

# QUARTERLY Q&A WITH PROFESSOR JEREMY SIEGEL

04/29/2013

*Every quarter, we hold a quarterly review and outlook conference call with our Senior Investment Strategy Advisor, Wharton Professor Jeremy Siegel, where listeners can submit questions ahead of time and help drive the content of the call. In this blog, we review the most pressing economic and market issues that were discussed during this quarter's call.*

**Question:** Professor, there have been a lot of interesting stories in the market this year. But of late, the gold and commodities markets are among the most interesting. What's your take on the moves we've seen and what that means for other asset classes? **J. Siegel:** Most definitely. I think the break in gold prices is extremely significant and, let me say, very positive for equities. We all know that, over the years, commodities have increasingly been introduced as an asset class for investors to hold. Back in the 1960s, investors primarily chose between stocks and bonds. As time went by, assets—[real assets](#), such as gold—were introduced in greater levels as a hedge against stock market declines. The tremendous [volatility](#) of gold, the tremendous decline of gold this year,<sup>1</sup> I think is going to put significant nicks in people's trust of gold as a safe asset class. One thing that came to my mind—many times when I talk to people about stocks—is that everyone is concerned about the volatility. I am surprised how many questions, even today, I get asked about the flash crash, which was three years ago and lasted for about 30 minutes, when the market dropped about 8% or 9% and then came right back.<sup>2</sup> Well, if they were scared about the flash crash, what about what we just saw with gold? We had much more than a 10% drop that only barely has come back. Gold was supposed to be safe in [QE](#). Everyone thought, "As long as QE is on, commodities are the place to be. Gold is the place to be." Well, QE is on around the world at a level that we could've only dreamed of a year ago, and yet gold broke downward. As a result, I'm not sure that people are going to be as comfortable with the commodities and gold and silver as they used to be, which I think is going to be to the benefit of the equity market. **Question:** Another big story of the year has been what Japan has been doing with monetary policy. Do you have any thoughts on the efficacy of their approach and what's happening in the Japanese market? **J. Siegel:** I find what Japan is doing, as a macroeconomist, to be one of the most fascinating macro policy moves of not only this decade but perhaps of the whole post-World War II period. Super-aggressive QE, and I support it. Now, I'm not one of those who think that [deflation](#) is the only cause of their problems. I think there are structural problems. I think there's an aging population that finds it very hard to deal with disruptive technologies and the concept of how fast one has to move in changing the world. But nonetheless, what they are doing and what they have done, and the market believes them, is depreciate the yen, help the exporters. **Question:** And the European central bankers have made comments about the interest rate policy and about potentially cutting rates. Do you think they will lower the interest rates, and what impact could that have on their economy and the euro? **J. Siegel:** I believe that they most certainly should lower the interest rates. I'm a supporter of Mario Draghi. He knows what protocols to follow. He knows how critical it is to prevent a financial crisis. I think deep down he would like to cause a little depreciation of the euro and lower those rates, but he has political considerations that he has to watch from Germany and elsewhere. I think ultimately, though, they will lower rates and they will lower the euro. The economic news out of Europe is terrible. Auto assemblies in Germany are near 20-year lows. Once the slow growth spreads to Germany, I think they will finally give in on a lower euro and lower interest rates. **Question:** We have seen continued interest on that currency hedging theme, as well as on the European hedged equities. The exporters are starting to do better than just the broader European markets this year, since we started focusing on the exporters in Europe for that hedged equity fund in Europe, HEDJ. Any thoughts on this approach? **J. Siegel:** This is with the euro at \$1.31. Think of what happens if the euro goes to \$1.20, as it should, or lower. It's great to see this interest with the euro at \$1.31. At \$1.20, the exporters will be jumping up and down as they are in Japan, wringing their hands about, "Wow, we've got opportunities abroad." It's really hard to predict the short runs on any market, but the next move of the euro, in my opinion, is definitely downward. **Question:** Let's go back to the U.S. market for a bit and talk about what you see for [valuations](#). **J. Siegel:** The valuation ratios are still extremely favorable. As you know, earnings dropped off at the end of last year. Many firms took a hit on their

