



Weekly Market Analysis May 2nd, 2011

Market Wrap-Up: Last week, earnings season continued with many announcements but nothing emerged that was either really strong or weak from any major US companies. One company that saw a sharp increase in earnings (61 percent higher than a year ago) was Colgate Palmolive, but the earnings increase was expected and therefore a non-market moving event. The markets moved higher last week with all three of the major US indexes breaking out of their respective trading ranges to the upside. Now the question is, Is this a true breakout or is it just an expansion of the trading range? The chart below shows the S&P 500 in green and the trading range that it has been stuck in for the past few months is shown in blue (with the exception of the sharp move lower at the start of the Libyan conflict):



As you can see from the chart the market is clearly higher than the trading range, but this could be a short-term phenomenon. At this point many of the market indicators we watch are indicating that the market is overbought and that it has moved up on very light volume, indicating that a profit taking downtrend could be in store in the near future, which could knock the markets right back down into the trading range. Going into a time of year that is typically slow for volume, hence the adage “Sell in May and go away”, this year could be pretty interesting since we saw the anemic levels of volume that are normally reserved for the middle of summer during April. Another awkward aspect of the recent market movement is that many of the strong upward movement days have been driven by a small number of companies that have beaten their earnings expectations by a

wide margin. With such erratic movements in the markets it is best to err on the side of caution and not get too caught up with the daily market movements.

International Politics: The biggest headline on the international front last week came Sunday night as news broke that the US had successfully killed Osama Bin Laden in a remote town in Pakistan. While most investors view Bin Laden's death as a good thing, there is uncertainty as to how the markets will react. When the news broke last night, world markets that were open for trading all initially jumped higher, but then seemed to fade into the night. The biggest wildcard in the world economy is what effect his death will have on the price of oil, since there has long been a "terrorism premium" (according to some oil pundits) built into the price. The initial reaction of the oil futures contracts was no reaction, followed by aimless meandering in prices during the following hours. On the global investing front, the Euro zone continues to have major issues with various countries' ten year debt interest rates creeping higher. The interest rate of Portuguese debt is creeping ever closer to 10 percent (currently it is at 9.90 percent) and the bailout package is still in the works with the IMF and the ECB. Unlike the bailouts of both Greece and Ireland, which were very hastily thrown together, it appears that the ECB and the IMF are thinking through the various benchmark timelines for Portugal much more thoroughly after seeing the problems that Greece and others have been experiencing in meeting their target figures and deadlines. Right now the total bailout for Portugal is around \$118 billion. One interesting aspect of the whole Portugal situation is that Finland, an EU member with a right to vote on EU bailouts through their parliament, has been making some noise that they do not support the bailout of Portugal. While it is yet to be seen if the noise will lead to any action (or in this case inaction), it could introduce some more friction into the Euro zone that is already heating, with debates and to what to do with countries that need a bailout. A somewhat positive element in The Euro zone mess is that the rates on Spain's debt have not stopped increasing and have actually pulled back a little bit, leaving some market participants thinking that they may not need a bailout after all.

National Politics: National politics remained very subdued last week as both the US Senate and the House of Representatives were both in recess. With not much excitement coming out of Capital Hill, Federal Reserve Chairman Ben Bernanke had the undivided attention of Washington DC for his press conference on Wednesday afternoon after the release of the FOMC rate decision. For Chairman Bernanke this sort of press conference was a first and he did look a little nervous, he was much more fidgety than usual and looked slightly uneasy. The biggest changes made by the Fed were cutting their growth rate estimate for the US from 3.4 to 3.9 percent down to 3.1 to 3.3 percent for 2011, their expected inflation rate for 2011 is now 2.8 percent up from 2.1 percent and the expected unemployment rate in the US for 2011 was lowered to a range between 8.4 and 8.8 percent from the previous range of 8.8 to 9.0 percent. While inflation is seen as being subdued, the Fed did acknowledge that the rising cost of oil was one of the main driving factors behind the increase in the inflation expectations. Aside from the aforementioned changes in figures there was very little said during the press conference that had not already been stated by either the chairman or other members of the FOMC. Chairman Bernanke did take a little bit of time to clarify what "an extended period of time" meant to him, saying that it would be a couple of meetings, which most people took to mean two or more. With this new information the market will be watching for when the language on "an extended period of time" leaves the FOMC statement, indicating that a change in rates is potentially coming after two more meetings. Other notable aspects of the chairman's answers to questions was that he continues to see the elevated prices in commodities, food and energy as transitory and not something that the Federal Reserve should make policy changes to accommodate. On the subject of quantitative easing two (QE2), Bernanke said that it will run its full course

