



Weekly Market Analysis

February 7th, 2011

Market Wrap-Up: After shaking off the unrest in Egypt and focusing in on better than expected economic news releases, the US stock market indexes all turned in positive returns last week. The Dow closed above the psychological 12,000 level and the S&P closed above 1,300 for the first time since the middle of 2008. The NASDAQ is not to be outdone by the recent moves to new highs on the S&P 500 and the DOW since it, too, is quickly closing in on the 2,800 level (a level that the NASDAQ has only closed above three days in the last decade). To give you some perspective, as to how much the NASDAQ has moved, the S&P 500 would have to reach 1,560 to attain new highs for the last decade while the Dow would need to be near 14,100. As with most economic recoveries and bull markets, it appears that the Technology heavy NASDAQ is leading the way higher; although it is not getting nearly the amount of fanfare that the Dow and S&P 500 receive. Activity in mergers and acquisitions seems to be once again picking up; there were several deals announced last week and over the past weekend, which seem to be concentrated in the energy and technology market spaces as companies work off some of the large cash balances sitting idle on their balance sheets. Looking back on the month of January, the S&P 500 saw a positive return of 2.26 percent. This bodes very well for the overall return in 2011, if history tells us anything about stock market returns. Since 1989, the S&P 500 has seen 14 years during which a positive return in January occurred. Of those 14 years, the annual return has been positive in the year during which January was positive 12 times (or more than 85 percent of the time). The two negative annual return years after a positive start in January were 1994 and 2001, and averaged a decline of 7.29 percent. The 12 positive annual returns after a positive start in January saw an average return of 19.85 percent for the year; while the overall average return for the 14 years that saw a positive return in January is 15.67 percent. So going by what has happened over the past approximately two decades after the S&P 500 saw a positive return for the month of January, 2011 could turn out to be a very good year to be invested in the stock market. This “good year to be invested in the stock market” seems to be the overall theme of many commentators when they are asked for their opinion about what is likely to come in 2011, and it appears to be justified by at least one set of historical figures.

International Politics: After a very unsettling time two weeks ago with unrest erupting in Egypt, last week seemed a bit uneventful as the protests continued in the Middle East but there was little reaction by the markets. We did see a little bit of a spillover/domino effect in the region last week as the King of Jordan decided to throw out the majority of the government officials and started to replace them. With ongoing protests in a variety of countries in the Middle East, the world markets will maintain a watchful eye over the situation, but barring some unforeseen event in an additional country the shock may be over. Oil, which moved up very quickly two weeks ago with the onset of the unrest has been trickling lower over the last few trading days as fears of the Suez Canal being closed to through traffic have dissipated. The Asian region of the world was excitedly quiet last week leading up to the Chinese New Year—2011 is the year of the Rabbit. Last week saw very little new developments in the European debt crisis; the markets are awaiting a second round of bank

stress tests, with various economies getting by on debt auctions that, while not going well, are not bad enough to cause a panic.

