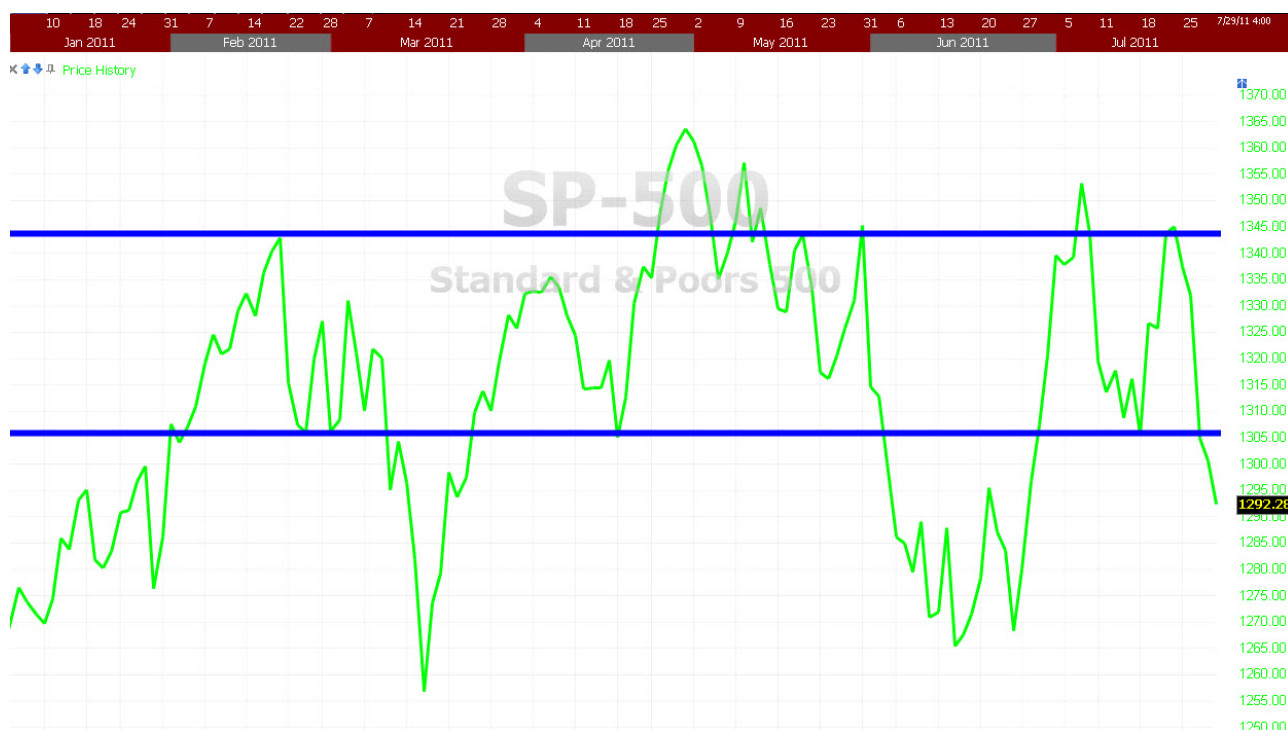




Weekly Market Analysis

August 1st, 2011

Market Wrap-Up: The rally that took the S&P 500 back up to the very upper edge of its recent trading range two short weeks ago quickly faded last week with the S&P plummeting back to and through the lower end of its trading range. As the chart below depicts, last week's reversal was very quick and unforgiving (trading range in blue, S&P 500's daily performance in green):



