Weekly Commentary by Professor Jeremy J. Siegel

Different Degrees of Market Recovery; Fed's new "Openness"

5:50 p.m. EDT, 3/25/2011, Philadelphia PA

U.S. equity markets have made a nice recovery, the S&P 500 recouping about two-thirds of its top to bottom loss of nearly 100 points and the Dow Industrials recovering an even larger fraction. As the markets rose, the VIX (volatility) index has fallen from over 31, when fears of a massive Japanese reactor meltdown hit a high, to just under 18 today, about three points above its low reached before the earthquake hit. The ten year Treasury has rebounded from its low of 3.17% to 3.45%, but still remains well below its 3.74% high reached before the earthquake. U.S. Treasuries continue to benefit from being the hedge asset of choice for investors when there is a sharp increase in uncertainty. Of course their low yields make them unattractive to long-term investors who do not care about short-term diversification. Equities, by comparison, are even more attractive.

European equity markets have fared worse than in the U.S., recovering slightly less than half of their fall, even less than in Japan where stocks have recovered half of their precipitous 25% loss. The reason for this is the increasing debt problems in Europe, where Portuguese and Irish bond yields continue to hit new highs (and Greek bond yields came close), while ECB President Trichet talks of tightening. This talk boosts the euro to a level which is, in my opinion, unsustainably high. Default of the sovereign debt of at least one of these peripheral countries is all but certain, and the euro will weaken as a result. But that could be several months away. In the meantime, European equities are still selling for a 20% discount off their American counterparts, which are in turn still cheap relative to earnings. Such discounts compensate for the risk of euro depreciation.

The other important development of the week is the announcement by Chairman Ben Bernanke that the Fed would hold press conferences following their remaining 2-day meetings this year, starting with the next meeting on April 27. On those days, the statement will be released early at 12:30 p.m. ET and a news conference would follow at 2:30 p.m. The new procedure may open Bernanke up to revealing disagreements on the FOMC which don't come out in the vote. Certainly next month he will be quizzed about the probability of a QE3, but QE3 seems most unlikely, given the recent statements of a number of FOMC members. The real question is when the Committee will begin the tightening process and whether the press can squeeze an answer out of the Chairman.
