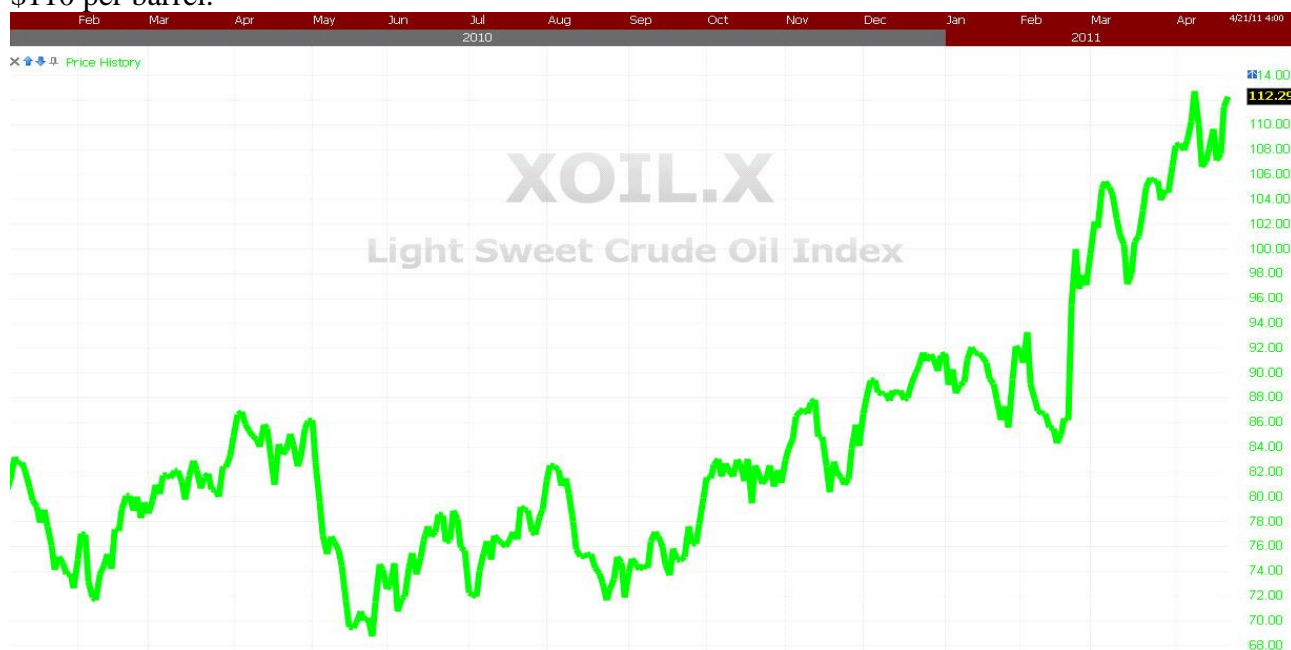




## Weekly Market Analysis April 25<sup>th</sup>, 2011

**Market Wrap-Up:** Last week saw a large number of earnings announcements that pushed the markets higher as they beat market expectations. Better-than-expected earnings were reported at Intel, GE, Johnson and Johnson, United Technologies, United Healthcare and Apple to name a few. Unlike the start of the earnings season a few weeks ago, the majority of the releases last week did not have a cautious tone on the outlook for the businesses or, if they did, they beat expectations by such a wide margin that investors did not care about the cautionary note. Despite the good round of earnings announcements, the US markets have yet to break out of their respective trading ranges; they are now solidly in the upper part of the trading range but, nonetheless, stuck in it. It would probably take another strong week of earnings in order to push the US markets over their previous highs from back in February. Even if the indexes were able to make it back there, until there is clarity on the political handling of the financial situation in the US, the upward trend is at great risk for a correction back down in the trading range. Also potentially weighing on the stock market is the continued rising costs of gasoline; with the US still a full five weeks from the summer driving season and prices continuing to climb, at some point the American consumer will really start to feel the pinch and cut back on driving. This reduction in driving and increased costs of doing so could negatively impact everything from consumer spending to manufacturing in the US and prices do not look as though they will come down any time soon. As can be seen in the chart below, oil broke through \$95 per barrel back in late February 2011 and has not looked back, recently moving above \$110 per barrel.



