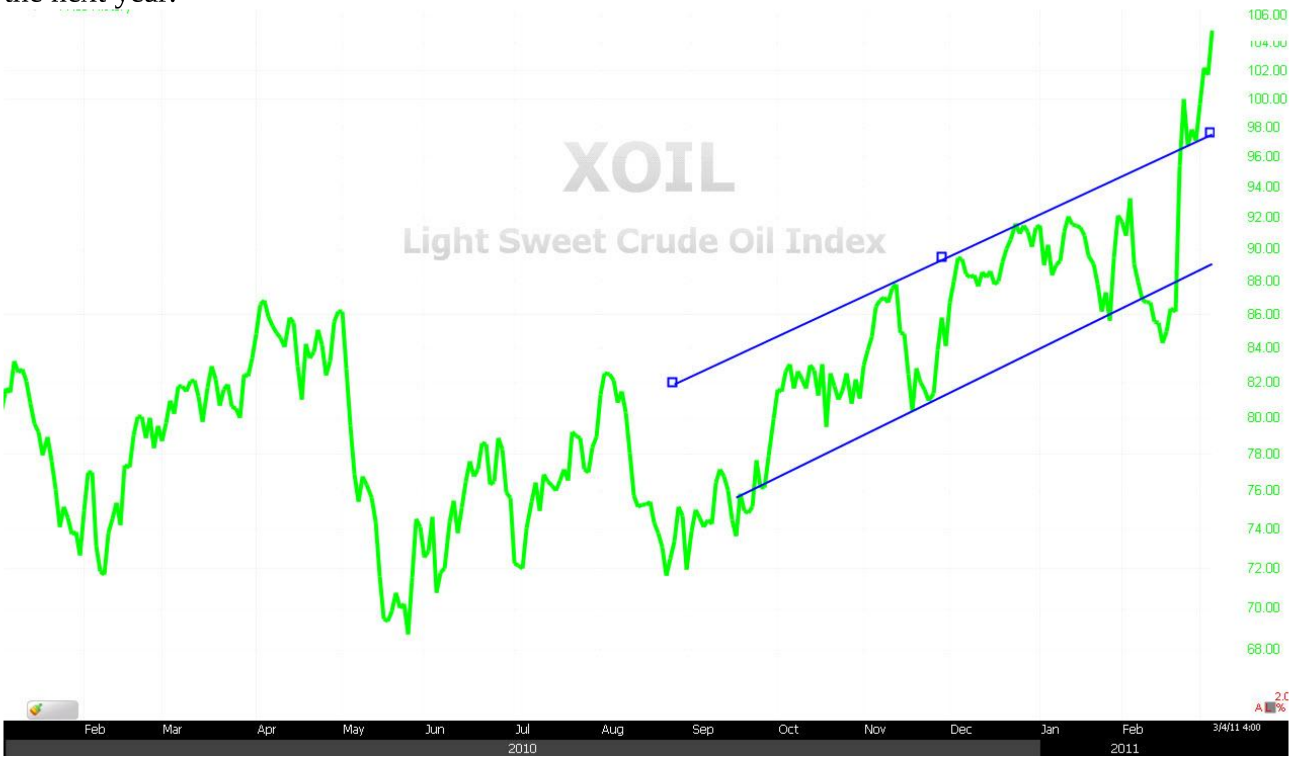
# Weekly Market Analysis

March 4th, 2011

**Market Wrap-Up:** Last week oil continued to drive stock market movement around the world. As was noted in the last weekly market commentary, oil broke above the trading channel that it had been stuck in since the middle of September 2010, as denoted by the blue parallel lines in the chart below. As can be seen clearly from the price of oil (green line below), oil tested the trading channel on February 25th then proceeded to move higher at a very fast pace and is now in an almost straight leg up. The rate of the increase in the price of oil is fully unsustainable as it amounts to an annualized rate of return of 2,500 percent if last week's increase were to continue uninhibited for the next year.




With oil marching higher, many economists have started to debate the level oil needs to reach in order for it to have a dampening effect on spending and, in turn, growth in the US economy. Prior to the unrest in the Middle East, many economists thought that the figure was $100 per barrel. Now that we have attained and surpassed the $100 per barrel level, new numbers are coming out that push the estimate higher; right now the aggregate consensus is around $110 per barrel, a figure that we are quickly approaching. If oil goes to $110 and beyond, it does not necessarily mean that the US will fall back into a recession, but there will be much more talk about a double-dip than there has been in recent weeks. Right now the US stock market looks as though it may have hit a new sideways trading range as there has been very little up or down movement in any of the three major indexes since the beginning of February. While this could be a topping pattern that will roll over and decline rapidly, it is too early to tell and no one will know for sure until after the decline begins to be substantiated. That being said, we here at Financially Speaking continue to manage money in an active way, attempting to protect on the downside while still partaking in the upside should it continue. With the market in a topping pattern and moving in a trading range, you may see an increase in trading as we adjust some positions and apply defensive hedges on others. If you have any concerns about your portfolio, please feel free to give us a call.

