21 to 4.09%, yet real estate has refused to get out of bed. We think there is room for a bout of REIT outperformance, aiding our dividend screens.

Many bears point out that the economy has not yet felt the full brunt of the tariff saga. But we think this risk is overblown, as we have said all year.

Consider the arithmetic: in the first three quarters of last year, “customs and certain excise tax collections” were \$95.7 billion. This year’s first three quarters witnessed \$214.9 billion collected, a jump of \$119.2 billion. Context: U.S. GDP is \$30 trillion, Medicare spending will be \$1.8 trillion this year, and NVIDIA’s market cap is \$4.6 trillion. Hundreds of billions matter, but the bears need to simmer down.

There is more to tariffs than just dollars and cents. The U.S. has strained trade relations, order books are mucked up, and so on. But the bears need to come up with a better list of scary things, because the

market doesn't care. When it comes to getting pulses racing, none of the 2025 news flow appears as severe as Grexit, COVID-19 layoffs, the collapse of SVB or several frights that have surfaced over the years. Because we frankly think the outlook for the economy in the next 6–12 months will prove more pleasant than the consensus, our view is to stay long and strong global equities.

Respondents to the National Federation of Independent Business (NFIB) survey seem to be coming around. In August, the ranks of those who said the economy would be better six months from now exceeded those who said it would be worse by 34 percentage points, akin to economic recovery era responses collected from 1991-1992, 2002-2004 and 2016-2018.

The problem for many years has been the stock market's rich valuations. The Street consensus for 2026 S&P 500 earnings is about \$300. At 6,715, the market's forward P/E multiple is 22.4. But the primary "risk" the Fed is running, if we can call it that, is sending this runaway stock market running even more.

Consider what banks told the New York Fed in its Senior Loan Officer Survey: as a collective, they are easing standards for the first time since spring 2022, with improvement in nine consecutive quarters.

Intriguingly, prior Fed rate-cutting cycles rarely commenced when banks were already lending freely and the unemployment rate's first digit was a 4. In many episodes, the New York Fed's survey was either at prohibitively tight readings or it was moving directionally toward one. We see it in U.S. loan growth, which has jumped 4.6% YoY; the trough was 20 months ago.

In the meantime, now that the Fed is easing into an economy that is doing anything but rolling over, we looked back to see which sectors tended to work out in the year after the Fed's first easing actions.

Using Datastream aggregates to 1974, the Consumer Discretionary sector went on to beat the market in 9 of the 12 one-year periods afterward. Poor performers included Energy and Utilities, which beat the market in only 17% and 25% of the 12-month windows, respectively.

Small caps are a real quandary. With balance sheets loaded with floating rate debt, the group stands to benefit more than large-cap peers if the Fed comes through on 2026 rate reductions. Also, Value players will find solace in seeing small caps trading at a 35% forward P/E discount to large caps; the median since 2002 has been a 16.6% discount.

However, take heed: junky small caps just posted one of their boldest six-month runs of our careers. The Russell 2000 is generally considered to be a lower-quality small-cap Index than the S&P 600, owing to the abundance of money-losing companies in the former. Over the last half year, the Russell 2000 has outperformed the S&P 600 by 6.4%, akin to the performance differential registered in spring 1999.

“Rate relief could fuel optimism, but rich valuations keep markets running hot.”

Yes, we like small caps, and yes, we think they should be overweighted. But no, the Russell 2000 does not look like a ripe idea. Aggressive quality screens are in order in small caps.

Our favorite stock market remains Japan. Despite prognostications of trade war doom, the country's economy remains in rude health; the primary manufacturing gauge, the quarterly Tankan survey, has been in a gentle uptrend since Q1 2023. It ticked up ever so slightly once again in Q3.

The Nikkei 225 Index is challenging 49,000, up from sub-40,000 levels at 2024's close. Fortunately, the stock market's sharp ascent in recent years has been matched by earnings and dividend growth. Those metrics are +250% and +209%, respectively, from the start of "Abenomics" in 2012. These figures easily exceeded the 143% and 138% growth in the MSCI USA's earnings and dividends, respectively.

The country's shareholder yield, which is the sum of the dividend and buyback yields, is 3.9%, the same level as was on offer in late 2008. There are cheap stocks and cheap stock markets, if you are willing to look overseas.

In Japan strategies, yen-hedged equity mandates look like they can be helped if the dollar's lopsided bearish sentiment gives way to a USD relief rally. In BofA's September Fund Managers Survey, the dollar ranked 21st out of 22 line items in the list of asset allocation choices. The other two groups that were similarly unloved (#20 and #22, respectively) were REITs and Energy.

Fixed Income: "Normal" Rates...the Sequel

So, where can Treasury (UST) yields go in this environment? Treasuries had rallied going into the September FOMC meeting and in the immediate aftermath of the rate cut. As a result, the UST 10-Year yield fell to 3.99%, but as we saw following last year's first rate cut, also in September, that didn't last long and quickly moved back above the 4% threshold.

It is important to note that the resumption of Fed rate cuts is not occurring against a backdrop of widespread economic weakness, but rather, as Powell himself put it, it's more of a "risk management" move. However, looking at Treasury yields, the broader market is discounting two more rate cuts for this year, especially at the front end of the curve.

To provide some perspective, the UST 2-Year yield is fully priced for two rate cuts and actually fell below the low watermark of 3.54% that was registered following the Fed's 50-bp rate cut at the September 2024 FOMC meeting. However, the 10-Year yield has not experienced the same type of *déjà vu*. Indeed, at this time last year, the UST 10-Year yield fell to almost 3.60% based on the increasing recession odds at that time. We're not there at this point in terms of recession expectations.

