Weekly commentary by Professor Jeremy J. Siegel

European Disappointment Sends Dollar up and Commodities down

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There are many cross currents influencing the market but the basic picture remains the same: a sustained increase in economic activity points to still higher equity prices. Today's U. of Michigan consumer sentiment numbers disappointed, but the data evaluating "current situation," which some economists view as the more important, was the highest since March 2008, while the volatile "future expectations" variable moved downward. Both are equally weighted to get the overall number.

Although retail sales were also a bit of a disappointment, November's data were revised up. MacroAdvisors, the most accurate GDP forecaster, is still predicting a 5.5% growth for Q4, more than one percentage point above consensus. (JPM just raised their estimate to 5.7% at 11.15 a.m.) MA also forecasts U.S. Q1 GDP growth at 3.0%.

There has been significant weakness in the Euro (down to $1.43 this morning) and for good reason. Europe was already lagging behind in its recovery and the German statistics office issued guidance that German GDP likely stagnated in 4Q09. Furthermore, the problems in the peripheral Euro countries, especially Greece, Ireland, Portugal and Spain give the European common currency its first real test.

Before the introduction of the Euro, there would have been devaluations of these countries' currencies that would have helped them restore competitiveness (although at the cost of higher inflation). Today no such adjustment is possible, and these countries must rely upon either local deflation or labor mobility that enables the unemployed to go elsewhere in the European Union to seek better opportunities. Neither of these two adjustments is easy, and if they are not made, the stagnation of their economies could be prolonged. This could lead to political agitation by nationalists to break away from the Euro and re-institute their own currency. We are not at that point now, but I would not be surprised to see sentiment shift in that direction if these countries remain stagnant.

The strength in the dollar is leading to some downward movement in commodity prices, particularly WTI oil, which is now well below $80 a barrel. This has caused a rally in the ten year treasury, whose yield is down to 3.66% from as high as 3.78% last week. Earnings season starts in earnest next week and Intel's report was excellent and lifted the market in after-hours. JPM Chase beat the street but was light on revenues, causing some selling. Obviously, expectations are high, but I still believe that equities will again reach post bear market highs next week.