(continue through the end of June) and then he laid out the case for how the monetary policy easing will essentially remain at the level seen at the end of June because the Fed is not going to be either adding or taking away any new funds. The first step toward tightening by the Fed will likely be to end the reinvestment of maturing securities on a monthly basis, in effect taking money out of circulation. By taking money out of circulation, the Fed would be sort of testing the water for a potential interest rate hike to see how the markets react. One thing that was made very clear by the Chairman's remarks is that they are going to be very transparent and vocal about what they are going to do in the future and give enough time between when something is announced and when it is done so that the world markets do not get spooked. Another focus of national politics last week was on the unusually powerful storms that moved across the south and east spawning numerous tornadoes and leaving a wide wake of destruction in their paths. So far, this year has been very unusual around the world for natural disasters. As Warren Buffett said on Saturday, in Omaha, it is going to be a very difficult year for both the insurance and reinsurance business around the world as claims are going to be unusually high.

Market Statistics: Last week all three of the major US stock market indexes increased in value, leaving them above their respective previous trading ranges. The best performer of the week in the US was the large blue chip heavy Dow which increased by 2.44 percent, while the S&P 500 increased by 1.96 percent and the technology heavy NASDAQ increased by 1.89 percent. The best-performing sector of the US markets was Transportation sector, which increased 4.31 percent. The worst-performing sector of the US market was the US Broker-Dealer sector, which declined by 0.40 percent on negative earnings announcements. Commodities turned in a positive performance, advancing by 0.49 percent overall, with Gold and Silver advancing 3.84 percent and 2.94 percent respectively, while Copper advanced 0.90 percent, energy advanced by 1.86 percent and oil increased by 1.42 percent. Silver continues to make an amazing run higher; it has increased in value during 13 of the past 14 weeks with current prices now over \$45 per ounce, at \$46.88. The US dollar decreased in value by 1.37 percent against a basket of international currencies during the course of the week. No one knows when the US dollar will stop sliding but many people are beginning to take notice of just how far down the dollar has moved against many other world currencies. This could be taken as a sign that the bottom is near. On the international investing front, the best return for last week was found in Germany, with the Frankfurt based DAX Index increasing by 3.00 percent. Globally, the worst-performing index was in China, with the Shanghai SE Composite Index decreasing by 4.63 percent. The VIX remained fairly flat last week, increasing by 0.41 percent.

For the shortened trading week ending on 4/29/11, returns in FSI's models were as follows:

