



Weekly Market Analysis

January 30th, 2012

Commentary at a glance:

- Most of the US markets continue 2012 with positive performance.
- Earnings season continues with 59 percent of companies beating expectations.
- Greek debt restructuring talks continue.
- US State of the Union address held a few new items but no major surprises.
- Economic indicators were mediocre.

Market Wrap-Up: Last week saw two of the three major US indexes move higher, starting off the New Year with a very unusual 4 week stretch of increases. The Dow was the one to falter after declining slightly on the back of some weaker-than-expected earnings projections for 2012. Overall, earnings continue to drive the markets as the situation in Greece and the debt restricting deal goes from hot to cold several times per day if you watch the headline news. According to Thomson Reuters, 59 percent of the 189 companies that are member companies of the S&P 500 Index who have released earnings so far for the fourth quarter of 2011 have beaten market expectations. While 59 percent sounds pretty good, it is below the average for this amount of time into earnings season. Below are a few of the bigger names that reported earnings last week that beat market expectations:

3M	McDonalds
Apple	Procter and Gamble
Boeing	Starbucks
Canadian National Railway	Texas Instruments
Johnson and Johnson	United Technologies

Perhaps the largest announcement last week came from Apple, which had a record-setting quarter during the fourth quarter on very strong demand for the iPhone 4s as well as the iPad, while sales for the iPod continued the nosedive they entered more than a year ago. As with all weeks during earnings season, a good number of companies did not meet market expectations. Below are a few of the bigger names that reported earnings last week that missed market expectations:

AT&T	E-Trade
Amgen	Ford
Ball Corporation	Kimberly-Clark
Bristol-Myers Squibb	Verizon
Chevron	Wellpoint

This is the busiest week of earnings season with several hundred companies announcing earnings. Some of the potentially most impactful include:

Aetna	Mastercard
Allstate	McGraw-Hill
Amazon	Merck
Archer Daniels Midland	Northrop Grumman
Broadcom	Pfizer
Chipotle Mexican Grill	Starwood Hotels and Resorts
Dow Chemical	United Parcel Service
Electronic Arts	United States Steel
Eli Lilly	Wendy's
Exxon Mobil	Weyerhaeuser
Hershey	Whirlpool

With all of the earnings announcements scattered throughout the week, this could prove to be the most volatile week of 2012 so far, as the market will likely react positively to companies that beat expectations and react adversely to company that either miss or meet market expectations.

From an overall investment point of view, the latest market movements have probably left the market a little bit ahead of itself and likely to experience a bit of a pull back as some investors take short-term profits. To give everyone an idea of how quickly the market has gone up this year, if you annualize the rate of return that has been experienced by the three major indexes so far in 2012 you would get a 12 month return for the Dow of 64 percent, S&P 500 93 percent and NASDAQ 198 percent. For a little humorous perspective I want to show what the price level of the NASDAQ would be if it really did move up by 198 percent during 2012. Below is a chart of the NASDAQ since before technology bubble of 2000 and on it you can see the current level of the NASDAQ (2,816) on the right hand side of the chart. The red line at the very top of the chart is at 5,158, which is 198 percent above the starting point of 2012. So in order for the current rate of change to continue during all of 2012 we would see the NASDAQ retake its all-time highs of the technology bubble of late 1999 and 2000.



International News: Throughout last week there were numerous news articles about the ongoing Greece debt restructuring talks, all of which have failed to produce anything tangible so far. The topic of Greece was much talked about at the annual World Economic Forum in Davos Switzerland, but there were no new ideas and while almost everyone spoke positively about the developments, their body language seemed to tell another story. The longer this whole situation drags out and the closer we get to March (when Greece will default without the next tranche of aid) the more likely we will see wide movements in global financial markets. It does appear that some parties in Europe are enjoying Greece having the spotlight because it is giving them time to try to get their own financial houses in order without the world watching and criticizing every move they make. While the debt is raging in Greece, other countries have been going about their business with numerous successful bond offerings that have drawn a reasonable amount of demand at rates that are not outrageous compared to where they were even two months ago. The latest action by the rating agencies came from Fitch rating agency as they took a swing at five of the European countries' sovereign debt ratings. The five countries that received a downgrade were Italy, Spain, Belgium, Cyprus and Slovenia. While those were the negative announcements, there was a semi-bright spot, and that Fitch reaffirmed Ireland's credit rating at BBB+ and did not downgrade it. With so many countries seemingly in the crosshairs, it seems more and more likely that the Euro zone will need to issue some type of Euro bond in order to get through the current situation with the least damage possible. Germany, however, is firmly against this idea and has threatened that it will support no such bond issuance in the future.

