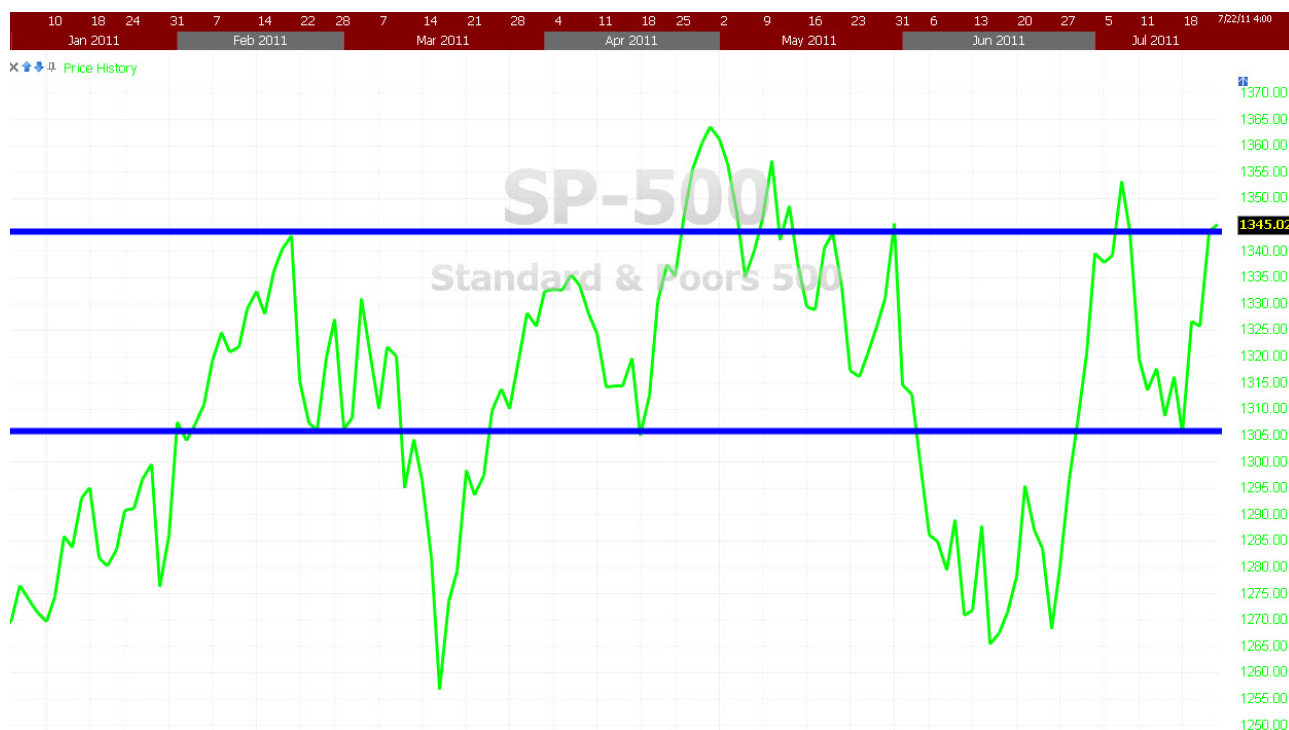




Weekly Market Analysis

July 25th, 2011

Market Wrap-Up: In continued volatility last week the S&P 500 moved back up to the higher end of its trading range as investors rallied around a debt ceiling deal that ultimately fell apart late on Friday night. The chart below depicts the move back to the upper end of the trading range (trading range in blue, S&P 500's daily performance in green):



