Weekly commentary by Professor Jeremy J. Siegel

Bernanke Disappointing; Remarkable Earnings Despite Slow Growth

10:00 a.m. EDT, 7/23/2010

Chairman Bernanke's testimony was disappointing last Wednesday in his semi-Annual "Humphrey-Hawkins" appearance before Congress. The Chairman should have been more convincing about the Fed's ability to stimulate the economy if the central bank chooses to do so. But when asked by Senator Bunning of Kentucky if "the Fed was out of bullets," he responded meekly, "I don't think so," when the market was looking for "Absolutely not." Later, in specifying the measures that Fed could take (such as reducing the interest rate on reserves, quantitative easing, and stronger language in the FOMC directives) he merely said that, "There is some probability that these measures would be effective." The tentativeness of the Chairman's response and his reluctance to indicate that the Fed was actively considering these measures to address the slowdown did not inspire confidence. And it is confidence that is lacking in today's markets. On his words the Dow dropped over 100 points and long-term Treasury yields plunged to new post recovery lows, with the 10-year touching 2.85%.

I hope that Bernanke takes cognizance of the market's disappointment in his remarks. As readers know, I have been a strong supporter of Bernanke through his tenure as Chairman, and one weak performance is not sufficient dismiss his superb leadership. I imagine that if data became weaker, the Fed would act on the very policy measures that Bernanke specified in his testimony and I have strongly advocated.

What is encouraging this past week is the strong performance of earnings in the second quarter despite the economic slowdown. Since July 1, 150 S&P 500 firms have reported second quarter earnings and, on my count 129, or 86% have beat analysts' estimates. GDP growth for the second quarter will be announced next Friday and most analysts expect growth between 2% and 2.5%, certainly subpar for a recovery and about one percentage less than expected a month ago. That firms are still able to beat estimates in this slow-growth environment is remarkable and confirms the strong profitability of the corporate sector. As in the past two quarters, more firms are missing top line revenue estimates than earnings, but that does not disturb me since it indicates that firms can leverage future revenue growth into even faster earnings growth. With a pickup of growth to the 3% to 4% range, firms would be on track to realize record profits in 2011.
