FINANCIALLY SPEAKING

Weekly Market Analysis

January 3rd, 2011

Fourth Quarter 2010 Wrap Up: Fourth quarter 2010 has come to an end, with very few fireworks. At the start of the quarter, most of the markets' fears hinged on the Euro zone and political uncertainty here in the US. Looking back on the quarter, the Euro zone looks like it is going to make it through the current uncertainty, albeit with a lower sovereign debt rating, and in the US the Republicans secured a majority in the House of Representatives. After the elections in the US, the necessary steps were taken on a number of key issues such as the Bush era tax cuts, estate tax uncertainty, unemployment benefit extensions and a myriad of other measures; all during the lame duck session. The stock market indexes in the US all moved higher over the course of the fourth quarter 2010, as well as for the full year 2010, as can be seen in the following table:

Index	4th Quarter 2010	Full Year 2010
NASDAQ	12.00 %	16.91 %
S&P 500	10.20 %	12.88 %
DJIA	7.32 %	11.02 %

Below is the standard style box performance for fourth quarter 2010, during which the markets saw growth continue to outperform value and small cap stocks outperform both mid and large caps.

Style / Market Cap	Value	Blend	Growth
Large Cap	8.77 %	9.61 %	11.75 %
Mid Cap	10.01 %	13.37 %	14.22 %
Small Cap	13.17 %	15.61 %	16.92 %

2010 in review: 2010 will be remembered by many investors as the year that the US economy got its legs back, while continuing to recover from the recession of late 2008 and early 2009. The US consumer seemed to gain a healthy appetite for spending over the course of the year as the US housing market turned upward in many locations and banks reluctantly started to lend money to credit worthy customers. The chance of a double dip recession became less likely as the year went on, and investors took the opportunity to move back into the equity markets. In general, the equity markets had a good year, with growth outperforming value in all three market caps; while small caps out performed both mid and large cap indexes as can be seen in the table below:

Style / Market Cap	Value	Blend	Growth
Large Cap	11.46 %	10.52 %	11.65 %
Mid Cap	17.06 %	24.60 %	27.39 %
Small Cap	23.35 %	26.27 %	30.86 %

The outperformance of both the small and mid cap stocks, as well as growth, is nothing unusual given the US is in the recovery phase of the market cycle. The Asian region started 2010 with the wind at their backs as their economies picked up the pace, but quickly found how hard it is for an economy to maintain fast economic growth. The Shanghi stock exchange closed 2010 with a loss of more than 14 percent with most of the decline being attributed to the government stepping in using monetary actions in an attempt to cool off the economy. However, the entire Asian region did not experience a rough year in 2010, as the South Korean KOSPI increased 23 percent and the Taiwanese stock exchange advanced 10 percent. Not surprisingly, with all of the market uncertainty surrounding the Euro zone, there was a wide range of returns on the stock exchanges in Europe; everything from the Stockholm exchange advancing by 23.66 percent to the Paris CAC index declining by 0.4 percent.

Outlook for 2011: Equity markets will most likely remain trading much the same way they did in 2010 with emotional investing driving large swings in the indexes throughout 2011. Geopolitical risks remain high both for the US and abroad, as there are many different events that could move the world recovery off course. The way in which countries attempt to fend off inflation is going to become more and more of an international football, because what is good for some countries could prove to be detrimental to others. The largest unknown going forward may be the outcome of the situation in the Euro zone. Positives developments that could continue to push the markets higher going forward include: increased manufacturing in the US, increased spending by the US consumer, lower taxes (lower than if the Bush tax cuts had been allowed to expire), increased corporate spending, and tame inflation. Negatives aspects for the US equity markets in the future could include things such as: oil moving over $100 per barrel and continuing to move higher, a housing market correction, inflation, currency wars, trade wars and a potential popping of a fixed income bubble.

Fixed income securities look like they could be in a big speculative bubble, as there were far too many dollars chasing too few securities as investors piled into fixed income. Fixed income currently appears to be a market in which many individual investors do not understand the risks that rising interest rates will have on their investments. Yes, you will get principal and interest back if an investor holds a bond to maturity, provided the bond does not default, but during the interim the value of the bond can go down drastically. When investing in fixed income, you usually have the chance of interest rates being lowered, which would make your bond holding look all the better, but at this point rates are about as low as they can go. The Federal Reserve's Fed funds rate currently sits between zero and 0.25 percent, and cannot move any lower, which is why we are seeing varying forms of quantitative easing which are moving the effective rate below zero. So, with rates only able to move upward from this point, it seems a bit curious that so much money has flown into fixed income. One thing is for certain, if there is a bubble in fixed income and it bursts, many investors will be running for the same exits and not everyone is going to get out at a reasonable price.

