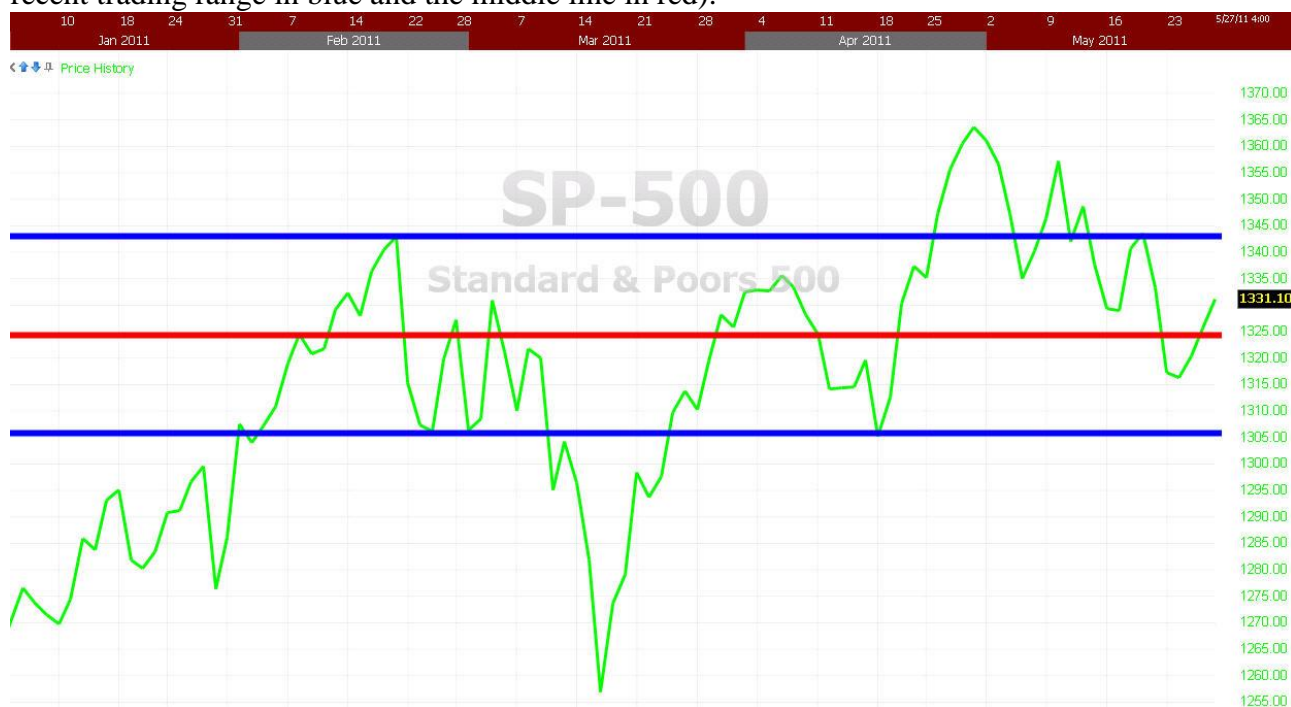




Weekly Market Analysis May 31st, 2011

Market Wrap-Up: Uneventful would be a good word to describe the market action of last week as the major US indexes continued to move sideways as they search for direction. As we wait for the summer season to kick off, volume has been low compared to past years, but it was not significantly lower than it has been for the past few months. The S&P 500 remains range bound after crossing below the midpoint of the trading range early last week, then proceeding to move slightly up through it at the end of the week as indicated in the chart below (S&P 500 is the green line with the recent trading range in blue and the middle line in red):



The news that came out last week seemed to indicate that the US economic recovery is continuing to lose steam, but much like the weekly volume the changes are not yet alarming. Gasoline, one of the most impactful purchases to the everyday American, has actually been becoming cheaper and the prices currently being paid to fill up. According to AAA's Daily Fuel Gauge report, which can be found here <http://fuelgaugereport.aaa.com>, the current national average for a gallon of regular unleaded fuel is \$3.780. That is down from \$3.828 a week ago and \$3.943 a month ago. Typically gas prices move up just before and during the start of the summer driving season, Memorial Day weekend, but this year seems to be different with prices having actually moved lower. So while on average gas is now \$0.163 lower than it was recently, it is still far more expensive than this time a year ago when we were paying on average \$2.732.

