Stock markets

War, inflation and Trump's tariffs have shaken the US. Why does the stock market keep going up?

Wall Street has proved incredibly resilient to instability, and while consumer confidence has dipped, shares have soared

US stock markets have not just recovered from the losses they suffered, but are thriving. Composite: Rita Liu/The Guardian/Getty Images

Lauren Aratani *and* **Andrew Witherspoon**

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It was a dark Friday for Wall Street on 27 March. Oil prices were climbing and the war with Iran raged on. Markets responded accordingly, with the Dow and Nasdaq entering correction territory, falling more than 10% below their peak, after a month of selloffs.

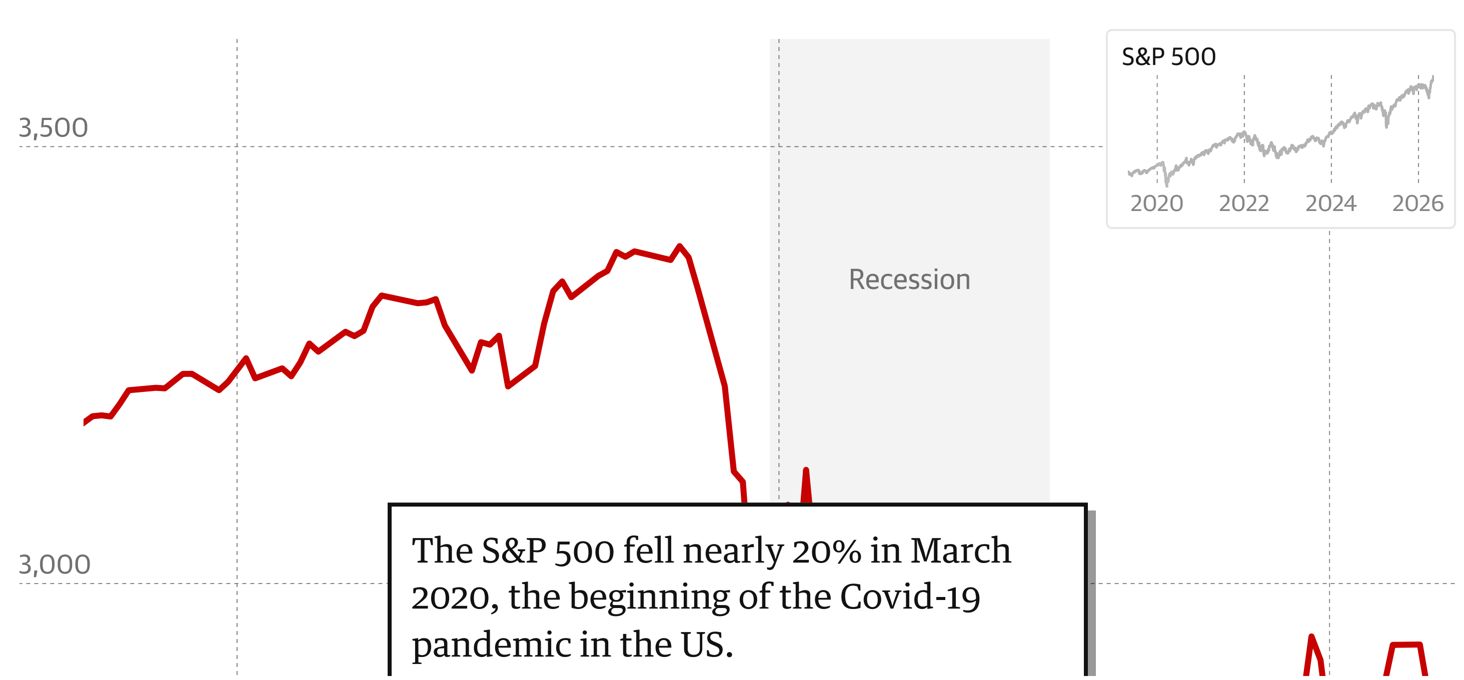
Fast forward seven weeks later to 13 May, and the situation in Iran only looked marginally better. Oil prices were high, and the strait of Hormuz was still closed. Peace talks with Iran seemed tenuous, even with the pressures of high gas prices. Donald Trump on Wednesday said he was "not even a little bit" motivated by Americans' financial situation to end the war.