Does this recent turn in the markets mean that it will fall over the coming week? No, it does not. The reversal last week was really just a movement that is expected when volatility increases as much as it has recently and there is so much political risk. Last week was not a major anomaly; it was the worst week of 2011 for the S&P 500 from a Monday to Friday point of view, but it was only the third worst five day period so far this year. We will probably see the US markets bounce back once Congress passes a debt ceiling bill and signs it into law, even if it happens after the August 2nd deadline. The bigger concern, and something that very few people are talking about, is whether the US economy can stay on the road to recovery. The data that came out over the course of last week was very concerning, with the most concerning aspect being the revision to the GDP figure from the first quarter of 2011, a figure that had been released and revised several times before. The figure prior to the latest revision was that the US experienced GDP growth of 1.9 percent during the first quarter of 2011, but this figure was knocked all of the way down to 0.4 percent with the revision. With the figure being so close to the level that indicates that the economic

expansion is actually contracting (zero is the inflection point between economic expansion and contraction), many economists are becoming concerned that we could slip back into a technical recession. Some argue that the US economy has not been in very good shape over the last few years and that it was only the life support that kept things moving higher, life support from the Fed that has now either ended or will be ending very soon. Unemployment remains a major concern for many, as we are still over 9 percent with no real indications that it will move below 9 any time soon. In light of all the turbulence, we remain invested very cautiously and have made changes to our models to lower overall volatility and increase the safety of models. The current market is not one to try to make a lot of money in; it is a market that is much more conducive to wealth preservation.

International Politics: International politics were largely quiet last week, or at least it seemed like it with the all of the tumult in the political system in the US. There was one development that potentially could impact the global economy: a report that was put out by the IMF in the middle of the week. The report took aim at France, one of the two recent pillars of the European Union, and called into question France's own austerity measures as well as its budget targets. France has long been known as one of the weaker fiscal countries to maintain a AAA rating with its debt to GDA percent running higher than all of the other AAA rated countries at approximately 84 percent. With the IMF actually mentioning that France could face a downgrade of their AAA rating, the world markets took notice and headed lower. If France runs into financial trouble it could prove disastrous for the EU as a whole because that would leave the majority of the economic rebuilding that needs to be done to Germany. In Asia the main focus was on what will happen in the US since many Asian countries hold a lot of the reserves in US treasuries.

National Politics: National politics continued to focus on raising the debt ceiling last week, which remains to be solved completely. The week started off with both parties trying to come up with their individual plans for dealing with the debt ceiling. The problem was that both sides knew that there was virtually no way that the other side would go along with their plan. During the week, we saw the Speaker of the House John Boehner lose control of his own party and have to delay a scheduled vote on his own bill while freshman Republicans needed a bit more convincing. After a now famous "Get your ass in line" quote from the speaker and a lot of wrangling, the bill did barely pass the House in a vote that took place late on Friday. Within hours of passing the House, the bill was killed in the US Senate, as was expected. With the House's bill killed, Senate Majority Leader Harry Reid quickly got to work on his own bill. After many sleepless hours for many people in Washington, D.C., a bill finally did emerge for a vote in the Senate but did not garner enough votes to pass with even the bill's main architect, Harry Reid, voting against it in the end. The bill was voted down so that quick action could be taken on an agreement that was reached between party leaders from both the House and the Senate and the President. On Sunday evening President Obama announced to the world that a deal had been struck and that it would save the US from default on August 2nd. With the news that a deal was done, the world markets that were open at the time shot up higher, but reality seems to be settling in on the markets in the US a little bit more as they quickly turned negative in early trading on Monday. The reason for the reversal is mainly due to continued uncertainty surrounding the debt ceiling debate. With several Senators unhappy about the deal that has been struck, they have the ability to filibuster the bill; the only way to end the filibuster would be to garner a 60 vote count for the bill, something that looks as though it could be very hard for the leaders in the Senate to deliver. Over in the House, both parties are trying to reel in their constituents and get them to vote for the new deal, but many are questioning many aspects of the bill. Even House Minority Leader Nancy Pelosi commented, calling the bill "very disconcerting." I

will have a review of what is in the bill once something actually passes, because right now it seems that most of the bill is still up for debate; as is normally the case in Washington, D.C., nothing is done until all of the votes have been counted and the President has signed the bill into law.

