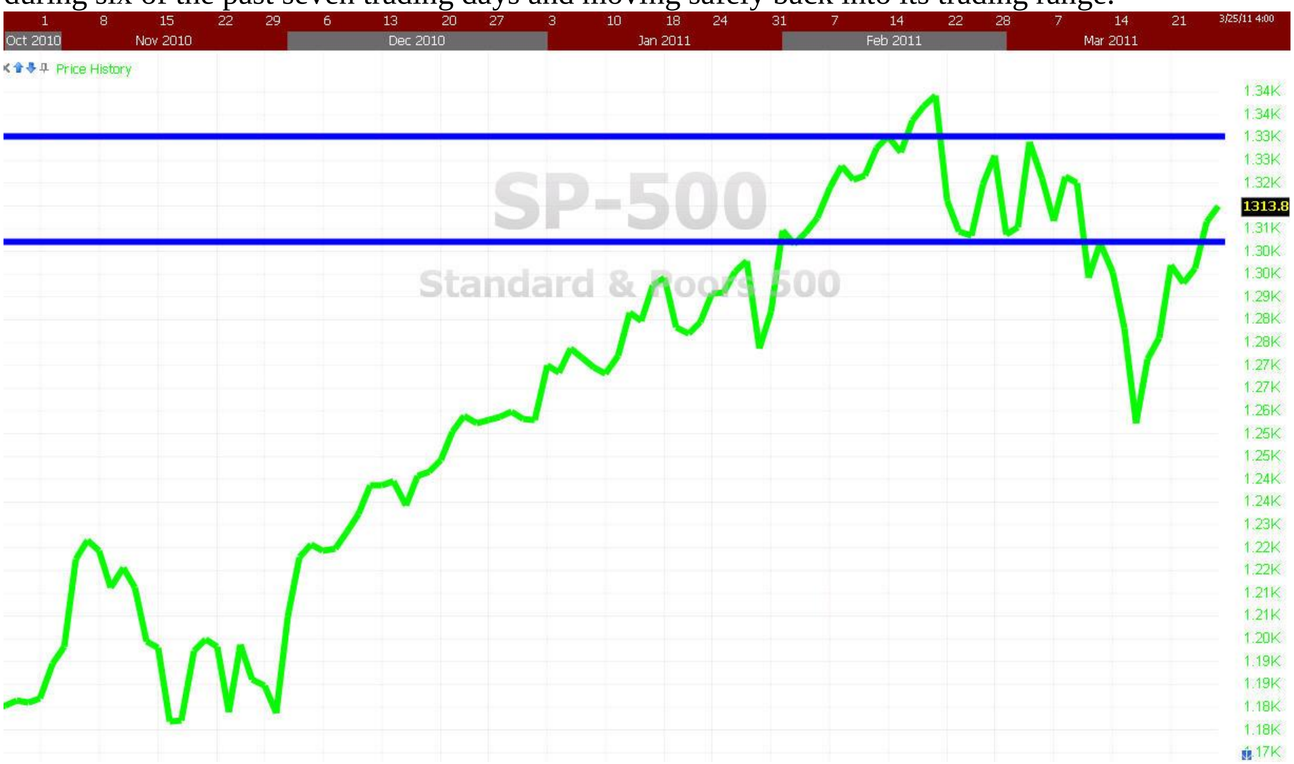
FINANCIALLY SPEAKING

Weekly Market Analysis

March 28th, 2011

Market Wrap-Up: Last week was a strong week for the US stock market as the support for the rebels in Libya appears to be working and the situation in Japan does not seem to be getting any worse. After a startling decline two weeks ago, the US markets managed to push high enough last week to make it back into their respective trading ranges that have been in place since February. As can be seen in the chart below, the S&P 500 (Green line) broke down through its previous trading range (blue lines) during the middle of March and looked like it would move substantially lower. However, on the 17th, the market turned higher and it has not looked back since; remaining high during six of the past seven trading days and moving safely back into its trading range.