International Politics: International politics once again focused on Greece and the current rounds of talks among finance ministers regarding how Greece will be able to get out of their financial predicament. Greek Prime Minister George Papandreou, speaking to a roundtable at an OCED meeting, said that the current situation in Greece is up to Greece to solve and repeatedly stated that Greece should be left alone to work out what needs to be done to rectify their financial situation. While it may be true that Greece has the tools needed to try to regain solid financial footing, the problem is going to be with Greece's ability to implement those tools. One such tool is the power of taxation and tax collection. Just because Greece raises taxes does not mean that they will actually receive more tax revenues. While tax increases look great on paper and in financial projections, if taxes are raised substantially there is much more incentive for people to try to come up with ways to avoid paying them. The problem of tax evasion in Greece has been around for a long time. Some of you may remember reports last year about people not reporting pools that they owned and would have to have paid taxes on. According to an article in the UK newspaper, The Guardian, and the New York Times, only 324 homes admitted to owning a pool on their income tax forms while a review of satellite images by the taxing authority in Greece counted 16,974 pools. In the grand scheme of things a pool tax, which people were lying to get out of having to pay, amounts to a very small portion of the person's overall tax bill but serves as a good reminder of the problems the government could face when they try to raise and collect more taxes. Since the news articles broke last year about satellite images being used to look for pools, a new business has emerged in Greece — the business of green colored pool covers being used to make the pool look like green grass when viewed from above by satellites; you have to smile at their ingenuity. The world is currently waiting for a report that is set to be released on June third regarding the progress that Greece is making on trying to get their finances in order. There is much speculation that Greece is going to look very bad when the report, which was put together by the IMF and the ECB, comes out. Then the question becomes what Europe should do about it. If Greece is not playing by the rules outlined in the aid packages, there should be some sort of financial ramifications. But with more and more people thinking that Greece is going to default, does it really matter if the report shows that they are not trying very hard to comply? Most of the investment world does not care if Greece defaults, since they represent such a small portion of the Euro zone and an even smaller piece of the world economy. There is still the fear that if Greece goes, contagion will spread through Europe taking down Ireland next then Portugal and eventually Spain and Italy. It is the continued fear of contagion that will keep many of the Europeans working diligently to keep Greece from being rated as "D" by the credit rating agencies.

National Politics: National politics was relatively quiet on the hill last week, as the main focus is now turning to the upcoming Presidential election in 2012. With candidates seeming to either join the race or drop out of the race on a daily basis there is plenty of action to keep the news media busy. While the election seems to have grabbed all of the headlines, there are still some major debates going on at the capital. In a move that some are calling simply a vote to make Republicans look bad, last Wednesday the Senate called a vote on the House GOP budget that made major changes to Medicare (according to some people killed Medicare outright), knowing that the vote was doomed to fail before voting even got underway. The budget did fail by a vote total of 57 against and 40 for the measure, but the whole vote seemed to be a smoke screen for the upcoming election to get members of the Senate on record voting that they would be okay with changing Medicare to a voucher system. Such shenanigans on Capitol Hill seem like they will only increase as the debates involve more and more money, such as the debate that is going to have to happen about raising the debt ceiling. The debt ceiling remains the most important issue currently facing Congress. If they continue to wait and kick the can down the road, the situation will only become

darker. The warnings by the Secretary of the Treasury, Tim Geithner, and Federal Reserve Chairman Ben Bernanke seem to have gone unheeded as the US treasury is now single handedly funding the US Government because the government cannot currently issue any more debt. With uncertainty as to when the debt ceiling debate will come to an end, the US stock markets will continue to trade in a very skittish manner, as day to day stories have the ability to make unusually large impacts. A sign of how fearful many investors have become is the current rate being offered on the 10 year US Treasury bonds, 3.06 percent (the yield is well below average), and there is still a lot of demand for them.

Market Statistics: Last week the three major US stock market averages were all down, with the broadly based S&P 500 having the top performance of the week after losing 0.16 percent. The second best performance was the technology-heavy NASDAQ, closing down 0.23 percent and the worst-performing index was the large-cap Dow, which declined by 0.56 percent. The S&P 500 and the Dow have now declined 4 weeks in a row for a cumulative decline of 2.38 percent for the S&P 500 and 2.88 percent for the Dow; the NASDAQ has declined in three of the last four weeks posting a cumulative decline of 2.67 percent. The best-performing sector of the US markets was the US Oil and Gas Exploration and Production Sector, which increased 2.84 percent. The worst-performing sector of the US market was the Healthcare Providers sector, which declined by 2.24 percent. Commodities made three weeks of advances in a row by increasing 1.55 percent as the more industrial metals led the move higher. Silver turned in the strongest performance of the commodities, gaining 8.34 percent while Copper increased 4.82 percent and Gold only moved higher by 1.50 percent. The overall energy sector advanced by 1.94 percent but Light Sweet Crude Oil was only up 0.49 percent. The US dollar declined by almost a full percent against a basket of international currencies in a move that gave up the previous two weeks advances; the dollar slid as concerns over a Greek default were said to be waning by the major media outlets. On the international investing front, the best return for last week was found in South America, with the Brazilian Sao Paulo BOVESPA Index increasing by 2.71 percent. Globally, the worst-performing index was in China, with the Shanghai Composite Index decreasing by 5.20 percent. The VIX declined by 8.32 percent for the week and now sits at the low end of the short term trading range as indicated by the daily chart of the VIX during the month of May below:



For the trading week ending on 5/27/11, returns in FSI's models were as follows:

