

A Conversation with Professor Jeremy Siegel

This week's commentary is a special one. I hope that you enjoy it as much as I did working on it.

Last week much of our Cabana team traveled to New York to meet with WisdomTree and their principals. I have always been an admirer of the company and a big believer in the economic foundations upon which they build and distribute their investment products. They are advocates of the receipt of dividends and keeping it simple by investing based upon the time-tested macro trends of asset classes. In a very real sense, they were pioneers in recognizing the efficiencies of using ETFs in building portfolios. WisdomTree's founders came from the University of Pennsylvania Wharton School of Business, which happens to be one of the top business schools in the nation. Jeremy Siegel is the Russel E. Palmer Professor of Economics at Wharton and one of the preeminent living economists in the world today. His book, "Stocks for the Long Run," is a staple of investment theory and practice. Professor Siegel was a founder of Wisdom Tree and remains an owner and adviser at the firm today.

I had the great opportunity on Thursday to spend time with Professor Siegel and ask him his thoughts on the current state of the economy and how it might impact investing for the rest of the year. Below are my notes from our conversation.

- He noted the wide disparity in predictions in second quarter GDP (the report came out the next day). Economists were forecasting between 0% and 2%. Professor Siegel stated that while the economy was undoubtedly slowing, there was not a recession on the horizon. He felt that the continued strength in employment was what mattered most and as long as the employment numbers were strong, fears of a recession were overdone. He predicted the second quarter GDP number to come in at 2%. It came in at 2.1%.
- He discussed the upcoming Federal Reserve meeting (it starts today) and the decision on lowering interest rates. Professor Siegel felt like a 25 basis point cut is likely. He noted a 50 basis point cut over the remainder of the year is appropriate to deal with problems associated with a yield curve inversion. The current flat yield curve is not good for banks and makes borrowing more difficult.
- He mentioned the strong negative correlation between stocks and treasury bonds. Because of this, treasuries are a great hedge for stocks, which results in people buying treasuries whenever there is fear in the market. This buying of treasuries (particularly long treasuries) causes a flattening of the yield curve and compounds the problem faced by the Fed in promoting a steeper yield curve. The downward pressure at the back end of the curve results in the Fed having to continually lower the short end to prevent an inversion. Professor Siegel predicted the 10-Year Treasury to remain rangebound between 1.5% and 2.25% over the next year.
- Professor Siegel stated that S&P 500 earnings are presently \$161.00 per share. Thus, the S&P 500 is currently trading at a price to earnings ratio (P/E) of 18.60. He feels like the market is fairly valued given the persistently low interest rates both here and abroad. He thought fair value was between a P/E of 18 and 20. He stated that low interest rates cause stocks to remain attractive. He particularly liked dividend payers and other safe equities. This comes as no surprise given his background and writings.
- In conclusion, we discussed the inter-relationship between the U.S. and other world economies. He pointed out that as the largest economy in the world, our strength or weakness will inevitably impact the rest of the world. Likewise, economies like China and Europe have ramifications on our economy. It is important to factor in these relationships when making investment decisions.

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The sum of his thoughts were that markets are fairly priced and that we are not facing an imminent recession. He would like to see some steepness return to the yield curve if for no other reason than precautionary. It is important that world economies work together for all to succeed. He did not feel that a full-blown trade war with China would occur as it would significantly harm growth worldwide and present major headwinds in President Trump's attempt to get re-elected.

It was a great honor to simply spend some time with one of the great thinkers in economics and finance. I believe everyone in the room felt the same way. I am hopeful that we will continue to work with WisdomTree going forward. As such, we may get to spend more time with Professor Siegel. If and when I do, I will pass along his thoughts.

Last week's commentary is available [here](#).

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