After seeing the fourth hard chop by the S&P 500 in the last two months, many investors have come to realize that the market really is not going anywhere in a hurry and, more importantly, it is taking the looming debt ceiling deadline in stride. Couple the debt ceiling debate with what is happening in Europe and very few people thought that the market would be holding up as well as it has. Some people point out that earnings have been good on the whole for second quarter 2011, others point to a variety of factors that indicate that the August 2nd deadline for the department of Treasury may be early. One of the main reasons for thinking that the August 2nd deadline may just be a ploy is that, according to some analyst's, tax receipts by the department of treasury have been unexpectedly strong over the past few months and the initial projections that showed August 2nd as the firm deadline were based on average collections. If there was more money taken in than expected, then the Treasury, in theory, would have more money to keep paying the bills for a short period of time. The best guess from analysts who are behind the theory is that the actual date of default is somewhere near August 10th. There has been no word from Treasury Secretary Tim Geithner on the subject, but if the markets really start to experience high levels of volatility as we inch closer to the August 2nd deadline we may see some type of announcement of the deadline being extended. If

members of Congress know that the August 2nd deadline is not the drop-dead date, it may explain why both parties still seem to be trying to get their own plans through instead of working together on an overall comprehensive plan. With the current market environment, our new models are performing as expected; not taking a large portion of the downside risk at the expense of not gaining as much as the markets when they move higher. Once a clear direction emerges in the market, we will adjust our models accordingly; if the direction is down, we will sell positions and move toward the relative safety of cash. On the other hand, if the direction is upward, we will adjust the equity positions that we hold in order to overweight equities and participate fully in the upside potential of the markets. The changes will be most noticeable on the more aggressive end of our models, as that is where we have pulled in the horns the most due to the recent volatility.

International Politics: International politics focused once again on the Euro zone for much of last week as an emergency session of European leaders seems to have finally hammered out a plan for what to do with Greece. While the plan is very convoluted and how everything will actually work is yet to be seen, the basics of the plan are as follows:

\$157 billion in total bailout money to Greece

\$49 billion—Traditional bailout cash (freebie money)

\$29 billion—Cash to buy back Greece bonds

\$50 billion—Bond Swaps and Rollovers (this is what is going to cause a default)

\$29 billion—Greek Bank recapitalization cash (cash to fix the repercussions of the plan)

Overall, the world's financial markets appeared to like this latest plan because the day it was announced all world markets moved higher. The puzzling aspect to this plan is that there is no way that Greece will avoid default on their debts; even if it is a selective default, it is still a default. The bond swap and roll back part of the plan is where the problem lies as there will need to be a 21 percent write down of Greece debt. The interest rate on the existing debt will also be lowered by approximately two percent and the maturities of the existing debt will be extended many years. This is the sharing of the pain and/or haircut that many politicians have been talking about for the past few weeks. One key that the plan seems to be missing is long-term changes to the Greek debt issues so that Greece does not just end up in the same problems again in a year or two. With the announcement of the plan, the rating agencies made all kinds of announcements at the end of the week and over the weekend; some further downgraded Greece debt, while others said that a default is now certain in Greece. Despite the mess that continues to unfold, the European debt markets took the plan as a very good thing and pushed the yields on other troubled countries, most notably Spain and Italy, down to below six percent on their ten-year bonds. This reigning in of the contagion fears is ultimately what this second bailout for Greece is all about, but it remains to be seen if it will have the desired effect in the long term. In other international politics, the voices from the international community keep getting louder with calls for the US to put aside their party differences and come up with a debt ceiling plan before a US default has a large impact on the global economy. One of the main concerns that leaders at the IMF are voicing is that no one knows what effect a default by the United States and/or a downgrade of our debt would have on the international markets as it has never happened before. Already we have seen some countries that hold a lot of US debt come forward and say publically that they would not be forced to sell their US treasury holdings if there were a downgrade in the sovereign debt rating, but there are still many key countries that have not made such a statement.