With the strong advance of the past few days behind us, market watchers are now primarily waiting to see if the market can make it back over previous levels of resistance (in the chart above the upper blue line at 1,332) and if the index can reach a new high over 1,344. If the market can achieve both of these goals, it will be an indication that the bull market is fully back on track. However, if either of these goals fail to materialize then we will probably just see the market wander aimlessly sideways for the next week while it tries to sort out all of the uncertainty going forward. A sideways trending market does not mean that there is not money to be made from investing, it just means that you have to be invested in the right places at the right times, which is a primary goal of active investment management.

International Politics: International news was highlighted last week by the ongoing military actions taken by the UN against Gaddafi in Libya. With the aerial attack and much of the heavy armor being used by Gaddafi now having been destroyed by allied bombing, it appears that the rebels may be able to retake cities that they had lost to Gaddafi and maybe even make a march toward Tripoli. As the fighting moves from east to west, we may see the oil fields in the east start production, and eastern Libya start to ship oil. Oil Shipments should come as a bit of a relief to the southern Euro zone, as they have been forced to make up the shortage of Libyan oil with much more expensive and heavier Brent crude oil. Unrest appears to be continuing its move through the Middle East, as the unrest in places like Syria and Yemen once again makes it back into the news. While the spreading of unrest is a concern for the market, the focus still seems to be on Saudi Arabia and the potential problem that unrest may cause for the international oil supply from the country. News out of the region is very spotty and typically information released is tightly controlled by the ruling party, so the whole situation is a wildcard.

In the Euro zone last week there was a bit of a shake up when the Prime Minister of Portugal resigned after failing to win passage of the fourth austerity measure from the Portuguese Parliament on Wednesday, the 23rd. Portugal has long been thought to be the next financially troubled country in the Euro zone and it is thought that they will have to seek a bailout, much like Greece and Ireland, unless they were able to pass some very strong austerity measures. With the fourth round of austerity measures having failed a vote in parliament, it pretty much all but seals Portugal's fate in having to ask for a bailout. The interest rate required by others to purchase Portugal's government debt spiked higher on the news of the failed plan and the Prime Minister's resignation. The 10-year sovereign note from Portugal now carries the hefty rate of nearly 8 percent, and it is universally agreed upon that it is a fully unsustainable rate for the government. Shortly after the outcome of the vote was known, both Fitch's and Standard and Poor's rating agencies dropped the credit rating of Portugal very close to junk status and cited the inability of Portugal to refinance its upcoming debt at a reasonable rate and increased political risk as the main reasons for the downgrade. Portugal has approximately $13 billion in debt repayments coming due between now and the end of June, prior to rates moving so high the country would have just issued new debt to cover the repayments; that now looks like it may not be an option. Another interesting aspect of the situation in Portugal is who can now ask for a bailout from the EU if it comes down to it? Now that the Prime Minister has resigned, he should only keep the day to day government running and not be making any major decisions, and elections for a new Prime Minister are two months away. The world markets are not all that concerned about a default by Portugal. When looked at in the context of the whole EU, they are a very small player with the total bailout likely costing less than $100 billion. The real concern is that there is a continued spread of financial difficulties throughout the region. If Portugal concedes to needing a bailout, three of the original PIIGS will have fallen and the focus will turn to Italy and Spain (with Spain being the most problematic since it is the largest economy in the EU that is potentially in trouble). Continued bailout of the troubled Euro zone countries seems like it will become harder and harder to sustain as it becomes very politically unpopular in places such as Germany where Chancellor Merkel's party suffered a major defeat in elections over the past weekend.

National Politics: Last week was a very slow week in national politics since Congress was in recess and will be back to work this week. With congress out of the spotlight, it seemed like the only nationally focused news story that made headlines was the United States' involvement in the ongoing Libyan conflict. After cutting his trip to Latin America short last week, President Obama is scheduled to address is the nation this evening at 7:30 pm eastern time to discuss the US's involvement in Libya. While some members of congress are going to try to make the decision look like a poor one, the US stock market and markets around the world largely view the intervention by the UN into Libya as a positive thing. If there is a sustained cease fire or Gaddafi gives up, the price of oil is likely to come back down as production out of Libya goes back to normal. With the members of congress back in Washington DC, we will likely see the debate about the budget start back up, once again, as both sides try to come to a compromise that will allow the 2011 budget to be passed. The markets appear to be pricing in a budget either getting passed this time around or a seventh continuing resolution that would keep the government open for business. If it becomes more likely that the government will have to shut down due to a lack of a budget, the US markets will probably correct lower as uncertainty typically leads to investors seeking safety.

