Weekly commentary by Professor Jeremy J. Siegel

Bond Yields Turn Upward; Commodity Rise due to Growth; Deficit Reduction

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Stocks have had a mildly disappointing week, but from a technical point of view equities are just moving back to the uptrend established just before last week's jump. This means that the bull move is still fully intact and could be accelerated by a slew of favorable reports on the economy due next week.

Bonds, on the other hand, have taken a hit, will the 30-year bearing most of the brunt of the selling. This has led some analysts to comment that QE2 is already a failure since rates have moved up, not down. What the naysayers fail to understand is that QE2 works through impacting the liquidity of banks and individuals, not through interest rates. In fact, that yields rise in response to greater economic activity and higher inflation is a sign of QE2 working, not failing. The same is true of commodity prices. Yes, oil has returned to its post -crash high of near $90 a barrel. One analyst on CNBC this morning noted that a recession has always followed a tripling of oil prices and oil had fallen to $30 a barrel at the height of the crisis. But that fall was from $150 a barrel the preceding summer, and oil prices are only half of the level now. In fact, I believe the rise in oil and other commodity prices is primarily due to the strong growth of the emerging economies, especially China, and not because of the Fed monetary policy.

The other news of interest was the release of preliminary recommendations of the deficit reduction committee. I am not going to spell out all the recommendations except to note that they move in the right direction – eliminating deductions and exemptions and flattening the rates. The slow increase in the retirement age to 69 is a no-brainer in my books, but unfortunately Medicare, and not Social Security is the largest reason for the burgeoning long-term deficits. There was a recommendation to eliminate any preferential rate for dividends and capital gains (the top rate would be 26% on earned and unearned income), but also a slashing of the corporate income tax. The re-commendations also called eliminating the mortgage deduction, and surprisingly did not garner as many howls from the housing industry as I expected. The best that the Obama administration can do is to extend all tax cuts for the next 2 years and work on a comprehensive overall of the entire tax code for 2012. That may be tough since the Republicans will want to see if they can capture the presidency (as well as the Senate) in two years and thus have their say on the new tax code. But without 60 GOP votes, the Dems can turn the tables and filibuster any Republican bill.
