



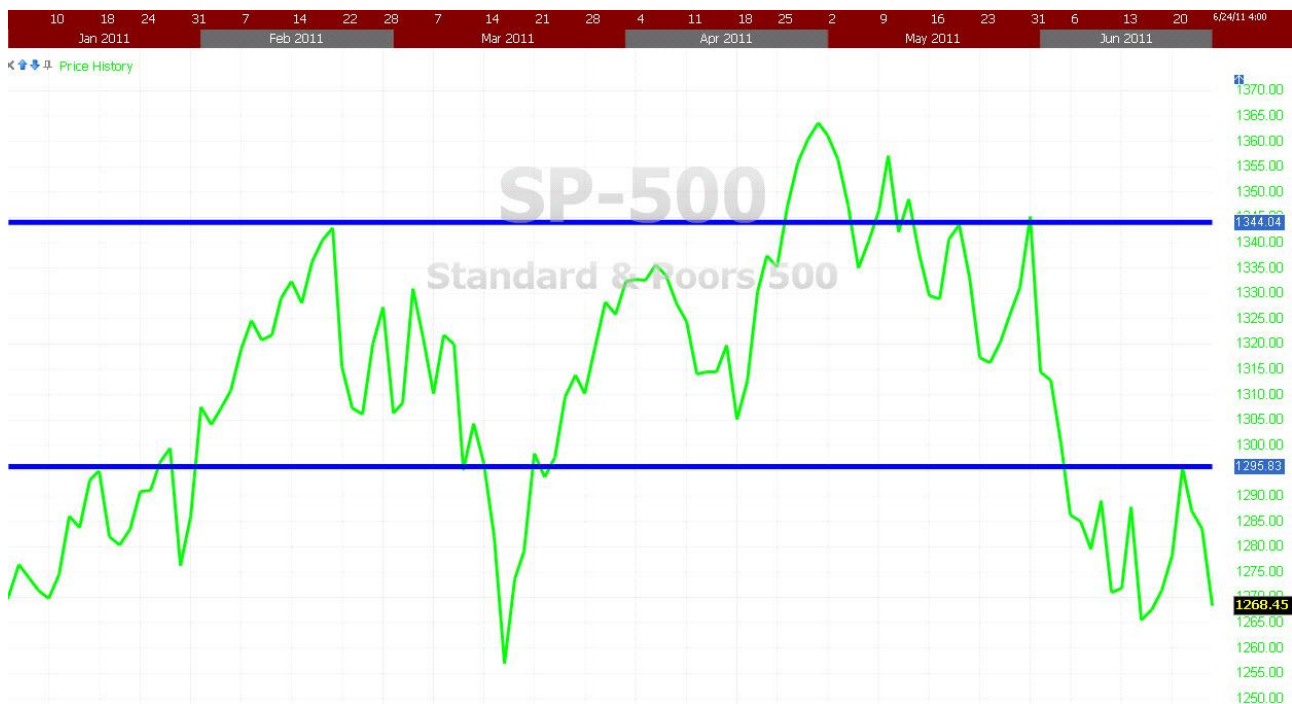
Weekly Market Analysis

June 27th, 2011

Market Wrap-Up: Last week political events largely drove world financial market movements, with the first major event occurring in Greece with the vote of confidence for Prime Minister George Papandreou, which occurred Tuesday evening in the US but well after midnight local time in Athens. The vote in Greece was very close with the final tally being 155 for Papandreou, 143 against and 2 abstentions; he needed a simple majority of 151 to remain in office. With Papandreou surviving the vote, the world financial markets reacted very positively as the austerity measures that Greece needs to implement survived to fight yet another day. Had there been a vote of no confidence, Greece would likely have defaulted on their debt as the opposition party is not in favor of accepting the EU and IMF bailout funds. The next major hurdles in the Greek saga will be met on Wednesday and Thursday of this week when the austerity plan is actually voted on and implementation of the plan is granted. While many expected the PM to survive the confidence vote because of his party's small majority in parliament, the austerity plan is much less certain. Many member of Papandreou's own party are not in favor of the plan, including many top officials who have resigned in recent weeks (not the least of which is the cabinet member who designed the plan). If the plan is not accepted, the Greeks must come up with something fairly quickly, as they will be in desperate need of funds by the middle of July and, unlike the US, they do not have a treasury department that can keep their financial system on life support. Throughout all of this turmoil, there have been two very distinct sides to the battle in Greece: the politicians who seem willing to take the bailout money in order to try to fix many years of financial mismanagement, and the people who seem to be growing more and more impatient with the whole process and are now calling for no austerity measures and for Greece to default on their loans. With many citizens not wanting anything to do with the bailout and seemingly willing to allow a default and possibly even a departure from the Euro as their home currency, the main question is, why are the politicians still trying to pass austerity measures to qualify for further aid? Why is the Euro zone so adamant that Greece be bailed out? Contagion is the main reason for the staunch stance that the EU and the IMF are taking. While Greece is a very small piece of the overall Euro zone, there is a lot of uncertainty as to what would happen to other peripheral members of the Euro zone should Greece default and/or abandon the common currency. The rating agencies have already downgraded numerous countries' sovereign debt ratings such as Ireland and Portugal, while at the same time they have taken individual shots at banks in many other European countries, the latest of which is a number of Italian banks. One of the further unknowns in the whole situation is who owns much of the Greek debt that would be affected in the event of a default and how many banks have derivatives that would be adversely affected. While a Greek default is highly unlikely to have the same impact as the Russian default back in the 1998 (the same default that took out many prominent financial firms such as Long Term Capital Management), it cannot be ruled out that a default by Greece could have very wide-reaching ramifications.