Market Statistics: During the course of last week, all three of the Major US indexes reversed course from two weeks ago and turned in positive returns for the week. The technology-heavy NASDAQ experienced the largest advance, increasing 3.76 percent thanks to strong reports by some of the large technology manufacturers. The mainly large cap Dow increased by 3.05 percent during the week while the more broadly based S&P 500 brought up the rear, advancing 2.70 percent for the week. The best-performing sector of the US markets was the semiconductor sector, which increased 5.51 percent, after declining very sharply after the earthquake in Japan. The worst-performing sector of the US market was the real estate sector, which declined by more than one percent after the less than positive economic news releases. Commodities had a pretty good week, advancing by 1.45 percent, with Copper and Gold advancing 4.35 percent and 0.64 percent respectively; while Silver turned in the best performance of any of the commodities advancing 6.19 percent for the week. Last week oil increased by 4.41 percent after a decline two weeks ago, as the unrest in the Middle East seemed to be abating, while energy in general advanced by 3.64 percent. With all of the uncertainty currently surrounding the Middle East, the price of oil (and in turn energy) will largely be driven by what is going on in countries such as Bahrain and Yemen, as the contagion seems to be continuing to other countries. The US dollar increased in value by 0.74 percent against a basket of international currencies, partly due to the uncertainty surrounding the situation in Portugal. On the international investing front, all of the major world indexes increased in value last week, with the best return found in the Indian Bombay based SENSEX index, which increased 5.24 percent. Globally, the worst-performing index was in Brazil, with the Sao Paulo based BOVESPA increasing by 1.32. The VIX fell sharply, declining by 26.72 percent during the course of the week. The decline, while not unprecedented, happens very rarely. The last time there was such a large weekly drop in the VIX was the week of August 20th 2007. There have only been six weekly declines in the VIX that are larger than last week's since 1992, making the decline in volatility last week pretty meaningful to the stock market as many market participants see the VIX as their overall fear indicator for how they are investing in the market. With the drop being so unusual, I decided to take a look at what happened historically the week following the decline. I found that the average move for the VIX the following week was an increase of about 5 percent, leading me to think that the market overreacts a little on the positive side and then readjusts higher after things settle down.

For the trading week ending on 3/25/11, returns in FSI's models were as follows:

	Last Week	YTD	Since 12/31/07
Aggressive Model	1.52 %	-1.12 %	-1.90 %
Growth Model	1.23 %	-1.75 %	-0.31 %
Moderate Model	0.90 %	-2.21 %	1.99 %
S&P 500 (benchmark)	2.70 %	4.47 %	-10.53 %

After starting the week very defensively, with the majority of our allocation being either cash or cash like investments, as well as hedging positions to protect some of the downside that may have occurred on a few of our funds; we ended the week very differently than we started. After selling our hedging positions (UXPIX and RYMHX) on Monday, we purchased the following funds:

Profunds Mid Cap Bull (UMPIX)
Profunds Oil and Gas (ENPIX)
Profunds Bull Fund (ULPIX)
Rydex Real Estate (RYHRX)
Direxion Small Cap Bull (DXRLX)
Rydex Technology (RYTIX)

With the above mentioned purchases we are now back to being fully invested in the market and are positioned for an upward trending market. After getting positioned mid week we were able to see the benefit to our allocation on Thursday and Friday as the models increased at a much faster rate than the S&P 500. We continue to utilize primarily tradable positions so that if the market does turn around and start another correction we are not stuck in a position that we cannot trade out of without penalty.

