## Weekly commentary by Professor Jeremy J. Siegel

# Europe's Crisis Dominates Financial Markets

10:50 a.m. EDT, 5/25/2012

An unexpected pop in the final University of Michigan Consumer Sentiment index to the highest level since before the financial crisis failed to stem the overriding fears of market participants: A European Currency and Financial Meltdown. I estimate that this fear is causing equities to sell for at least 10% less than they would in the absence of such a crisis. Unfortunately, there are no signs that the situation will soon be resolved.

As I mentioned in my Financial Times article sent out to subscribers earlier this week, the debt crisis is not central to what is now happening. Greece, Spain and the other peripheral European countries are suffering a woeful lack of demand because labor costs are too high. Austerity will not help, nor will the establishment of "euro bonds," backed by the ECB, a solution advocated by some economists. A lower price of the euro is the last best, but by no means sure, chance to keep the Eurozone together.

The euro has fallen dramatically this week and this morning briefly breached the $1.25 barrier, the lowest in almost two years. But it needs to fall much further, and even parity with the dollar might not be enough.

The market's fear is that a Greek exit from the Eurozone will spark a run on all other banks in peripheral Europe, sparking huge and destabilizing monetary flows towards Germany. Of course the ECB will accommodate such a "run," but the process will be so disruptive that credit flow will slow and credit spreads skyrocket. This is never good for stocks, and I would predict such an event could bring a sharp 10% pullback in European stocks and a 5% fall in U.S. stocks.

Could this event be a buying opportunity for investors? Probably yes. Right now Europe is selling for 8 to 9 times this year's already reduced earnings, a sufficient discount to attract dollar investors even with the euro risk (and of course, hedging that risk would be most preferable). It is true that if the euro falls, dollar earnings of U.S. companies selling to Europe will also fall. But that would be cushioned by an uptick in European demand as their export market booms. If equities fall 5% to 10% more, this would be a unique buying opportunity for stocks.

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