



## Weekly Market Analysis

February 13<sup>th</sup>, 2012

### Commentary at a glance:

- US averages saw their first negative week of 2012 last week.
- Greece passed their latest round of austerity, riots ensued.
- The situation in Syria continues to deteriorate.
- The 2013 US budget proposal has been delivered to congress by the President.

**Market Wrap-Up:** Last week was the first time in 2012 during which all three of the major US indexes experienced a decline in value over the course of the week. While the decline was slight, it was still enough to break the winning streak that the US averages had been on since the beginning of the year. In looking at the daily chart of the S&P 500 below you can see that the S&P 500 (green line) did break above the previous trading range (blue lines) but failed to stay above it and moved back below the level at the end of the week:



Last week's market movement does not necessarily mean that the bull run that we have seen in the US markets will come to a quick end, but it does seem to signal that investors stand ready to pull some short-term profit out of the portfolios. The main factor driving the move lower last week was the continuing battle over austerity in Greece and the ensuing riots that started to take place toward the end of the week. With Greece coming back into play and making headlines, we also saw a spike in the VIX (+21.58 percent) much like what we used to see during 2011 every time Greece austerity

was mentioned. In some ways, it seems as though the euphoria of the great start to the year has now diminished and investors are coming back to the realization that the situation in Europe will drive global markets more than a continued US economic recovery and a decent fourth quarter earnings season. The fourth quarter earnings reports last week came in slightly better than the market expected; according to data compiled by Reuters, the “beat ratio” for the quarter now stands at 63 percent. This 63 percent figure indicates that of the 352 companies in the S&P 500 who have reported their fourth quarter earnings, 221 have beaten analyst earnings expectations for the fourth quarter of 2011. One of the key aspects of the earnings releases has been the forward-looking guidance for 2012, which most companies offer when they announce earnings. This guidance has been strong, with many companies expecting a good year if everything holds together politically around the world—it is this “if” that is giving investors some pause currently.

**International News:** Greece is once again in the spotlight with the world watching as the Greek government tries to pass the necessary austerity in order to continue receiving bailout funds that it desperately needs. The latest round of austerity measures add up to a total of about 7 percent of the GDP of Greece over the next three years. The most immediate effects of the austerity will include cutting 15,000 government jobs, decreasing minimum wage by 22 percent for people currently working, and for people hired into new minimum wage jobs there will be a 32 percent decrease in the wage rate. In the end, this round of austerity will likely assure the original amount of bailout funds which Greece is due in late February, but it still does not prevent these types of measures from taking place in the future as more austerity will be needed. The vote on the austerity measures did pass parliament on Sunday, and in response to the passage people rioted in the streets of Athens as well as many other towns in Greece. Of particular concern is the unrest that has now spread to the resort towns, causing many vacationers to become fearful of the instability. If tourism is hurt by the unrest taking place in Greece, this would be a painful blow for the government because a large amount of the Greek economy is based on tourism. In addition to the usual throwing of rocks and Molotov cocktails, the riots this time around in Athens also saw more than 45 buildings burn down as the unrest escalated. With all of this unfolding in Greece, it is now up to the Euro zone finance ministers to approve the next round of bailout money. The ministers will hold a meeting on Wednesday of this week to determine whether the latest round of austerity is enough for them to release the latest round of bailout money, some €130 billion—a figure that is already thought to be at least €15 billion to little for what is currently needed. It looks like this time around the EU finance ministers are taking a hard look at the numbers as they have announced that they want to see specifics on how the government will actually achieve the budget savings which they have projected. Another sticking point to the next round of money being sent to Greece is that they have to have the bond swap agreement in place with all of the banks and creditors in order to move forward, something that has been agreed to in principal but is far from finalized. The problem with Greece remains that they are taking very quick measures to ensure that they do just enough to receive the money that they are set to receive but are not fixing the long-term issues. The long-term fundamental flaws are exactly what the Germans and other countries are pointing out and they have yet to see much, if any, action taken on them. Elsewhere in the world, the Middle East continues to be a bit of a powder keg, with both the violence continuing in Syria and uncertainty with the situation in Iran causing oil to increase slightly over the course of the past week.

