



Weekly Market Analysis

February 6th, 2012

Commentary at a glance:

- January is now behind us and it was a very good month for three main US averages.
- Greek debt talks had a 24 hour deadline that has now passed.
- The situation in Syria continues to deteriorate.
- The US saw an unexpected downward move in the unemployment rate during January.

Market Wrap-Up: Stocks in the US ended January of 2012 much like they started—on a tear to the upside. For the Dow, January of 2012 represented the best January since 1997 (15 years ago), the S&P 500 had its best January since 1999 (13 years ago) and the technology heavy NASDAQ turned in its best performance since 2001 (11 Years ago). The table below indicates returns for January and the corresponding returns for the whole year going back to 1989 for the three indexes:

January	Dow	S&P 500	NASDAQ		Year	Dow	S&P 500	NASDAQ
January 2012	3.40%	4.36%	8.01%					
January 2011	2.72%	2.26%	1.78%		2011	5.53%	0.00%	-1.80%
January 2010	-3.46%	-3.70%	-5.37%		2010	11.02%	12.78%	16.91%
January 2009	-8.84%	-8.57%	-6.38%		2009	18.82%	23.45%	43.89%
January 2008	-4.63%	-6.12%	-9.89%		2008	-33.84%	-38.49%	-40.54%
January 2007	1.27%	1.41%	2.01%		2007	6.43%	3.53%	9.81%
January 2006	1.37%	2.55%	4.56%		2006	16.29%	13.62%	9.52%
January 2005	-2.72%	-2.53%	-5.20%		2005	-0.61%	3.00%	1.37%
January 2004	0.33%	1.73%	3.13%		2004	3.15%	8.99%	8.59%
January 2003	-3.45%	-2.74%	-1.09%		2003	25.32%	26.38%	50.01%
January 2002	-1.01%	-1.56%	-0.84%		2002	-16.76%	-23.37%	-31.53%
January 2001	0.93%	3.46%	12.23%		2001	-7.10%	-13.04%	-21.05%
January 2000	-4.84%	-5.09%	-3.17%		2000	-6.18%	-10.14%	-39.29%
January 1999	1.93%	4.10%	14.28%		1999	25.22%	19.53%	85.59%
January 1998	-0.02%	1.02%	3.12%		1998	16.10%	26.67%	39.63%
January 1997	5.66%	6.13%	6.88%		1997	22.64%	31.01%	21.64%
January 1996	5.44%	3.26%	0.73%		1996	26.01%	20.26%	22.71%
January 1995	0.25%	2.43%	0.43%		1995	33.45%	34.11%	39.92%
January 1994	5.97%	3.25%	3.05%		1994	2.14%	-1.54%	-3.20%
January 1993	0.27%	0.70%	2.86%		1993	13.72%	7.06%	14.75%
January 1992	1.72%	-1.99%	5.78%		1992	4.17%	4.46%	15.45%
January 1991	3.90%	4.15%	10.80%		1991	20.32%	26.31%	56.84%
January 1990	-5.91%	-6.88%	-8.58%		1990	-4.34%	-6.56%	-17.80%
January 1989	8.01%	7.11%	5.22%		1989	26.96%	27.25%	19.24%

The first set of four columns in the table above are highlighted green if historically (going back to 1989) the index had a better return in January than the return experienced during 2012. As you can see, it is somewhat rare. The S&P 500 has only had two years of returns better than in January of 2012, which amounts to less than nine percent of the time. The four columns on the right hand side of the table indicate that happened for the whole year after such a strong start in January, with almost all of the numbers looking positive and very large. Does this mean that we are in for a stellar year during 2012 for the three major US averages? Probably not, because that is a very short sample of time that has been analyzed. In fact, there has been much more extensive research done on what is known as the “January Effect” but the results have been somewhat mixed. The January Effect, in its simplest terms, says that as goes January so goes the year - meaning if January is a positive month for returns then the year will also be positive. In the last 23 years the theory has held up pretty well with the Dow only experiencing a single year of total decline after a positive start to January. The S&P 500 and the NASDAQ did not fare quite as well, as they both had three years that experienced a decline after a positive January. When looking at much longer-term data, the theory falls apart a little bit, especially when the 1930’s are included in the data set. We will just have to wait and see if 2012 continues along the recent trend of the theory working or if longer history takes hold and the theory deteriorates. One of the theories about the January Effect is that companies normally release better than expected earnings for the fourth quarter of the previous year during January, boosting stock prices.

