



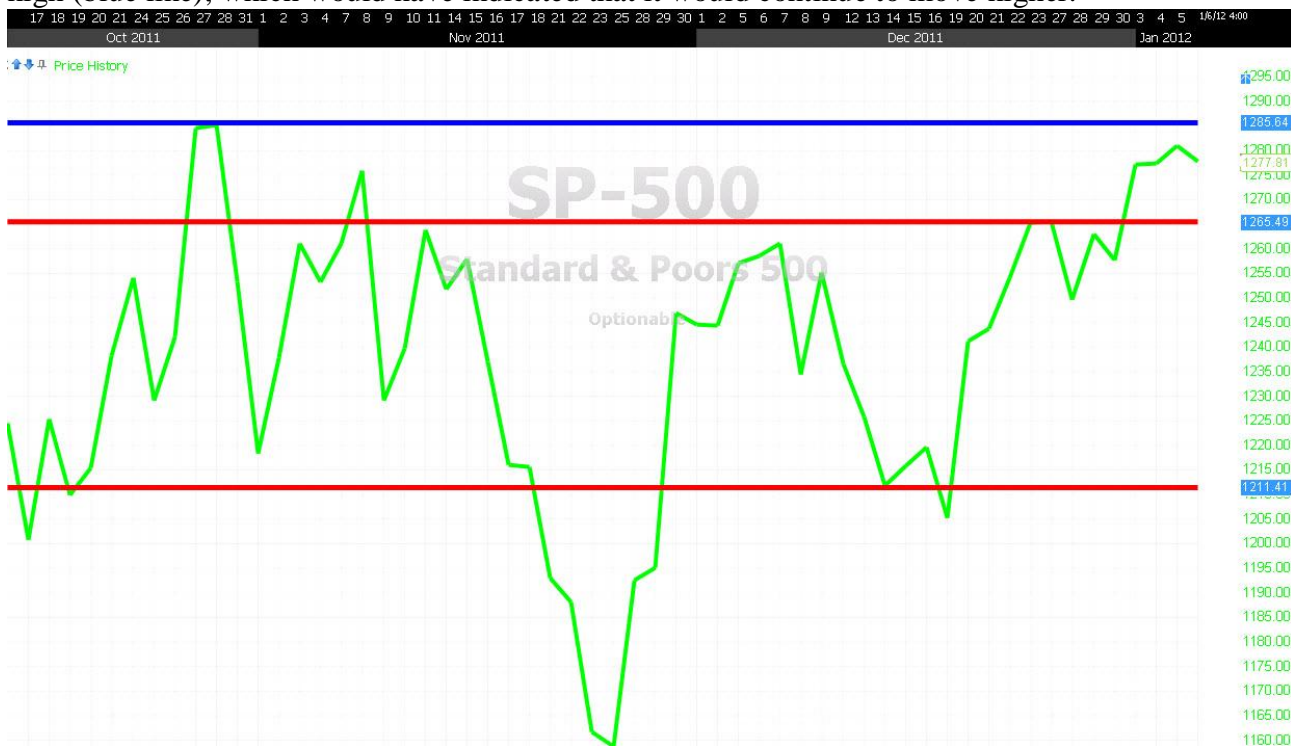
Weekly Market Analysis

January 9th, 2012

Commentary at a glance:

- The markets were positive during the first week of 2012.
- Hungary is the latest European country to run into trouble.
- Iran continues to threaten to close the Strait of Hormuz.
- The unemployment rate made a surprise move down during the month of December.

Market Wrap-Up: Last week volume picked up significantly when compared to the prior week (the week after Christmas), but volume was still anemic when compared to the average volume for the markets over the past 30 days. Keeping the extremely low volume in mind, last week there were very few meaningful changes in the overall market. As you can see from the chart below, the market did move back over the previous trading range (upper red line) but it failed to create a new high (blue line), which would have indicated that it would continue to move higher.