National Politics: National politics continued to focus on raising the debt ceiling last week, which will continue until something is decided. There was a lot of excitement in the market during the week that a deal was very close to being struck between President Obama and House Speaker Boehner, and up until the market closed on Friday it looked like things were going pretty well. Then late Friday evening, Speaker Boehner walked away from the talks saying that they were still very far apart. The President, immediately after Boehner walked away, held a very rushed press conference at the White House at which viewers could tell that he was very angry. The political leaders reconvened on Saturday morning at the White House, but the long hours of meeting over the weekend ultimately bared no fruit. With the Asian markets open and moving lower Sunday night in the US, many politicians were looking to the US futures market for indications of just what the immediate repercussions of no deal being made might have on the US markets. The US markets opened the day on Monday down about one percent but, at the time of of this writing, were fighting their way back up from the lower levels with the NASDAQ even making it into positive territory for the day. While anything can happen at the end of the day, so far today (Monday) looks pretty bullish as the market did not fall apart. Seeing that the market did not take the proverbial nose dive may be exactly what some members of Congress wanted to see as a way of reassuring themselves that the debt ceiling debate is not as big as it has been talked up to be by the Federal Reserve Chairman and the Secretary of the Treasury. I think that ultimately the members of Congress that think this way will be proven wrong and see that the debt ceiling is, in fact, a very important issue that they need to take very seriously. A sharp market correction may be exactly what is needed for politicians to realize that this debate is not something to be taken lightly. Right now, both sides have decided to come up with their own plans for how to fix the debt ceiling and the budget, and chances are that the two plans will be very different and achieve very different goals. President Obama has indicated that he will veto any short-term deal that either party comes up with, but the Republicans are still moving ahead with a two step deal that would involve both a short and long term deal. In the end, both sides will have to give a little from their current stances or nothing will be accomplished. As the debate draws on the stock market in the US, we will probably see very wide swings in returns as portions of plans are leaked and the market reacts either positively or negative to them. Virtually all other national political news is on hold pending the outcome of the debt ceiling debate.

Market Statistics: In keeping with the theme of many market reversals, last week saw the US markets increase in value to roughly where they were prior to the decline of two weeks ago. The NASDAQ performed best of the indexes last week, advancing by 2.47 percent. The NASDAQ normally sees the most magnified market movements as it is the index that runs the highest beta. The second-best performance was the broadly based S&P 500, which increased 2.19 percent during the week on strong earnings announcements. Bringing up the rear this week was the Dow, which increased by 1.61 percent. Not surprisingly, the best-performing sector of the markets was the technology-related semiconductor sector of the market, which advanced by 5.15 percent. The worst-performing equity sector of the US market was Telecommunications, which advanced 0.16 percent. Commodities advanced strongly for the third week in a row, gaining 1.41 percent overall for the week. Overall, the energy sector increased by 3.34 percent, with oil advancing by 2.21 percent. Precious metals had a decent week, with silver increasing by 2.17 percent and gold increasing by 0.59 percent as market participants continued to watch retail investor put on the “scare trades.” Gold crossed over the \$1,600 level for the first time as investors remain wary about the overall health of the US markets. Copper was a bit of a laggard this week, declining by 0.10 percent as the overall global recovery was being questioned in light of a possible US default. With all of the uncertainty surrounding the debt ceiling debate, the US dollar fell like a rock last week, declining by 1.40

percent against a basket of international currencies. On the international investing front, the best return was found in France with the CAC-40 Index advancing by 3.12 percent. Globally, the worst-performing index was in China with the Shanghai Se Composite Index declining by 1.94 percent. With the debt ceiling debate seemingly less worrisome to every day investors, the VIX dropped back by about ten percent last week. The VIX now sits right in the middle of its recent trading range and indicates that a move of about five percent either up or down from current levels will likely occur in the next 30 days.

For the trading week ending on 7/22/11, returns in FSI's models were as follows:

	<u>Last Week</u>	<u>YTD</u>	<u>Since 12/31/07</u>
Aggressive Model	0.15 %	-2.61 %	-3.38 %
Growth Model	0.14 %	-2.30 %	-0.86 %
Moderate Model	0.11 %	-1.68 %	2.54 %
Income Model	0.13 %	0.09 %	(Insufficient Data)
S&P 500 (benchmark)	2.23 %	6.95 %	-8.40 %

We made only one change in a few of our models over the course of last week and that was to sell a small portion of our holding in Sierra Core Retirement Fund (SIRIX). We made the sell so that we have cash on hand to purchase an ETF during market hours should we need to invest quickly as the debt ceiling debate draws on. As you can see from the above performance last week, we remain cautious as there are many geopolitical uncertainties moving forward. If you have any questions or concerns about the model in which you are invested or what to expect from the models in a volatile market, please feel free to call our office.