So far for the fourth quarter earnings numbers for 2011, sixty percent of the companies reporting have beaten market expectations. This is a little bit below what you would expect for such a large move having taken place in the markets. The list of companies from last week’s commentary that released earnings last week turned in results as indicated by the table below:

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

This simple list of 24 stocks that released earnings had 16 stocks beat expectations (highlighted green) while 6 either met (white) or missed expectations (highlighted red), equaling a beat ratio of 66 percent. This week is another very full week for earnings, so they could have an impact on the overall market movement but so far the 60 percent beat ratio seems to be holding up very well, so we would have to see a wide deviation from that level in order to see much of a reaction. With the increase last week the major US indexes have now pushed through recent highs and are, in the case of the NASDAQ, trading at a level not seen since late 2000, on the downside of the technology

bubble. Both the S&P 500 and the Dow have yet to make it back to the highs seen in early 2008 before the recession took hold. Below is a chart of the S&P 500 (green line) with the most recent trading range being indicated by the red lines and longer term trading range being indicated by the blue lines:



As you can see the S&P 500 is close to breaking out to the upside of the trading range it was stuck in for most of 2011, but it has not yet broken through.

International News: Last week there were two main topics in international news; Europe and the the Middle East. On the European front there was little progress on the situation in Greece as it pertains to the restructuring of Greek debt. The latest news out of Greece is that they were threatened with a 24 hour deadline over this past weekend for them to either make a deal or risk not receiving the scheduled bailout payment that is due to them in a few weeks. The main issue that is being fought over right now is that the projected cuts, which are being pushed on the banks, may not be high enough to actually fix the situation in Greece and that it would only temporarily fix things. The number that is being talked about currently is a haircut of between 70 and 80 percent on the outstanding debt. This is a far cry from the initial 25 percent haircut which was talked about last year, but slightly better than just saying “sorry banks your assets are getting nothing”. Another key issue that is being discussed is the ability of the Greek government to actually push through and implement the austerity measures that have already been approved. If they can’t do that then there is really no point in continuing the discussions over bailout money because they are going to default anyway. In the Middle East, Syria continues to be an issue, with President Assad’s regime continuing to kill protestors. The latest news on the situation is that both Russia and China vetoed a UN Security Council resolution over the weekend that would have called for President Assad and his government to step down from power and end the violence that is spreading in Syria. Both Russia and China said that the decision to veto the measure was due to the violence in Syria being an “internal affair” and that they did not want to get involved with another country’s internal affairs. In reality, both countries have trade agreements with Syria and stand to lose money on blocked trade if the resolution was actually passed. In addition to financial impacts on both Russia and

China, both countries also seem to be highly susceptible to having the same kind of issue within their own countries, with people rising up against the government. If they were to condemn what is taking place in Syria they might be opening themselves up a little bit more to an internal revolution at home. Iran failed to make many headlines last week, as the situation that was quickly escalating now appears to be cooling off a little bit. There was, however, news out of Washington DC that Israel was looking at military operations to take out the nuclear capabilities of Iran - an action that could have very adverse affects on the regional stability.

