Weekly commentary by Professor Jeremy J. Siegel

Labor Report is mixed, but the Real Story is Euro and the EMU

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The labor market report was on the soft side, with the big downward revision to December (and big upward revision in November payrolls), otherwise it wasn't far from expectations. Manufacturing employment rose (consistent with ISM reports), and hours worked increased. The household data, which showed a big increase in employment and a suprising drop in the unemployment rate to 9.7%, is at odds with the payroll, but politically, a drop in the unemployment rate of this magnitude is a plus for the Obama administration. All told, I would say this is a mixed report for the markets.

Granted the jobless claims report yesterday was disappointing, but the real cause of yesterday's decline was the turmoil in Europe. As anxiety about the peripheral countries in the EMU (European Monetary Union) rises, concerns about the safety of the sovereign debt of these states sparks fears of another debt crisis. I have been asked if this resembles the emerging market crisis in 1997, which crashed the Asian currencies from Korea to Indonesia and tanked their stock market. There is a fundamental difference, Greece, Portugal, Spain and other peripheral countries do not have their own currency, and in many ways this crisis is worse since even if these countries default on their debt, they will still remain deeply uncompetitive. Devaluation is the easiest way to restore competitiveness. The current EMU had grown beyond its optimal size: there is not enough labor mobility and there are not enough fiscal transfers between the countries. The peripheral countries can pull out of the EMU, but only with a lot of pain and dissension. The question is, does this matter to U.S. investors? Asia is the strongest growth area in the world, followed by the United States, and Europe lags far behind. Even before the crisis, European growth was projected to be less than 2% this year. There is no question that the ECB will keep interest rates lower for longer because of the crisis and therefore the dollar could gain considerably on the Euro.

The yen rose yesterday because the increased risk curbs the appetite for the "carry trade" of borrowing yen to invest in other currencies. It was of note that despite the problems in the world's paper currency, gold fell drastically, as did oil and other commodities, and these falls far exceeded the rise in the dollar. This is ultimately good for the U.S., an energy importer. I would still hold European stocks, but I would hedge the decline in the dollar. U.S. stocks will probably fall as anxiety increases, but I would accumulate on any decline. Relative to every-rising earnings estimates in 2010, U.S. stocks are very reasonably valued.
