



Weekly Market Analysis

January 3, 2012

2011 Year in Review: 2011 came to an end without much fanfare, in the end the three major US indexes ended little changed on the grand scheme of things, but that was thanks only to a late year-end Santa rally. The year was fully of excitement for the stock market as various aspects of the global economy pushed the market up and down with amazing speed. The year started off with the Arab Spring sweeping through much of the Middle East and causing large dislocations in the price of oil around the world. The ramifications of the Arab Spring are largely still unknown because many of the powerful leaders that succumbed to the uprisings have yet to be replaced by anything other than transitional governments. Following on the wave of protests in the Middle East, protests sprang up in other parts of the world such as Greece, Germany, Russia, China and even the US. Protests were so prevalent during 2011 that the protester was named by Time Magazine as the person of the year. Protests were taken both ways by the world markets: typically as the unrest broke out, if the country was largely relevant to the world markets, then the markets would move lower; as the protestors either achieved their goals or stopped protesting, the world markets settled down and slowly moved higher. Political actions and inactions were also a major part of 2011 and will likely remain center stage as we move into 2012.

The global financial markets seemed very aware of what was going on politically during 2011, more so than has been the case during previous years. Maybe the difference was that we have not seen political steps taken like we saw (or did not see) during 2011 to curb spending, cut government debts and even try to save one of the major world currencies. The main focal point of the markets for the latter half of 2011 was on the evolving situation in Europe that quickly turned from muddling through taking small actions here and there to a full blown emergency which had some economists calling into question the Euro's ability to survive as a currency. Greece was a tipping point but the situation of countries overspending and carrying large amounts of debt quickly became a major issue as stronger countries such as Italy and Spain ran into trouble (both countries are too large for the standard methods of dealing with countries having too much debt). While the situation is far from resolved, there has been enough progress out of the European region to calm some nerves as the actions taken appear to have kicked the can down the road far enough for the countries to have the time necessary to make fundamental changes to the way countries have been managed in the past.

Overall volatility of the financial markets was elevated throughout the year, as indicated by the number of days during which there was a move of greater than two percent either up or down. With 252 total trading days during 2011, the S&P 500 experienced moves in excess of two percent on 35 days or approximately 14 percent of the time. The NASDAQ saw 40 such days or approximately 16 percent of the time and the Dow saw 32 days of such moves or 13 percent of the year. The movements indicate that volatility was higher in 2011 than it was in 2010, but lower than the volatility experienced in both 2009 and 2008. Volatility as measured by the VIX increased over the

course of the year by nearly 32 percent despite experiencing a decline of more than 45 percent during the fourth quarter of the year. To wrap up the figures for the quarter and year, the three major indexes and the VIX turned in performance as follows:

Index	<u>4th Quarter 2011</u>	<u>Full Year 2011</u>
DJIA	11.95 %	5.53 %
S&P 500	11.15 %	0.00 %
NASDAQ	7.86 %	-1.80 %
VIX	-45.53 %	31.83 %

For those of you who follow and are interested in the style box performance of various investments throughout the quarter, below is the standard style box performance for fourth quarter 2011.

Style / Market Cap	<u>Value</u>	<u>Blend</u>	<u>Growth</u>
Large Cap	11.64 %	11.42 %	9.59 %
Mid Cap	12.22 %	13.53 %	7.18 %
Small Cap	15.93 %	14.86 %	13.64 %

For the full year the style box performance figures were a bit more dispersed than they were for the fourth quarter. Large-cap outperformed both mid and small-cap stocks, with large cap blend outperforming both growth and value. In general growth saw better performance during 2011 than value but in both large and mid-cap the blended allocations outperformed both value and growth. Below is the standard style box performance for full year 2011.