National News: In the first piece of major legislation to come to the floor that was referenced in the State of the Union address, the Senate has passed a bill that would prevent insiders in Congress from trading stock in public companies on non-public information. The bill is aimed at reforming some long standing traditions in congress during which many members see their wealth increase at a much faster rate than the average American, with the majority of the gains being made in the financial markets. The bill will now have to go before the House of Representatives, where there is sure to be a fight because of the amount of tacked on amendments that made it through on the Senate side, but in the end the bill will likely be passed. President Obama is calling for the House to act quickly so that he can sign the bill into law. This prodding by the President will likely only make the process slower, as the republicans seem to want to do the opposite of what the democrats do on most topics. If the bill does get signed into law, the impact on the financial markets could be interesting. We could see everyday investors following the financial transactions of certain members of congress very closely just like they follow people in the hedge fund world and key investors such as Warren Buffett. Another bill that got a little bit of movement last week was a bill that extends the payroll tax cut that is currently in place through the end of the year, but there is still disagreement between the two sides over how to pay for the extension. February 29th is the deadline to watch for a bill related to the payroll tax credit extension because that is when it is currently set to expire. The impact on the stock market would be seen if the extension is not passed along, because it is money that workers could be spending that instead would be diverted to taxes. In other national news, Mitt Romney won the Florida and Nevada caucuses, and did so by a very wide margin over the other Republican contenders. It is now onto the next three states which are set to hold their caucuses; Colorado, Minnesota and Missouri. With the caucuses that have been held so far, it looks like if all of the candidates really do stay in the race until the end we may not see a republican nomination until late summer. The financial markets still seem to be leaning toward Romney getting the nomination and in the latest polls between President Obama and Romney it is running at a dead tie, with any differences being well within the margin of error of the poll.

Market Statistics: Last week all three of the major US indexes moved higher, continuing the remarkable stretch that has started 2012. The best-performing of the three major indexes was the technology-heavy NASDAQ, which experienced an increase of 3.16 percent. Coming in second was the broadly-based S&P 500, which increased by 2.17 percent; while the laggard was the blue chip Dow, which increased by 1.59 percent. The best-performing sector of the markets was the Home Construction sector, which increased 5.10 percent. The worst-performing equity sector last week was the Utility sector, which increased by 0.29 percent. Fixed-income investments had a negative week as the long-end ETFs saw a decrease of 1.28 percent while the shorter-term ETFs also saw slight declines. Commodities decreased last week with the overall GSCI Index declining by 0.38 percent as oil and precious metals moved lower. Gold and silver both declined, with silver giving up 0.82 percent and Gold 0.79 percent. Copper bucked the trend, increasing 0.16 percent. Oil fell last week by 1.92 percent as the situation in Iran does not appear to be getting out of hand any more than it already has. The US Dollar Bull ETF increased by 0.18 percent as investors decided to move

back to the dollar as the situation in Europe continues to drag out. On the international investing front, the best-performing index was found in Taiwan with the Taiwan Weighting Index, which advanced 6.10 percent. The worst-performing index was found in Australia, with the Sydney All Ordinaries Index declining by 0.65 percent. The VIX fell last week by 7.72 percent, as investors continued to think that the risks to the overall market have abated. The VIX is quickly approaching the lowest level prior to the downturn in 2008, but it is susceptible to large increases in a short amount of time as investors assess the amount of risk in the markets very quickly.

For the trading week ending on 2/3/2012, returns in FSI's hypothetical models (gross of fees) were as follows:

	<u>Last Week</u>	<u>Since 12/31/07</u>
Aggressive Model	0.75 %	-10.04 %
Growth Model	0.62 %	-6.41 %
Moderate Model	0.53 %	-1.27 %
Income Model	0.49 %	(Insufficient Data)
S&P 500 (benchmark)	2.17 %	-8.41 %
S&P 500 with Dividends	2.21 %	0.14 %

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. We are currently evaluating making a change in our conservative investment allocation, which would allow us to better participate in some of the upside, should the markets continue to run away from reality.

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	1/30/2012	Personal Income	December 2011	0.50%	0.40%
Neutral	1/30/2012	Personal Spending	December 2011	0.00%	0.10%
Neutral	1/30/2012	PCE Prices - Core	December 2011	0.20%	0.20%
Slightly Negative	1/31/2012	Case-Shiller 20-City Index	November 2011	-3.70%	-3.20%
Slightly Negative	1/31/2012	Chicago PMI	January 2012	60.2	62.8
Negative	1/31/2012	Consumer Confidence	January 2012	61.1	67
Slightly Negative	2/1/2012	ADP Employment Change	January 2012	170K	200K
Neutral	2/1/2012	ISM Index	January 2012	54.1	54.5
Slightly Positive	2/1/2012	Construction Spending	December 2011	1.50%	0.40%
Slightly Positive	2/2/2012	Initial Claims	Previous Week	367K	375K
Slightly Positive	2/2/2012	Continuing Claims	Previous Week	3437K	3538K
Positive	2/3/2012	Nonfarm Payrolls	January 2012	243K	155K
Positive	2/3/2012	Nonfarm Private Payrolls	January 2012	257K	168K
Positive	2/3/2012	Unemployment Rate	January 2012	8.30%	8.50%
Neutral	2/3/2012	Factory Orders	December 2011	1.10%	1.50%
Slightly Positive	2/3/2012	ISM Services	January 2012	56.8	53.1

