Business

Ignore the Fed's stock market forecasts

Federal Reserve heads have little credibility when it comes to the stock market, yet they periodically enter the forecasting game.

Alan Greenspan said there was "irrational exuberance" when technology stocks were rising. That was in December, 1996, more than three years before the market top. Investors became a lot more irrational and far more exuberant.

A year ago Ms. Yellen said biotech stocks were "stretched." They promptly became more stretched; they rose another 45 percent.

So in May Janet Yellen indicated stock market valuations are "generally quite high." The reaction from investors? A yawn, and correctly so.

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Market Pulse

Ms. Yellen should look instead to the Treasury market for high valuations, in good part due to years of Federal Reserve actions (the QE's) and inactions (leaving rates at zero). Not a word about that.

The reason Janet Yellen is wrong about stocks is that she didn't complete the thought. If stock valuations are "quite high," one should ask "compared to what?"

To CDs and money-market funds that pay nothing? To Treasury notes and bonds with low yields?

Stocks deserve premium valuations, especially when earnings grow, if alternatives yield little or involve far more risk. That has been my take for a few years to justify higher and higher prices. I haven't changed my mind.

Stocks may not advance during this summer but there are still better days ahead.

Expect both rallies and profit-taking triggered by any number of things — the recent rise in long-term rates, higher oil prices, Greece (again), earnings surprises, the sell-off in German bonds, a falling stock market in China ... or nothing in particular.

The same goes for the bond market, which has been under pressure. Well, Treasuries and utilities have seen selling pressure.

If there were truly a concern about sharply higher rates, we'd see selling in traditional preferreds (I've written about RNR, PRE, NLY, and BFS issues).

I see none. And floating-rate issues and bank-loan funds would be rallying. They are flat.

Bottom line: like the temper tantrum in 2013, people overreact. Inflation will remain subdued and that means cash equivalents will pay almost nothing, interest rates and bond yields won't rise much ... and stocks will.

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