## Weekly Commentary by Professor Jeremy J. Siegel

# Stocks Break out on Upside on Earnings; Thoughts on Housing

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Three major forces have been weighing against the market this year. The first is the threat of recession. The second, not unrelated to the first, is whether earnings can come in as high as anticipated, and the third is the possibility of a severe European banking crisis that will send Europe and possibly the rest of the world into another recession.

The data of the last several weeks have put to rest fears of a recession. The data this past week have also put to rest fears that firms will not at least reach this year's earnings target. By my count, of the approximately 100 firms in the S&P 500 Index that have announced earnings since Alcoa, 70% have beat estimates, 20% have fallen short, and 10% have come in line (within 1% of the Bloomberg estimate). This is not saying that firms will meet the rosy 2012 projections, which for the S&P is northward of $110 per share, but stock prices have never been priced at that level (if they were, they should be 20% to 30% higher).

The only missing piece to complete a bullish picture is the European situation. I have written on this subject extensively in past commentaries and maintain that the ECB must come up big with guarantees not unlike what the Fed implemented following the Lehman bankruptcy in 2008. If a real banking crisis develops in Europe I do believe the ECB will supply the needed liquidity, but every day they delay there are more stresses on the banking system. It is likely too late to avoid at least a mild recession in Europe. If the ECB does come up big there would be a huge rally in European and world stock markets.

Housing starts for September picked up from an annual 572k unit rate in August to a 658k rate and the NAHB housing sentiment index jumped from 14 to 18. But these are still pitifully low numbers. The average number of housing starts since government started collecting statistics in 1959 is about 1.5 million per year. That is also the number that many housing experts believe is needed to keep up with normal population growth and household formation. So the housing industry is currently running at about 1/3 of capacity. Here is an interesting fact: from 1998 through 2006, the housing boom created about 2,340,000 units more than the long-run average. But since 2007, the U.S. has built 3,300,000 units less than the long run average. That means there is a cumulative deficiency of over 1 million units. When the economy recovers, this could set in play an impressive boom in housing.

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