Elsewhere in the world last week, the violence in Syria continues to escalate as pressure builds against President Assad, and the Arab league has pulled their monitors out of the country on fears of escalating violence. In the same region, Iranian President Mahmoud Ahmadinejad announced that he was ready to hold talks with the members of the UN Security Council, but that stopping Iran's nuclear facilities was not on the table. The announcement comes just days after the EU announced

an oil embargo, which by some estimates would cost Iran \$2.2 billion per day. In addition to wanting to talk, Iran also allowed the UN nuclear team into the country on Saturday for the first time in several months. In reaction to the developments in Iran, oil failed to move lower, in part because of the offsetting violence in the region coming from Syria. If there are talks and some sort of resolution to the nuclear concerns, we will likely see the price of oil decline back to near \$90 per barrel. Most of the rest of the world was reasonably quiet last week, due to the major holiday week (Chinese New Year) in many parts of the world.

National News: National news last week that impacted the financial markets focused on two things—politics and the Federal Reserve. First the State of the Union address given by President Obama on Tuesday evening received a lukewarm reception by the financial markets on Wednesday, as much of what was said had already been said and the likelihood of anything actually getting done on the actionable items is slim. The flat tax of 30 percent on anyone making more than \$1 million during a year was a major point of contention between Democrats and Republicans. When even a joke about spilled milk fails to make everyone laugh, you know it will be tough sledding for the President and members of Congress over the coming year. Energy once again made its way into the address but this time instead of Solyndra (solar company that was in the speech in 2010 and bankrupt in 2011); one of the companies highlighted was Ener1. Maybe it was just coincidental that after being mentioned in the State of the Union, the company filed for bankruptcy (the following day) or maybe it is a signal that being mentioned in the State of the Union is a kind of death sentence for a company. Other topics in the State of the Union included: regulation, consumer protection, trade practices, healthcare and education. Overall there was some impact on the markets, but there was enough skepticism about the ability to get anything done that the movement in the market was muted.

Chairman Bernanke, on the other hand, did manage to get the market's attention last week after the announcement of the FOMC rate decision and his press conference. The biggest change to the FOMC rate decision last week was the announcement that rates were likely to stay at current levels until late 2014. This is a major shift away from the previous announcement which indicated that rates would stay low until the middle of 2013. The change in the length of time can only mean one thing: that the economy still faces "significant downside risks." Chairman Bernanke also took the unusual step of indicating that the Fed's target for inflation was 2 percent; in the past the number has been ambiguous but now it is a hard and fast number. The announcement of low long-term rates helps push the prices of commodities higher, with oil reacting possibly the most as the Fed still seems to be looking for inflation to help the US economy. One of the more impactful aspects of the announcement came from the Chairman's remark that the Fed is prepared for further accommodation in the realm of quantitative easing. This would be QE3, if it were to take place, and exactly how the Fed would go about it remains unknown, but the speculation is that it would involve the mortgage-backed securities markets. According to Mark Mobius, lead manager of the Templeton Asset Management's Emerging Market Mutual Fund, this action by the US Federal reserve would be very positive for the Emerging Markets; as investors' risk appetites increase, emerging markets is a very logical place to look for excess return. The division amongst members of the Federal Reserve about the length of time that rates should remain so low was also very evident in the FOMC release, as some members think that rates should begin to increase this year and others think as far out as 2016. Overall the release by the Fed was an FOMC rate decision that did the very unusual thing of surprising the markets.

