



Weekly Market Analysis September 6th, 2011

Market Wrap-Up Last week the US stock market experienced continued emotional trading as investors jumped aggressively into equities early in the week. It appears they were hoping to get in on a bull market breakout only to be mostly shaken out of their trades later in the week. The movement in the market was done largely on low volume since it was the week leading up to the extended Labor Day weekend. Currently, all three of the major US averages appear to be stuck in trading ranges that were established during the beginning on August. With the uncertainty ahead it is unlikely that the trading ranges break to the upside in a meaningful way, while breaking through the lower end of the range is very possible. Below is a chart of the daily price movement since the end of last year for the S&P 500 (green line) with the most recent trading range between the blue lines:



As you can see from the chart above, the S&P 500 managed to break out of its trading range last week, but its stay above the line was very short lived. From here we are likely to see the all of the indexes test the lower end of the trading range, as September is historically the worst month of the year for stocks. Looking back at historical data for all three of the US indexes I found that September has the following average returns:

S&P 500	Since 1950	-0.46 percent
NASDAQ	Since 1971	-0.53 percent
Dow	Since 1929	-1.30 percent

In looking at the historical returns, the political uncertainty and the economic uncertainty around the world, September 2011 could make for a very interesting month. With many headwinds blowing in

the face of the US markets, now remains a time to use caution in investments and not take on more risk than you can handle in an attempt to make a quick return.

International Politics: Last week, international politics was once again focused on the Euro zone and the looming problems that are starting to make themselves known yet again. With the ECB stepping in over the past few weeks and buying Italian and Spanish debts, yields were temporarily lowered, but they have been on a steady rise since the initial infusion. The ever increasing yield on Italian debt could spell major problems for the entire Euro zone. Right now the yields are around 5.5 percent (nowhere near the almost 50 percent that Greece is seeing), but any yield over 5 is unsustainable for the Italian economy. The growing issue for the region is that at some point the ECB, IMF and the Euro zone will be unable to contain the debt issues. Germany, in particular, is starting to show signs of not being fully supportive of the ongoing bailouts. Over the weekend chancellor Merkel's political party was dealt a severe blow in her home region when her party lost many political seats to a rival party. If the trend continues next year in the main elections it is unlikely that Merkel will be able to retain the chancellorship. With Merkel and her party potentially losing control in Germany, the main platform that seems to be coming to power is running on a platform of not bailing out the whole Euro zone. The Euro zone pot is also being stirred up by Greece as talks between Greece, the IMF and the ECB had to be suspended on Friday because of Greece's failure to stay on the deficit cutting schedule initially agreed to in the bailout. If Greece does not stick with the plan, it is pretty clear that the bailout funds will be cut off and Greece will be once again looking at an outright default. A sign that lender countries are very worried is that many countries are demanding collateral for the loans that they have been giving to Greece so that if Greece were to default they would take control of physical assets. One potential outcome that is gaining steam in the Euro zone is to make the countries come together much more cohesively and adopt a framework much more like that of the United States. While a plan like this would take decades to implement, even coming up with a bare-bones outline could have a soothing effect on the markets. Elsewhere in international politics, China made headlines this week with the release of their PMI, which showed a decline from 53.5 in July down to 50.6 in August (one of the lowest readings on record). The main problem in China is that they are an export driven economy with the majority of their exports going to developed countries that are having financial difficulties and are therefore purchasing less goods from China. At the same time, China has been trying to deal with rampant inflation that is a product of a growing middle class that is gathering assets and purchasing a wide variety of items.

National Politics: National politics this week will be all about jobs as President Obama prepares to address a joint session of Congress on Thursday evening to outline his plan to create jobs. Even setting up the address was full of problems. The President initially asked to hold the joint session on Wednesday evening (the evening of the first major Republican Presidential debate), and Speaker of the House John Boehner declined, requesting Thursday instead. President Obama will likely outline a plan that will involve creating many new jobs through government spending, as government spending is the most immediate way to try to get people back to work. The spending will likely focus on rebuilding the US after the wrath of natural disasters that plagued parts of the US over the past few months. In tying the money to infrastructure, the President has the ability to reach a large number of individuals because people take notice when a new bridge is being built to replace an old one and a washed out road is being fixed and improved so that the next time a hurricane goes through it will not wash out. Republicans are likely to overwhelmingly reject his plan, citing a lack of money to accomplish everything the President wants done and pointing out that in these uncertain financial times we should cut back on spending, not extend ourselves further. With the