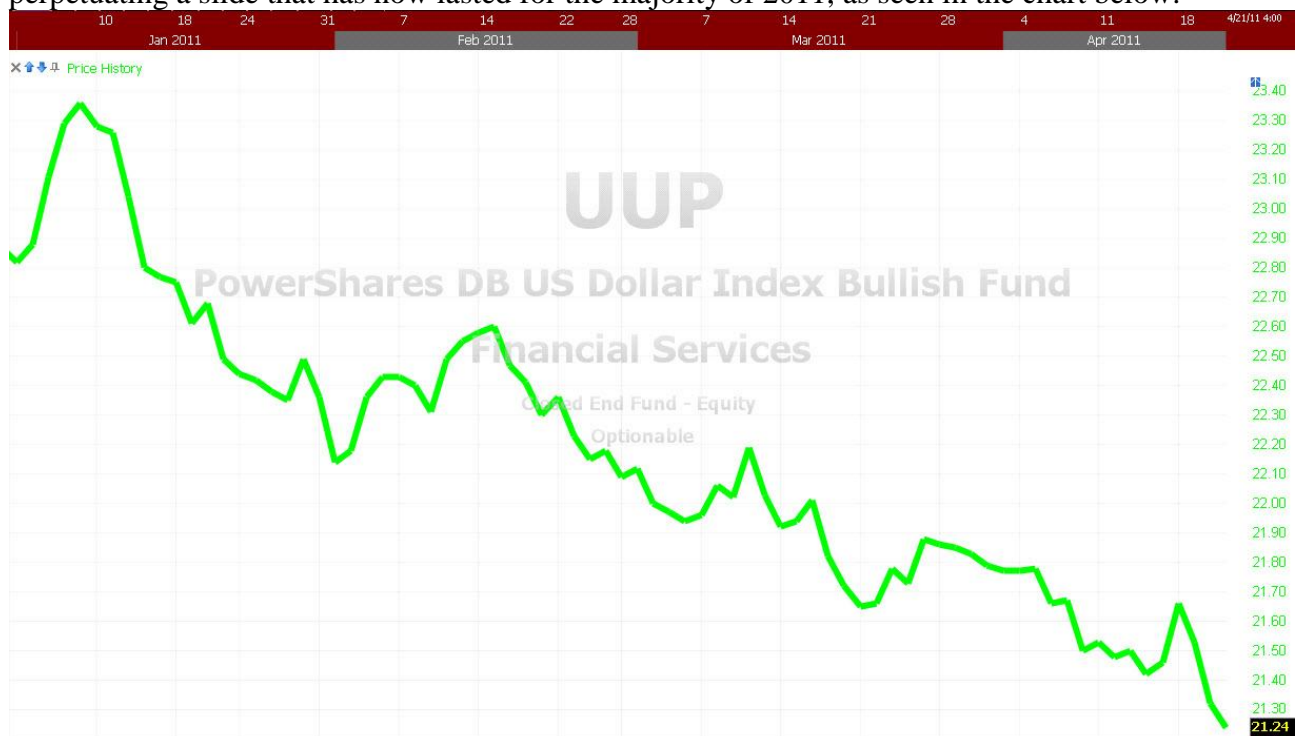
**International Politics:** Last week International politics once again focused on the Middle East, with Syria making most of the headlines. Syria has seen an increased amount of unrest since the “Day of Rage” back on March 15<sup>th</sup> of this year with protestors demanding removal of the current government and the installation of a more democratic government. Much like the unrest in the rest of the region, the Syrian trouble focuses on people’s anger toward their government, which many think is not doing enough for the people. The President of Syria, Bashar Assad, took over after the death of his father in 2000. The country has been run by the Assad family now for more than 40 years and the country has been under Emergency Law, which suspends most of the constitution protections of the people and puts in place a kind of martial law, since 1968. Much like Libya, the world is condemning the Syrian government’s crackdown on protestors and once again there are questions of unrest spreading further into the oil-producing region. Foreign governments are much less likely to become involved in the unrest in Syria because they produce much less oil than a country like Libya. According to the CIA world fact book, Syria is the 29<sup>th</sup> largest oil producer in the world, producing some 400,000 barrels of oil per day according to the latest figures. This represents much less of a potential impact on the world oil market than Libya, the 17<sup>th</sup> largest oil producer, which produces 1,790,000 barrels of oil per day (much of which goes to southern Europe). For now the situation looks like it will remain a Syrian issue but, with the country sharing a border with Iran, the situation could become much more precarious for western powers.