Style / Market Cap	<u>Value</u>	<u>Blend</u>	<u>Growth</u>
Large Cap	-1.06 %	1.13 %	0.64 %
Mid Cap	-4.83 %	0.25 %	-3.09 %
Small Cap	-4.56 %	-5.98 %	-1.44 %

The following tables give the performances for various sectors of the market as well as commodities and fixed-income investments for full year 2011. The top-performing sectors for full year 2011 were as follows:

<u>Sector</u>	<u>Change</u>
Utilities	14.55 %
Biotechnology	11.70 %
Healthcare	9.48 %
Consumer Staples	6.55 %
Aerospace and Defense	3.98 %

The bottom-performing sectors for full year 2011 were as follows:

<u>Sector</u>	<u>Change</u>
Financials	-27.91 %
Basic Materials	-21.91 %
Networking	-18.38 %
Semiconductors	-14.68 %
Telecommunications	-10.14 %

Commodities had a wild ride during 2011 with the returns finishing as follows:

<u>Commodities</u>	<u>Change</u>
GSCI Commodity Index	-3.28 %
Gold	9.57 %
Copper	-25.48 %
Silver	-10.74 %
Oil	8.13 %

As is normally the case when equity markets struggle for direction, fixed-income turned in one of its strongest years in a very long time:

<u>Fixed Income</u>	<u>Change</u>
20+ Year Treasuries	28.82 %
10-20 Year Treasuries	17.95 %
7-10 Year Treasuries	12.52 %
3-7 Year Treasuries	6.45 %
TIPS	8.53 %

The outlook is always the most difficult part of investing, and the outlook for 2012 is very unclear. On the positive side, corporate balance sheets are very strong and companies are continuing to make money during what has been described by some as a difficult time. The US consumer is also another very positive aspect to the economy, as they are getting more confident and are becoming more willing to spend their hard earned money. On the negative side of investment we have a lot of political risks in the current situation, the foremost of which is Europe. Right now they have managed to kick the can down the road, but at some point they are going to run out of road if actions are not taken that actually fix the underlying problems and not just the side effects, as we have seen for the past several months. China is another wild card that will have a large impact on the overall global economy and world financial markets as investors try to figure out if they are headed for a soft or hard landing with their economy. China may have more of an impact on the markets in 2012 than Europe provided Europe does not blow apart at the seams. Yet one more situation that could have a large impact on world markets is the situation that continues to unfold in the Middle East; as long time leaders fall, there is a void left that will need to be filled. Right now everything is still in limbo, but drastic changes in the types of government that have been in control of the region for years could have a large impact on the price of oil. Iran in particular is one area to watch as they have been stepping up their saber rattling in recent months and weeks, and recently

have threatened to close the Strait of Hormuz, something that the US will likely not allow to happen for long if at all. The final aspect of investing in 2012 will be political uncertainty in the US. Already during 2011 we saw what can happen when politicians cannot agree (the US credit rating was downgraded), and at the end of the year we saw the super committee end up being a complete failure. The partisan bickering that is taking place in Washington DC is likely to worsen, as 2012 is a presidential election year. This bickering will probably only make it tougher for investments during the year because there is so much uncertainty about items such as taxes and regulations moving forward for businesses in the US. In the end, 2012 will likely be a flat year for performance of the major US indexes, but the caveat on that is the possibility for some drastic market movements. These movements are likely to balance each other out, so the expected return for 2012 is in the middle. Things will either be very positive or very negative in 2012 and the market will move rapidly as investors have a lot of money sitting on the sidelines just waiting for a reason to invest it. It is going to be another wild year in 2012!

Weekly Commentary

Commentary at a glance:

- Very little news out of Europe.
- Bickering continued on Capitol Hill, but the payroll tax extension was extended.
- Consumer Confidence beat expectations by a wide margin.
- Santa made his presence felt in the financial markets.

Market Wrap-Up: The last two weeks of 2012 ended much like the rest of the year went with a quick move in the markets. As you can see in the chart below, the move happened to be higher. The S&P 500 (green line) is now back in the recent trading range (red lines) and has tested the upper edge of the range.



