

# Jeremy Siegel on the Stock Market Volatility: 'Don't Start Panicking and Pull Out of Equities'

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*Wharton finance professor Jeremy Siegel is world-renowned for his expertise on the economy and financial markets. This week, Siegel stopped by the [Knowledge@Wharton radio show on SiriusXM](#) to discuss the recent U.S. stock market volatility and provide insight into what the macroeconomic landscape means for investors.*

*First and foremost, Siegel recommends that long-term investors not panic at the stock market's recent deep dips – down some 3% in recent weeks before regaining some ground — and he continued with his forecast from January for equities to be either flat or up by as much as 10% for all of 2018. “I would not be surprised if the Dow Jones Industrial Average is up between 5% and 10% for 2018, but next year ... I think it could be zero or up by 5%.” Siegel also said that if there was a positive resolution of the trade issues underway with China, “before year-end of the Chinese situation, we could easily have a 10%, 15% pop in the market.”*

*Siegel said that the key driver for the change in market sentiment recently is the reaction to the Fed's interest rate increases. When returns outside of equity markets increase, those alternative investments become more attractive and equities relatively less so. The news of strong 2018 earnings “is priced in the market,” noted Siegel. “The fear of those interest rates was not. I think the reaction we see is the fear of higher interest rates.” Other key factors weighing on the market are President's Trump trade actions against China and a slowdown in housing. “From a long-term perspective, I think the stock market is fairly valued. For long-term investors, your 401(k)s, all your pension funds – don't start panicking and pull out of equities. I still look for returns that are 7% to 7.5% per year in stocks, which is much greater than bonds.”*

*An edited transcript of Siegel's Knowledge@Wharton radio show interview appears below.*

**Knowledge@Wharton:** Tell us why investors should not panic, apart from the fact that the market seems to be recovering some ground.

**Jeremy Siegel:** I see this as a normal correction. I thought the market was getting a little ahead of itself. Now, let's step back because at the beginning of the year I said it's going to be a zero to 10%. We're just tickling a 10% and above. And I said that the market is going to be challenged by higher interest rates. At first, [the market] tended to ignore it and tended to ignore Trump's threats on tariffs.

And finally, when the 10-year [bond yield] really started moving into new post-cyclical high ground and people looked around and said, my goodness the 90-day Treasury bill, three-month yield is 2.5%, and the Fed says a hike in December and three hikes next year. That's going to get the short-term rate above 3%. For the first time in many years, you've got to get gains on stocks to be ahead of a savings account [to make them attractive], which used to be a no brainer, right? Savings accounts used to be zero percent. So, people are beginning to say, all right, what kind of gains?

We had a super year for earnings. But all of that news is out, it's in the market, and in fact we've been seeing some markdowns in fourth quarter and 2019 earnings. Nothing significant. But the good news of 2018 earnings is priced in the market, the fear of those higher interest rates was not. I think this reaction that we see was this fear of the higher interest rates.

**Knowledge@Wharton:** Will we see some correlation with this particular move when we start to see the next round of GDP numbers come out?

**Siegel:** At the end of this month, we are going to get the third-quarter GDP and it's going to be good. It's going to be in the mid- to high threes [3%]. But the markets are forward looking, and most estimates that I see for this quarter that we just started two weeks ago is in the high twos, not higher than that. We've seen the slowdown in housing, the threat of tariffs. I would love us to continue on a 3% roll economy for 2019, but at this point it looks like that might be a stretch.

**Knowledge@Wharton:** You mentioned the quarter-point interest rate hike. There is another one expected to come up this year, and three more next year. Why does the Fed believe it needs to have this pattern through 2019?

**Siegel:** Several reasons. First, we saw that unemployment rate get down to 3.7%, a 49-year low. It is definitely true that economists as well as the Fed have been surprised about how low the unemployment rate has gotten without sparking significant wage increases. We've gotten some, but not really severe. But when I look back at the data, and the Fed looks back at the data, if we ever get to 3.5% unemployment, [that is potentially significant].

If we keep creating 200,000 jobs a month, when the demographics of the population is only producing 100,000 new employees, that means you've got to eat into that pool of unemployed, which means that the unemployment continues to go down. We've only been down to 3.5% two other times – during the Vietnam War and the Korean War. Both of those times we've had some major price increases. What I am saying is we are drum tight on that labor market. This goes back to, why is the Fed raising rates? It wants to slow us down to 100,000 or 120,000 new jobs per month so that we can glide back to a position where supply and demand for labor comes back into balance.

The second reason is really important. We are at 2% to 2.25% on the Fed funds rate, with 2-2.25% inflation. That means our real rate is zero, and that is historically very low. It is even somewhat below the Fed's current estimate of where they want the long-term interest rate to be.

**Knowledge@Wharton:** The market has become more volatile.

**Siegel:** Yes, and it's just a historical fact that when you have a big downward break, it follows with further volatility. Now, let me say two things. When I said don't panic, from a long-term perspective I think the stock market is fairly valued, which means for those long-term investors, those 401Ks, all of your pension funds and everything, don't start panicking and pull out of equities.