	<u>Last Week</u>	<u>YTD</u>	<u>Since 12/31/07</u>
Aggressive Model	0.85 %	-2.19 %	-2.96 %
Growth Model	0.58 %	-1.95 %	-0.51 %
Moderate Model	0.22 %	-1.22 %	3.02 %
Income Model	0.22 %	0.88 %	(Insufficient Data)
S&P 500 (benchmark)	-0.16 %	5.84 %	-9.35 %

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

Economic News: As mentioned above, most of the news that was released last week was negative about the economic recovery. Last week kicked off on Tuesday with the strongest release of the week, the new home sales figure for the month of April, which indicated 323,000 homes sold during the month topping market expectations of 300,000. While this figure seems strong it should be cautioned that the data is a bit stale and that with the weather issues that have been occurring in the Midwest we could see a dramatic drop-off in the coming months. On Wednesday, the 25th, durable goods orders for the month of April were released and came in much worse than expected. The market had been looking for a decline of two percent but instead the release showed a decline of 3.6 percent for overall durable goods and a decline of 1.5 percent when transportation was taken out of the equation. These two releases seem to be indicating that spending, at least on big ticket items, is starting to be hurt by higher costs on other items such as food and fuel. Crude oil inventories were also released on Wednesday but they were in line with market expectations and therefore a non market moving event. On Thursday, perhaps the largest economic news release of the week was released, the second estimate of GDP in the US for the first quarter of 2011. The announcement missed market expectations of an increase of two tenths of a percent but it remained the same as the first estimate. Following the semi disappointing news about GDP, the initial jobless claims were shown to be higher than expected during the previous week (424,000 versus expectations of 400,000) adding to the market decline. In the end, on Thursday the market launch a bit of a rally throughout the day after the rough start and ended the day higher than it had opened. Wrapping up the week on Friday were numerous economic news releases that started with personal income and spending for the month of April. Both personal income and spending were shown to have increased by 0.4 percent during the month, which would normally be viewed as a positive development, but when the numbers were more closely examined the spending side of the equation was shown to have all been due to rising costs of fuel and food, which somewhat negated what would have otherwise been viewed as positive. Later in the day PCE Prices for the month of April were released and they came in exactly in-line with market expectations with a 0.2 percent increase during the month. Still later in the day on Friday the University of Michigan Consumer Sentiment Index for the month of May was released and showed an increase which seems to be at odds with other reports about consumer confidence which seem to be on the decline. Wrapping up the week was the pending home sales figures for the month of April which showed a much stronger drop than was expected -11.6 percent versus expectations of -1.4 percent. With this negative data about the housing market some questioned the better than expected numbers earlier in the week from new home sales for the same period; we will have to wait and see if a trend starts or if the changes in the data are just noise.

This week is a pretty full week for economic news releases since it is a shortened trading week for the markets due to the Memorial Day holiday on Monday. The week starts off on Tuesday with the release of the Case-Shiller 20 City Home price index, which is expected to register a 3.7 percent decline during the month of March. This data is so stale that unless the reading is very far from the expected value, it will not be a market moving release. Later in the day on Tuesday there are two more releases that could potentially have an impact on the overall market; the Chicago PMI and the consumer confidence Index (both for the month of May). The Chicago PMI will be watched closely after conflicting data has been released by various regions of the country over the past few weeks. If the data indicates a slowdown greater than what is expected, we could see a move lower for the broad markets. Consumer Confidence is something that is very hard to measure but also something that is very closely watched by many on Wall Street so the release on Tuesday has the potential to move the market, expectations are for no change over the April level. On Wednesday, June 1st, the ADP Employment change figure for the month of May as well as the Challenger Job cuts report and the ISM Index are all released. Currently the market is looking for positive figures from both of the employment related figures and a slight decline in the ISM Index, but not enough of a decline to cause alarm. Later in the day, on Wednesday, construction spending and auto sales are set to be released with an expected contraction in construction spending and strong auto sales thanks in large part to the sales of smaller more fuel efficient vehicles. On Thursday the standard weekly jobs related figures both initial and continuing jobless claims are set to be released with expectations that both will be better than last week's figures. Also released on Thursday is the revised Productivity figure for the US during the first quarter of 2011 but with no expected change to the previously released figure it should be a non market moving release. Wrapping up the day on Thursday is the release of factory orders for the month of April, which are expected to show a slight decline of one percent compared to the March reading of a 3.4 percent increase. Friday is all about employment figures with the government releasing their official unemployment rate for the US for the month of May along with both nonfarm payrolls and nonfarm private payrolls. The market is currently looking for slightly worse figures out of the payrolls data when compared to April's figures but not enough to push the unemployment rate higher than the current level of 9.0 percent. The potentially market moving aspect of the releases is going to be if the unemployment rate ticks up by even one tenth of a percent, this combined with the recent negative economic developments could turn into enough reason for the markets to move lower.

Have a great week,
Peter Johnson

Feel free to forward this email.

Financially Speaking, Inc
5889 Greenwood Plaza Blvd., Suite 400
Greenwood Village, CO 80111
Telephone 303.290.0702
Toll Free 800.228.9876
Fax 303.290.6581

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