**International Politics:** Last week international politics were once again focused on the unrest in the Middle East, with the primary focus remaining on Libya. Colonel Gaddafi maintains the control over Tripoli and has recently been launching counter attacks against the rebel forces primarily through the use of his air force and a few elite units of soldiers under the direction of one of his sons. With the daily back-and-forth news about which side controls what in Libya, the world markets seem to be taking the stance that this will be a prolonged conflict that could have long-term effects on oil production and exportation in the region. This is clearly seen by the chart above showing the increasing price of oil as uncertainty continues. Elsewhere in the world, China made some headlines after Chinese Premier Wen Jiabao gave the equivalent of the US President's State of the Union address to 3,000 delegates of the National People's Congress in Beijing. The speech held little that was unexpected and reiterated the government's stance that China has to make controlling inflation the number one priority moving forward. A second main point of the address was calling on China to narrow the gap between the rich and poor within the country. Some other key points in the address included outlining a 5 year budget for China which included a 12.7 percent increase in military spending during 2011 and the need for educational reforms so that continued educational growth remains sustainable. In another part of the world, the European Central Bank has stopped purchasing government bonds and will take a break until the outcome of a meeting among European leaders takes place on Friday, March 11th. The meeting that is taking place on Friday will be closely watched by the world stock markets as it is a meeting that should produce a complete package that will attempt to deal with the Euro zone debt crisis. If the talks seem as though they will be unfruitful, the fixed-income markets could react in a big way, increasing the spreads on the sovereign debt of the weak countries. This trouble in the Euro zone could benefit the US dollar by helping reverse the downward trend we have seen developing between it and many of the major world currencies.

**National Politics:** National politics was once again focused on the budget debate after the passage of a two week budget extension bill that was designed by Republicans; in exchange for the two week extension the Republicans received $4 billion in immediate budget cuts. This kind of political horse trading between the Democrats and Republicans will probably continue for the next two weeks as the deadline for passing a budget comes near. Wisconsin remains in the political spotlight as Governor Walker's budget has yet to be voted on since the Democrats skipped out of the state to avoid a vote on the very controversial bill that makes some changes to union powers. Many states remain focused on the outcome of the Wisconsin budget struggle, as they too have budget deficits that will need to be filled and, in some cases, unions may be asked to take some cuts. Federal Reserve Chairman Ben Bernanke brought up the topic of allowing individual states to go bankrupt as he spoke before the House of Representative Financial Services Committee last week. Chairman Bernanke did not seem to want to wade very far into the uncertain waters of state bankruptcy, saying little more than that it is very a very complex idea to allow states to go bankrupt. Chairman Bernanke was also questioned about the Fed's QE2 program and whether the program may be cut short, to which he made it sound like the reasons the program was started have not really changed, so the program would continue as originally scheduled. He did make special note of oil and the increase possibly causing a bit of a problem for the economic recovery that he seems to have orchestrated reasonably well thus far. Another area of concern for Congress was whether the Fed was seeing a major shift away from the US dollar in international markets and, if so, what the Fed would do about it. This line of questioning came from a report that shows many large financial institutions, including hedge funds and banks, have recently made large bets against the US dollar, favoring currencies like the Euro. The reason for favoring the Euro over the dollar is fairly simple; the ECB may increase interest rates next month and many market participants see a large amount of money willing to flow out of dollars and into other currencies in order to attain a more attractive higher yield.

**Market Statistics:** After a decline two weeks ago, last week saw the three major US indexes increase in value. The primarily blue-chip Dow led the advance, increasing by 0.33 percent while the technology-heavy NASDAQ advanced only 0.13 percent. The more broadly based S&P 500 turned in the smallest increase of the week, advancing only 0.10 percent. The best-performing sector of the US markets was the Healthcare Providers sector, which increased by 2.86 percent thanks in large part to the budget battle being waged in Washington DC taking the focus off healthcare reform. The worst-performing sector was the US Regional banking sector, which declined 2.23 percent. Commodities turned in a second very strong week in a row with the GSCI Commodity Index increasing by 4.50 percent. Within commodities, oil saw the largest increase, advancing by 7.18 percent. Precious metals also had a strong week, with silver increasing by 6.54 percent while gold advanced 1.43 percent. On the industrial side of commodities, copper saw a flat week of +0.04 percent indicating that manufacturing around the world that utilizes Copper may be taking a wait-and-see approach to the worldwide economic recovery. The US dollar continued its decline last week, falling by 1.08 percent against a basket of international currencies. On the international investing front, the best return came out of India, with the Bombay Se Index advancing by 4.46 percent. Globally, the worst-performing index was in Saudi Arabia, with the Tadawul Index declining by 3.01 percent after falling by more than ten percent during the first three days of trading, then recovering during the last two days. The news coming out of Saudi Arabia is very limited as to why this happened, but most market watchers cite the uncertainty surrounding the region for the volatility. The VIX was very tame last week, ending with a decline of less than one percent; this represents the lowest weekly change in volatility since September of 2010. This relatively stable VIX reading was a welcome sign for many investors as fear about the ongoing unrest in the Persian Gulf States and North Africa continues to push oil higher.

