Weekly commentary by Professor Jeremy J. Siegel

Disappointing Labor Report; Equities Still Vulnerable

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Although not disastrous, the June employment report was disappointing, as private sector growth lagged expectations by 27k and most of the work week gain of the previous month was erased. The unemployment rate surprisingly dipped to 9.5%, but that was due entirely to a big drop in the labor force, as employment in the household survey dropped by 300k. Also discouraging was the drop in hourly wages by 0.1% (a +0.1% gain was expected) and a downward revision of last month's wage gain. As a result, y-o-y wage gain is only 1.7% instead of the +2.0% that was expected.

S&P futures bounced around after the announcement, as the recent market decline attracted enough bulls hoping for some upside. But the breakdown of the equity market below its February lows, and the weak performance yesterday, on the first day of trading of the new quarter, which is normally quite bullish, does not presage well for the equities in short-term. Lacking any bullish news, I expect some further downside.

Nonetheless, there are no data that suggest a double-dip recession, and that is clearly what the government bond market is pricing in with the ten year falling well below 3% this week. TIPs yields are also falling, with the ten year at 1.18%. This means that the gap between prospective stock returns, based on the most conservative measures of earnings, and real bond returns are extraordinarily high and reflect the extreme risk aversion in the market.

This bearishness in U.S. equities comes despite some improvement in the European situation. European banks are now undergoing "stress tests" similar to what occurred for U.S. banks after the Lehman crisis. The U.S. results surprised on the upside and led to a substantial rally in financial stocks and there are some bulls expecting the same to hold for Europe. The euro has also rallied sharply and is now attracting some technical support.

The bottom line is that the U.S. economy has definitely slowed, but in no way reversed. If the data weaken, I would much prefer the Fed to step in and provide more credit support than further government spending. On the fiscal side, I also would like to see the 2011 tax rates resolved soon – uncertainty is not helping the market or the economy. The best solution on that front would be for the Obama Administration to defer upcoming tax increases for one year; such a move would provide a huge market boost.
