

Weekly Commentary with Professor Jeremy J. Siegel

A Good Environment for Stocks Amid Inflation Concern ***Monday, 3/8/2020***



Jeremy Schwartz, Executive Vice President, Global Head of Research for WisdomTree, hosts a weekly discussion with Professor Siegel, typically on the Wharton Business Radio podcast. The notes below summarize their conversation along with further commentary and context.

Professor Siegel started a weekly podcast series to answer your questions—email AskSiegel@wisdomtree.com and he will try to answer as many of your questions as possible each week.

If you would have told Professor Siegel that the S&P 500 would be at a higher level than where it started the year—despite the coronavirus pandemic shutting down the economy, the highest unemployment rate in 75 years, and the greatest drop in quarterly Gross Domestic Product (GDP) in our history—he might ask how that could possibly be true. But it is true—and it is important to understand why the financial markets are behaving this way.

The S&P 500 is driven by huge technology firms and international firms that employ only a fraction of those employed in the United States. The hardest hit companies are restaurants and small businesses, but they are not listed on the major exchanges. The firms with big market value are those with international reach and financing that allows them to manage through the pandemic.

Professor Siegel looks at the money supply as one of the most critical variables in this environment. This money supply measure is not just dollars created by the Federal Reserve, but how much money is going into the banking accounts of individuals and businesses. Since March 1st, we have seen a 34% increase in the money supply—more than 2x what happened in the year following the Lehman bankruptcy during the last financial crisis. This liquidity is one of the primary reasons why the stock market is so vibrant.

This liquidity is also the reason Professor Siegel thinks, for the first time in decades, we will see substantially higher inflation levels in 2021. Not hyper-inflation or double digit inflation, but higher levels than the Federal Reserve (Fed) target of 2%—about 3-5%. He sees this as continuing for a few years.

This is a good environment for stocks. Stocks are real assets and companies who can raise prices of goods benefit in that scenario.

Professor Siegel first spoke about this concept in late March and early April and there were sceptics. But what do we see today—oil is rebounding, gold is reaching record highs, with a surge in other commodity prices and precious metal prices. The beginning of this scenario—that is good for stocks and bad for bonds—is starting to play out.

Will the Fed stop this inflation? In Professor Siegel's opinion, unemployment is going to stay elevated for a long time, so the Fed will remain accommodative. Companies are re-thinking how many employees they need—how much office space is needed—which will lead to a surge in productivity and benefit margins and profits.

Over the last few weeks, we've seen a surge in virus cases—but Arizona and Texas seem to have gotten their surges under control. While we saw a record number of deaths in Florida, there was a drop in hospitalizations to the lowest level since June and a slowdown in the positivity rate for tests. Professor Siegel believes these elevated cases in the south are not part of a 'second wave of the virus' but really the first wave as it spread across the country. We are certainly not done with the virus, but the fatality rate is between 50-75% lower than when it first hit in March. The vaccine news has come in much better than expected and we think there could be a vaccine for high risk people by the end of this year.

The risks for the market certainly include higher taxes under a Democratic administration that sweeps the House, Senate, and Presidency. Higher taxes would be a negative. Professor Siegel thinks there are positives of a Democratic sweep—there would be a more rational stance to trade negotiations than the uncertainty created by the Trump administration. There will be even further money thrown at unemployment. Biden also does not want to remove all of the corporate tax cuts.

Professor Siegel doesn't think it pays to wait to get back into the market to find out the results of the election. It could surprise everyone that even under a democratic sweep, stocks may rise just from the settling of uncertainty risk premiums.

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