Economic News: Last week was a slow week for economic news, with an even number of good and bad economic indications from the releases. The week started off on Monday with a worse than expected release in the existing homes sales figure, 4,880,000 versus expectations of 5,050,000. This weaker than expected figure added to the already weak information released two weeks ago that showed poor readings for both housing starts and permits. Compounding the problems for the housing market on Wednesday, the 23rd, was the release of the worst sales figure for new home sales (250,000) ever recorded. Both inclement weather and a lack of financing were targeted as the main reasons for the poor showing in the new home sales figure. Additionally, it was pointed out that the number is frequently adjusted the following month once all of the data has been compiled. On Thursday, both the initial jobless claims and continuing jobless claims were released with initial jobless claims coming in slightly better than expected and the continuing jobless claims coming in slightly worse than expected - leading to a net effect of zero impact on the market. Released at the same time as the unemployment data, the durable goods orders for the month of February were shown to be dismal. The market had been expecting a durable goods orders figure increase of 1.1 percent during the month, but instead the actual reading was -0.9 percent and when automobiles are taken out the figure was -0.6 percent while the market had been looking for 1.8 percent. While the impact on the market of such a bad figure was muted, due to international markets moving higher on Thursday, if this becomes a trend on durable goods orders in the US it could pose a very large problem for the economic recovery. While some economists are pointing out that a single data point is not a trend, the durable goods orders for the month of January (excluding automobiles) was a decline of 3.6 percent when the market had been expecting 0.6 percent growth. The same economists are quick to point out that overall durable goods orders during the month of January increased 2.7 percent, so we will just have to wait and see what the figure for March holds for the market once it is released on April 27th. On Friday, the market received a bit of good news when the third estimate of fourth quarter GDP was released and came in at 3.1 percent, better than the expected 2.9 percent. Wrapping up the week on Friday was the release of the University of Michigan Consumer Sentiment index for the month of March. The release showed a slight decrease over the reading from February, but the decrease was so small that it did not affect the market. Overall, last week was a mixed week with continued weakness being shown in the housing market and the durable goods orders, but better than expected readings on the unemployment figures and GDP.

This week has a number of key economic news releases that have the potential to affect the overall US markets. The week starts on Monday, with the release of personal income and spending for the month of February, both of which are expected to be slightly positive. After such a poor reading in durable goods orders last week, market participants will be watching the spending report particularly closely to see if they can glean any information about overall consumer spending and what an impact the high price of oil is having on spending, if any. Also released on Monday is the PCE Price Index for the month of February. Expectations are for a slight increase, due to food and energy costs rising. Wrapping up the day on Monday is the release of the pending home sales figure for the month of February. This is the economic news release pertaining to the housing market that could make the month of February anything but dismal. So far, all of the housing related releases have been very poor, so the housing market is hanging their hat on this release hoping that the figure will be a good one thus breathing some life in to the housing market. On Tuesday, the 29th, the tardy Case-Shiller 20 City home price index is set to be released with expectations of a decline of 3.3 percent. Also released on Tuesday is the official consumer confidence figure for the month of March and it is expected to have dropped by approximately eight percent over the level seen in February. A dropping consumer confidence is cause for concern, but unless we see a large drop or a sustained downward trend, the market seems to be willing to overlook the data and continue to move forward. On Wednesday, March 30th, two important jobs related figures are set to be released; the Challenger job cuts data and the ADP employment change, both for the month of March. Both readings are expected to be positive for the employment market, thus opening up the possibility of disappointment by the markets. On Thursday, the 31st of March, the standard weekly jobs related figures are set to be released with expectations that both figures will be better than they were last week. Later in the day, on Thursday, is the release of the Chicago PMI for the month of March and factory orders for the month of February. The Chicago area PMI is expected to have decreased slightly, but not enough to cause concern. Factory orders are expected to have remained flat during February when compared to January levels. Wrapping up the week on Friday, there are many releases since it is the first day of April. The day starts out with the release of the payroll data, both public and private, for the month of March and the official unemployment rate in the US by government calculations for the month of March. Both the public and private payroll releases are expected to be slightly worse than they were in February and the overall unemployment rate is expected to have either remained the same or ticked up by a tenth of a percent to 9.0 percent. Later in the day, on Friday, the ISM Index for the month of March is set to be released with expectations of no change over the level in February. The next release of the day is the construction spending report for the month of February which is expected to show a decrease of approximately one percent. This is in line with the not so great showing from the housing market over the past few weeks. The week wraps up with the release of auto sales for the month of March. Auto sales are expected to be pretty strong, with a decline expected over the next few months by the Japanese car makers as they continue to have troubles recovering from the earthquake and tsunami.

Have a great week,
Peter Johnson

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