Weekly commentary by Professor Jeremy J. Siegel

QE Bubble Continues to Expand; Jobs Report as Expected

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As we warned last week, the overall jobs report was apt to disappoint, but most of the disappointment was in government hiring, not the private sector. Nevertheless, every soft report sends another surge of investors betting on Quantitative Easing, sending yields down to record lows, the dollar down, and commodity prices higher.

This bubble is really extraordinary. QE, even if it does occur, is apt to involve the purchase of about $100 billion in the first installment, about 1% of the Treasury market. Furthermore, the government budget deficit is pushing out $1.4 trillion of new Treasury bonds this year, dwarfing QE. The 10-year bond yield has fallen to 2.39% and 10-year TIPS are now 0.40%. This is extraordinary and most certainly cannot be sustained. The dollar has been oversold and commodities are overbought. Perhaps the least over-hyped asset sector is equities, which still haven't scaled their April highs. And it is equities that are apt to be helped the most by QE, as individuals gain confidence to move out of low-yielding bonds into higher yielding stocks.

As I noted in the past, I am a strong supporter of QE, but wish it were done in the credit market rather than the Treasury market. We don't need lower interest rates on Treasuries, what we need are lower interest rates on higher grade private debt in order to shrink the risk premium and encourage banks to lend. This opinion is also shared by Alan Blinder, former vice-Chairman on the Fed. However, the FOMC is very reluctant to favor one type of credit over another and Bernanke spent much capital last year convincing the committee to buy mortgage backed securities in QE1. He now has to be satisfied with gaining support in QE2 and that is to acquiesce to purchases in the Treasury market. However it is done, QE will impact spending and lending positively and list the economy – and with it interest rates.

The labor report confirms what other reports have indicated – GDP is increasing at about 1.5% in the third quarter and at about 2.5% in the fourth quarter. There have been some scattered signs of better news in October – retail spending has held up well and jobless claims have fallen to a 3-month low. And we could see some further gains as the Dow closed above 11,000 on Friday. Technically the equity market looks very strong, suggesting that the April highs will soon be breached.