Market Statistics: Last week two of the three major US indexes moved higher while one moved lower. The best-performing of the three major indexes was the technology-heavy NASDAQ, which experienced an increase of 1.07 percent. Coming in second was the broadly-based S&P 500, which increased by 0.07 percent while the laggard was the blue chip Dow, which decreased by 0.47 percent. The best-performing sector of the markets was the Medical Devices sector, which increased 4.24 percent. The worst-performing equity sector last week was the US Regional Banking sector, which decreased by 2.06 percent on several weaker-than-expected earnings announcements. Fixed-income investments had a positive week as the long-end ETFs saw an increase of about one percent while the shorter-term ETFs also saw slight advances. Commodities advanced last week, breaking a two week slide and gaining 2.28 percent as oil advanced and precious metals jumped higher. Gold and silver both moved higher, with Silver gaining 5.57 percent and Gold advancing 4.26 percent. Copper also had a strong week with the spot price of copper advancing by 5.20 percent (the two week gain on Copper is 11.4 percent). Oil moved higher by 1.38 percent as unrest in the Middle East continues to increase. The US Dollar Bull ETF dropped by 1.70 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 was found in India with the Bombay based SENSEX Index, which advanced 2.96 percent. The worst-performing index was found in Mexico, with the main Mexican Index declining by 0.50 percent. The VIX increased slightly last week, moving up by 1.37 percent as investors took a bit of a pause on volatility as they await any changes out of Greece and the possible default.

For the trading week ending on 1/27/2012, returns in FSI's hypothetical models (gross of fees) were as follows:

	<u>Last Week</u>	<u>Since 12/31/07</u>
Aggressive Model	-0.25 %	-10.71 %
Growth Model	-0.29 %	-6.99 %
Moderate Model	-0.48 %	-1.79 %
Income Model	-0.70 %	(Insufficient Data)
S&P 500 (benchmark)	0.07 %	-10.35 %
S&P 500 with Dividends	0.12 %	-2.03 %

We made one change over the course of last week, and that was to decrease our holdings of cash by investing into the Forward Select Income fund (KIFAX), which is a very low volatility real estate income mutual fund. We are now fully invested across our models, albeit with a tilt toward conservative investments, as the situation is still very fluid in the Euro zone.

This week's fund spotlight is Wisconsin Energy (WEC). Wisconsin Energy is a power utility company that provides electricity to 1.12 million customers in Wisconsin and Michigan, gas to 1 million customers in Wisconsin and steam power to 460 customers in Milwaukee, Wisconsin. The company was started in 1981 and has a monopoly on many of the power markets in which it operates; the company also invests in and develops real estate in Wisconsin. From a balance sheet standpoint Wisconsin energy is pretty strong, especially when you compare it to other similar Utility companies. The current assets to current liabilities ratio is over 1.0 meaning that it has more current assets than it has liabilities. The total assets to total liabilities is even better, with WEC having \$1.42 in assets for every \$1 that it has in liabilities. With the energy company being regulated, the income stream for the company is very steady, as it is very difficult for someone to

drop WEC's service in exchange for another company. WEC generates approximately \$1 billion per quarter in revenues and has a quarterly net income of approximately \$125 million. The company also pays out a quarterly dividend and currently is running an annualized dividend yield of 3.5 percent.

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 Negative	1/25/2012	Pending Home Sales	December 2011	-3.50%	-3.00%
Positive	1/25/2012	FOMC Rate Decision	January 2012	0-0.25%	0.25%
Neutral	1/26/2012	Initial Claims	Previous Week	377K	375K
Neutral	1/26/2012	Continuing Claims	Previous Week	3554K	3550K
Slightly Positive	1/26/2012	Durable Orders	December 2011	3.00%	2.00%
Slightly Positive	1/26/2012	Durable Orders -ex Auto	December 2011	2.10%	0.70%
Slightly Negative	1/26/2012	New Home Sales	December 2011	307K	321K
Slightly Negative	1/27/2012	GDP-Adv.	Q4 2012	2.80%	3.20%
Slightly Positive	1/27/2012	Michigan Sentiment - Final	January 2012	75	74.2