**National Politics:** National politics was nearly silent last week except for the ever-present hum of the 2012 election process coming into full swing. With both the Senate and the House of Representatives on “Spring Recess” both last week and this week, I am sure that the members of Congress will come back to session on May 2<sup>nd</sup> full of ideas as to how reign in the budget deficit and fix the long term problems of entitlement programs in the US, or maybe they will mostly just come back with a tan. While some take time to play away from Washington, D.C., all eyes will be focusing on one person: Federal Reserve Chairman Ben Bernanke. Chairman Bernanke is taking a bold step on Wednesday when for the first time he will hold a press conference during which he will field questions from the press. Unlike the majority of the questions that the chairman experiences during his testimony before both the House and the Senate, the members of the press will probably ask much more pointed and meaningful questions and the market will hang on every word. The main points of the news conference are somewhat known, with questions focusing on the end of QE2, inflation expectations and potential interest rate movements. After the chairman answers the press’s questions, we may see information on manufacturing in the US, the housing market, inflation in energy and food, and possible outlooks for the US dollar. Market participants will listen to and watch for what is not said as much as what is, with the chairman not saying some things potentially holding more meaning for the market than what he does say.

Moving back to national politics, when the members of Congress do reconvene they will face some major issues that must be resolved quickly, the first issue being US spending. With Standard and Poor’s issuing a warning shot last week about the credit rating of the US debt by changing their outlook on the AAA rating of the US to negative, there is now a 33 percent chance of a downgrade coming in the next 24 months if history is any indicator of what is to come. The implications of such a downgrade from AAA to AA are very wide. The immediate impact on the US would be an increase in our borrowing costs, as investors have to account for the additional risk of default. This increase in borrowing costs could present a problem to the US system of financing because we currently run the day-to-day business of the government through the issuance of cheap debt, as long as the debt ceiling has not been reached. The longer-term implications of a credit downgrade of the US by any of the major ratings agencies are vast and include pressure on the US dollar around the

world, pressure to move the barrel of oil off of the US dollar and onto a basket of currencies, and major changes in the flow of goods and services around the world. It will be up to politicians to start taking steps toward rectifying the situation in the US because, sooner or later, if they do nothing, forces beyond the reach of politics will weigh heavily on the US economy.

**Market Statistics:** During the shortened trading week last week all three of the major US stock market indexes increased in value, leaving the indexes in the upper half of their trading range but still a good distance from breaking out to new highs. With the help of a few better-than-expected earnings announcements out of select technology companies, the NASDAQ turned in the best performance for the week, increasing by 2.01 percent. The S&P 500 and Dow turned in returns of 1.34 percent and 1.33 percent, respectively. Not surprisingly, with the NASDAQ turning in the top performance, the best-performing sector of the US markets is also technology-related and was the Semiconductor sector, which increased 3.74 percent. The worst-performing sector of the US market was the regional banking sector, which declined by 1.78 percent on falling negative earnings announcements. Commodities turned in a positive performance, advancing by 1.25 percent overall, with Gold and Silver advancing 1.17 percent and 8.84 percent respectively, while Copper advanced 4.23 percent, energy advanced by 2.31 percent and oil increased by 2.40 percent. Silver continues to make an amazing run higher; it has now increased in value during 12 of the past 13 weeks with current prices now having moved over \$40 per ounce to \$45.54. The US dollar decreased in value by 1.03 percent against a basket of international currencies during the course of the week, perpetuating a slide that has now lasted for the majority of 2011, as seen in the chart below:



