Weekly Commentary with Professor Jeremy J. Siegel

Markets Rallied, but Have We Seen the Lowest Point of the Cycle Yet?

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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.

US equity markets had their best week since 1974, with over 12% gains in the S&P 500 and almost 18% in small cap stocks and the Russell 2000. We had another 6.6 million people file for unemployment benefits, bringing the total job losses in the last three weeks to 16.6 million or over 10% unemployment. We've heard calls for this to reach 30%.

But the markets are focused on the virus spread and how soon we can return to a more 'normal' opening of the economy. Virtually everywhere social distancing is practised, we see evidence that case counts plateau. The case counts where the virus outbreak hit hardest in the US—New York—are encouraging. Estimates for total deaths in the US are coming down from 250,000 to 60-70,000. Very favourable dynamics there.

Meanwhile, the Federal Reserve (Fed) continues to roll out new packages to support lending in the economy. On Thursday, the Fed announced a program to buy bonds of state and local governments, fallen angel bonds (investment grade credit that got downgraded to high yield), and even potentially high yield bond Exchange Traded Funds (ETFs). This created a rally in the high yield segments, which had seen spreads blow out.

The combination of better virus news and these additional support measures helped the markets regain half their losses. This is not unusual in bear markets to have strong and quick rallies, particularly as traders buy back their short positions.

Professor Siegel is getting more confident the low of the cycle was hit, but to go higher, we need to focus on how we can meaningfully re-open. We would need a dramatic drop in number of cases but, more likely, evidence that therapeutic drugs can mitigate the virus. Without a general sense this virus can be treated, people will continue to shelter and keep the economy relatively constrained.

If we do get a therapeutic drug developed and confidence returns by 2021, Professor Siegel believes all the built up liquidity in the system has to go somewhere and it could put upward pressure on prices. We had 3.5% unemployment before this situation hit—and this added liquidity might start putting inflation to 3, 4 or even 5%. This could support commodity based economies and companies for the first time in long time and be negative on bonds. Is it possible the 40-year bull market in bonds is coming to an end? The 10-year yield hit 16% in 1980 and has dipped even below ½ of 1%—perhaps this bull market had its top with this virus and turns around in 2021.

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