



Weekly Market Analysis

January 23rd, 2012

Commentary at a glance:

- The US markets continue 2012 with positive performance.
- Greek bond discussions continue despite “impasses” over the size of potential haircuts.
- Another Republican candidate drops out of the race.
- Initial jobless claims came in much better than expected.
- The State of the Union address is going to be tomorrow evening.

Market Wrap-Up: Last week was the third week in a row that the US markets climbed higher, making the start to 2012 somewhat of an anomaly. Looking back over the past eleven years of historical returns for the S&P 500, the only year other than 2012 that the S&P started the year with three weeks in a row of positive returns was in 2004. It is much more common for the first two weeks of the year to be positive and then in the third week, the reality of the Christmas shopping season being over sets in and the markets take a more normal path, giving up some of the recent gains. This pattern has occurred in four of the past eleven years. The average return for the third week of the year for the past eleven years has been a decline of 1.64 percent, a decline which we have yet to see in 2012. With this history in mind, it seems like the market is currently skating on pretty thin ice. We are likely to see some give-back in returns coming in the very near future. On a more positive note, 2004 (after such a stellar start) turned out to be a better than average year for returns with the S&P 500 gaining 10.6 percent over the course of the year. One of the driving factors in many years for strong performance at the start of the year is speculation about the fourth quarter earnings season, which is now well under way and so far has been largely positive. Some of the bigger names that have reported earnings and beaten expectations so far include:

American Express	Morgan Stanley
Consolidated Edison	Schlumberger
Ebay	Southwest Airlines
Goldman Sachs	United Health
Intel	General Electric
Microsoft	Wells Fargo

Some of the larger companies that failed to meet market expectations over the past week include:

Bank of New York	Johnson Controls
Citigroup	Parker Hannifin
Dish TV	Sealy
Google	State Street

According to Thomson Reuters, so far 60 percent of the S&P 500 member companies have beat market expectations. On the whole the outlooks and guidance figures for the remainder of 2012 and beyond have been looking up as many companies see the worst of the financial mess now behind us. One caveat that many companies are throwing into the releases is that if Europe comes apart in a non orderly fashion, that could greatly change their outlook on the future. This week is one of the busiest weeks of earnings season with many large companies' announcing earnings. The main companies to watch include:

3M	McDonalds
Apple	Procter and Gamble
AT&T	Starbucks
Boeing	Texas Instruments
Johnson and Johnson	United Technologies

From a technical trading standpoint, last week was the point at which the S&P 500 signaled that it had broken out of its recent trading range staying above the range for the entire week. This can be seen on the chart below in which the upper end of the trading range is represented by the top blue line, while the S&P 500 is portrayed by the green line.



International News: Greece has once again moved to front and center stage as the world's financial markets try to make sense of the ongoing negotiations over both the proposed haircuts that bond holders are going to take and the Greek commitments going forward. After a week of fighting over the particulars, the Euro zone finance ministers will meet early this week to decide the terms of the restructuring. Right now it looks like the figure for the haircut has been increased from the original 50 percent up to something closer to 65 or 70 percent. While a hard and fast number would be nice to see, they really do not have to do anything until mid-March when the next tranche of payments to Greece is set to be released, so we could see this fight continue for quite a while. Also

in the Euro zone, over the weekend there was a deal struck that would limit the amount of oil that member countries would import from Iran. At first glance, the deal is for no new agreements to be made by any member countries for the importation of new oil from Iran. The current contracts will stay in effect until July, giving countries the time they need to find alternative suppliers to fulfill their oil needs. After July there is a proposed full embargo of Iranian oil to Europe. According to data on the US Energy Information Administration webpage, the European Union imports about 18 percent of the oil that Iran exports, with Italy and Spain accounting for 13 percent. Larger importers of Iranian oil include China, Japan and India; all of which are not particularly keen on partaking in any form of oil embargo against Iran, but the US and others are still trying to convince them that not taking Iranian oil is the correct thing to do. Natural gas may also become a bit of a sticking point with Iran, since they have the second largest proven reserves in the world behind only Russia, but currently do not export enough natural gas to other countries for it to be worth trying to stop. Staying within the general region, Syria continues to be a hotspot, with violence erupting daily. Most recently the Arab League has called for a new unity government in Syria and for President Assad to step aside and not disrupt what they are calling “progress” in the country.