Last week the new year started off with a bang. During the first day of trading there was higher than average volume and the market moved higher as fund managers and some retail investors took part in their annual rebalancing of accounts and models. After the quick start and new news out of Europe about their ongoing situation, the market muddled around the final three trading days of the week. The coming weeks will be driven primarily by the earnings season, with many companies

offering results for the fourth quarter of 2011 and guidance for full year 2012. Already there have been some market watchers who have been calling for the fourth quarter figures to be worse than expected as the situation in Europe will finally start to be seen as having an adverse impact on many industries and companies. It seems like the market is already pricing this in, so a large move down from here seems unlikely if it were only due to earnings announcements. Overall, while the situation in Europe looks uncertain (to say the least), here in the US consumers are spending more money and the economy has taken timid steps forward towards stronger economic growth. One of the key numbers that everyday Americans like to look at as a gauge for the economy is the headline unemployment rate, which just last week moved down to 8.5 percent. Whether or not you agree with how the government calculates or miscalculates this figure, it is a figure that a large number of Americans watch and therefore it is meaningful when it is trending downward. We will be hearing much more about this downward trend in the unemployment rate as the Presidential election starts to heat up later on this year.

International News: There was a new name in the international news headlines last week - Hungary. Hungary has had its fair share of issues for a long time, but last week they all seemed to come to a head with the outright failure of a bond auction. On Thursday the government of Hungary tried to sell 45 billion forint (the main unit of Hungarian currency - \$180 million USD) but only received interest for 35 billion forint and the interest rate that they had to offer to sell the one year bills was 9.96 percent, up from 7.91 percent just two weeks earlier. A lot of the increase in borrowing costs had to do with the recent round of downgrades that has besieged the country's finances. Moody's and Standard and Poor's both downgraded Hungary to junk status in late December, indicating that their bonds were below investment grade and that there was a high risk of default on the bonds. At the same time, Fitch rating agency decided to keep the country's rating at investment grade but at the very lowest rating they could while remaining investment grade. Last week, however, Fitch jumped on the bandwagon and lowered its debt rating for Hungary down to junk like the other two rating agencies. With all three of the major rating agencies rating Hungary as junk, their bonds had to be issued with junk status assigned to them. If Fitch had stayed with an investment grade credit rating then all of the bonds would have been considered investment grade, but that was not the case. With the failed auction, the rest of the Hungarian bonds saw their interest rates increase, with the 5 and 10 year bonds both surpassing 11 percent yield, while at the same time the forint currency took a bit of a nosedive against all of the other world currencies. In light of last week's developments it now looks like Hungary is going to have to turn to the IMF and the EU for help in order to avoid an outright default and they are going to need assistance very quickly. While there will probably be a lot of discussions about how the central bank of Hungary is acting against the EU and the IMF from a policy standpoint I think Hungary will receive the bailout money needed in the end, especially with it being such a small amount relative to other countries such as Spain and Italy. This week is an exciting week for Europe as it appears that most of the countries in the region are going to back to work after their holidays and meetings between German Chancellor Merkel and French President Sarkozy will once again resume along with meeting of the European finance ministers. Any news out of the group could have the potential to move the world financial markets but it is unlikely that a plan will actually be worked out over the coming weeks. It will more likely take several months of negotiations by the politicians to get anything meaningful done. With interest rates rising in countries such as France, time may not be on the side of politicians and they may have to take action sooner than they would like. In another part of the world, the Middle East is now back in focus.

Iran has been issuing warnings now for almost two weeks about closing the Strait of Hormuz, should the US and other countries impose stricter sanctions on them for the ongoing nuclear program, which many countries believe is aimed at creating nuclear weapons and not nuclear power. After a round of naval war simulations two weeks ago, Iran once again called for a stop to ongoing and new trading restrictions, but the US and the world do not seem deterred as we have stated repeatedly that we will not allow Iran to hold a third of the world's oil supplies hostage by restricting passage through the strait. Iran is the fourth largest oil exporter in the world and while some countries have said that they will step up production to make up any shortcoming in production if Iran is not allowed to ship any oil, it seems like it would be very difficult to get the same quality oil that Iran puts out in any meaningful amount. We saw the reaction to the war of words over the past few weeks in the oil markets around the world as the prices have noticeably risen. In the end, if Iran were to close the strait they would be cutting off their own financial lifeline because nearly all of the oil they produce goes through the strait as well. If Iran is not bringing in money from selling oil, the government would quickly have major problems and the people in Iran would likely suffer until they decided to take action. This could include actions against the government like we saw with the Arab Spring last year and like those we are still seeing in Syria.

