Weekly Commentary with Professor Jeremy J. Siegel

Strong Earnings Support Stocks Despite Softer Economic Data

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The market continues to impress, with the S&P 500 reaching another record high despite a surprisingly weak retail sales report. I had to look twice at the numbers because the weakness was broad, including the important control group, with the previous month also revised slightly lower. One report does not make a trend, and higher-frequency indicators are not showing anything close to a major deterioration. But this did bring third-quarter GDP estimates down to the 2+ range, healthy but not booming.

At the same time, inflation news last week was encouraging. Both CPI and PPI were better beneath the surface, and estimates for the July PCE deflator have been revised slightly lower. Goldman Sachs is estimating a 0.2% monthly increase, with roughly half coming from the unusual measurement of portfolio management fees. Shelter inflation was somewhat firmer, but the longer-term trend remains favorable. Oil remains remarkably contained in the low $80s despite geopolitical uncertainty surrounding the Strait of Hormuz. Recent info suggests up to 9m barrels a day may be making themselves through the Strait. The U.S. economy can certainly handle oil at these levels.

Taken together, these developments put another notch for the Fed staying on hold in September. I thought keeping rates unchanged at the last meeting was defensible. My concern was not the decision itself but Chairman Warsh's failure to explain the Fed's reaction function. I understand his reluctance to provide forward guidance; markets can treat guidance as a promise and leave policymakers trapped when circumstances change. But abandoning forward guidance does not relieve the Fed chair of explaining what indicators will determine whether rates rise, fall or remain unchanged.

That makes Warsh's upcoming Jackson Hole speech notable. The market does not need him to promise where rates will be six months from now. It needs the rules of the road. Is the Fed primarily watching inflation expectations, the Treasury yield curve, labor markets, futures or financial conditions? Powell at least told markets what he was looking at. Warsh has not, and I hope Jackson Hole provides that clarity before the September FOMC meeting.

I also continue to watch the money supply. It has begun to tail off, with the bank deposit base actually contracting over the last couple of weeks. I do not want to make too much of two observations, but this does lessen some of my concern about renewed inflationary pressures. Money growth is no longer the dominant monetary indicator it was in the 1970s and 1980s, but it remains an important supplemental signal.

Against these monetary-policy questions stands an extraordinarily powerful support for equities: earnings. This earnings season could rank among the most impressive in recent history. We are seeing double-digit earnings growth despite second-quarter real GDP growth of only about 1.5%, while the magnitude and breadth of earnings beats have been exceptional. Outside of rebounds from severe recessions, it is difficult to find many comparable periods. Earnings are strong, forward guidance is strong and corporate finances remain healthy.

The recent stress surrounding leveraged growth positions unwinding was also revealing. It rolled through the market without producing broader financial stress, effectively becoming a stress test for growth stocks that the market passed with flying colors. Growth subsequently rebounded sharply. I still expect some rotation after the extraordinary run in the biggest winners, but fears that leverage was about to trigger a systemic event have, at least for now, been put to rest.

The combination remains favorable for equities: earnings are exceptional, oil is manageable, inflation is gradually improving and economic growth, while moderating, is not collapsing.

Please see the WisdomTree Glossary for definitions of terms and indexes.