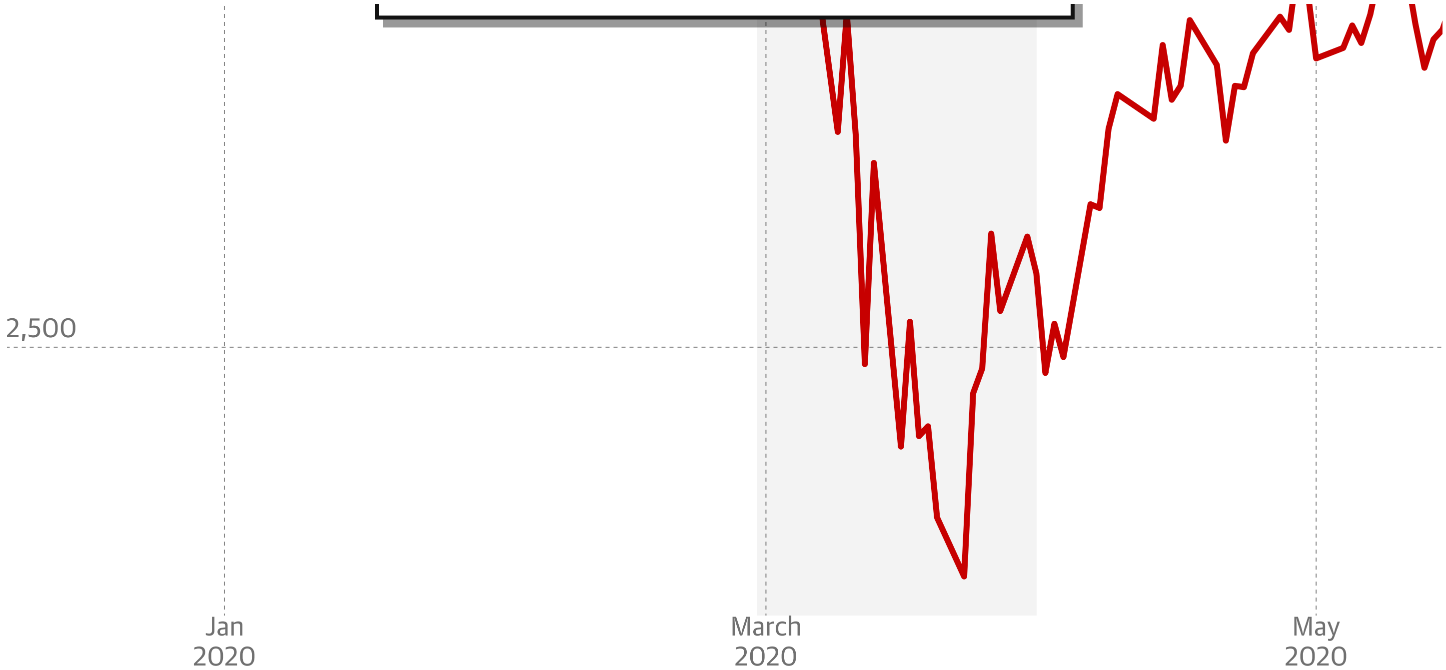
And yet, stock markets have not only recovered from their losses - they are thriving.

Even before the start of the war, the US stock market proved incredibly resilient to political and economic instability. The market has shrugged off the Covid-19 recession and generational-high inflation, absorbed Russia's invasion of Ukraine and increasingly turned a blind eye to Trump's tariff spats. Everyday Americans continue to struggle with an affordability crisis and consumer confidence has crashed, but the markets just keep going up and up.

Yes, Wall Street still has its down days. But the tech-heavy Nasdaq index has continued to surge amid continued investment in AI. The index has gone up 11% since the start of the year - nearly half of the gains that it saw last year. The Dow and S&P 500 continue to bump close to record highs.

Each time investors shake off the latest shock and reach new highs, questions arise: what is driving this phenomenon, and how long can this bull market last?





But the stock market started to recover quickly, especially after the federal government passed three stimulus packages that totaled nearly $5tn.

markets jumped again.

Guardian graphic. Source: S&P and Dow Jones Indices via Yahoo Finance

Every day is Taco day

Some economists point to a mindset that investors have embraced - that the president will back off of his most extreme policies: Trump Always Chickens Out, or Taco.

Backtracking threats has been a hallmark of Trump 2.0, particularly when it comes to tariffs and Iran. When Trump announced his slate of "liberation day" tariffs, he delayed implementing them hours after they were announced. He similarly threatened a 25% tariff on eight EU countries when he was angry about annexing Greenland. Those tariffs were also called off.

Now, even as Trump says the Iran ceasefire is on "life support", markets still keep going up.

But as Eswar Prasad, a former IMF official and an economist at Cornell, points out, investor confidence in the midst of the crisis predates Trump and Taco.

"Investors now have a pretty clear view that if there is significant trouble in the financial system, the [US Federal Reserve] and the US government will step in and not let things get too deep into the hole," Prasad said.