pension funds because interest rates were at record lows. That caused, even in [operating earnings](#), a lot of those late December/January [write-downs](#). I've maintained that the rally to new highs that I see in the next nine months—this year and into 2014—is going to be based on [multiple expansion](#). I believe we are going to get multiple expansion as people begin to move from bonds to stocks. And don't forget, it has only been a trickle so far. I believe we're just at the very beginning of this train. This train might gain momentum as people say, "Wow, if I can't trust gold, where is there a place for me to go?" They're going to be looking at equities and alternatives and emerging markets, both debt and equity—asset classes that are worthy of their consideration. **Question:** Let's talk about risks. Many worry about a potential Fed exit. Any views on what the timing of that would be and how they would actually exit their policies? **J. Siegel:** I've written a piece about an exit that appeared about two weeks ago in the Financial Times. I said that in addition to or in place of just selling bonds they should consider raising [reserve requirements](#). Raising reserve requirements shouldn't be viewed with as much fear it once was, because they can pay interest on those reserve requirements. In fact, I worked out that if the Fed puts a 15% reserve requirement on deposits, I believe the Fed would not have to sell one dollar out of its portfolio to mop up all the [excess reserves](#) that are now in the banking system. That's pretty amazing, because there are approximately \$1.7 trillion worth of excess reserves now in the banking system<sup>3</sup>. Many people worry when they start finally having to tighten and remove it—is the market going to be strong enough to absorb a \$1.7 trillion open-market sale from the Federal Reserve? What I'm claiming is they don't have to get rid of all of those. They could do a mixture of raising the reserve requirements and selling them as they desire to mop up those excess reserves and to prevent any of that money from truly becoming inflationary. <sup>1</sup>Refers to the price of gold in U.S. dollars over the period from 12/31/2012 to 4/18/2013. <sup>2</sup>Refers to the performance of the S&P 500 Index on May 6, 2010, the date of the so-called "flash crash." <sup>3</sup>U.S. Federal Reserve, 3/31/2013.

#### Important Risks Related to this Article

This article was reprinted with the permission of Jeremy Siegel. WisdomTree is not responsible for its content and has reprinted this article to be viewed as informational. The information provided to you herein represents the opinions of Jeremy Siegel and is not intended to be considered 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. Past performance is no guarantee of future results. Professor Jeremy Siegel is a Senior Investment Strategy Advisor to WisdomTree Investments, Inc., and WisdomTree Asset Management, Inc. Neither Professor Siegel nor WisdomTree nor any other party involved in making or compiling any information makes an express or implied warranty or representation with respect to information in this article. There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Investments in currency involve additional special risks, such as credit risk and interest rate fluctuations. Derivative investments can be volatile and these investments may be less liquid than other securities, and more sensitive to the effect of varied economic conditions. As HEDJ can have a high concentration in some issuers, the Fund can be adversely impacted by changes affecting those issuers. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

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](http://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**

**Real assets** : Assets that have their own value independent of their price, typically used to mitigate the potential impact of inflation lessening the purchasing power of an investor's home currency.

**Volatility** : A measure of the dispersion of actual returns around a particular average level.&nbsp;.

**Quantitative Easing (QE)** : A government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.

**Deflation** : The opposite of inflation, characterized by falling price levels.

**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.

**Operating earnings** : Earnings from continued, regular business operations that do not account for certain one-time charges that may be unique to a particular quarter or period and not repeatable.

**Write-downs** : Occur when assets on a firm's balance sheet are reduced in value in a way thought to be closer to what the market's current valuation would be, should those assets need to be sold at present. The impact of this lowering in value is felt on the income statement in terms of lower earnings.

**Multiple expansion** : Term for a rising P/E ratio, meaning that share prices are rising faster than earnings are growing.

**Reserve requirements** : Mandated amounts of cash that banks must hold on hand to cover their liabilities.

**Excess reserves** : bank reserves in excess of a reserve requirement determined by local central bank. They represent reserves of cash more than the minimum required amount.