**National News:** It is official: we have a starting point for the 2013 budget, so Congress has something to fight over for the next few months. The starting point is the budget that the White House drafted and sent to Congress this morning. The budget has several items which are sure to

ruffle a few feathers in Congress. The main one is a tax increase on the wealthiest Americans; something which the Republicans are adamantly against. In total the budget is \$3.8 trillion and does almost nothing to reform our biggest issues here in the US – including our entitlement spending, which is quickly turning into one of the largest line items in the budget. Under the proposed budget projections, 2012 will see the US run a budgetary deficit of \$1.3 trillion, but then in 2013 we are projected to see the deficit fall to just under \$1 trillion. Already the budget is making news on the Republican campaign trail with several candidates pointing out that the overall deficit is still about where it was when President Obama took office after pledging to cut it in half during his first term in office. The market did not react to the news that a 2013 budget was delivered to Congress mainly because if last year's budget is any example, we could be in for a long, drawn out fight over various aspects of the bill, and it is far too early for the market to make educated guesses about what will actually end up in the final budget. In other news out of Washington DC, the House of Representatives did pass the insider trading bill that prevents members of Congress and their immediate family members from taking advantage of knowledge that is not public and using that knowledge to make money in the stock market. The final vote in the House was 417 for the bill with 2 against. The bill now goes to the President's desk for his signature. In the national news last week there were several news outlets that picked up on a well known technical trading signal, reporting that the S&P 500 had produced what is known as a "golden cross." A golden cross is when a slow daily moving average crosses up above a longer term moving average; in this case it was a 50-day moving average crossing above a 200-day moving average. One thing that confused me a little bit was that the cross over actually occurred on the last day of January, so why the mainstream media just now picked up on it is beyond me. Either way, the signal in a nut shell means that the bull market rally that started in late December has now been confirmed (technically) and if history plays out, we will likely see the stock market move higher than its current level twelve months down the road. Wrapping up national news this week is the Republican race to the nomination, with Rick Santorum pulling off a great round of three caucuses last week, winning Colorado, Minnesota and Missouri. Mitt Romney came in second to Santorum in all three of the races, but pulled out a decisive victory in Maine over the weekend. Now political watchers will be counting the days until Super Tuesday, which is March 6<sup>th</sup>, when ten states hold their caucuses and the future of several candidates may be decided.

**Market Statistics:** Last week all three of the major US indexes moved lower for the first time in 2012. The best-performing of the three major indexes was the technology-heavy NASDAQ, which experienced a decrease of 0.06 percent. Coming in second was the broadly-based S&P 500, which declined by 0.17 percent, while the worst performing index was the blue chip Dow, which slid 0.47 percent. The best-performing sector of the markets was oil and gas exploration, which increased 2.33 percent. The worst-performing equity sector last week was basic materials, which decreased by 2.45 percent. Fixed-income investments were largely unchanged across the market, with movement of primarily less than one-tenth of a percent. Commodities increased last week with the overall GSCI Index advancing by 0.74 percent as oil moved higher. Oil increased by 1.24 percent and the price of gasoline also increased across the US although demand for oil actually decreased; much of the rise in oil prices can be attributed to the violence in the Middle East. Precious metals declined last week as investors for the most part continued to gravitate toward equity investments. The US Dollar Bull ETF increased by 0.14 percent as investors decided to move back to the dollar as the situation in Europe drags on. On the international investing front, the best-performing index was found in Taiwan for the second week in a row with the Taiwan Weighting Index, which advanced 2.44 percent. The worst-performing index was found in the Netherlands, with the Amsterdam Index declining by 1.91 percent. The VIX spiked last week by 21.58 percent, making back all of the

downward movement it had seen over the past several weeks and doing so in a hurry. As mentioned above, the VIX appeared once again to be focused on the situation in Europe and not on the bumping along of the US economy, which it seemed to be stuck on earlier this year. The VIX remains well below the average level of 2011, but traders will be watching very closely to see if any further increases could cause investors to put the brakes on risky investments.