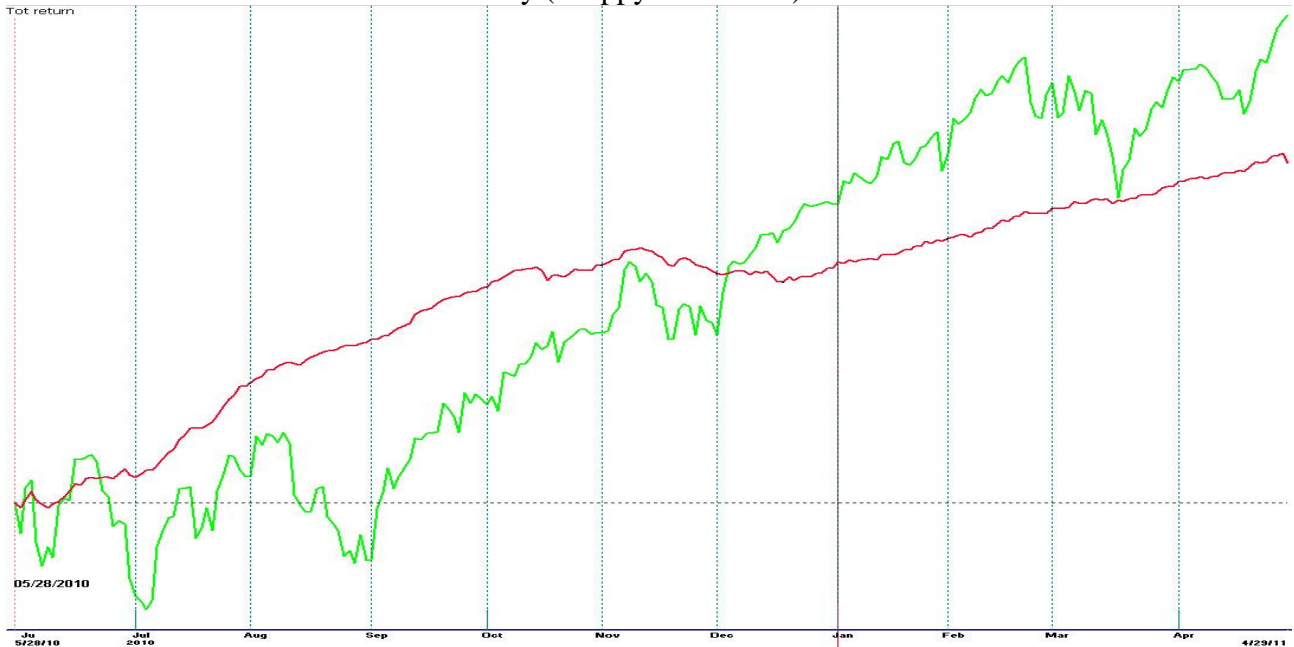
	<u>Last Week</u>	<u>YTD</u>	<u>Since 12/31/07</u>
Aggressive Model	1.23 %	0.71 %	-0.09 %
Growth Model	0.94 %	-0.36 %	1.10 %
Moderate Model	0.56 %	-1.00 %	3.24 %
Income Model	0.43 %	0.66 %	(Insufficient Data)
S&P 500 (benchmark)	2.00 %	8.43 %	-7.13 %

We made no changes to our models during the course of the week.

Fund Spotlight: This week's fund spotlight focuses on the Cohen and Steers Preferred Securities and Income Fund (CPXAX) that is used in our Growth, Moderate and Income portfolio models. CPXAX is a mutual fund that invests primarily in preferred stock and debt instruments of both US and non-US based companies. The fund seeks high income and capital appreciation and has demonstrated proficiency in both goals through a variety of market cycles. The fund is currently being used in our models because as the stock market moves sideways and future appreciation becomes less certain, it pays to be invested in both funds and stocks that are paying out strong dividends. CPXAX pays out a dividend every month and the current 30 day SEC yield on the fund is 5.13 percent. Many of the issuers of preferred securities are in the financial industry, but with the fund invested in the preferred equities, which experience much less volatility than holding the individual equities, the sector breakdown of the fund holdings as of 3/31/2011 is as follows:

Banking and Finance 57 %
 Insurance 18 %
 REIT's 14 %
 Telecom and Media 5 %
 Utilities 4 %
 Other 2 %

CPXAX (red line) is a good example of a mutual fund that is in a low volatility uptrend and while the fund does correlate with the S&P 500 (green line), as you can see from the historical chart below it does so with much less volatility (choppy movement):



Economic News: Last week was full of economic news releases, which were pretty much split between positive and negative for the economy. The week started out on Monday with the release of new home sales figures for the month of March which came in at 300,000 (20,000 higher than the market had been expecting), providing a good sign for the housing market in the US. On Tuesday the Case-Shiller 20 City Home Price Index for the month of February was released and showed a decline of 3.33 percent, which was slightly worse than the expected 3.2 percent decline. Later in the day on Tuesday, the all-important consumer confidence index for the month of April was released

