Weekly Commentary by Professor Jeremy J. Siegel

Problem with the "G's" Weigh on Equities

7:00 p.m. EDT, 5/1/2010, Philadelphia PA

The flow of economic data was good; it was the G's – Greece and Goldman – that kept equities down last week. Analysts are beginning to aggressively update their earnings estimates not only for the first quarter but also for all 2010 and 2011. Current S&P 500 estimates for bottoms-up operating earnings are $80.87, and for 2011 $95.08. The latter is above the $91.47 record reached at the end of the second quarter 2007, at the peak of the previous bull market. And interest rates moved down last week, with the ten year sinking to 3.65% on sovereign debt fears. This is the lowest in 2 ½ months.

The GDP numbers were almost exactly on expectations. Consumption was strong, and although the inventory build was a bit higher than expected, government purchases declined, which meant that the private sector was even stronger. Furthermore, the first quarter ended on a strong note, which bodes well for a 4% to 5% growth rate in the second quarter.

Readers of my commentary know I've been very pessimistic about Greece, and Spain and Portugal are also in big trouble. If any of these countries withdraw from the euro – with or without default on their sovereign debt – this would elicit a sharp short term negative reaction from both stock and currency traders. But on such a reaction, I would be a buyer, since many European stocks are selling for a 20% discount off comparable valuation for U.S. firms. In the meantime, markets are defensive until the situation clarifies.

Problems for the euro are long-term bullish for the dollar. Foreign central banks have been edging towards greater euro holdings in the past several years on the strength of the European currency. That shift will clearly slow, if not stop and reverse. This means there is more capacity to absorb long-term U.S. debt without putting upward pressure on interest rates.

Next week we receive the important labor market report. Expectations for overall payroll growth are +200k, and +80k for gains in the private sector (the difference is government hires for census takers). The ISM report Monday is expected to be over 60; if it reaches 61.5, one would have to go back almost 30 years to find a stronger report. If anxiety about the G's fades, we should witness a sharp upturn in equities. .