The second major event of the week was the release of oil from the strategic oil reserves of 28 countries around the world, with half of the total release coming from the US. Under the guise of adding back the oil supply that has been cutoff since the Libyan crisis started, the world community decided to release 60 million barrels of oil at a rate of 2 million barrels per day for the next 30 days. Immediately, many people were skeptical that the move was an entirely political attempt to lower gas prices because the US did not get oil from Libya. Before the conflict, Libya pumped and exported 1.5 million barrels of oil per day, primarily to southern Europe. With such a drastic and unforeseen action taking place, oil immediately fell by nearly five percent sending many commodity traders scrambling to cover some of their trades. Some of the lingering questions are: “Will the oil released really impact the price of gas at the pump?” and “If so, will any money saved at the pump be put back into the economy?” Having the money make it back into the economy is the key as the US economy needs a bit of a lift to keep the recovery moving forward. The other unknown in the oil release is what actions, if any, OPEC will take in response. Will they cut production to increase oil prices? Will they increase production like many thought they would at their last meeting when they decided to leave production the same? Only time will answer these questions and show if the highly unusual release of the strategic petroleum reserves will positively or negatively impact the world economy.

For the week, the US markets turned in a mixed performance with two of the three major indexes moving lower for the week. As can be seen in the chart below, the S&P 500 (green line) rallied through the first part of last week and then moved lower quickly during the last part of the week after bouncing off of the previous level of support (blue line). For now, the market looks as though it is creating a new trading range; we would need to see it either break above the lower level of resistance or fall below the previous low back in March for us to say that it has broken out of its trading range. Either direction seems possible with the wide trading ranges we have seen recently.



International Politics: As mentioned above, international politics focused last week on the situation in Greece and the actions that were taken. However, there was further discussion around the world about China, which is experiencing a bit of a slowdown in relative terms for them (they are now expecting 9.3 percent instead of the 30 years annual average of 10 percent), a potential housing bubble, government intervention in the markets and very persistent inflation. Some people have begun to call for an end to China's attempt to counteract inflation in the ways that they have tried before (raising reserve requirements and interest rates) out of concern that they are not actually working. Adding to uncertainty is the fact that many economists and investors around the world do not want China to reverse the recent monetary moves hastily as they had to do back in 2008 when they applied the brakes too hard to their economy. A contraction in the Chinese economy would be felt throughout the world as they have become such a dominant supplier of goods and large user of commodities. A good amount of recent commodity volatility can be tied back to China with speculators guessing the quantity of the commodities China will use in the future. China is also getting more involved with the European situation, recently announcing that they will back European countries through the purchase of their debt in the future. Elsewhere in the world, the Libyan conflict now looks as though it may come to an end relatively shortly as there are more and more rumors that Gaddafi is thinking about leaving the country. Should Gaddafi decide to leave the country, the question becomes how fast the new government can get the oil wells back on line and shipping oil so that they can start to receive some much needed cash. Another question for the region is: Does the end of the Libyan situation put pressure on other countries in the region that are experiencing unrest and, if so, is it enough to make them change their current courses of action?

