Weekly commentary by Professor Jeremy J. Siegel

Great Employment Report Should Drive Stocks Despite Rising Yields

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Finally, an unalloyed good payroll report: the payroll loss was lower than estimated, the revisions for May and June were in the right direction, manufacturing employment dropped much less than expected, hours worked increased, the gains in payroll were almost entirely in the private sector and, most surprisingly, the unemployment rate dropped. It should be noted that Goldman and JPMorgan revised their estimated job loss down yesterday after the better-than-expected jobless claims data yesterday.

S&P futures jumped, as expected on the news. The only thing holding stocks back is the big jump in the long bond, who yield jumped 14 bps, and is now 10 bps higher. This has kept the equity market from exploding (Nasdaq futures, which are less sensitive to the interest rate, jumped more). The only totally counterintuitive move in the market was that the dollar initially fell versus the Euro on the news. That has now been reversed as I type this report.

The biggest political impact of the report will be the drop in the unemployment rate. The decline was caused by two factors: the household survey, not as complete as the establishment (payroll) survey, showed a lower employment loss and there was a drop in those actively seeking work. I have long maintained that the 10.8% postwar record unemployment rate would not likely be hit, and this reinforces that forecast. I still expect 10% to be hit. In the previous two recessions, there were months of slightly lower unemployment rates, but then the rate continued upward by one half to one percentage point before topping off. That might happen here.

A noteworthy development in the last few days is the strong rise in down-and-out financials, particularly AIG. In my opinion this was a short squeeze. Even though AIG reported a profit last quarter, I don't see how the firm can ever generate enough profit to pay back all the government loans for all the losses on its swaps and other real estate securities. As I have said before, there are now great opportunities for financial institutions that can weather their losses. However, for Fannie, Freddie, and AIG, I believe that their losses are too severe to overcome. This is an important topic that will be treated in more detail later.

The bottom line for investors is an excellent employment report that should support a much stronger equity market. Only bonds and commodities can hold back stocks from exploding on the upside, but higher yields are not likely to stop stocks from continuing in rise.