Last Week's Market Wrap-Up: Last week was a very uneventful week for the stock market. As 2010 came to a close, the markets experienced low volume and almost no trading action. Most of the stocks that experienced some movement, moved because of year-end tax harvesting. They were either stocks that were down for 2010 and were being sold to book the losses, or they were stocks that had large gains and were being sold so that losses elsewhere could be offset. With the markets leveling off the last two weeks of the year, all three of the major US indexes managed to close very close to their two year highs, with the NASDAQ having almost fully recovered from the losses incurred during the decline in 2008.

International Politics: International politics remained fairly uneventful over the course of the previous week as many politicians from around the world were taking time off of work for the holidays. China hit a bit of a bump in the road last week, as it was announced that expectations for growth in GDP during 2011 have slowed to 8.5 percent after the GDP grew at near 10 percent during 2010. China also faces rising costs in terms of increased prices on the commodities that they consume to produce goods. This, in turn, could force an increase in prices and ultimately lead to inflation in the economy. Inflation is one of the main concerns going forward for the Chinese government, and they will likely take a number of steps throughout 2011 in an attempt to combat inflation. Such actions might include raising interest rates and altering the reserve requirements of banks, as well as a number of other potential monetary and fiscal steps. In another part of the world, Dilma Rousseff was sworn in as President of Brazil over the weekend, and in her first speech she made it very clear that her number one priority as President would be inflation, which she refers to as a plague. Currently, Brazil's GDP growth rate is seven percent and their inflation rate is six percent. Inflation is going to be a recurring theme in 2011, as there are many countries in the world that currently find themselves at very different points in the economic cycle. The developing countries that have continued to grow at a fast pace throughout the recent market upheaval have a very real threat of inflation, and are going to take actions to combat it.

National Politics: With very little news on the national political scene, it seems that the snow storm that hit the east coast took all of the limelight last week. While some storms are more newsworthy than others, this one was of particular note because it disrupted after-Christmas holiday sales on the eastern seaboard. The markets could be feeling the after-effects of this for the next few weeks, since it could affect aggregate holiday sales for December. While December may not look as good as it could have, January sales will likely be a bit better than expected because of the pent up demand for items which will now be purchased a week late. As 2011 begins, the new dynamic of the Republican controlled House and the Democratic controlled Senate and Presidency, is going to take shape. Through the lame duck session, most disagreements remained civil, as compromises were reached between both parties. If compromise continues to be the trend, this could turn out to be a very productive two years from a legislative standpoint and the stock market should like this stability. However, if party politics once again becomes the norm, the US stock market and other indexes around the world will have to contend with an increased amount of volatility.

Market Statistics: The US markets had a mixed week during the last week of 2010, with two of the three major indexes closing higher, while one moved lower. The S&P 500 turned in the best performance of the week, advancing by 0.07 percent, while the Dow increased 0.03 percent. The largely technology driven NASDAQ turned in the worst performance of the week, after declining by 0.48 percent, driven by some late-in-the-game tax harvesting. The best performing sector of the US markets last week was the small cap sector, which increased by 2.50 percent. The worst-performing sector last week was the biotechnology sector, which declined by 1.32 percent.

Commodities continued to move higher last week as the GSCI commodity Index advanced by 0.56 percent, helped by continued upward movement in Silver (+5.49 percent) and Gold (+3.01 percent). Oil moved lower last week (-0.25 percent) as traders booked some nice gains to close out 2010. The US dollar fell last week, by as much as 2 percent against a basket of international currencies, as international appetite for US dollars appears to be waning (at least temporarily). Despite the lack of movement in the US indexes, the VIX moved higher by 7.77 percent, but this reading is slightly skewed by the end of the year and options expiring and being rolled forward. The overall volatility going forward remains low compared to the last few years, but above longer-term historical averages.