National News: National news remains focused on the upcoming Presidential election with a lot of excitement over the Republican nomination process, which threw one of the candidates a bit of a curve over the weekend. Mitt Romney has long been seen as the front runner for the Republican nomination, but after South Carolina’s primary on Saturday this is much less certain, as Newt Gingrich won by a wide margin. After the votes were tallied, Gingrich ended up with 40 percent of the vote while Romney garnered only 28 percent. Much of the surge for Gingrich came from the attack ads, which raised questions about Romney and his time at Bain Capital. Also helping Gingrich’s case was the fact that Texas Governor Rick Perry dropped out of the race last week and endorsed Gingrich over Romney. Looking at a little bit of history, the Republican who has won South Carolina has gone on to win the nomination in every election since 1980. Adding to the bad week for Mitt Romney, it was officially announced last week that Romney did not win Iowa and that Rick Santorum actually did clearly win after the votes were recounted certified. This week the focus in Washington DC is going to be on President Obama’s State of the Union address, which he will give tomorrow evening. The address will largely focus on the employment situation in the US and will likely sound like a reelection speech. There will be calls for both sides of the aisle to work together for the good of the country and for getting the government budget back in line, while at the same time there will be deliberately placed political shots at Republicans for not working with Democrats. Much of the speech will probably be addressed at the middle class Americans, which Republicans and Democrats alike need to swap to their side in order to win the election in November. In the latest issue to come to a head in Washington DC, President Obama rejected the Keystone XL oil pipeline because there was not sufficient time to assess the impact of the pipeline. We are going to be hearing a lot more about this decision in the future because Republicans can point to the number of jobs that were not created because of the decision and Democrats can point to the potential environmental impacts of such a pipeline.

Market Statistics: Last week was the third positive weekly move for the three major US indexes in a row. The best-performing of the three major indexes last week was the technology-heavy NASDAQ, which experienced an increase of 2.80 percent. Coming in second was the mainly blue-chip Dow, which increased by 2.40 percent while the laggard was the broadly-based S&P 500, which increased by 2.04 percent. The best-performing sector of the markets was the Semiconductor sector, which increased 7.02 percent. The worst-performing equity sector last week was the Utility sector, which decreased by 0.80 percent. Fixed-income investments had a negative week as the

long-end ETFs saw a decline of 3.23 percent while the shorter-term ETFs also saw noticeable declines, this move in the fixed income market can all be attributed to the news that has been slowly coming out of Europe about their ongoing struggles to finalize a plan that will end the fears of contagion. Commodities declined for the second week in a row, losing 0.30 percent as oil declined and precious metals increased. Gold and silver both moved higher last week, with Silver gaining 8.33 percent and gold advancing 1.76 percent. Copper also had a strong week with the spot price of copper advancing by 5.89 percent. Oil moved lower last week by 0.79 percent as there were no major changes in the situation with Iran. The US Dollar Bull ETF moved lower by 1.67 percent as investors decided to sell US dollars in favor of other currencies that have the potential to increase in value faster than the dollar. On the international investing front, the best-performing index last week was the Mexican IPC Index, which happened to be the worst-performing index two weeks ago, with an advance of 5.40 percent. The worst-performing index of last week was found in Taiwan, with the main Taiwanese Index advancing by 0.73 percent. The VIX declined last week by 12.58 percent as investors continued to favor more risky assets over less risky assets. The VIX is now at its lowest point since mid-July of 2011, before the US saw its AAA credit rating downgraded.

For the shortened trading week ending on 1/20/2012, returns in FSI's hypothetical models (gross of fees) were as follows:

	<u>Last Week</u>	<u>Since 12/31/07</u>
Aggressive Model	1.14 %	-10.49 %
Growth Model	0.74 %	-6.72 %
Moderate Model	0.59 %	-1.32 %
Income Model	0.40 %	(Insufficient Data)
S&P 500 (benchmark)	2.04 %	-10.42 %
S&P 500 with Dividends	2.07 %	-2.22 %

We made no changes in our models over the course of the previous week, but we are getting close to a point where we could begin to sell some of our position in High Yield bonds in favor of other asset classes such as large and mid-cap value mutual funds. From a relative strength point of view, these two asset classes have been performing very well as we have followed them for the past few weeks.

This week's stock highlight is Hormel Foods (they make much more than just Spam). Hormel has been in business since 1891 and has a wide variety of products which are distributed throughout the world. In addition to the Hormel brand products that Hormel makes are sold under the following brand names Chi-Chi's, Dinty Moore, Farmer John, Herdez, Jennie-O, Lloyd's, Spam and Stagg brand. Within each brand there are numerous products. According to Hormel, more than 122 million cans of Spam are sold each year around with world and there is even a Spam museum in Austin, Minnesota. Financial strength is one aspect of Hormel that is not to be overlooked. Hormel does not utilize much long term debt at all; in fact they currently have only \$250 million in long term debt compared to their market cap of almost \$8 billion. Being in the consumer staples sector of retail sales helps Hormel have strong and stable revenues as well as strong and consentient net income while paying a quarterly dividend that amount of about two percent per year.