National News: The Iowa votes have all been tallied and some candidates have moved on to other states along the campaign trail, while others have gone back home after dropping out of the race completely. In the end Iowa ended up being a virtual tie, with Mitt Romney receiving eight votes more than Rick Santorum with both candidates receiving roughly 24 percent of the vote. Ron Paul came in third with 21 percent of the vote and Newt Gingrich held onto fourth place with 13 percent of the vote. Dropping out of the race after the votes were counted was Michele Bachmann, who managed only 5 percent of the vote. Rick Perry decided to go back home to Texas and “reevaluate his options”, but it now looks like he will remain in the race - at least for the time being. Up next for the Republican contenders is New Hampshire, where Mitt Romney holds a sizable lead over the rest of the field and where the attack ads are coming out in full force. Wall Street still seems to be positioning for Romney to get the Republican nomination, so any major deviations from such an outcome could have an impact on the stock market. With both the US House of Representatives and the Senate out on recess until later this month, it has been a very quiet time in Washington DC. When both sessions of congress reconvene, it is going to be very interesting to watch the debates as we have successfully kicked the can down the road on a number of topics with very short-term measures. Of most interest to the financial markets is the payroll tax cut extension, and the ongoing budgetary fight over the automatic cuts that are set to take place at the start of 2013.

Market Statistics: Last week was a pretty good start to the new year with the majority of the move in the financial markets coming on Tuesday (the first day of trading during 2012). The best performing index of the three major indexes last week was the technology heavy NASDAQ, which experienced an increase of 2.65 percent. Coming in second last week was the broadly based S&P 500, which increased by 1.61 percent while the laggard of the week was the mainly blue chip Dow, which increased by 1.17 percent. The best-performing sector of the markets was the Home Construction sector, which increased 4.88 percent, with very little news to justify such a large move. The worst-performing equity sector last week was the Utility sector, which decreased by 2.67 percent. Fixed-income investments had a poor week as the long end ETFs saw a decline of 2.08 percent while the shorter term ETFs saw a slight decrease in value. As the meetings really start to get under way in Europe, we should see increasing movement in currencies as trades adjust their positions. Commodities had a strong week last week with the overall GSCI Commodity Index increasing by 2.94 percent. Gold and silver both bucked their recent downward trend and moved

higher last week, with Silver gaining 3.60 percent and gold advancing 3.43 percent. Oil, thanks in large part to Iran, increased by 2.76 percent with WTI Crude oil topping \$100 per barrel; energy as a sector increased by 1.78 percent. The US Dollar Bull ETF moved higher by 1.11 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 Brazil with the Sao Paulo based BOVESPA Index, which advanced by 3.25 percent. The worst-performing Index of last week was found in China, with the Shanghai SE Composite declining by 1.64 percent. The VIX moved lower by almost 12 percent last week as investors started 2012 much less fearful than they ended 2011. With the downward move last week, the VIX now sits at its lowest point since July of 2011 with a reading of 20.63; that level on the VIX implies a move of approximately six percent over the coming 30 days, but the direction is unknown. Looking at the last ten years of data for the S&P 500, the first week of 2012 (+1.61 %) had almost double the average return (+0.85 %) of the index for the first trading week of the year. The first week of trading, however, does not appear indicative of how the full year will turn out.

For the shortened trading week ending on 1/6/2012, returns in FSI's hypothetical models (gross of fees) were as follows:

	<u>Last Week</u>	<u>Since 12/31/07</u>
Aggressive Model	0.06 %	-11.37 %
Growth Model	0.09 %	-7.49 %
Moderate Model	0.14 %	-2.14 %
Income Model	0.20 %	(Insufficient Data)
S&P 500 (benchmark)	1.61 %	-12.98 %
S&P 500 with Dividends	1.64 %	-5.08 %

We made several changes throughout the week last week with the first change being the adjustment of cash through selling part of our position in Mainstay High Yield (MHCAX). We raised cash in order to implement our new stock model, which we put into action later in the week in some of our models. Some of the stocks which were purchased include the following:

Consolidated Edison	Amerisource Bergen
General Mills	AptarGroup
Hormel Foods	Canadian National Railway
JM Smucker	Chevron
Johnson & Johnson	Church & Dwight
Kimberly-Clark	Coca-Cola
McCormick	Flowers Foods
McDonald's	MSC Industrial Direct
Procter & Gamble	Nike
Southern	Owens & Minor
Wal-Mart Stores	RLI Corp
Wisconsin Energy	South Jersey Industries
	V F Corp

Over the coming weeks I will be highlighting two or three of the stock holdings in each weekly commentary and providing you with the high points about each company. Some of the names I am sure everyone is very familiar with, while others will be companies that you have never heard of but who's products you use every day. We received a special rate at Schwab for all of our trades which were placed last week in order to help us smooth our implementation of the new pieces of our models. If you have any questions about our current models or would like more information about your specific holdings please feel free to give us a call. I will also be making a change next week to the way in which I report weekly performance in the above table going forward.