On the international investing front, the best return for last week was found in Taiwan, with the Taiwan Index increasing by 2.75 percent. Globally, the worst-performing index was in China, with the Shanghai SE Composite Index (two weeks ago it was the best performing Index) decreasing by 0.77 percent. The VIX tumbled last week, falling by 4.11 percent, making the four week decline through Friday, April 15th on the VIX 37.37 percent. We have not seen the current level for the VIX (14.69) since mid-June 2007, indicating that volatility should be unusually low during the coming 30 days.

For the shortened trading week ending on 4/21/11, returns in FSI's models were as follows:

	<u>Last Week</u>	<u>YTD</u>	<u>Since 12/31/07</u>
Aggressive Model	1.33 %	-0.53 %	-1.31 %
Growth Model	1.00 %	-1.29 %	0.16 %
Moderate Model	0.55 %	-1.56 %	2.67 %
Income Model	0.46 %	0.23 %	(Insufficient Data)
S&P 500 (benchmark)	1.37 %	6.95 %	-8.92 %

We made no changes to our models during the course of the week as will be the case most weeks.

**Fund Spotlight:** This week I am spotlighting a fund that we have used in the past, but since I will be reviewing the new model's funds in alphabetical order, it is the first fund to be spot-lit. The Appleseed Fund (APPLX) is a mutual fund that is unconstrained by any one style box and allows the management team to invest in any companies that meet their value screens. There is also a socially conscious component to the fund, as they will not invest in companies that derive substantial revenues from the tobacco, alcohol, pornography, gambling, or weapons industries. The fund prides itself on being an eclectic, value-oriented mutual fund that takes concentrated positions in order to beat the market over the long term while at the same time minimizing downside risk to the overall portfolio. Not being constrained to one style box is evidenced in the holdings of the fund as of 3/31/2011:

Giant Cap 26.98%  
 Large Cap 10.81%  
 Medium Cap 35.16%  
 Small Cap 1.46%  
 Micro Cap 25.60%

Within the market-cap holdings, the fund was allocated as follows:

Health Care 34.63%  
 Financials 19.41%  
 Energy 19.19%  
 Consumer Discretionary 9.92%  
 Consumer Staples 9.56%  
 Materials 7.29%

As of 3/31/2011 the Appleseed Fund held only 29 stocks, of which 45 percent were based in the US while 21 percent were foreign stocks, and the remainder of the fund was in fixed-income and money markets. Overall the fund provides our models with participation in the upside of market movements, limits the downside movement and has relatively low correlation to the S&P 500.

**Economic News:** With last week being a shortened trading week due to Good Friday, there were fewer economic news releases than normal. The week started off on Monday with the release of the NAHB Housing Market Index for the month of April, which came in slightly below expectations (16 versus expectations of 17), indicating that the housing market in the US is still not improving. On Tuesday, the 19<sup>th</sup>, news out of the housing market was more upbeat as both the housing starts

and building permit figures for the month of March were released to show unexpected increases above expectations in both readings. Housing Starts increased during March by 549,000 while the market expected only 520,000 and the February figure was only 512,000. Building permits surprised the market by an even greater percentage to the upside, increasing by 594,000 while the market expected only 540,000, making it a ten percent upside surprise compared to only five percent on the housing starts. On Wednesday, yet more housing-related releases came out; the MBA Mortgage Purchase Index for the previous week and the existing home sales figure for the month of March both beat market expectations. These two figures, coupled with the other figures released on Tuesday, are providing the housing market with a breath of fresh air as many investors have waited for these positive signs out of the housing market for quite a long time. Later in the day on Wednesday, the US crude Inventories report was released to show that US inventories fell by 2.3 million barrels of oil over the course of the previous week, leading to higher oil prices and the persistent march higher of prices at the pump. On Thursday, the standard weekly jobs-related figures were released and, once again, were disappointing, as both figures were higher than the market expected. Initial jobless claims stayed over the 400,000 level at 403,000 while the continuing jobless claims figure increased to 3,695,000 – down slightly from the previous reading of 3,702,000 but not very close to the expected 3,650,000. Much like the US housing market, the employment picture in the US seems to be somewhat stuck in a horizontal trend even as headline unemployment numbers have come down according to the US Department of Labor. Later on Thursday, the Philadelphia Federal Reserve released their latest manufacturing index for the month of April and to many investors' surprise the announcement was a very negative 18.5 while the market had been looking for 33. The main reason cited for the decline in manufacturing was a significant decline in new orders during the month. Wrapping up the week on Thursday was the release of the FHFA Housing Price Index for the month of February, which experienced a decline of 1.6 percent during the month, bucking the trend of positive news out of the housing sector, but the market paid little attention to this release as the data is very stale.