Economic News:

<u>Economic Impact</u>	<u>Date</u>	<u>Economic News Release</u>	<u>Date Range</u>	<u>Actual</u>	<u>Expectation</u>
Positive	1/17/2012	Empire Manufacturing	January 2012	13.5	10
Natural	1/18/2012	PPI	December 2011	-0.10%	0.10%
Slightly Negative	1/18/2012	Core PPI	December 2011	0.30%	0.10%
Natural	1/18/2012	Industrial Production	December 2011	0.40%	0.50%
Positive	1/18/2012	NAHB Housing Market Index	January 2012	25	21
Positive	1/19/2012	Initial Claims	Previous Week	352K	385K
Positive	1/19/2012	Continuing Claims	Previous Week	3432K	3600K
Neutral	1/19/2012	CPI	December 2011	0.00%	0.10%
Neutral	1/19/2012	Core CPI	December 2011	0.10%	0.10%
Slightly Negative	1/19/2012	Housing Starts	December 2011	657K	673K
Neutral	1/19/2012	Building Permits	December 2011	679K	680K
Slightly Negative	1/19/2012	Philadelphia Fed	January 2012	7.3	10
Neutral	1/20/2012	Existing Home Sales	December 2011	4.61M	4.55M

Data for table from Econoday.com, Bloomberg and Yahoo Finance

Last week was a busier week than normal for economic news releases but on average the releases were positive for the US economy. The week started off on Tuesday with the release of the Empire Manufacturing Index for the month of January, which came in well above market expectations and indicated that manufacturing in the greater New York region was going strong. This is a very positive sign for the overall US economy because the New York region is such a large part of the economy. On Wednesday, the 18th, the Producer Price Index (PPI) for the month of December was released and indicated that overall PPI was in line with expectations while Core PPI increased a little bit faster than most economists are comfortable with. Later in the day, on Wednesday, the NAHB released their Housing Market Index for the month of January which held a very nice upside surprise. The market had been expecting a reading of 21 and the actual reading was 25, indicating that there is, in fact, life in the US housing market. On Thursday the standard weekly jobs related figures were released and they really tore the cover off the ball. The market had been expecting initial jobless claims to come in at 385,000 after being 402,000 the previous week but the release showed only 352,000. This release coupled with the better than expected reading on continuing jobless claims really gave the market a boost and will likely also provide a bit of a boost to President Obama in the upcoming election. Later on Thursday, the Consumer Price Index (CPI) for the month of December was released but the release had little impact on the overall markets as both CPI and the core CPI met market expectations. Also released on Thursday were the building permits and housing starts figures for the month of December. Both of these housing related releases missed market expectations but were close enough to not have a large negative impact on housing related investments. Wrapping up the day on Thursday was the release of the Philadelphia Federal Reserve Index for the month of January, which missed market expectations by a pretty wide

margin. With the Philadelphia Index missing by approximately the same amount that the Empire Manufacturing Index beat expectations, the markets took these two releases as a bit of a wash. Wrapping up the week on Friday was the release of existing home sales for the month of December, which came in slightly above the market's expectations negating some of the negative vibes that the housing starts and building permits figures presented earlier in the week.

This week is a slow week for economic news releases, which will start on Wednesday. On Wednesday the pending home sales figure for the month of December is set to be released with expectations of a three percent decline over the level of pending sales seen in November. The more important piece of economic news to be released on Wednesday is the FOMC rate decision (they are going to leave interest rates alone) and the all important statement which Federal Reserve Chairman Ben Bernanke will be making after the release. On Thursday the standard weekly jobs related figures are set to be released with expectations that initial jobless claims will have increased by about 25,000 over the extremely low level seen last week and that continuing jobless claims will show an increase of approximately 100,000 jobs. Durable goods orders and new home sales, both for the month of December, are also set to be released on Thursday. However, there is not an expectation of much variance from what was released in November so these releases should have a minimal impact on the overall markets. On Friday comes the most potentially impactful economic news release of the week, the advanced estimate of GDP for the US during the fourth quarter of 2011. Expectations are pretty high for this release with the market expecting a reading of 3.2 percent up from the third quarter's reading of 1.8 percent. While this is very possible it seems like the market is overestimating the amount of growth experienced in the US on this release. Wrapping up the week on Friday is the release of the University of Michigan Consumer Sentiment index for the month of January, which is expected to show very little change over the level seen in December and should be a non-market moving news release.

Have a great week,

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