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	1/3/2012	ISM Index	December 2011	53.9	53.4
Positive	1/3/2012	Construction Spending	November 2011	1.20%	0.50%
Neutral	1/3/2012	FOMC Minutes	Previous Meeting		
Neutral	1/4/2012	Factory Orders	November 2011	1.80%	2.10%
Very Positive	1/5/2012	ADP Employment Change	December 2011	325K	180K
Positive	1/5/2012	Initial Claims	Previous Week	372K	375K
Slightly Positive	1/5/2012	Continuing Claims	Previous Week	3595K	3620K
Slightly Negative	1/5/2012	ISM Services	December 2011	52.6	53
Slightly Positive	1/6/2012	Nonfarm Payrolls	December 2011	200K	150K
Slightly Positive	1/6/2012	Nonfarm Private Payrolls	December 2011	212K	170K
Very Positive	1/6/2012	Unemployment Rate	December 2011	8.50%	8.70%

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

Last week was a pretty slow week for economic news releases but there were a few releases that made an impact on the overall market. The week started out on Tuesday with the release of the ISM Index for the month of December which slightly beat market expectations and indicates that manufacturing in the US continues to expand, which is positive for the US recovery. Construction spending also made an unexpected move upward as spending increased 1.2 percent during the month of November, which helped provide a boost to a housing market that has been pretty stagnant. In a release that typically holds very little new information, the most recent FOMC meeting minutes outlined how the Fed is going to be giving the details of their plans in the future for dealing with short term interest rates. This is a major change and should alleviate some of the guesswork that the stock market does as it relates to where interest rates are going to be in the future. On Wednesday, January 4th, factory orders were shown to have increased by 1.8 percent during November and declining during October. This reversal was taken as a positive sign for the

US economy as a whole. Auto sales for the month of December were released last Wednesday and showed a strong finish to 2011. In total, 1.2 million cars were sold during the month and for fiscal year 2011, 12.8 million cars were sold. Both of these figures were a nice increase over the same time period during 2010. US manufactures saw some of the highest increases in numbers of cars sold, while some of the foreign manufacturers, especially Honda, struggled against natural disasters which backed up their supply lines through much of 2011. On Thursday we received our first positive piece of economic news, the ADP Employment change figure for the month of December, which indicated that 325,000 jobs had been added to our economy while the stock market had been expecting only 180,000. This, coupled with better than expected initial and continuing unemployment claims, led the market to think that Friday's government release of the official unemployment rate could surprise the market and move lower. Later during the day on Thursday the ISM Services Index for the month of December was released and came in slightly below market expectations, but still well above the critical 50 level, and indicated that the service sector in the US is indeed expanding. On Friday the government released their official unemployment rate for the month of December and surprised the market when it was shown to have decreased from 8.6 percent down to 8.5 percent, while the market had been expecting 8.7 percent. In the same releases the government also revised their last five years of unemployment data and indicted that the overall unemployment rate in the US peaked at 10.0 percent, which is lower than first reports back in 2009. Overall, the releases of last week seem to be pointing to a US economy that is still in recovery mode and has the ability to withstand some turmoil during 2012.

This week is another slow week for economic news releases, with really only one main release that investors will be watching for. The week starts off on Monday with the release of consumer credit for the month of November, which is expected to show an expansion of \$7 billion. On Tuesday, wholesale inventories for the month of November are set to be released with expectations of a modest increase of approximately 0.6 percent. On Wednesday, the Fed's beige book for the month of January is set to be released, with investors ready to closely scrutinize several of the districts' economic growth. On Thursday, the most potentially impactful release of the week comes out, the retail sales figure for the month of December. Expectations for this release are pretty high so it is one that could disappoint the market, but if previous data is correct retail sales have been strong, so the high figure may be warranted. Wrapping up the week for economic news releases on Friday is the release of the University of Michigan's Consumer Sentiment Index first estimate for January. After a strong reading in December, expectations are for the index to show an additional increase pushing it to its highest level since April of 2011. In addition to the economic news releases coming out this week we are also going to have ten speeches by members of the Federal Reserve board at various engagements throughout the week and a number of debt auctions of various maturities both here in the US and abroad—it could be an exciting week.

Have a great week,

Peter Johnson

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