With this being a full trading week, we will see many more economic news releases than last week, some of which may have a large impact on the broad markets. The week starts off on Monday with the release of the New Home Sales figure for the month of March, which is expected to show a slight increase over the February level. On Tuesday the Case-Shiller 20 City Home Price Index for the month of February is set to be released with expectations of a slight decline of 3.2 percent over the course of the month. Later in the day on Tuesday, the all-important consumer confidence index for the month of April is set to be released, with many investors waiting to see if the price of gas at the pump has started to take a noticeable toll on consumer confidence. This release could be a major market mover. On Wednesday the 27<sup>th</sup> durable goods orders for the month of March are set to be released with expectations of a positive 1.8 percent increase over the previous month's level. This would be a welcome relief as the reading in February showed a decline in durable goods orders of 0.6 percent. Midday on Wednesday, investors may be watching a standard weekly report that is normally overlooked a bit, that being the Crude Inventories report: last week saw a large decline and many investors will be eager to see if that is a trend or if it was a onetime event. Later in the day on Wednesday, the FOMC will release their latest rate decision, but expectations are for no change. Chairman Bernanke also holds his first ever press conference question-and-answer session Wednesday afternoon and it will be the event of the week as most market participants will be watching and listening very closely to see how the chairman answers the questions posed to him. On Thursday perhaps the release with the largest potential to impact the market is set to be released, that being the advanced GDP figure for the first quarter of 2011. Expectations vary widely on this release ranging from 0.1 percent up to about 2.0 percent; the entire range is below the fourth quarter

level of 3.1 percent. If the announcement comes in at the upper end of the range it would be seen as a very positive sign for the US economy, while on the flip side, if it comes in near the lower end of the range, the release could be seen as very negative for the economic recovery continuing. At the same time that the GDP figure is released, the standard weekly jobs-related figures are set to also be released with expectations once again of both figures improving over the course of the previous week. Wrapping up the day on Wednesday is the release of the pending home sales for the month of March which, much like the GDP figure, has a wide range of opinions as to how the figure will shake out. If the release posts a strong number, then the data on the housing market that came out last week will be somewhat validated, if not, then last week's positive housing related announcements will be seen as a slight blip. On Friday the 29<sup>th</sup> Personal Income and Spending for the month of March is set to be released, with expectations of both measures having increased slightly over the level experienced in February. Spending will be closely watched for signs of pull-back due to increasing cost of both food and energy, and this may be a topic of Chairman Bernanke's press conference on Wednesday afternoon. Also released on Friday is the Chicago PMI for the month of April, and after last week's miss by the Philadelphia Fed on their manufacturing report, this week's report will be very closely watched to see if the downturn in the Philly region was contained to only the one region, or if it was felt in other manufacturing regions as well. Wrapping up the week on Friday is the release of the University of Michigan Consumer Sentiment index for the month of April: expectations are for no change over the previous level and any deviation from the expected on this release would come as a big surprise to the markets. Overall this week, there are some important news releases taking place but the market will mainly focus on Chairman Bernanke's question-and-answer press conference.

Have a great week,  
Peter Johnson

*Feel free to forward this email.*

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