Reading Jeremy Siegel

Twice in the last twenty years, a tidal wave of selling has engulfed the stock market and sent prices reeling. The first occasion was the dot-com debacle of the late 1990s, when excessive demand for tech stocks set up the conditions for a terrible selloff. Companies were trading “on air,” as they say, when profits were scant and everyone buying stock hoped to become the next internet millionaire. Cell phones were new, the internet and email were but a few years old, and many were convinced that the Fed had abolished the business cycle. Unbroken growth would become a permanent characteristic of the U.S. economy. When tech spending by American companies unexpectedly slowed and the news caught up with the market, selling began in earnest. The bear market that took hold in the spring of 2000 lasted for almost two years and took the S&P 500 stock index down by 47 percent.

Not until the summer of 2006 did investors find their stocks returning to levels attained before the selling took hold—if their stocks were still listed at all. The second occasion, far worse, was in 2008-09, when the market registered the effect of a second debacle, this one involving the housing market. Bankers and mortgage brokers originated and sold to the public, banks and brokerages massive numbers of mortgages that had little or no value. The public bought property it couldn’t afford, and the firms packaged and sold mortgage-back securities that were nearly worthless. (For a good description of this phenomenon, read Edmund Andrews’s *Busted: Life Inside the Great Mortgage Meltdown.*)

The brokerage Lehman Brothers went bankrupt in September 2008, and it was very nearly followed by the insurance company AIG, which was responsible for covering the insurance demands on the failed mortgage securities—demands that proved impossible to meet. The S&P 500 peaked in the summer of 2007, after which selling accelerated for another eighteen months. By March 2009, the index had plummeted to its low, a stunning 57 percent off its high. Losses would have been even worse but for unheard of emergency steps taken by Barack Obama’s Treasury Department and the Federal Reserve.

It seems that two once-in-a-lifetime bear markets had struck the investing market in less than ten years. And I found the experience as rattling as nearly everyone else. I was a GM bondholder, and the company fell into bankruptcy in the spring of 2009. The value of the bonds dropped to zero, the semi-annual interest payments obviously stopped, and years passed before we bondholders recovered a modest amount of the face value of the issue. And then there were the losses in my mutual funds. . . .

My experience was no different from the one that beset millions of others, of course, and many had it for worse. What reminded me of those years was a rereading of Jeremy Siegel’s *Stocks for the Long Run*, which I had read when it was originally published in 1994. (The edition I’m reporting on now was the fifth edition, which came out in 2014). A specialist in finance at the Wharton School at Penn, Siegel has been a staunch proponent of buying stocks and holding on to them for years and even decades. He bore considerable criticism after the dot-com bust and

took even heavier fire after the mortgage disaster of the 2000s. But on both occasions the market came roaring back, and those who were able to tolerate the selling and hold on to their positions did very well for themselves.

Siegel can justifiably say that he told us so. He concedes that economic forecasting is demanding and fraught with peril. “But those who have persisted with equities have always been rewarded,” he writes. “No one has made money in the long run from betting against stocks or the future growth of our economy.” He argues that stocks, including reinvested dividends, have averaged an annual return of 6.6 percent over the decades. This eclipses the return of the bond market, whether Treasuries, corporates, or municipals, and excludes the tax advantages of investing in stocks. (Dividends and capital gains are taxed at a lower rate than interest payments.) Other asset classes, including real estate, commodities and art, are too unpredictable for most investors.

Siegel encourages readers to disregard market opinion purveyed by the press and TV. “The worst course an investor can take is to follow prevailing sentiment about economic activity,” he writes. The direction of markets, interest rates and individual stocks is intrinsically unpredictable. In 2009, the Fed drove rates down to levels unseen since Eisenhower was in office. And every time that analysts have expected a recovery in rates, the rally sputters out. Rates drifted higher last year, when the ten-year Treasury note briefly climbed over 3 percent. But the Fed got anxious over falling estimates of growth this year, and backed down from its pledge to raise rates. As I write this during the first week in April, the ten-year note is yielding a paltry 2.5 percent. Who would have predicted that?

The second point that Siegel emphasizes is the need to pay close attention to valuation. Never overpay for a stock. Make sure the price/earnings ratio—the price of the stock divided by its earnings per share--is acceptable, which means a figure at or below about 15. Siegel compares the performance of IBM and Standard Oil of New Jersey—now Exxon—over the 62-period of 1950 to 2012. IBM was entering a phase of impressive growth, but Exxon had a lower p/e and paid a higher dividend. The differences were critical. By 2012, those who had bought the oil company made more money than people banking on computers.

“Survival is the only road to riches,” the late Peter Bernstein told the business writer Jason Zweig in an interview from 1994. Indeed it is.

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