National Politics: National politics primarily focused once again on the debt ceiling during the last week but there were a few other very interesting votes during the week. The House rejected a bill that would have authorized an ongoing military campaign in Libya for another year, and just a little while after that vote, a bill came up that would have cut off funding for the mission but failed to pass the house. The big question that law makers are turning into a political football is if the US should be involved in the NATO mission in Libya at all. Republicans mostly say that it is a NATO mission and they do not want the US to foot the bill for 80 percent of it, while Democrats stand behind the President's decision to get involved. This costly conflict comes on the heels of very costly engagements in Iraq and Afghanistan, and is the heart of what many Americans think should have funding cut in order to reduce spending. In short, politicians are just adding fuel to the fire—the debt ceiling debate—by tying in the budget, domestic spending and military spending. So far, the tactic has worked, with very little progress being made on lifting the debt ceiling because of constant bickering about other smaller items. Elsewhere in national politics, Federal Reserve Chairman Ben Bernanke made headlines this week with his press conference that was held on Wednesday after the announcement of the Federal Reserve's interest rate decision. While he said nothing new about what the Fed plans to do after the expiration of QE2, some investors got a little spooked by the amount of frustration that was shown in the statement about the slow economic recovery in which we seem to be stuck. More information about the press conference and statement can be found in the economic news section below.

Market Statistics: Last week's three major US indexes performed opposite from how they did two weeks ago. The Nasdaq (the lowest performer two weeks ago) turned in the top performance last week, advancing by 1.39 percent, while the more broadly based S&P 500 experienced a decline of 0.24 percent and the mainly blue-chip stock Dow suffered a 0.58 percent decline. The best-performing sector of the markets was the US Home Construction Sector for the second week in a row after advancing 3 percent, thanks to solid housing numbers from both existing and new home

sales. The worst-performing sector of the US market was the regional banking sector, which declined 3.02 percent. Commodities tumbled thanks to the unexpected release of the strategic petroleum reserve, decreasing by 2.99 percent overall, oil dropping by 2.32. The precious metals did not fare much better with gold declining by 2.45 percent, silver sliding by 4.55 percent and copper bucking the trend strongly, advancing by 1.47 percent. After such a drastic move down in the price of oil on Thursday, the overall energy sector saw a weekly decline of 1.41 percent. In light of the ongoing uncertainty surrounding the situation in Greece, the US dollar saw a nice gain last week advancing by 0.84 percent against a basket of international currencies. On the international investing front, the best return for last week was found in China, with the Shanghai Index increasing by 4.40 percent. Globally, the worst-performing index was in Sweden with the Stockholm 30 Index declining by 2.60 percent. Last week the VIX actually moved down, this due in large part to the strong rally that we saw in the market on Tuesday (a rally lowers the VIX), more than compensating for the increase it experienced during the later part of the week. With the VIX only pulling back by 3.34 percent for the week, we remain at an elevated level. This level warrants caution, as the volatility in the market will likely be heightened as we draw closer to August 2nd, the date that the Department of Treasury has laid out as the last day that they will be able to self-fund the government and put off default.

For the trading week ending on 6/24/11, returns in FSI's models were as follows:

	<u>Last Week</u>	<u>YTD</u>	<u>Since 12/31/07</u>
Aggressive Model	0.06 %	-5.16 %	-5.91 %
Growth Model	0.04 %	-4.33 %	-2.92 %
Moderate Model	0.09 %	-2.74 %	1.43 %
Income Model	0.11 %	-0.77 %	(Insufficient Data)
S&P 500 (benchmark)	-0.20 %	0.86 %	-13.61 %

We made no changes to our models over the course of the week. Our triggers that would indicate that we need to sell our positions to cash have yet to trip, but we have moved pretty close to them. In the event that the triggers do trip, we will sell our positions that do not have a penalty for doing so and hedging the positions that we cannot sell due to two percent redemption penalties. Until the triggers are reached, our models will remain invested in an attempt to participate in the upward movements of the markets while at the same time not participating fully in the short-term downturns.