National Politics: National politics was headlined last week by a vote in the US Senate to repeal the Healthcare bill that was passed last year. The vote failed, as was expected, but the fact that it was even brought to the floor and a vote was taken in the democratically held Senate as somewhat of a victory for the Republicans. While the vote to repeal the entire healthcare bill did fail, there was a small piece of the healthcare bill that was voted on and repealed by the Senate; the 1099 reporting requirement which had been deemed a “paperwork burden” to small businesses. Elsewhere in politics last week, Senate majority leader Harry Reid agreed to a moratorium on earmarks that are attached to any new pieces of legislation, something which President Obama brought up in his State of the Union address. Also making the news from Washington, DC, is another round of debate as to whether or not the government should have the power to turn off the internet, as was done in Egypt after the recent unrest started to gain steam through the use of social networking web pages. While the debate is not new (a proposal was drafted in the Senate during 2009), any new discussions are likely to be very heated as people in the US are very split over the merits of the government being able to control the internet. From an investment standpoint, the ability of the government to turn off the internet would add a large amount of uncertainty to the financial markets, as much of the trading is now done electronically. Also making news headlines last weekend was the announcement that the NASDAQ’s computer systems had been breached by hackers. While NASDAQ said that the break in did not make it to the systems that actually route and process the trades, and that no trades were ever at risk, the incident did add to investors’ wariness about technology in general - especially after the recent “flash crash.” Federal Reserve Chairman, Ben Bernanke, gave an interesting speech at the National Press Club on Thursday, February 3rd, during which he addressed people’s fears that fuel and energy cost increases would lead to inflation, the high and sustained levels of unemployment and the need for congress to raise the US Debt limit which is currently \$14.3 trillion. The US is very close to the limit that was passed on January 28th, 2010 and signed by President Obama on Feb. 12th, 2010. If the US debt limit is not raised, we could see a point in the near future where the government is legally not allowed to issue any more debt. While this may be viewed as a good thing by some constituents, it would greatly limit our government’s ability to deal with changes in the current economic environment. It was somewhat ironic that as Chairman Bernanke was calling for an increase in the debt limit, he was also saying that the government needs to come up with plans to cut down on the budget deficits, which look like they will plague the US for years to come.

Market Statistics: All three of the major US markets turned in strong performance over the course of last week, with the technology heavy NASDAQ leading the way, advancing 3.07 percent. The second best performance was the broad based S&P 500, which increased 2.71 percent, and the smallest advance of the week was the primarily large cap DOW, which increased by 2.27 percent. The best performing sector of the US markets last week was the Semiconductor sector, which increased by nearly six percent. The worst performing sector last week was the Real Estate sector, which advanced by half of a percent. Commodities turned in a positive performance last week, the GSCI Commodity Index advanced by 1.02 percent. Leading the advance in commodities was two of the major metals, Copper and Silver, with Copper advancing 5.37 percent and silver moving up by 4.03 percent. Gold increased, but not as much as Silver and Copper, advancing only 1.06 percent. Energy moved up by 4.17 percent, but oil bucked the overall commodity trend and settled lower by 0.45 percent, after having risen sharply two weeks ago when the unrest in Egypt first broke out. The US dollar declined slightly over the course of last week, ending the week 0.27 percent lower than it

started out. On the international investing front, the best return of last week outside of the US was in Canada, with their main stock index increasing by 2.64 percent. Globally, the worst performing index was Brazil, which declined by 2.14 percent as uncertainty about future government monetary interventions weighted heavily on the exchange. The VIX fell like a rock last week giving up 20.51 percent as the markets weighted the unrest in Egypt and decided that the world will most likely not be seeing a domino effect of government regimes falling in the Middle East.

For the trading week ending on 2/4/11, returns in FSI's models were as follows:

	<u>Last Week</u>	<u>YTD</u>	<u>Since 12/31/07</u>
Aggressive Model	3.58 %	2.31 %	1.50 %
Growth Model	3.63 %	1.81 %	3.31 %
Moderate Model	2.93 %	1.63 %	5.99 %
S&P 500 (benchmark)	2.77 %	4.30 %	-10.73 %

Over the course of last week we made only two changes to our models. First, we allocated some of our cash to the basic materials sector of the market, through the use of the Profunds Basic Materials Fund (BMPIX). We moved into basic materials because the sector is showing a lot of leadership in the latest advance higher, and because demand for materials around the world appears to be headed higher from the industrial sector. The second move of the week was to add to our position in the Rydex Energy Fund (RYEIX). Energy has become one of the top performing sectors of the market over the past few weeks, and with the uncertainty surrounding the Middle East, it is a sector of the market that looks like it has room to move higher. At this point, we are fully invested across our models and intend to remain so for the foreseeable future, in order to participate fully in the upside of future market movements. We continue to utilize mutual funds that are fully tradable at a moment's notice if the market really starts to deteriorate, so that they can be sold and the proceeds moved to cash in order to limit losses in portfolios.