For the trading week ending on 2/10/2012, returns in FSI's hypothetical models (gross of fees) were as follows:

	<u>Last Week</u>
Aggressive Model	-0.23 %
Growth Model	-0.29 %
Moderate Model	-0.36 %
Income Model	-0.50 %
S&P 500 (benchmark)	-0.17 %
S&P 500 with Dividends	-0.13 %

We made only two changes over the course of last week, and they were both made in order to increase our overall potential return in our models. The two changes came in the form of moving partially out of our most conservative investments and putting the proceeds into Rydex Small Cap Pure Growth (RYWAX) and Natixis Real Estate Fund (NRFAX). We moved so as to better participate in some of the upside should the markets continue to move higher, while at the same time reserving the flexibility of being able to sell the position without incurring a penalty and move toward safety should the market warrant it. The positions that were initiated were just the first step in what could turn out to be a few steps we take to increase our participation in potential market upside.

### **Economic News:**

<b><u>Economic Impact</u></b>	<b><u>Date</u></b>	<b><u>Economic News Release</u></b>	<b><u>Date Range</u></b>	<b><u>Actual</u></b>	<b><u>Expectation</u></b>
Positive	2/7/2012	Consumer Credit	December 2011	\$19.3B	\$8.5B
Positive	2/9/2012	Initial Claims	Previous Week	358K	370K
Slightly Negative	2/9/2012	Continuing Claims	Previous Week	3515K	3475K
Slightly Negative	2/10/2012	U of M Consumer Sentiment Index	January 2012	72.5	74

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

Last week was very slow for economic news releases but overall the releases were slightly positive. The week kicked off on Tuesday with the release of consumer credit for the month of December, which was shown to have increased by \$19.3 billion, far exceeding the market expectations of an increase of \$8.5 billion. This is a good release for the overall US economy because it signals that the banks are indeed lending again and lending is what keeps the US economy moving forward. On Thursday February 9<sup>th</sup>, initial jobless claims beat market expectations, coming in at 358,000 while

the market expected 370,000. The good news, however, was short lived as the continuing jobless claims figure came in worse than expected at 3,515,000 while the market was looking for 3,475,000. One thing that the news media did not pick up on, or at least failed to mention, was the fact that the initial jobless claims figure for two weeks ago was revised higher by 6,000 jobs increasing it up to 373,000 claims. The current trend seems to be to release something strong for the headline news stories but then make revisions that may the media may ignore at a later date. Eventually, I would think that the market will catch on to this and discount strong releases until after the revision has been made. On Friday, the University of Michigan released their consumer sentiment index for the month of January, which was a bit of a downer for the markets, as it indicated that the US consumer sentiment declined for the first time in several months. This decline will be watched very closely by traders as it is indicative of people typically spending less money in the future.

This week is an average one for economic news releases with a few releases that could impact the market overall. The week kicks off on Tuesday with the release of the retail sales figures for the month of January, with the market expecting to see that sales stayed strong during the month after a strong finish to 2011. On Tuesday, the much anticipated Empire Manufacturing Index for the month of February is set to be released, with expectations of a slight increase over the level seen in January, indicating that manufacturing is expanding in the greater New York area. Later on Tuesday, Industrial production for the month of January is set for release, with expectations that production will have risen by 0.6 percent during the month. Wrapping up Tuesday is the release of the FOMC meeting minutes from the previous meeting, which could show some interesting conservation that took place over the new targeted inflation figure as well as the extension of ultra low interest rates through the end of 2014. In the end, most of the market moving news from the meeting has already been released, so this release should hold little new information. On Thursday, the standard weekly jobs-related figures are set to be released, with expectations that initial jobless claims will have increased by 7,000 applications and continuing jobless claims will have increased by 45,000 jobs. Again, as mentioned above, watch the revisions to this week's data to see if there is a trend forming. Also released on Thursday is the Producer Price Index (PPI) for the month of January, which is expected to show a slight increase of 0.3 percent, thanks in part to the rising cost of energy. Wrapping up the day on Thursday is the release of the Philadelphia Federal Reserve Index for the month of February, which will show economic activity in the area. The market expects this release to jump up by almost 30 percent, increasing from 7.3 up to 10.0. While this move would be very welcome, it seems like it could be a little bit overambitious. The economic news releases of the week are capped on Friday with the release of the Consumer Price Index (CPI), which is expected to show a slight increase of 0.3 percent, with much of the blame resting, again, on the rising costs of energy. Overall this week, the market will once again be at the mercy of the situation in Greece, and it would take a drastic deviation from expectations in any of the above mentioned news releases to really impact the overall market.

Have a great week,

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