Weekly Commentary by Professor Jeremy J. Siegel

Stocks at Recovery Highs and Should Move Higher

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Very good retail sales data cap a week of mixed economic news. February sales were up 0.3%, versus an expected decline of 0.2%, and ex-auto and ex-autos & gas – so-called core retail sales – were up even more. Although January retail sales data were reduced somewhat, today's news appears to contradict the gloomy consumer confidence data we have seen over the last month. As predicted last week, equity markets have continued to perform well with the S&P 500 eking out a recovery high on the basis of yesterday's close. Small stocks and Nasdaq continue to surge and today's retail sales data should set up a good day for equities.

First quarter GDP is still tracking at about 3% growth. The January trade balance was better than expected, although the volume of both imports and exports were down. Jobless claims remain stubbornly high at 462k, almost exactly on expectations. JPMorgan claims that their models show that claims around this level are consistent with employment gains of about 40k per month, below their (and my) forecast for payroll gains in coming months. To get 100k payroll gains, claims must move down to between 400k and 440k.

Some readers may have seen Tuesday's Wall Street Journal's article by E.S. Browning about the competing views of the stock market of myself and my good friend, Professor Robert Shiller from Yale University. Another key driver of stock prices, omitted from the article, is the extraordinary low level of interest rates. The average P-E ratio of U.S. markets when interest rates are as low as they are today is in the 18-22 range. Stocks are now tracking about 15 times expected 2010 earnings. It is true that interest rates will rise in the future, but by then earnings will also rise, so that stock market has many favorable drivers going forward.

Bloomberg has reported that Obama is considering Janet Yellen, current President of the San Francisco Federal Reserve, as the new vice-Chair of the Federal Reserve Board, replacing Don Kohn, who is resigning in June. Although Yellen is known for her "dovish" views on interest rates, she is a fine economist (her husband is a Nobel Prize winner in economics) who will serve Bernanke well. Another reported choice for the open seat is Peter Diamond of MIT, who was my professor when I received my doctoral degree at MIT 40 years ago. Diamond is an extraordinarily bright economist who will also be a good selection. The third selection, Sarah Raskin, Maryland's commissioner of financial regulation, is not a specialist in monetary theory and will likely follow Bernanke's lead. None of these selections should change the basic thrust of monetary policy.