In looking at the daily chart above, it appears that if the S&P 500 manages to close above 1285 that we could be in for a bit of a leg up in the markets, but we would have to see several days of closing

prices above that level to confirm that the move is anything but a one-time pop prior to the index moving right back down into the trading range. The move over the course of the past two weeks was done on relatively light volume, which is why a continued rally here at the start of the New Year with more market participation could be a very good sign for the markets in the near term.

International News: News on the international front was pretty scarce over the past two weeks, in part because the Europeans certainly were not going to let a crisis that has the potential to end their currency get in the way of their holidays. There were several bond auctions throughout the region over the past two weeks with the results all being pretty good. In fact, during the last auction, Italy saw borrowing costs cut in half from the levels of just two months ago. While there was little news out about the upcoming plan/new treaty that is being worked on, there was a lot of speculation from economists about how the new plan would need to function in order to be effective. Now we will just have to wait and see if the politicians heed the advice of the economists or if they ignore the experts as they usually do and try to come up with something on their own. In another part of the world, China has recently produced some figures that are encouraging and seem to indicate that its economy is not in for a hard landing. Mainly the encouragement came from data which was released by the government that showed that manufacturing in the country picked up during December. Staying in the Asian region, North Korea has buried their dear leader, Kim Jong Il, and his son Kim Jong Un has take over command of the country. Some economists are viewing this hand-off of power as a good thing for the country that is quite possibly the most isolated country in the world. If the North opens lines of communication with the South and the rest of the world, that would be one less wild card that the market tries to prices into the future movement of the world markets. In other international news, Iran has once again caused the price of oil to increase around the world as they have engaged in more saber rattling with the US. Two weeks ago, Iran issued a warning that they would shutdown the Strait of Hormuz to commercial traffic if the US and others continued to push economic sanctions on the country. This led the countries advocating for sanctions against Iran (for its nuclear program) to, in a sense, push harder. This all occurred at the same time as Iran was holding military exercises in the area and trying to intimidate the world through the launching of at least one missile. All of this was done while the US's 5th fleet based in Bahrain looked on, and the US said that it, along with other countries in the region, would not allow Iran to stop the passage of any commercial ships through the strait. While the chance is extremely high that Iran is bluffing, if they were to shut down the strait (which is only 21 miles across at its narrowest point) the price of oil would skyrocket since more than one third of all of the oil transported throughout the world travels through the strait. Oil analysts believe oil could easily climb as high as \$200 per barrel if Iran were able to close the straight for any amount of time but still believe that the likelihood of that occurring is very small.

National News: National news primarily focused on the fighting between Democrats and Republicans on Capitol Hill as both sides wanted to try to get the last say before they all went home for the holidays. The main fight came up with the payroll tax cut extension that was extended by the Senate for two months into 2012 and the Republicans in the House eventually caved in to pressures and voted for the same extension. This was a victory for the Democrats because it keeps the debate going in 2012 at a time when Republicans will be very cognizant of what they are saying; if they are running for reelection, the media will scrutinize every word. The upcoming election made headlines throughout the past two weeks as the Iowa caucus is now upon us. Right now the frontrunner out of Iowa is Mitt Romney, followed by Ron Paul and Rick Santorum, but the votes have yet to be tallied so it is still a wide open race. The financial markets seem to think that Romney will get the

nomination but they have been wrong before when trying to predict the outcome of elections, so we will have to wait and see.