current gridlock in Washington DC, it is unlikely that the President's plan will be fully implemented and highly likely that both sides will fight about it in a very public way on the campaign trail. Overall the President's speech will be more symbolic than anything else and the markets should react very little to it. Elsewhere in national politics, both the House of Representative and the Senate are back in session starting on Tuesday from their summer recess. Their first order of business appears to be fighting with the US Postal Service over how they can justify keeping the service running when it loses more than \$5 billion per year. This is a timely debate to have because many voters will be watching closely to see if the USPS has to shut down. At the same time behind the scenes and under much less public scrutiny, the super committee will start to meet to see if they can come up with enough spending cuts and deficit reductions to fend off the automatic cuts that go into place later in the year if they cannot agree on anything. Wall Street will be watching this committee very closely as the ideas that are floated could significantly impact a variety of companies that do business in the US. Wrapping up national politics last week, the Chairman of the Federal Reserve Ben Bernanke made statements to suggest that the Fed does not really have any tools to utilize to help lower the unemployment level in the US. Since many of their tools have to do with the money supply and how much moves through the US economy, in short, they cannot force companies to hire new employees nor can they force consumers to spend. The first two rounds of quantitative easing did little in the long run to lower the unemployment rate, and another round of easing—should it come to fruition—will likely be less effective than the first two rounds.

Market Statistics: Last week saw continued market volatility. Two of the three major US indexes declined for the week, but did so with pre-holiday volume. The best-performing index in the US was the technology-heavy NASDAQ, which advanced by 0.02 percent. The second-best was the broadly based S&P 500, which declined by 0.24 percent. Bringing up the rear was the primarily large-cap blue-chip Dow, which experienced a decline of 0.39 percent. After little overall movement, all three of the major indexes remain right in the middle of their latest trading range. The best-performing sector of the markets was the technology-related networking sector, which advanced by 1.34 percent. The worst-performing sector of the markets was financial services, which declined by 2.59 percent after news came out about the government filing suit against many of the major banks in the US over mortgage fraud. Fixed-income markets had a good week with many of the fixed-income US government bond ETFs advancing, thanks in large part to people moving toward the safety of US government backed debt. Commodities increased by 0.65 percent, helped in large part by an increase in precious metals and oil. After declining two weeks ago, gold came back with a vengeance, advancing by 3.25 percent. During trading on Monday (9/5/2011), gold pushed back up over \$1,900 per ounce, regaining all of the losses experienced two weeks ago. Silver made an even larger move last week, advancing by 4.38 percent. Oil increased by 1.27 percent after initially moving lower on the news that rebels remained in control of a large portion of Libya. The US dollar declined by only 1.31 percent against a basket of international currencies as investors chose to diversify assets away from dollars and into currencies such as the Yen and Swiss Franc. The top-performing index on the international investing front was India's Bombay Sensex Index, which advanced 6.14 percent after being the worst-performing index two weeks ago. Globally, the worst-performing index was in China with the Shanghai Index, declining by 3.21 percent as investors assess the future growth ability of the Chinese economy. Volatility came down again last week, making it two weeks of decline in a row. After last week's decline of 4.69 percent, the two week decline of the VIX is more than 21 percent. Despite the drastic decline in the VIX, we still remain at a very elevated level as illustrated by the week chart of the VIX since 12/31/2008 below:



Performance: For the trading week ending on 9/2/11, returns in FSI's models were as follows:

	<u>Last Week</u>	<u>YTD</u>	<u>Since 12/31/07</u>
Aggressive Model	0.10 %	-7.45 %	-8.17 %
Growth Model	0.08 %	-6.84 %	-5.47 %
Moderate Model	0.08 %	-5.42 %	-1.36 %
Income Model	0.09 %	-3.36 %	(Insufficient Data)
S&P 500 (benchmark)	-0.24 %	-6.65 %	-20.05 %

We remained in cash throughout last week and did not participate in any of the overall market volatility. Our models still indicate that cash is the most prudent investment option during these uncertain times. We continue to watch for a signal/trigger to move back into the markets. Currently, the models are approximately halfway to the point that would signal us to buy back into the market.

Economic News: Last week was one of the busiest weeks for economic news releases that we have seen in a long time. While some of the releases were positive, there were also a number of releases that seemed to indicate that the economy will continue to slow. The week started off on Monday the 29th of August with the release of Personal Income and Personal Spending for the month of July. Personal Income came in at the expected level while spending surprised the market a little, coming in stronger than expected (in part due to spending on automobiles). Released at the same time as personal income and spending, the PCE Price change for the month of July indicated that prices remained relatively flat, as expected, with an increase of 0.2 percent during the month. Later on Monday, the pending home sales figure for the month of June was released and came in as expected, showing a decline of a little more than one percent. On Tuesday, August 30th, the Case-Shiller 20-City Home Price Index for the month of June was released and, much like pending home sales the day before, the release came in as expected and very few market participants paid any attention to it at all. Later on Tuesday, one of the more watched releases of the week came out; the Consumer Confidence figure for the month of August showed a decline, as expected. It was the magnitude of the decline that took the market by surprise as the reading came in at 44.5 while the market expected a decline from 59 down to 52. With a plunge moving the confidence level under 45, many investors decided to move to the sidelines and wait out this uncertainty. The main