Economic News: Last week was, on the whole, slow for economic news releases, but the lack of releases was made up for by the number of companies that reported second quarter earnings figures. Earnings season is, indeed, in full swing with a large percentage of the S&P 500 as well as the other major indexes reporting earnings either last week or this week. Overall the earnings have been strong with the number of announcements that either met or exceeded market expectations outnumbering those that did not by a three-to-one margin. One of the more noticeable earnings surprises to the positive side was that of Apple, which exceeded market expectations by more than 33 percent. Other well known companies that beat expectations included: American Express, Coca Cola, Abbott Labs, Wynn Resorts, F5 Networks, eBay, US Bank, Johnson and Johnson, Wells Fargo, AT&T, and Microsoft. One of the more noticeable companies that did not meet its earnings expectation was Goldman Sachs, which missed the mark by more than 18 percent. Other companies that missed earnings expectations throughout the week included: Chipotle, TD Ameritrade, Hasbro, American Airlines, Sherwin-Williams, Honeywell and Caterpillar. For the standard scheduled economic news releases, the week kicked off on Monday with the release of the NAHB Housing Market Index for the month of July, which came in slightly better than expected at 15 rather than the expected 14. On Tuesday the 19th more positive housing-related information was released, that being the housing starts and building permits figures for the month of June. Both beat market expectations, with housing starts coming in 10 percent higher than expected while permits surprised the street by about three percent. These housing-related figures seem to point to positive things materializing in the US housing market—something many people have been waiting a long time to see. On Wednesday the housing related data was mixed, with existing home sales coming in lower than expected but the MBA Mortgage index coming in stronger than expected. The releases neutralized each other. On Thursday the standard weekly jobs-related figures were both released,

with initial jobless claims coming in slightly higher than expected and continuing claims coming in as expected. While the initial jobless claims figure missed expectations, it did not miss by a large amount and stayed near the psychological level of 400,000 with the current reading of 418,000. One of the larger surprises of the week was held in the Philadelphia Federal Reserve's release on Thursday that showed an uptick in business activity in their region. Expectations had been for the release to show no growth in the region with a reading of zero but, instead, the reading was shown to be +3.20, indicating an economic expansion in the region.

This week is, once again, a pretty slow one for economic news releases, but a few of the releases that are set to be announced could greatly impact the markets. The week starts off on Tuesday with the release of the Case-Shiller 20 city Home Price Index for the month of May, which is expected to show a year-over-year decline in home prices of 4.4 percent. This is a release from which we could see a surprise better reading if last week's releases about housing are any early indication. Later in the day on Tuesday, the consumer confidence index for the month of July is set for release, with expectations that confidence has fallen slightly during the month as uncertainty about the debt ceiling continues to drag on. Wrapping up Tuesday is the release of new home sales for the month of June, which is expected to be little changed when compared to the level seen in May. On Wednesday the 27th durable goods orders for the month of June are set to be released, with expectations of a positive 0.5 percent change during the month; this release seems a little bit overly optimistic, meaning we could see a bit of a negative reaction by the market if we do not see the 0.5 percent increase as expected. Near the end of trading on Wednesday, the Fed's Beige Book is set to be released and, as usual, this should be a non market moving event. On Thursday the weekly jobs-related figures are set for release, with expectations that both declined by the slightest amount during last week. Later on Thursday, the pending home sales figure for the month of June is set to be released. Expectations on this release are a little bit bearish, with the common figure being a decline in sales of about three percent. On Friday, the last trading day in July, the advanced GDP figure put out by the US government for the GDP growth rate during the second quarter of 2011 is set to be released. While this release is very important, it is only an advanced figure and is prone to be corrected later on, in some cases by very large amounts. Later in the day on Friday, the Chicago PMI for the month of July is set to be released, with hopes of only a slight decline from 61.1 down to 58.0. Wrapping up the day and week on Friday is the University of Michigan Consumer Sentiment Index for the month of July, which is expected to show that the US consumer sentiment was unchanged during the month. Overall this week, the market moving events will come from the unscheduled announcements more than the scheduled.

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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