Market Statistics: Last week was a down week for all three of the major US indexes. The best-performing index was the technology based NASDAQ, which decreased in value by 0.52 percent. The more broadly based S&P 500 experienced a decrease of 0.61 percent and the primarily Blue Chip Dow brought up the rear declining by 0.62 percent. The best-performing sector of the markets was the Telecommunications sector, which increased 0.83 percent. The worst-performing equity sector last week was the Financial Services sector, which decreased by 1.50 percent. Fixed-income investments had a good week as the long end ETFs saw an advance of 2.52 percent while the shorter term ETFs saw an increase in value of about half of a percent. Commodities moved lower last week, with the GSCI Commodity Index declining by 0.15 percent as oil dipped by 0.85 percent, and the overall energy sector saw slide of 0.72 percent. Gold dropped to give up 2.76 percent as investors continued to pour out of the precious metal in favor of cash. The other two heavily traded metals, copper and silver, also had negative weeks with Silver declining 4.74 percent and Copper sliding 0.77 percent. The US Dollar Bull ETF moved higher by 0.36 percent as the US remains a safe haven for investors looking for a currency that is strong when compared to other viable alternatives. On the international investing front, the best performing index last week was found in France with the Paris based CAC-40 Index, which advanced by 1.86 percent. The worst-performing Index of last week was found in South Korea, with the KOSPI declining by 2.22 percent, on fears of what happens in the north after the passing of their ruler. The VIX moved higher by almost 13 percent last week as the few investors who were making trades last week decided that the risks in the market were higher than first thought, primarily due to the noise out of Iran.

For the shortened trading week ending on 12/30/2011, returns in FSI's hypothetical models (gross of fees) were as follows:

	<u>Last Week</u>	<u>YTD</u>	<u>Since 12/31/07</u>
Aggressive Model	0.05 %	-10.72 %	-11.42 %
Growth Model	0.10 %	-8.91 %	-7.57 %
Moderate Model	0.11 %	-6.30 %	-2.28 %
Income Model	0.11 %	-3.67 %	(Insufficient Data)
S&P 500 (benchmark)	-0.61 %	0.00 %	-14.35 %
S&P 500 with Dividends	-0.58 %	2.04 %	-6.61 %

We made no changes to our current model during the previous week as the risks in the market remain high, but we are looking at making some changes in the near future. The biggest change is going to be the implementation of some individual stock holdings that should form a core position within each portfolio. We will provide more details about the implementation in the coming weeks.

Economic News:

<u>Economic Impact</u>	<u>Date</u>	<u>Economic News Release</u>	<u>Date Range</u>	<u>Actual</u>	<u>Expectation</u>
Slightly Positive	12/19/2011	NAHB Housing Market Index	December 2011	21	19
Positive	12/20/2011	Housing Starts	November 2011	685K	627K
Positive	12/20/2011	Building Permits	November 2011	681K	633K
Slightly Negative	12/21/2011	Existing Home Sales	November 2011	4.42M	5.03M
Very Positive	12/22/2011	Unemployment - Initial Claims	Previous Week	364K	380K
Very Positive	12/22/2011	Unemployment - Continuing Claims	Previous Week	3546K	3650K
Negative	12/22/2011	GDP - Third Estimate	Q3 2011	1.80%	2.00%
Positive	12/22/2011	Michigan Sentiment - Final	December 2011	69.9	68
Positive	12/23/2011	Durable Orders	November 2011	3.80%	2.00%
Neutral	12/23/2011	Durable Goods Orders -ex Transportation	November 2011	0.30%	0.30%
Neutral	12/23/2011	Personal Income	November 2011	0.10%	0.20%
Neutral	12/23/2011	Personal Spending	November 2011	0.10%	0.30%
Neutral	12/23/2011	PCE Prices - Core	November 2011	0.10%	0.10%
Neutral	12/23/2011	New Home Sales	November 2011	315K	313K
Neutral	12/27/2011	Case-Shiller 20-city Index	October 2011	-3.40%	-3.00%
Positive	12/27/2011	Consumer Confidence	December 2011	64.5	58
Slightly Negative	12/29/2011	Initial Claims	Previous Week	381K	368K
Neutral	12/29/2011	Continuing Claims	Previous Week	3601K	3600K
Slightly Positive	12/29/2011	Chicago PMI	December 2011	62.5	60.1
Positive	12/29/2011	Pending Home Sales	November 2011	7.30%	0.60%

