# MAKING SENSE OF THE MARKET CRASH WITH JEREMY SIEGEL

**Jeremy Siegel — WisdomTree Senior Economist**
**08/28/2015**

I made a call for a 10% correction in the markets roughly three weeks ago, which was followed by a more-than-10% sell-off in the S&P 500 between August 17 and August 26, 2015. Considering the uncertainty of short-term moves in the market, my call for a correction was an uncharacteristic one. What concerned me the most was the dismal earnings picture: while analysts were calling for a 10% increase in 2015 earnings late last year, estimates have progressively been shaved down to a 1%–2% earnings contraction in the course of the year. Given that the U.S. is not in recession territory, an earnings contraction is unusual. Both U.S. dollar strength and lower oil prices have been large detractors for corporate earnings. Given that 40% of profits in the S&P 500 are derived from abroad and 25% of profits come in foreign currencies, analysts estimate that 2014 earnings took a $5 hit from the stronger dollar. Furthermore, some estimate that weaker oil prices have resulted in a $7 hit. The other warning sign was the abnormally depressed Volatility Index (VIX), where at a 12–13 handle markets appeared fearless despite mounting uncertainties. **Speed of Correction Surprising** I was surprised by the speed at which the markets corrected. This speaks volumes about forces that have underpinned this sell-off: the Federal Reserve (Fed) threatening to increase rates in September, a stronger U.S. dollar, weaker oil prices and collapsing global commodity prices. While cheaper commodities are a net positive for the U.S. economy, considering our commodity importer status, they are not encouraging for S&P 500 earnings. Given that the sell-off was followed by a 600-point recovery in the Dow on Wednesday—resembling a V-shaped market—I would not be surprised if we retest the lows or even surpass them. That said, I do not foresee a more than 15% decline. **Interest Hike in September Looks Less Likely** The probability of the Fed hiking rates in September has dwindled, given the global turmoil, but is not zero. What is particularly striking is the collapse in oil prices both in spot and in the far-dated futures. The December 2019 contract is pricing oil at $55, down from $67[1]. Long-run oil prices do not typically move as much—this suggests a longer-term reassessment of oil prices, which could put downward pressure on headline inflation. **Equity Risk Premium Still Offers Compelling Values** From a price-to-earnings (P/E) perspective, the S&P 500 is selling at 17x earnings, where the median and average since 1954 are at 16.4x and 17x, respectively, implying fair valuations. But these are especially good valuations if we were to consider the low interest rate environment, when 18x–20x P/E is warranted. I also believe we are in for permanently lower interest rates—I am expecting the normal Federal Funds Rate to trade close to 2%, not 4%, and long bonds to trade closer to 3%–3.5% by the end of the tightening cycle. Value and dividend stocks have been under pressure over the past 1.5 years, given that people have been trying to position ahead of the Fed raising rates, which caused momentum stocks and low-dividend payers to outperform. Consider this: The 10-Year Treasury yields 2%–2.5%, while high-yielding stocks yield 4%. This may imply a shift to value and dividend strategies in the years to come. As a result, dividend-oriented stocks could perform well going forward. **Euro and Yen Gains Mostly Short-Term Risk Aversion** The surge in the euro and yen is primarily a function of the unwinding of carry trades. Both currencies have been used as funding vehicles, where investors pay very little—or even get paid—to borrow these currencies. This is due to the present-day short-terms rates in the eurozone and Japan, which trade in negative territory. As a result, everyone has been borrowing in euros and yen to buy higher-yielding assets. Due to the extreme risk-off, markets have unwound their carry trades, resulting in short-run appreciation of the yen and the euro. I can see the euro trading around $1.05 again, as well as further declines in the yen. **EM Equities and FX Trading at Deep Discounts** I will admit to being too early on this call, but I believe emerging markets could potentially be the best-performing asset class in the next three to five years. Emerging market currencies look very reasonably priced compared to their history and the stocks are at depressed valuations. And even with the slowdown in China, emerging economies are growing at three to four times the rate of developed economies. [1]Source: Bloomberg, as of 8/26/15.

Important Risks Related to this Article

Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty.

Investments in emerging, offshore or frontier markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments.

The material contains the current opinions of the author, which are subject to change without notice. Statements concerning financial market trends are based on current market conditions, which will fluctuate. References to specific securities and issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations to purchase or sell such securities.

For standardized performance and the most recent month-end performance click here NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our Economic & Market Outlook

View the online version of this article here.

## IMPORTANT INFORMATION

**U.S. investors only: Click here to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.**

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages ( www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

## DEFINITIONS

**S&P 500 Index** : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

**Federal Reserve** : The Federal Reserve System is the central banking system of the United States.

**Spot price** : The current price at which a particular security can be bought or sold at a specified time and place.

**Headline CPI** : measure of the total inflation within an economy, including commodities such as food and energy prices.

**Valuation** : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

**Federal Funds Rate** : The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the "policy rate" of the U.S. Federal Reserve.

**Value** : Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over tim.

**10-year government bond** : a debt instrument backed by a government guarantee with an original maturity of 10 years.

**Carry** : The amount of return that accrues from investing in fixed income or currency forward contracts.