Economic News: Last week was slow for economic news releases, but that did not stop a few of the releases from having a fairly large impact on the overall market. The week started out on Tuesday with the release of the existing home sales figure for the month of May, which came in slightly better than expected at 4,810,000 homes sold during the month but lower than the level seen in April when 5,000,000 homes were sold. On Wednesday the 22nd the FHFA Housing Prices Index for the month of April was released and indicated that housing prices increased by 0.8 percent during the month, which was slightly better than expected. Later in the day on Wednesday the FOMC released their interest rate decision as well as a statement and Chairman Bernanke held a press conference to take questions from the media. The decision to leave rates where they currently are was no surprise to anyone that has been watching the fed, but the Fed's statement did hold some new language. The new language expressed surprise and frustration as to how slowly the economic recovery is moving. This coupled with the end of QE2 led some investors to turn negative about the

economy and pushed stocks lower. The question-and-answer press conference with the chairman did not hold any new information, and he did reiterate that rates will probably stay low for an extended period of time (meaning at least two or three more meetings). Items that were cited as issues for the economic recovery included manufacturing, unemployment, housing and higher commodity costs. There was no hint of new information about what comes after QE2 as some market participants had been hoping. On Thursday morning the standard weekly jobs-related figures were released with both missing expectations to the high side. Initial jobless claims came in at 429,000 while expectations were set for a slight decline from last week's 420,000 down to 413,000 this week. Continuing jobless claims came in at 3.697 million while the market was looking for 3.680 million and the previous week's level was 3.698 million. On Friday one of the large economic news releases came out: the third estimate of first quarter GDP for the US. The estimate was for 1.8 percent or no change over the second revision, but the market was a little surprised to see that the figure was increase by a tenth of a percent up to 1.9 percent for the quarter. While this is a positive release, the market had very little reaction to the news as the information is very stale. Wrapping up the day and week on Friday was the release of durable goods orders for the month of May, which beat market expectations at 1.9 percent, 0.4 percent above market expectations. Overall, it seemed to be a bit of a mixed week for economic news releases, but the market largely ignored the releases and focused on events occurring across the pond.

For this first full week of summer, there is very little economic news that is set for release that has the potential to move the market either up or down. The week starts off on Monday with the release of personal income and spending for the month of May. Personal income is expected to have risen by 0.4 percent while spending is expected to have increased by 0.1 percent. It would take a major dislocation from market expectations to really get the market to move on these two releases, but if spending were to show a contraction (a negative number), that would be a very negative sign for the economy. Released at the same time as personal income and spending is the PCE price index for the month of May as well and it is expected to show an increase in prices of 0.2 percent, which is not high enough to worry about inflation. However if the reading misses to the high side, some economists may start to speak more loudly about the adverse effects of inflation on the US economy and the need to raise interest rates in order to head it off. On Tuesday the 28th the Case-Shiller 20-city home-price index for the month of April is set for release with expectations of a 3.9 percent year-over-year decline having occurred during the month. While a negative number is a bad sign for the housing market, the figure is so stale that it should have little overall effect on the market. Later in the day on Tuesday, the Consumer Confidence Index for the month of June is set to be released with expectations of no change over the level seen in May. Pending home sales for the month of May and Crude inventories for the previous week are the only two releases on Wednesday and they should be non events as it is hard to see how either of these figures could miss expectations by enough to move the market. On Thursday, the standard weekly employment-related figures for the previous week are set to be released with expectation of initial jobless claims having decreased by 8,000 while continuing jobless claims are expected to have increased by 3,000. Later in the day on Thursday the Chicago PMI for the month of June is set for release with the market watching this release very closely for signs of continued manufacturing weakness that we have been seeing trickle out of various federal reserve banks over the past few weeks. This release is expected to come in at 53.8 (the May reading was 56.6), but if this misses and comes in below 50, it would be taken as a major warning sign for the economy. On Friday, the first day of July, the University of Michigan consumer sentiment index for the month of June is set to be released with expectations of no change. The market is expecting that the decrease in prices at the pump will more than offset the pinch that US consumers are feeling in other parts of their lives. Later in the day on Friday the ISM

Index for the month of June is being released as well as construction spending for the month of May. If construction spending goes the same way that other recent releases regarding housing have gone, we could be in for a bit of a surprise increase, which should give housing a little bit more of a boost. Wrapping up the week on Friday is the release of auto and truck sales for the month of June which are both expected to have decreased as consumers have pulled back on big ticket purchases until they determine that the economic recovery in the US is likely to continue.

Have a great week,
Peter Johnson

Feel free to forward this email.

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