Weekly Commentary by Professor Jeremy J. Siegel

Euro Crisis grows, U.S. data soft, but Gasoline Prices Going Down

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I have just returned from a trip to Poland and Estonia, visiting the latter in order to give the keynote address for the 15th anniversary of the Tallinn Stock Exchange. In January Estonia became the 17th country to join the euro. To reach the ECB requirements they cut government expenditures by over 30%, precipitating a short recession. But they have bounced back strongly and the government has the full support of this small country's 1.5 million people who are committed to the principles of the free market. By the way, Eastern Europe in general bypassed the financial crisis because they never had the housing boom or its toxic mortgage-based securities.

In the meantime the euro crisis grows as Greek and Portuguese yields hit new highs. Default is inevitable. It is discounted in the market, but the tiny chance that the default will lead to another financial crisis such as we had 3 years ago has depressed equities worldwide, especially last Friday. I give the possibility of another banking crisis virtually a zero possibility. The market has well discounted the budget situations and has driven some Greek securities to 50 cents on the euro. This may in fact be more than the rescheduling (or now the euphemism is "reprofiling") will accomplish. Stocks frequently overweight the worst possible outcome. When the event happens and the world doesn't fall apart, there is usually a relief rally.

In the U.S., the data are coming in soft. Even though jobless claims dropped, the four week moving average is still up from a month ago. The Philly Fed manufacturing index was clearly disappointing. Nevertheless, gasoline prices are finally dropping and at a rate of about 2 cents a day. By next week, this will be big news and the eventual drop in the next 2 to 3 weeks could be another 20 to 30 cents. It is important to remember that gasoline prices are the single most important short run component of consumer confidence.

The trends are favorable for stocks and will become more so if commodities continue to cool. Where else can you get well covered yields that historically have grown more than inflation? As dividend-paying stocks continue their moderate outperformance of the broad market, more advisors will conclude that this is the place to be.