"Fed easing is risk management, not recession response—UST yields may steepen further."

Against this backdrop, the more likely scenario is for the UST 2-Year/10-Year yield curve to continue to steepen in the months ahead. In fact, without further weakening in the labor markets, one could argue that the UST 10-Year yield could resume an upward trajectory to close out 2025.

Opportunities in Asset Allocation

Fixed income markets regained some balance in the third quarter. Interest rate swings moderated, corporate spreads fully retraced their first-quarter widening, and the U.S. dollar steadied. Emerging market debt maintained its leadership, with both hard currency and local debt delivering strong results. The most notable surprise was the resurgence of municipal bonds, which, after two muted quarters, delivered their third-best quarterly return in the past decade. Investors, reassured over the security of municipal tax exemptions, took advantage of attractive valuations and favorable seasonal supply dynamics.

Despite a year marked by pre- and post-Liberation Day anxieties, a mid-year reassessment of labor market strength and recurring challenges to Fed independence, our base-case scenario from January remains largely intact: gradual Fed easing, a resilient economy and reasonably anchored inflation expectations. This supports maintaining a steady fixed income allocation. We remain duration neutral, with selective over-weights in securitized debt and in corporate credit positions screened for quality.

“Municipal bonds surprised with one of their strongest quarters in a decade, reinforcing the value of steady fixed income allocation.”

Income Remains Central

Securing diversified income sources continues to be a priority for the remainder of 2025; carry remains king. Within U.S. taxable markets, securitized debt is our favored source of income—supported by both relative value and attractive risk-adjusted return potential. We see opportunity in agency RMBS and, increasingly, in non-agency markets for Value-oriented investors.

Corporate bonds remain a core component of income portfolios. However, spreads relative to Treasuries are at historically tight levels, leaving less margin for error. Fundamentals still support current yields, but discipline is critical. In both investment-grade and high-yield, we prioritize issuers with stronger fundamentals than the market as a whole.

Within investment-grade, we favor the shorter end of the corporate curve. In high-yield, we prefer low-duration bonds over senior loans, given broader sector diversification and the anticipated impact of future Fed rate cuts.

“Carry remains king—
securitized debt and
quality corporate credit
stand out as reliable
income sources.”

Select Opportunities Abroad

For investors with higher risk tolerance, select opportunities remain in emerging market local debt. While currency support versus the dollar may moderate compared to earlier in the year, 10-year real yields remain compelling in certain countries, and fundamentals across many EM economies are sound.














Municipals: Room to Run

For tax-aware portfolios, municipals should continue to benefit from their third-quarter rebound. Yields remain attractive both on an absolute basis and relative to taxable alternatives, while credit quality is solid, and technical conditions are improving as we move deeper into the fall. Within municipals, we prefer stable revenue sectors—such as public utilities and water and sewer systems—over general obligation credits.

WisdomTree Asset Allocation Views

Equities











- + Our model portfolios remain over-weight in U.S. equities, and we recently upgraded mid-caps and small caps to an over-weight, which have seen improved earnings growth and stand to disproportionately benefit from cheaper short-term financing conditions
- + We hold a neutral stance between Value and Growth as neither valuations nor earnings momentum provides a clear advantage
- + In developed international equity markets, we believe a dynamic approach to currency hedging can mitigate risks while retaining flexibility when dollar volatility increases active risk versus benchmarks

Equities		Neutral 	
Equities vs. Bonds			
U.S. Equities			
U.S. Large-Cap Growth		 	
U.S. Large-Cap Value		 	
U.S. Mid/Small-Cap			 
Developed International			
Emerging Markets			

Source: WisdomTree, as of 9/30/25. Evaluations are subject to change as market conditions change. This is for illustration purposes only and does not represent investment advice. All evaluations are on a relative and not an absolute basis. Red = a negative relative evaluation; gray = a neutral relative evaluation; green = a positive relative evaluation. **Past performance does not guarantee future results.**

Fixed Income

- + We are maintaining a neutral duration stance with an expectation for ongoing rate volatility and Fed policy decisions that will remain data-dependent into next year
- + Corporate credit fundamentals are stable, yet valuations are at their richest levels in more than 20 years, led by U.S. investment-grade
- + Securitized credit and select non-U.S. debt markets continue to offer more attractive relative Value opportunities
- + Within tax-aware portfolios, we recommend an over-weight in municipal bonds

Fixed Income		Neutral 	
Duration			
U.S. Treasuries			
Investment-Grade Credit			
High-Yield Credit			
Securitized Credit			
Non-U.S. Developed Government Bonds			
EM Local Currency Debt			

Source: WisdomTree, as of 9/30/25. Evaluations are subject to change as market conditions change. This is for illustration purposes only and does not represent investment advice. All evaluations are on a relative and not absolute basis. Red = a negative relative evaluation; gray = a neutral relative evaluation; green = a positive relative evaluation. **Past performance does not guarantee future results.**

Alternatives

- + For investors who are hesitant to reduce their allocation to equities and fixed income, efficient core strategies may provide an innovative solution to free up capital for alternative strategies
- + With the possibility that stock-bond correlations could remain in positive territory, we believe trend-following and other liquid alternative strategies can play an important role in multi-asset class portfolios
- + We continue to favor strategies that seek to generate uncorrelated returns in periods of heightened volatility.

Alternatives		Neutral 	
Liquid Alternatives			
Real Assets			

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