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

Overall, last week was a slightly positive week for economic news releases with the largest positive news coming from the employment figures. The week kicked off on Monday with the release of personal income and spending for the month of December. Personal income slightly beat market expectations while spending just missed expectations. The slight increase in personal income could be due to better than expected employment figures during the month of December, this would also explain why spending did not increase, as people who are recently back to work typically do not go out and dramatically increase their spending since they are likely to be uncertain about their new job. Later during the day on Monday, the PCE Prices figure for the month of December was released and was exactly in line with market expectations, therefore having little impact on the overall market. On Tuesday, the Case-Shiller 20-city home prices index for the month of November was released and it missed market expectations by a pretty wide margin. This is a slightly negative signal for the US housing market, despite the release being very dated. Later on Tuesday, there were two other releases that had a negative impact on the overall market; the Chicago PMI and the Consumer Confidence Index for the month of January. The Chicago PMI came in at 60.2 while the market had been looking for 62.8, which is negative, but it stayed well above the very important 50 level indicating that manufacturing in the greater Chicago area is expanding. The bigger negative of the day was the consumer confidence figure, which showed a sharp decline after many months of slow advancements. This is something that will need to be watched in the future very closely, because if the consumer loses faith in the economic recovery and starts to pull back on spending that could easily derail the recovery that has been limping along. Wednesday, February 1st, was a very busy day for economic news releases. The day started off with the release of the ADP employment change for the month January, which missed market expectations and signaled that the unemployment rate set to be released on Friday may in fact be correct in showing no change. However, this turned out not to be the case. The ISM Index came in slightly below market expectations at 54.1, but much like the Chicago PMI, it stayed well above the critical 50 level.

Construction spending for the month of December was strong - in fact it was a full percent above what the market had been looking for. This provided the US housing market with a bit of a boost on Wednesday that made up for the decline seen earlier in the week. Throughout the day on Wednesday, the auto industry was releasing their sales figure for the month of January. When everything was tallied up, January was a great month of auto sales, with sales being above the 14 million annualized rate (a level not seen since the 2009 cash for clunkers program). On Thursday the standard weekly jobless data was released with both readings missing expectations but doing so by a small amount, making the two releases very non-impactful on the overall market. On Friday came the the most anticipated release; the unemployment rate in the US for the month of January according to the government. The unemployment rate was shown to have dropped from 8.5 percent down to 8.3 percent, but there is much speculation that the figure had a bit of election year politics behind it. In addition to the headline figure, both nonfarm payrolls and nonfarm private payrolls beat market expectations, indicating that the 8.3 percent could actually be correct. We will just have to wait and see next month how much of a revision is applied to the previous figures, but for Friday the release had a large positive impact in the overall market movement for the day. Later during the day on Friday, the factory orders data for the month of December was released with the figure coming in just below the market expectations but still remaining positive at 1.1 percent. The week wrapped up on Friday with the release of the ISM Services index which surprised the market to the upside and indicated that the services sector continues to expand in the US.

This week is a very slow week for economic news releases with only a couple of releases that could have any impact on the market whatsoever. The week kicks off on Tuesday with the release of consumer credit for the month of December, which is expected to show an expansion of \$8.5 billion, far less than the \$20 billion that was seen in November but at least it is still a positive number. On Thursday, the standard weekly jobs related figure is set to be released with expectations that both initial and continuing jobless claims both increased slightly over the course of the previous week. 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 a slight increase. This will be a welcome sign if it comes to fruition as the print last week on consumer confidence did not look good. Greece will continue to dominate the headlines over the course of the next week and it would take something very unusual for any of the economic news releases to overshadow the ongoing situation.

Have a great week,

Peter Johnson

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