Market Statistics: In keeping with the theme of many market reversals, last week saw the US markets decrease in value to below where they were prior to the advance of two weeks ago. The NASDAQ performed best of the indexes last week, declining by 3.58 percent. The second-best performance was the broadly based S&P 500, which decreased 3.92 percent; bringing up the rear for the second week in a row was the Dow, which decreased by 4.24 percent. The best-performing sector of the markets was real estate, which declined by 1.05 percent. Not surprisingly, the worst-performing sector of the markets was the technology-related networking sector, which declined by 8.53 percent. Fixed-income markets saw a great week with many of the fixed-income US government bond ETFs advancing by more than one percent on fears about the debt ceiling debate. With the US markets falling sharply, it was not surprising to see that Commodities declined, losing 2.41 percent overall for the week. Oil got hit very hard, dropping by 3.91 percent as global demand seems to be drying up as the US recovery is being called into question. Precious metals had a great week in relative terms compared to the equity markets; all three of the major metals benefitted from the “scare trade” being fully implemented. Copper increased by 1.57 percent while gold advanced by 1.39 percent. Silver was the lone laggard of the group, declining by 0.56 percent for the week. With all of the continued uncertainty surrounding the debt ceiling debate, the US dollar fell again this week, declining by 0.47 percent against a basket of international currencies. On the international investing front, the best return was found in Mexico with the Mexican Index advancing by 1.27 percent. Globally, the worst-performing index was in France with the CAC-40 Index declining by 4.46 percent. With the debt ceiling debate driving volatility, the VIX rocketed higher by about 44 percent last week. The VIX blew right through its previous trading range and now rests at its second highest point so far this year, second only to the spike that occurred during the onset of the Libyan crisis. The following is a daily chart of the VIX:



Performance: For the trading week ending on 8/1/11, returns in FSI's models were as follows:

	<u>Last Week</u>	<u>July 2011</u>	<u>YTD</u>	<u>Since 12/31/07</u>
Aggressive Model	-0.85 %	-0.13 %	-3.44 %	-4.20 %
Growth Model	-0.64 %	0.03 %	-2.92 %	-1.50 %
Moderate Model	-0.26 %	0.20 %	-1.94 %	2.27 %
Income Model	-0.16 %	0.20 %	-0.07 %	(Insufficient Data)
S&P 500 (benchmark)	-3.88 %	-2.15 %	2.75 %	-11.99 %

We made only one change in a few of our models last week and that was to sell our most volatile equity position, Weitz Hickory Fund (WEHIX), at the beginning of the week. We made the sale in order to lower our overall exposure to the equity markets as the volatility has continued to increase as we draw closer to the debt ceiling deadline. I added a column this week to the above table, July 2011, since the month just ended. In looking at the return numbers for the month, I thought that it would be good to show everyone a little bit more detail as to how the numbers for July were achieved. Below is another table which shows a few more details about the models (Return July 2011 is the monthly return, Max Drawdown is a peak-to-trough worst drawdown of the month calculation, Standard Deviation is a measure of volatility that the model experienced during the month—lower numbers mean less volatile than higher numbers).

Model	Return July 2011	Max Drawdown	Standard Deviation
Income Performance	0.20%	-0.53%	0.60%
Moderate Performance	0.20%	-0.54%	0.66%
Growth Performance	0.03%	-1.07%	1.32%
Aggressive Performance	-0.13%	-1.52%	1.79%
Dow Industrials Index	-2.18%	-4.57%	3.93%
S&P 500 Index	-2.15%	-4.50%	4.47%
NASDAQ Index	-0.62%	-4.05%	5.41%

As you can see from the above table, all four of our models outperformed all three of the indexes from a return standpoint and did so while experiencing a much lower maximum drawdown and standard deviation. If you have any questions about our models or know of anyone that may benefit from protecting assets in the current market environment, please feel free to call our office.

