Weekly Commentary with Professor Jeremy J. Siegel

Volatile Market Ahead of Election
Monday, 2/11/2020

Jeremy Schwartz, 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.

We had a 'volatile' market last week—with broad market averages declining. After the market closed Thursday, the prices of large cap technology stocks, except Google, sold off sharply despite robust earnings.

The equity markets were disappointed that fiscal stimulus talks collapsed. This, combined with the virus upsurge, means the stimulus could have been even more helpful. Professor Siegel is optimistic that regardless of who wins the election, we will have a stimulus. The timing, though, is much harder to predict. We can survive without stimulus, but with partial lockdowns and cautious behaviour, this can make for a more dismal holiday season— weighing on the markets.

Furthermore, Europe is facing an even worse upsurge in the virus than we are in the United States, and Europe is taking further measures to restrict activities and shut down their economies again. This is also not a positive development for markets.

Professor Siegel still thinks we will have a vaccine soon—with Pfizer applying for emergency use authorization of their vaccine later in November. It will first go to health care workers and high risk individuals in January and more people will be able to get it in February and beyond. One issue with this vaccine is that you need to get two shots and then wait a few more weeks before immunity starts to set in. So it will likely be February before front-line workers and high-risk individuals can attain vaccine immunity. The current wave should be on the wane by then in any case.

On the political front, the virus surge comes at a poor time for President Trump—particularly in midwestern states like Wisconsin. Professor Siegel thinks the most interesting action in the betting markets for the election is happening in the Senate, with four Senate races incredibly close: North Carolina, Iowa and the two seats in Georgia. The two seats in Georgia are virtually 50/50 now and one, if not both, races could result in a run-off situation that is not decided until January 5th. The Senate could therefore potentially be 49/49 on Tuesday and we would have to wait another 2 months to determine who controls the Senate.

Professor Siegel moderated a discussion on the merits of value investing for the long run with Cliff Asness, Josef Lakonishok, and Mario Gabelli. The panel sees extremes in the market today, similar to the technology bubble, but Asness emphasized numerous times that even excluding the large technology companies that predominate cap-weighted indexes, growth valuations were at record extreme levels within industries.

Many think value underperformance is tied to the very low interest rates, but Professor Siegel reminds us that the tech bubble in 2000 occurred with very high real interest rates and TIPS yields above 4%, while they are negative 1% today.

Lakonishok cited research on the largest stocks in the index, which his studies have shown tend to underperform the market by 1-1.5% per year over longer periods of time. The 10 largest firms usually sell at a similar multiple as the next 490 largest firms in the S&P 500. Today, Lakonishok sees them selling at 1.57x—showing extremes for large companies today and making forward returns more problematical.

The panel closed with sentiment that value strategies may earn premium returns because it is difficult to stay with value when growth soars. The panel encouraged value investors to stick with these strategies over the coming cycle.