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

Last week was pretty slow for economic news releases, with the majority of the releases having little impact on the overall financial markets. The week started out on Wednesday with the release of a slightly lower than expected reading on pending home sales for the month of December. This release caused a bit of a reaction in the US home construction sector which had been performing very well but gave up some of the recent gains on the release. The release that had a much larger impact on the market on Wednesday was the Federal Reserve's interest rate decision and ensuing press conference which is discussed above under the national news heading. On Thursday both initial and continuing jobless claims came in very close to market expectations and were therefore a non-market moving event. However at the same time that jobless claims data was coming out, durable goods orders were released and showed a better-than-expected rise in orders, with orders during December being three percent higher than orders in November. Even when auto sales are stripped out of the figures, durable goods orders still beat market expectations; this was taken as a sign that consumers are indeed still spending money and that they are not just buying low dollar items like Christmas presents, but that both they and businesses are making big ticket purchases. Wrapping up Thursday was the release of a less-than-stellar reading for new home sales for the month of December, which came in at 307,000 homes sold while the market had been expecting 321,000. This, coupled with the release earlier in the week about pending home sales, dampened the housing market mood in the US. On Friday the second most impactful release of the week was announced: the fourth quarter 2011 advanced GDP figure as calculated by the government. The market expected a reading indicating a 3.2 percent annual rate of growth in GDP, but a reading of

2.8 percent was shown. This 2.8 percent level is dangerously close the critical level of 2 percent which is the target inflation rate that the Federal Reserve would like to see. Wrapping up the week on Friday was the release of the University of Michigan Consumer Sentiment index for the month of January, which showed a slight increase in consumer sentiment but not enough to excite the markets.

This week is a busy one for economic news releases with numerous releases that could impact financial markets. The week starts out on Monday with the release of personal income and spending for the month of December, which are both expected to show a slight increase over November levels. Later on Monday, the PCE prices are set to be released with expectations of very little change over the November levels, an indication that inflation is currently not an issue in the US. On Tuesday, the last day of January 2012, the Case-Shiller 20-city home prices index for the month of November is set to be released along with the Chicago PMI and the Consumer Confidence Index both for the month of January. For the home price index, the market is expecting a decline of 3.2 percent, which, much like the releases last week, would indicate that while the worst of the housing market cycle may be behind us, we are still a long way from a strong housing market in the US. The Chicago PMI will be watched very closely after the Philadelphia Fed missed expectations of manufacturing so badly two weeks ago; let's hope that this release turns out more like the Empire release of a few weeks ago and beats market expectations. Wrapping up Tuesday is the consumer confidence index for the month of January, which is expected to show that consumers grew slightly more confident during the month. On Wednesday, February 1st, the ADP employment change figure for the month of January is set to be released with expectations of an increase of 200,000 jobs. Released at the same time as the ADP report is the ISM data for the month of January, which is expected to change very little over the December level. Rounding out the busy day Wednesday is the release of construction spending for December and auto sales for January. Construction spending could disappoint the market, but the disappointment will likely be overshadowed by a better-than-expecting reading on auto sales as the trends seen in December are likely to have continued in January. On Thursday the standard weekly jobless data is set to be released with expectations of very little change over the previous week's reading. Released at the same time as the jobless figures is the Challenger job cuts projections for the month of January which are expected to show that businesses are still not hiring, but instead doing more with less from an employee standpoint. On Friday the government releases their official unemployment rate for the month of January which is expected to show no change over the 8.5 percent rate seen in December. Remember nonfarm and nonfarm private payrolls are going to be more important than the overall headline unemployment rate in the long term. Later on Friday the factory orders for the month of December are set to be released with expectations that they increased 1.5 percent over the level seen in November. Wrapping up the day on Friday is the ISM services index for the month of January which is expected to show a reading of 53.1, which is good but still dangerously close to the all-important 50 level that indicates either expansion or contraction depending on which side of the line the reading falls.

Have a great week,

Peter Johnson

Feel Free to forward this e-mail

Financially Speaking, Inc.

5889 Greenwood Plaza Blvd. Suite 400

Greenwood Village, CO 80111
T 303.290.0702
T 800.228.9876
F 303.290.6581

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