[For the long term], I still look for returns of 7%-7.5% per year – 6% to 7% after inflation– which is much greater than bonds. The short term though this quarter, as I have said before is going to be a challenging quarter because of the rising interest rates. We have political uncertainty, we have the midterm elections coming up. The expectation is that the Republicans keep the Senate but lose the House. Does that change how Trump views bargaining with the Chinese? The Chinese wanted to say we are not bargaining until after the election, they think they've got a better chance of making a better deal after that.

So, there are a lot of uncertainties. With the unemployment rate at 3.7%, unless we see a significant downward move in the stock market — something like 10%-15% – the Fed is not going to be persuaded by this little pullback: “Oh golly, we need to change our policy.”

This year, returns might be a little lower. At the beginning of this year I said zero to 10% gains, and that was before inflation – so minus 2% to plus 8% after inflation. And we're almost in the middle of that range with this pullback. At first, I thought maybe I was a little too pessimistic just three weeks ago, but now it's right in that middle of the range.

Again, I wouldn't be surprised if by December 31st the market is up 5% to 10%, but I am looking at next year and saying that could be zero to 5%, or if I want to broaden it, minus 5% to plus 10%. Because again, the good news is out, and we're going to have to deal with that higher interest rates. But three to five years hence — these are still good values.

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“Unemployment down to 3.7% has usually been within a year to two of the beginning of a recession.” — Jeremy Siegel

**Knowledge@Wharton:** Last week you told a group of journalists here at Wharton that investors at times are being too emotional. Can you elaborate?

**Siegel:** If you follow the market every day, you get wrapped up in the prevailing psychology. And just as a matter of almost definition, if the market is soaring upward, everyone is optimistic. And you can get caught up; I don't want to miss anything — FOMA, fear of missing out. I've got to jump on the bandwagon.

And then when everything sells off, everyone is so pessimistic, things are so bad, terrible, and “I've taken such losses.” You say, “Oh, I don't want to get in now.” But we all know intellectually the best time to get out is when everyone is excited and there are no problems. And when you want to get in is when everyone throws in the towel and says, “Hey, things are just terrible.”

But it is so hard to do that. So some of the best players in the market — either they are in for the long run, they are indexed and they are getting long-term gains, or if they want to play sentiment they just go opposite that sentiment.... Those are the most successful ones.

**Knowledge@Wharton:** What do you see in the U.S. economy now?

**Siegel:** I showed an investor recently the plot of the unemployment rate up and down since World War II — and it's all the way down now. And he said, “Professor Siegel, this is the scariest chart I've seen. Look what happens right after it gets down to this 3.5%, 4% range, we've shot up and that's been a recession.” And I said, you know what, you're right. We really have never engineered a smooth landing where we can get that unemployment rate there.

The dynamics of an economy are up and down. We have not abolished recessions. We could have a recession. The indicators say it is going to be one and a half to two years out, and we could have some decent gains in the stock market coming forward. But, we haven't abolished the business cycle, and sometime we will have that recession. Unemployment down to 3.7% has usually been within a year to two of the beginning of a recession.

**Knowledge@Wharton:** What does it take to get that smooth landing?

**Siegel:** Well, the Fed is trying to. It is very hard. To some extent, to completely smooth out business cycles is impossible. One thing you accept when you buy into a market economy is there are going to be cycles. The best you can hope for is that the Fed and the government can smooth those out so that we don't have terrible outcomes like the 1930s.

**Knowledge@Wharton:** So, there really isn't a magic number?

**Siegel:** I think there is. We'll all hope against hope that maybe the Fed has just got it right this time. But the truth of the matter is that there will be a cycle almost no matter what the Fed does. Let's hope it's a mild cycle. There is encouraging news. Our cycles — recovery periods between recessions — have gotten longer and longer. If we get to July next year, which is odds on, we will have eclipsed the longest economic recovery in U.S. history, which was the 10 years between 1990 and 2000. We have already by certain measures been the longest bull market, although not the strongest bull market, but the longest bull market in history.

So, in a way we are succeeding in lengthening the recoveries, and hopefully moderating the downturns. We did not do that with the financial crisis, but the recession that we had before that, the 2000-2002 recession, and that followed the

longest recovery, that was the mildest recession we had in a post-World War II period. So we messed up on that, we should have seen the danger signals. That shouldn't have been as bad as it was. But all of the other evidence over the last 20 or 30 years is we have been lengthening the recoveries and smoothing down recessions. But the ability to say we have eliminated them I think is premature.

**Knowledge@Wharton:** Is part of the reason we have lengthened the cycle [due to] the policy moves on banking?

**Siegel:** Yes, banking is much safer. I don't see any excesses of risk that could cause anything like that. Another reason we have had a long recovery is we went pretty deep down. So we had a long way to climb, although we went deep down in the 1930s, and then we had another severe recession, '36, '37. So, it doesn't guarantee you that you are going to have a long recovery. But we had a long road. We brought the unemployment rate from a peak of 10% down to 3.7%. Remarkable. What has been missing in this great recovery is good GDP growth. We have had very poor GDP growth. It's anemic.