Economic News: Last week was a busy week for economic news releases, kicking off on Monday with Personal Income and Spending for the month of December. Both income and spending came in very close to the expected values, with income increasing 0.4 percent while spending was shown to have increased 0.7 percent. Later in the day, on Monday, the Chicago PMI for the month of January was released and it, too, came in slightly better than expected at 68.8 (versus expectations of 65 and a December reading of 66.8). This increase is yet another positive sign that the US economy is picking up in 2011. On Tuesday, February 1st, Construction Spending for the month of December was released. As expected, it showed a decline in spending, but the magnitude of the decline was unexpectedly large (-2.5 percent versus expectations of -0.5 percent). This negative surprise in construction spending caught the market a little by surprise and gave investors a bit of pause about the future of the housing market in the US. In my mind, negative spending may turn out to be a good thing because it indicates that there is not as much building going on, and may ultimately result in the real estate market working off some of the excess inventory. The ISM Index, for the month of January, was released at the same time as Construction Spending and, much like the Chicago PMI data released the prior day, the ISM data beat market expectations. Later in the day, on Tuesday, the auto industry released their figures for the month of January and they showed an increase of 17 percent in new vehicle sales. On Wednesday, the 2nd, ADP put out their employment change figure (+187,000 new jobs) for the month of January. While less than the December figure, this was still a positive sign for unemployment in the US, and seemed to point to a positive

unemployment rate change for Friday. Thursday, the 3rd of February, the government released their productivity and unit labor costs for the fourth quarter of 2010. Productivity came in better than expected, while unit labor costs were shown to have declined by 0.6 percent during the same time period. The weekly initial unemployment change and the continuing jobless claims were released at the same time as the productivity and unit labor cost figures; both came in better than expected, but the revision to two weeks prior release took some of the light away from the release. Wrapping up the day, on Thursday, was the release of the factory orders for the month of December and the ISM services Index for the month of January. Factory orders came in unexpectedly strong (+0.2 percent versus the expected -0.6 percent), but the strength was almost nothing compared to the November level of 1.3 percent, indicating a possible slowdown in ordering after the Christmas rush. The January ISM Services Index came in higher than expected, much like the overall ISM Index released earlier in the week, and was a non market moving event. On Friday, the big economic news release of the week was the official government unemployment rate in the US for the month of January, which was 9.0 percent (much better than the expected 9.5 percent). The way in which the government arrived at this 9.0 percent unemployment rate is a bit convoluted, so the market looked to two key components of the release instead, nonfarm payroll and nonfarm private payrolls. Nonfarm Payrolls were shown to have increased by a paltry 36,000, while the market had been expected something around 150,000. Private payrolls increased by only 50,000 when they were expected to increase by 163,000. So, the unemployment rate in the US went down overall, but did so on much weaker than expected payroll numbers, leaving some market participants more than a little skeptical about the 9.0 percent figure.

This week is very slow for economic news releases with only one major news release taking place during the week. The week starts off on Monday, with the release of consumer credit for the month of December, which is expected to have expanded by \$2.5 billion as banks continue to loosen their purse strings and lend money. On Thursday, the 10th, we get the weekly jobless related claims, both of which are expected to have remained very close to the levels seen two weeks ago, as the winter weather around the US continues to hamper people's ability to look for jobs. Later in the day, on Thursday, is the release of wholesale inventories for the month of December and the Treasury Budget for the month of January. Wholesale inventories are expected to have increased by 1.5 percent, up from a November change of -0.2 percent. The Treasury budget for the month of January is expected to be -\$59.5 billion. Compared to December's -\$42.6 Billion, it seems like all the budget does is expand to the downside. Wrapping up the week on Friday is the release of the trade balance for the US for the month of December and the University of Michigan Consumer sentiment index. The Trade balance is expected to be a -\$40.4 billion dollars. As we imported much more than we exported, the -\$40 for the month is actually just about average, so it is nothing to be alarmed about. The University of Michigan Consumer Sentiment Index for the month of February, which is the last release of the week, is expected to have increased slightly over the January level— an early indication that the US consumer is continuing to have more faith in the economic recovery.

Have a great week,
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