

The Market Wants a Fiscal Stimulus Deal

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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.

There has been a ton of news in the last week. It is really clear that the market wants a fiscal stimulus deal. Despite the news that President Trump tested positive for COVID-19, many of the cyclical sectors and small caps rallied on Friday on positive indications from Nancy Pelosi and Steve Mnuchin that compromises were progressing and a fiscal deal was still possible.

The market is getting used to the idea of a Biden presidency—and can deal with it. Even before Trump’s health news, he lost ground in the prediction markets following the debate, losing three percentage points in the betting markets with a performance viewed as unappealing to the independents that he needs to win. He lost more ground on Friday following the virus announcement and Biden is now slightly less than a 2 to 1 favourite to win.

Despite some of Trump’s risk factors from age to obesity, the overwhelming odds support him having a full recovery from the virus—there is an excellent chance he recovers. News that he has taken Regeneron’s antibody cocktail (and assuming he recovers) will spur the biotechs and increase the public’s willingness to take vaccines. On the latter, Professor Siegel expects good news in the next one to two weeks.

In the prediction markets for the Senate, Iowa flipped Democratic and, for the first time, the model (most likely) outcome right now is a Democratic takeover of government. However, a “sexting” scandal encompassing the Democratic Senatorial candidate in North Carolina has made that race much tighter—so stay tuned.

The jobs report was mixed—there was a drop in the unemployment rate, partly driven by people leaving the labour force. Yet hopes of progress for a new CARES Act is what powered the recovery Friday from the sell-off following the news of Trump’s illness.

The virus news is mixed. Deaths are trending lower and positive tests are remaining stationary. There are still fears of another wave breaking out this year. But the news of Trump contracting COVID-19 might make more people wear masks and cut down the spread.

On Friday, we saw some market rotation, with technology stocks and the Nasdaq taking a hit, with small-cap value stocks gaining ground. There could have been fears of more economic shutdowns following Trump’s COVID-19 diagnosis, but the fiscal stimulus deal was the dominating factor. Professor Siegel sees the economy opening next year with more stimulus supporting a very robust 2021.

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We have a new feature—you can email in questions to Professor Siegel at AskSiegel@WisdomTree.com and we will try to address as many as possible each week.

Here are this week's questions:

Question 1: We have talked about low interest rates supporting some of the elevated market multiples we see in the markets, but also how inflation pressures are coming. Can this lead to a rise in rates and depressed multiples looking forward?

Professor Siegel believes the Fed is going to keep interest rates very low until inflation rises well above 2%. Longer-term interest rates should rise, but less than the rate of inflation—a moderate inflation environment that he expects can be quite positive for stocks. If we have 4% inflation and the long-rate rises to 1.5%–2%, that is still terrible for bonds but ok for stocks. Really high inflation is bad for stocks because the Fed will ultimately tighten. But the environment he sees calls for the Fed to allow ample liquidity. The Fed may eventually have to hike rates to slow things down, but that could be years down the road.

Question 2: On a related point, Professor Siegel has talked about moderate investors who have used a 60/40 approach to portfolio allocations to increase stocks over bonds and go toward dividend paying stocks. For more conservative investors, is the advice similar?

The question for bond investors is: Will they be happy seeing the purchasing power erode at 2-3-4%? Is that the price they want to pay for the safety of principal? There are broad portfolios of dividend-paying stocks that yield well over that rate of inflation—in many ways these are conservative, high-quality ways to protect from long-term inflation pressures.

Question 3: Broad commodity markets used to have a negative correlation to equity markets, but have been disappointing from a returns perspective. Will inflation make commodities better diversifiers going ahead?

During the 1970s and 1980s, when we had very high inflation, commodities performed incredibly well and served as that portfolio diversifier. A return to inflation can help, as the last 10 years saw deflationary pressures that caused commodities to be bad diversifiers, but treasury bonds to be great diversifiers. Bonds were bad diversifiers during the 70s and 80s with that inflation threat. With inflation coming back, the diversification advantages of commodities are apt to return.

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