Economic News: Last week saw both positive and negative economic news releases, but the more impactful releases were tilted toward negative. The week started off on Tuesday with the release of the Case-Shiller 20 City Home Price Index for the month of May which, as expected, showed a decline of approximately 4.5 percent for the month on a year-over-year basis. This release, coupled with the lower-than-expected new home sales figure for the month of June, made many investors question the already very weak housing market in the US. Housing is a very important part of the US economy and is the item that kicked off this mess back in 2008, so it should be watched very closely for signs of weakness. Also released on Tuesday was the consumer confidence index for the month of July, beating expectations only by a small margin, and therefore not having enough strength to push the markets higher. On Wednesday the 27th, the durable goods orders figure for the

month of June became the first major release to badly miss market expectations coming in with a change of -2.1 percent while the market expected a 0.5 percent increase. The large drop off in durable goods orders was due to the transportation aspect of durable goods falling off a cliff in June when compared to May. If transportation is taken out of the figure, durable goods orders actually increased by 0.1 percent—still below the market expectation but an expansion nonetheless. The Federal Reserve will be watching all of the data points very closely but, if durable goods in particular continue to slide, they will have to step in and try to do something to reverse the trend—Cash for Clunkers Part 2 anyone? Later on Wednesday, the Fed released their beige book but, as expected, it held almost no new information, so it was a non-event. On Thursday the standard weekly jobs-related figures with both initial and continuing jobless claims were released with a pleasant surprise. The surprise came from the initial jobless claims figure which fell below the 400,000 mark down to 398,000 for the first time in many months. This was seen as a small victory because the 400,000 level is a psychological level for the markets. Continuing jobless claims did not surprise the market in a positive way as they came in worse than expected at 3,703,000, while the market expected 3,688,000. In the end, these two releases washed each other out and provided no real market movement. Later in the day on Thursday, pending home sales bucked the housing data trend from earlier in the week and came in higher than expected at a positive 2.4 percent while the market expected to see a monthly decline 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 was released to show a figure slightly below market expectations at 1.3 percent versus expectations of 1.7 percent. The real surprise was not in that figure, but in the revision that came for the previous quarter's GDP growth. The revision, as mentioned above, knocked the first quarter GDP figure from 1.9 percent all of the way down to 0.4 percent. This could be a major issue moving forward for the overall market and global economy. Later in the day on Friday, the Chicago PMI for the month of July came in as expected, as did the University of Michigan Consumer Sentiment Index for the month of July. The damage for the day was already done though, with the GDP revision having a much larger negative impact on the markets than the other two releases meeting expectations could offset.

This week is pretty light for economic news releases, but there are a few that could move the market. The week starts off with the release of the ISM Index for the month of July, with expectations set for a slight pull back off of June levels, but not enough to cause concern. Construction spending is also set to be released on Monday but it, too, is not expected to be very different from the previous month. On Tuesday August 2nd, personal income and spending for the month of June is set for release and, while the data is a bit stale, it could have a meaningful impact on the overall market if it were to miss expectations by a wide enough margin. Both income and spending are expected to show an increase of about one-tenth of a percent. Later on Tuesday, the PCE prices and auto sales figure for the month of July are set to be released. Prices are expected to have stayed relatively flat, possibly increasing by as much as 0.3 percent, while auto sales are expected to be stronger than they were in June. On Wednesday, one of the major releases of the week, the ADP Employment change figure for the month of July, is set for release and could prove to be a good indicator of what to expect from the official government unemployment report that is due out at the end of the week. Along with the ADP number factory orders for June, the ISM Services index for July are also set to be released with expectations of factory orders showing a decline and the ISM Services Index showing no change. With the overall ISM being released earlier in the week, it would not be surprising to see the services side of the index either beat or fall short of expectations in much the same way. On Thursday, the only economic news releases are the standard weekly employment figures, but this week may be watched a little bit closer than normal to

see if initial jobless claims can stay under 400,000 for a second week in a row. On Friday, one of the major releases of the week is set to be released: the official unemployment rate for the US during the month of July as calculated by the US government. Expectations are all over the place on this release with some calling for a decline to 9 percent, while others think it will increase to 9.3 percent. Market consensus expectations predict no change from the current level of 9.2 percent. Wrapping up the week on Friday afternoon is the release of consumer credit for the month of June, which is expected to show an expansion of approximately \$5 billion as banks continue to increase the amount of lending going on in the US. Overall, non-scheduled events, such as the debt ceiling and the ramifications of any agreements, will drive the markets this week.

Have a great week,

Peter Johnson

Feel free to forward this email.

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