question that everyone seems to be asking now is: Will the US consumer pull back on spending due to falling confidence, or will they continue to spend despite the bleak outlook? If the consumer loses faith in the economic recovery and pulls back on spending, it could easily be enough of a catalyst to push the already weakened US economy back into a technical recession (two consecutive quarters of GDP declining). Wrapping up the day on Tuesday was the release of the FOMC meeting minutes from the last meeting, but since they held no new information they were a non market moving event. On Wednesday, the ADP employment change for the month of August was released to indicate that 91,000 jobs were added to the economy during the month of August, which was very close to the expected 100,000 jobs and was seen as a mediocre release about jobs in the US. With the release close to expectations, most economists did not feel any revisions were necessary to the jobs release that was coming from the government on Friday. Later on Wednesday, the Chicago PMI for the month of August came out better than expected, showing a reading of 56.5 when the market expected something closer to 53. This was seen as very positive because of how poor manufacturing readings over the past few months have been. Now we will have to see if manufacturing expands in other regions or if it continues to move into contraction. The last release on Wednesday was the factory orders figure for the month of July, which came in better than expected at 2.4 percent while the market expected 1.8 percent. With many of the releases being positive on Wednesday, the markets were able to briefly break above the resistance level, but this break was short-lived. September started out with a bit of a stumble in the economic news releases with both initial and continuing jobless claims failing to meet the market expectations. To make matters worse, the government also revised the previous week's figures higher, making them worse than first thought (continuing jobless claims were revised upward by 112,000 jobs while initial jobless claims were increased by 4,000). Later on Thursday, the ISM Index for the month of August was released, and it did manage to stay above the all-important 50 line, coming in at 50.6 (indicating expansion). The market expected this release to move below 50, so when it stayed above it was seen as a positive sign for the economy. Next on the list on Thursday was the release of construction spending for the month of July, which showed a small, unexpected contraction of 1.3 percent (not enough of a change to really shift the housing market). The last release on Thursday was the auto sales figures for the month of August, which indicated that sales increased during the month despite the uncertainty about the economy. The big three US manufacturers saw the largest increase in sales, while sales from Japanese manufactures continue to decline due to shortages related to the earthquake back in March. On Friday the US stock market was thoroughly disappointed by the government's release of jobs data, which showed zero new nonfarm payroll jobs added during the month of August. This release was expected to show an increase of around 70,000 new jobs, so zero left the markets in a bit of a lurch and a sell-off began. Nonfarm private payrolls did not fare much better, showing an addition of 17,000 jobs while the market expected 110,000 jobs. Overall, these two releases were dismal and will probably negatively impact consumer confidence and spending in the future because jobs are one thing that hits very close to home for the American consumer. With the lack of any real change in payrolls, the overall US unemployment rate did manage to stay at 9.1 percent (the same rate that it was during July).

After such a busy week last week with economic news releases, this one will be nice in that it is a short week with very few economic news releases. The week kicks off on Tuesday with the release of the ISM Services Index for the month of August. After last week's better-than-expected ISM Index reading, this week's release could also be slightly better than expected. The problem is that the expectation is a reading of 51, so there is not much room to miss to the downside and still stay in expansionary mode since a reading under 50 would indicate a contraction. On Wednesday the release of the day is the Fed's Beige book for the month of September, which is expected to show

nothing new since most of the data is actually compiled from August figures. On Thursday the standard weekly jobs-related figures are set to be released with expectations that both initial and continuing jobless claims have declined during the past week. This may actually turn out to be the case since some unemployed people may have found work helping to clean up the aftermath of Hurricane Irene. Wrapping up the day on Thursday, the release of the consumer credit figure for the month of July is expected to show a credit expansion of \$5 billion during the month. Wrapping up the week on Friday, the release of the wholesale inventories figure for the month of July is expected to show a slight 0.7 percent increase from the level seen in June. With very few economic news releases that have the potential to move the US markets during the shortened trading week, the markets will likely look to external news for indications about the health of the financial markets. Mainly, the spotlight will rest on Europe as the situation seems to be getting worse and doing so rapidly.

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

In addition to our Financially Speaking weekly commentary, emailed on Mondays, we post the commentary on our blog, which you can find by clicking the following link:

<http://financiallyspeakinginc.wordpress.com/>

If you would like to unsubscribe to this weekly commentary, please send an e-mail to Judy at jrborsheim@financiallyspeakinginc.com and you will be removed from our mailing list.