But federal intervention in a crisis, say the collapse of regional banks such as Silicon Valley Bank, whose depositors were bailed out by the government, can hide risks, said Prasad, especially when supervision and regulation of financial markets are weakening.

"This is a concern we already saw with how ineffective supervision led to problems with Silicon Valley Bank and First Republic" in 2023, Prasad said. "The question is, where is the risk being hidden right now?"

The K-shaped economy

Though inflation has come down since its 40-year high in 2022, Americans are still feeling the pain of increased prices. Amid the war on Iran, inflation has started to go up once again. In April, annual inflation surged to 3.8%, up from 2.4% in February.

Higher prices would typically mean less spending among all Americans. But instead, wealthier Americans continue to spend while lower-income Americans try to manage their budgets.

The most recent evidence of this came through a report from the New York Federal Reserve, which showed that while low-income Americans have cut down on their gas usage amid the Iran war, high-income Americans haven't changed their gas consumption at all.

Economists have started to refer to this phenomenon as the "K-shaped" economy to represent the bifurcated experience of Americans whose wealth is tied to the stock market, and have thus been doing really well over the last few years, and those who are not.

The vast majority of the stock market is owned by just a small chunk of Americans: the top 10% income percentile in the US owns 87.2% of the market. The bottom 50% own just 1.1% of all stocks.

Continued spending from the top has kept many companies afloat as other consumers cut spending.

"Our consumers, which sit at the top of the 'K', are continuing to invest in travel, it's their priority, and they want to have that experience," Ed Bastian, the Delta Air Lines CEO, told CNBC last month when the company announced its quarterly earnings, noting that revenue from Delta's premium offerings doubled over the last year.

Though the rising stock market has kept a handful of Americans happy and spending, recent polls show that a majority of Americans currently disapprove of Trump's handling of the economy, and 63% said they specifically blame Trump for recent high gas prices.

Rising tide lifts all

The release of ChatGPT in 2022 kicked off a race to build up AI systems and the infrastructure needed to support them. Tech companies are spending hundreds of billions on AI investments, with no end in sight. Thousands of datacenters are being built around the country. This colossal investment in AI has been immune to the geopolitical events seen over the last few years.

Now, just seven companies out of the S&P 500 carry 30% of the index's weight. All of them are tech behemoths who have heavily invested in AI in recent years: Alphabet (Google's parent company), Amazon, Apple, Meta, Microsoft, Nvidia and Tesla.

Nvidia, which produces and sells the microchips needed to power AI, currently tops the S&P 500 and was the first company to reach a $5tn valuation last fall. Its stock has gone up 1,450% over the last five years.

The huge amounts of spending in AI in such a short space of time have raised concerns among those who believe that there is an AI bubble holding up the stock market. AI spending outpaced consumer spending as a percentage of US economic growth in the first half of 2025.

"In a weird way, we have the largest private sector stimulus program in US history," said Paul Kedrosky, an investor and research fellow at the MIT's Institute for the Digital Economy. "The private sector is spending so aggressively on this one thing."

The White House is also all in on the AI boom. Kevin Warsh, Trump's Federal Reserve chair pick, has argued that AI is "the most productivity-enhancing wave of our lifetimes - past, present and future". Warsh is likely to advocate for interest rate cuts once he assumes his role as chair, using the growth of AI to bolster his argument, even as inflation rises.

What goes up ...

Alan Greenspan, who served as Fed chair for 18 years, delivered a now-famous speech in 1996 where he warned of "irrational exuberance" from investors driving markets to unsustainable highs - what would eventually be known as the dotcom bubble.

Despite Greenspan's warning, the S&P 500 would go on to double in value after 1996. Then in April 2000, a massive sell-off began when the profitability of many of the new tech companies came into question. By 2002, the S&P 500 was at half the level it was just two years earlier.

Kedrosky believes that the current AI boom could experience a similar bust.

Three AI startups, OpenAI, Anthropic and SpaceX, the parent company's for Elon Musk's xAI, are all planning trillion-dollar IPOs for this year.

"Just three IPOs would be larger than the whole dotcom bubble," Kedrosky said. "That money has to come from somewhere. So what's going to happen is you're going to see massive selling in a host of equities because institutions want to be able to buy these things."

In other words, investors are placing all their bets on AI. For Kedrosky, the risk that comes with this has made him a firm believer that it's not a matter of whether the AI bubble will ever pop, but when exactly it will.

"I would cheerfully be wrong. It would just be the first time in history that we've had this kind of a [capital expenditure] wave and not had it go bad," Kedrosky said. "So history's on my side."