and much to the markets' relief was shown to have increased by more than was expected. There was some concern about this release as consumers have been feeling the pinch at the pump, but so far it does not seem to be adversely affecting how the consumer feels. If we start to see this going way down and the movement attributable to the cost of fuel then we may get into a bit of a pickle. On Wednesday, the 27th, durable goods orders for the month of March was released and much to the markets' surprise, the release showed an overall increase of 2.5 percent while the market had only been expecting 1.8 percent. This release, combined with the durable goods orders release (when transportation is removed), is also beating market expectations which helped to propel the market higher and provided the necessary momentum for the indexes to break through their trading ranges. Midday on Wednesday, investors were watching a standard weekly report that is normally overlooked by the markets, the Crude Inventories report. Two weeks ago this report showed an unexpected drop in oil reserves and many oil watchers were hoping that it was a onetime event. The release last week indicated that oil reserves have increase by 6.156 million barrels of oil over the course of the previous week, much to the oil investors' relief it looks like the drop in inventories that was experienced two weeks ago was indeed a onetime event. Later in the day, on Wednesday, the FOMC statement was released showing that rates were being left alone and Fed Chairman Ben Bernanke held his press conference that was mentioned above. On Thursday the 28th the largest the economic news releases that had the largest potential of the week to move the market was released and had very little impact on the overall market—the advanced release of the first quarter 2011 GDP figure for the US economy. The release showed that GDP grew at a rate of 1.8 percent ahead of the expected 1.7 percent. While this number is much lower than it was a year ago, it is still positive and shows that the economy is growing rather than contracting, which means we are headed in the correct direction. At the same time as the GDP release, the government also released their initial jobless claims as well as the continuing jobless claims reports from the previous week. Initial jobless claims unexpectedly increased to 429,000, much higher than the expected 390,000 but the continuing claims muted the negative impact of the miss by coming in better than expected by 50,000 jobs. Later in the day, on Thursday, the pending homes sales figure for the month of March was released and indicated that pending sales were up 5.1 percent compared the market expectation of 1.7 percent. This combined with the other positive housing related news releases that have been coming out in the past few weeks, seem to be signaling that the housing market may finally be getting some traction, but it is still too early to really tell. On Friday, the 29th, Personal Income and Spending for the month of March was released with both releases beating market expectations while the PCE prices for the month of March were shown to have changed by only 0.1 percent. Thankfully, the Chicago PMI released later in the day on Friday, was in line with market expectations seeming to indicate that the unexpected drop in the Philadelphia Fed's figure was an isolated incident. Wrapping up last week was the release of the University of Michigan Consumer Sentiment index for the month of April, which came in as expected and ended up being a non-market moving event.

This week is a fairly slow week for economic news releases, with the week kicking off on Monday with the release of construction spending for the month of March and the ISM Index for the month of April. Construction spending is expected to have remained flat during March when compared to February levels and if this release can somehow beat expectations it could be yet another good sign for the US housing market. One thing to consider is that construction spending will pick up in the coming months as rebuilding takes place the areas hardest hit by the natural disasters of the past week in the US. The ISM index is not expected to have moved much either and should have little impact on the overall market. On Tuesday, May 3rd, auto sales figures for the month of April are set to be released and this is going to be the first time that we could see the partial impact of the

Japanese disaster in the numbers. Also released on Tuesday is the US factory orders change for the month of March, expectations are for approximately a two percent increase over the February level. On Wednesday, May 4th, the ADP Employment change figure for the month of April is set to be released and may be a precursor for the official unemployment rate release that is set for Friday. The expectation for the ADP release is for an increase in payrolls of 200,000 jobs, which would be a good sign for the economy and the potential move the unemployment rate (if any) at the end of the week. Later in the day, on Wednesday, the ISM Services Index for the month of April is set to be released with expectations of no change over the March level. On Thursday, the only news releases of note are the standard weekly jobs related figures, both of which are expected to have improved over last week figures, and the Preliminary Productivity figure for the US during the first quarter of 2011. Friday the 6th's economic news releases are going to be all about employment as the official unemployment rate in the US for the month of April is set to be released along with the breakdown of both nonfarm payrolls and nonfarm private payrolls. Expectations are for no change in the overall unemployment rate of 8.8 percent but the release sets up the potential for the market to be surprised to the upside if the release shows a rate under 8.8 percent. Unfortunately, the flip side is also true if unemployment unexpectedly increased. Wrapping up the week on Friday is a late day release of consumer credit for the month of March, which is expected to show an expansion of some \$5 billion as the banks are shown to have continued to increase lending during the month.

Have a great week,
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