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

The table above shows the economic news releases from the past two weeks, on the whole there were more releases that were positive than there were negative or neutral. The housing numbers on the whole were good with housing permits, building starts and pending home sales all turning in very positive figures that seem to indicate that the US housing market has leveled off and is starting to slightly climb back. Now all we need is for the Case-Shiller data to turn around and we could start to see a much better recovery in the US housing market. Over the course of the past two weeks we saw the jobless data come out much better than expected, with only 364,000 initial jobless filings two weeks ago, only to see initial jobless claims come back up to 381,000 last week. While 381,000 initial jobless claims is not ideal, it is far better than earlier this year when we were consistently seeing more than 400,000 initial jobless claims on a weekly basis. Most economist point to sustained initial jobless claims of less than 375,000 before the overall unemployment rate is actually moved lower. Continuing jobless claims saw the same sort of dip two weeks ago followed

by a slight uptick last week, but they too remain well below the level that they were experiencing for most of 2011. The two indicators of the past two weeks that pertain to consumer confidence both ticked up, with the University of Michigan's Consumer Sentiment Index increasing slightly up to 69.9, making a six month high. The government calculation of consumer confidence also moved up with the reading last week being 64.5 which is an eight month high. Much of the consumer optimism is due to the better outlook for unemployment in the US which has been stubbornly high but has come back down a little bit over the past few months. One dampener on the economic news releases last week was the third revision of the GDP estimate for the third quarter of 2011 which was revised lower, down to 1.8 from the previous release of 2.0. The closer we get to zero, the more jittery the markets are going to be, so this is something to watch very closely. Wrapping up the economic news releases that were released over the last two weeks was the durable goods orders for the month of November. While the orders not including transportation met market expectations, the orders including transportation far exceeded the market expectations as consumer spent more than expected, and companies spent more than expected on big ticket items such as airplanes.

This week is pretty slow for economic news releases, but a few could have a meaningful impact on the overall market. The week starts out on Tuesday with the release of the ISM Index for the month of December and construction spending for the month of November. The ISM data will be watched very closely because expectations are for a reading of 53.4 which is close to the all important 50 inflection point between expansion and contraction. I am looking for very little surprise out of these two releases. Released later in the day on Tuesday is the FOMC meeting minutes from the last meeting which should hold a little bit more insight into what was discussed but is not expected to show any major new information. On Wednesday the 4th of January, factory orders for the month of November and auto sales for December are set to be released with expectations of a slight increase in factory orders and a strong showing from auto sales as consumers took advantage of year-end deals that many of the manufacturers were offering. On Thursday the standard weekly jobs-related figures are set to be released with expectations that initial jobless claims will come in near 375,000 while continuing jobless claims are expected to show an increase of approximately 50,000 up to 3.64 million. If we can get both of these numbers to beat their expected values, that would be viewed as very positive and something that the market could really rally behind. At the same time as the weekly jobs data is released, the ADP employment figure and the Challenger Job cuts figure (both for the month of December) are going to be released. These two could be more impactful to the market than anything else on Thursday. The ADP figure is expected to show approximately 180,000 new jobs having been created during December while the jobs cuts figure is expected to show a slight decline. If the ADP figure beats expectations by enough, it could signal a very positive release on Friday when the government releases their official unemployment rate. Wrapping up the data released on Thursday is the release of the ISM Services Index for the month of December, which is expected to show very little change over the November level. On Friday some of the biggest releases of the week are set to be released, the biggest of which is the government official reading for the unemployment level in the US during the month of December. Expectations are for a one tenth of a percent increase from 8.6 up to 8.7 percent, but the market will be watching very closely for how the number is arrived at and will probably react more to nonfarm payrolls and nonfarm private payrolls, as those are much better indicators of the overall economy than just the headline number. Overall the first week of 2012 could be a very interesting week from an economic news release standpoint, but it looks like the majority of the releases will shape up well for a strong beginning to 2012.

Have a great week,

Peter Johnson

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