Weekly commentary by Professor Jeremy J. Siegel

Treasury Strength could set Stage for Equity Run; Meaning of B of A's Recovery

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As is usual, the week following the labor report rarely has market-moving data. This past week was no exception. Some were disappointed in today's University of Michigan report that showed only a marginal increase in June's consumer sentiment, but one should remember that April's and May's increases were huge, so it is noteworthy that June did not backtrack. Also Thursday's jobless claims fell to 601k when the market was hoping to be in the 500k range. Nonetheless, I believe that June or July will mark the end of this "Great Recession."

The most important development last week was that the near-panic in the government bond market, which pushed the 10-year Treasury yield above 4%, ended with a decent auction on Thursday that brought yields down to 3.79% by week's end and produced some buying in the dollar. The steady rise of oil and other commodity prices has been worrisome to bond holders. The bond market is signaling that the Fed must begin its tightening well before 2010 or risk higher inflation. I believe that the Fed will heed this signal eventually although they are not ready to do so now.

If this rise in long rates has subsided, even temporarily, then the equity market can move significantly higher. 950 is a very strong barrier for the S&P 500 Index. It was where the early January rally in the S&P Index stopped, before plunging to new lows. (The Dow is lagging a couple of percent while the Russell 2000 is already above its January highs). If the January highs can be breached, a further 5% to 10% upward move would be quite likely.

I also am impressed with B of A's strong rally today, as it was recommended yesterday by Morgan Stanley (and pushed by Jim Cramer on Mad Money) and today by Stifel Nicolaus. We know that profit margins for banks should be very strong, it is only their legacy assets that are holding them back. If B of A can really earn enough to pay back its TARP loans that means that it has overcome the legacy hurdle and this would be significant. Of operating banks that have remained intact, only Citi was deemed in worse shape.

Yet even if all the banks recover, we know that Bear, Lehman, AIG, Fannie and Freddie, Washington Mutual and others will be gone forever, their equity capital destroyed by overleveraging in real estate assets. So even a complete recovery of Citi and B of A will not be enough to bring the financial sector of the S&P 500 Index, which plunged 85% from top to bottom, back to its old highs.