For the trading week ending on 3/4/11, returns in FSI’s models were as follows:

| | Last Week | YTD | Since 12/31/07 |
|---|---|---|---|
| Aggressive Model | 0.68 % | 3.42 % | 2.61 % |
| Growth Model | 0.38 % | 2.52 % | 4.03 % |
| Moderate Model | 0.53 % | 2.25 % | 6.63 % |
| S&P 500 (benchmark) | 0.12 % | 5.28 % | -10.03 % |

Last week we made a few changes within the models based on market movements. The first change was to increase our hedging positions in our least aggressive models; this was done through the purchase of Direxion Funds Developed Markets Bear (DXDSX), the money was moved out of Oppenheimer Floating Rate (OOSAX) to initiate the position. Toward the end of the week, with the markets looking like they were able to absorb the higher oil prices, we decided to remove the hedge positions and put the proceeds into a NASDAQ Fund (RYVYX) and Healthcare (we used either FACDX or RYHIX depending on model). From a relative strength standpoint, Healthcare recently moved way up the rankings list from among the lower half of all sectors to one of the top-performing sectors. The only other adjustment to the models was done late last week when we moved a small amount (2 to 3 percent) from Real Estate (REPIX) to Healthcare (FACDX) in order to take advantage of the strong relative strength of the sector.

**Economic News:** Last week kicked off on Monday February 28th with the release of personal income and spending for the month of January. Personal income increased more than expected, by 1.0 percent versus 0.3 percent, which was a very positive sign for the economy, but the release was somewhat dampened by a worse-than-expected reading on personal spending. Personal spending came in at 0.2 percent versus expectations of 0.4 percent; this lack of spending is a concern for the markets because the economic recovery depends on the continuation of strong consumer spending. The income and spending report was followed by the PCE Core Price Index for the month of January; the report showed little change in prices, as expected. The release of pending home sales for December and the Chicago PMI for February wrapped up Monday's releases. Pending home sales for the month of December declined by 2.8 percent, slightly better than the expected decline of 3.2 percent, but not good enough to get many investors excited about the US housing market. The Chicago PMI however did provide some excitement as the reading came in 5 percent higher than expected, at 71.2. On Tuesday, Construction Spending for the month of January was released, falling in line with expectations. ISM data released at the same time showed a very small increase over January levels. Late in the day, auto sales for the month of March were shown to have increased by 27 percent in February, much faster than any one was expecting, a very positive sign for the economic recovery continuing in the US. On Wednesday the ADP employment change for the month of February was released, showing a better-than-expected 217,000 jobs added, while expectations had been for 165,000 jobs added. Later in the day on Wednesday, the Fed released the beige book and, not surprisingly, it held no real new information. On Thursday, the standard weekly jobs-related figures were released with both figures beating market expectations. These better-than-expected figures gave the markets a nice boost as employment seems to be the piece of the puzzle lagging the economic recovery in the US. Also released on Thursday, the ISM Services Index for the month of February showed that while the overall ISM index had a good month, the services side of the index did not fare as well, as the release came in as expected. On Friday the main release of the day was the government's figure for the unemployment rate in the US during the month of February. The rate was shown to be 8.9 percent, while the market had expected something closer to 9.1 percent; this dip below the psychological 9 percent barrier was a big step for the employment market in the US. Both the non-farm payrolls as well as the non-farm private payrolls coming in better than expected played a part in the lower unemployment rate. Wrapping up the week on Friday was the release of factory orders for the month of January. Orders came in at 3.1 percent, a full percentage point above the expected figure, indicating that orders remain strong in the US. Overall, although last week provided many positive signs about a continued US economic recovery, the incessant rise in oil prices put the brakes on what otherwise would have been a great week for the markets.

This week will be slow for economic news releases, with the majority of the releases occurring on the last two days of the week. The week starts off on Monday with the release of consumer credit for the month of January; credit is expected to have increased by $3.3 billion. If the release comes in as expected it will still be a positive development for the economy as it will signal that banks are continuing to lend money and have not tightened down as the recovery has slowed. On Wednesday, March 9th, Wholesale Inventories for the month of January will be released, with expectations of a 1 percent increase over the December level. On Thursday the standard weekly jobs-related figures are set for release, with expectations that initial jobless claims fell over last week and continuing jobless claims stayed the same. Rounding out economic news releases for the day on Thursday is the release of the US Trade Balance for January and the US Treasury budget for February. Both releases are expected to be very large negative numbers (the Trade Balance -$41.5 billion and the Treasury Budget -$196 billion). On Friday the largest economic news release of the week, the retail sales figure for the month of February, will be announced. The expectations are for an increase of 1.4 percent over January levels for overall retail sales and 1.0 percent for retail sales not including automobiles. With demand having been pent up a little in part of the country due to adverse weather in December and January it would not be surprising to see retail sales come in better than expected. Later in the day on Friday, the University of Michigan releases their consumer sentiment index for the month of March (February data) and expectations are for a slight increase over the previous month's level. Wrapping up the week on Friday is the release of Business inventories for the month of January; expectations are for no change over the December level. Overall this week does not really have any economic news releases that should be market movers, but that can change in a hurry.

Have a great week,
Peter Johnson

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