For the trading week ending 12/31/10, returns in FSI's models were as follows:

	Last Week	Year to Date	Since 12/31/07
Aggressive Model	1.02 %	3.91 %	-0.38 %
Growth Model	1.02 %	4.63 %	0.16 %
Moderate Model	0.81 %	3.35 %	2.21 %
S&P 500 (benchmark)	0.16 %	12.88 %	-14.27 %

We made no changes to our models over the course of the previous week, as we were well positioned for the quarter and year end. We continue to weigh investment opportunities and will make adjustments as we see fit.

Economic News: As expected, last week was the slowest week of the year for economic news releases, with only the necessary releases coming out during the shortened trading week. The week started off on Tuesday, December 28th, with the release of the Case-Shiller 20 City Home Price Index, for the month of October, coming in slightly below expectations. This showed that home prices slid by 0.8 percent while the market had been expecting an increase of 0.1 percent. Later in the day, on Tuesday, Consumer Confidence for the month of December was shown to have dipped a little bit, which took the market somewhat by surprise. Fortunately, the negative news was shaken off by the prospect of a continued rally through the end of the year. Wrapping up economic news releases for the week (and year) on Thursday, the 30th of December, was the release of the weekly jobs related figures: initial jobless claims and continuing claims, as well as the Chicago PMI for December and pending homes sales for the month of November. Initial jobless claims came in better than expected, under the 400,000 level at 388,000, but the positive reaction to the initial jobless claims was very short lived since continuing jobless claims turned out to be slightly worse than expected. With the two jobs reports offsetting each other, the market moved on to the next release very quickly, as it seemed to be eager to head into the holidays - much like most investors. The Chicago PMI gave the markets something to cheer about when it turned in better performance than expected, coming in at 68.6 when expectations had been for a reading of 61.5. This reading bodes well for manufacturing going into 2011. Pending Home Sales rounded out the economic news releases for the week, with the announcement showing a better figure than expected during the month of November. While this figure is a very good thing, the exuberance may be short lived as interest rates have increased at a very fast pace since the calculation for pending homes sales was done. This increase in interest rates could make the housing market slow down a little bit as some purchasers are going to wait a while and see if rates come back down so that they can lock in a low 30 year interest rate.

The first week of the year always holds more economic news releases than the last week of the year, but it is not an unusually heavy week for announcements. The week starts off with the release of construction spending for November and the ISM Index for the month of December, both on January 3rd. The ISM data is going to be much more meaningful than construction spending as it affects a much larger swath of the economy. On January 4th, factory orders as well as auto sales for the month of December are both set to be released. It looks like auto sales could disappoint slightly, as consumers spent more on holiday sales and less on big ticket items such as cars. Late in the day, on Tuesday, the FOMC releases their meeting minutes from the previous meeting and it will be interesting to see if there was much discussion about continuing with the government bond purchases, in light of what looks like an awakening US consumer. On January 5th, two jobs related announcements are set to be released: the Challenger jobs cuts figure for December as well as the ADP employment change for the month. Both figures are expected to show an increase in jobs during December, 2010, and could provide some insight into the government's official release of the unemployment rate for December later in the week. Later in the day, on Wednesday, the ISM services index is set to be released and is expected to have changed little over the November level. On Thursday, the only releases are the two weekly jobs related figures: initial jobless claims and continuing jobless claims. Initial jobless claims are expected to have risen slightly, while continuing claims are expected to have declined slightly. If the two releases come out as expected, this should have an offsetting effect on the market impact. On Friday, January 7th, the first major economic news release of the year comes out; the official government unemployment rate in the US for the month of December. Expectations are for a tenth of a percent decline, down to 9.7 percent from 9.8 percent, but expectations are very different depending on who is speaking. Overall expectations range from 9.6 to 10.0. The market, of course, would like something in the lower half of the range. Some more meaningful numbers than the unemployment rate that are also released on Friday are the nonfarm payroll and nonfarm private payroll jobs numbers. These numbers will give a good indication as to how the private sector is hiring and how they may act going forward in 2011. The week wraps up late in the day, on Friday, with the release of the consumer credit figure for the month of November. Expectations are for a small expansion, as banks continue to loosen up on lending practices. All of this economic news comes while the "January Effect" should be in full swing, which is typically a time when the stock market moves higher.

Have a great week,
Peter Johnson

Feel free to forward this email.
Financially Speaking,Inc.
5889 Greenwood Plaza Blvd., Suite 400
Greenwood Village, CO 80111
Telephone 303.290.0702
Toll Free 800.228.9876
Fax 303.290.6581