



Weekly Market Analysis

November 7th, 2011

Commentary at a glance:

- Greek Prime Minister wanted to let the people vote on the latest bailout package.
- Greek Prime Minister scrapped the idea of the people voting.
- Greek Prime Minister resigned, after surviving a nail biting confidence vote.
- US economy looks like it will not fall back into a recession.
- US unemployment rate unexpectedly ticked down to 9.0 percent during October.

Financially Speaking News: As some of you may know, last week we bid farewell to a long-time member of the Financially Speaking staff, Janette Denton. We wish Janette all the best as she pursues a new opportunity in her career. The rest of our staff is available to assist you with any questions or account servicing needs that you may have.

Market Wrap-Up: Last week the situation unfolding in Greece continued to roil world markets. The market's movements were emotional reactions by traders and investors alike as news of a referendum vote called by the Greek Prime Minister early on in the week failed to materialize. Had the referendum vote actually moved ahead, there was a good chance that the people would have voted not to accept the bailout package that the rest of Europe had worked so hard on just a few days earlier. As you can see in the chart below, the S&P 500 (green line) broke above the recent trading range (red lines) two weeks ago, making it back into the lower end of the previous trading range (blue lines). Last week, however, the S&P 500 proved that it could not sustain the move and broke back down through the old trading range and tested, or bounced off of (see black circle), the upper end of the recent trading range. That bounce is a very good sign for the market, as it signifies a valid level of support for the markets going forward.



With a new government being formed early this week in Greece, it is likely that the bailout package will be accepted and that the latest installment of cash will be sent to Greece. Coupled with some good economic news from the US government, it was on this revelation that the market rallied into the end of the week. Where we go from here is anyone's guess, but it looks as though for the time being we will probably see the market move in a sideways direction due to the headwind that is in place with the super committee deadline coming up. Despite the uncertainty ahead, most of the underlying fundamentals of the market look strong, as many companies have solid financial statements combined with lower overall expenses than before the downturn in 2008.

International Politics: Last week international politics once again dominated the headlines and pushed financial markets up and down around the world. The week started off with a move that caught the world by surprise when Greek Prime Minister George Papandreou called for a referendum vote by the people of Greece to see if they were willing to take the bailout package that had been hammered out by European leaders the previous week. When news of a vote by the people made headlines, the world markets immediately moved lower because there was a real sense that they would vote not to take the money. In fact, there was a poll released in the Greek news paper *Kathimerini* that indicated that a full 66 percent of the Greek population preferred to move off of the Euro and back onto the Drachma rather than continue the austerity and bailouts. As could be expected, the other Euro zone leaders were furious about the announcement of a people's vote and almost immediately said that they would not pay the latest tranche of bailout funds if there was going to be a referendum vote. All of this happened during the first two days of last week, ahead of the G20 meeting that was to be held in France starting on Wednesday. On Wednesday Papandreou was called to a private meeting with German Chancellor Merkel and French President Sarkozy. While a transcript of the meeting was probably not taken and information about the meeting will probably never be revealed, Papandreou had a change of heart about the referendum vote after the meeting and decided to call it off. This decision was followed by loud calls from the opposition party that called for Papandreou to immediately resign his post. After saying that he had no intentions of resigning from Prime Minister, there was a confidence vote held at the Greek parliament late on Friday night that ended up going in Papandreou's favor by only 3 votes. After trying and failing over the weekend to form a coalition government that would be able to deal with the ongoing situation, Papandreou announced that he would resign from his post so that a coalition government could be formed. With an election not scheduled until mid-February, there is now a lot of uncertainty about how the interterm government will handle the current situation and if a compromise among the parties can be reached in order to move forward with more austerity and continue to receive bailout funds. As for whom the next Greek Prime Minister is likely to be, the early polls suggest that Lucas Papademos is the frontrunner. Papademos is a strong candidate because of his previous economic experience; he worked for the US Federal Reserve Bank of Boston, was the governor of the Bank of Greece and most recently was the Vice President of the European Central Bank.

While all of the mayhem was going on in Greece last week, other countries were experiencing their own uncertainties, with the markets focusing on one country in particular—Italy. Italy has long been the focus of the European finance ministers because it is literally too big to fail and almost too big to save. The government bond market evidences just how bad the situation in Italy really is. Last week the bond market saw the Italian 10-year bond yields move to their highest level since the formation of the Euro zone, with yields pushing over 6.5 percent. While the yield is far better than countries such as Greece and Portugal (32.5 and 12.2 percent, respectively) Italy issues so much

debt on an annual basis that, at current rates, they will have a very hard time moving forward. Last time rates went over six percent in Italy, the ECB stepped in and started to purchase Italian debt on the open market in an attempt to drive down yields. The ECB continues to purchase Italian debts but these efforts are becoming more difficult as yields have continued to rise after initially declining when the ECB started to purchase to make purchases. The Bloomberg yield chart of 10-year Italian bonds is below:



In another sign of the infighting and uncertainty surrounding Italy, the Italian Prime Minister announced over the weekend that he would not resign from his post, echoing a line that seems to have doomed many politicians in the past. In other news out of Europe last week, the new President of the ECB, Mario Draghi (an Italian), announced a cut in the benchmark interest rate of 0.25 percent moving the rate from 1.5 down to 1.25 percent. This announcement was made at the same time as he announced lower projections for economic growth in the Euro zone over the next year, so some of the benefit that the market normally would have seen in the announcement was muted by the negative outlook.

National Politics: A glimmer of hope was seen last week on Capitol Hill as a bill was actually passed by the House of Representatives by a count of 405 for the bill and only 16 against in the largest sign of bipartisan support in many months. The bill repealed a tax of three percent on government contractors that was set to go into effect at the start of 2012, so it was not a major piece of legislation but it was something. Most of last week focused on the fight over job creation by the President's plan and the alternative plans that the Republicans have devised. While the President keeps hammering his jobs plan, which has already been largely rejected by both Republicans and Democrats, Republicans point to 15 bills that have passed the House of Representatives but are dead on arrival at the US Senate. They say in the words of John Boehner "that the bills will help get our economy moving again," but most of the bills deal with cutting Federal regulations so the long-term outcome of the bills on the economy is questionable. Lawmakers remain divided on even the most mundane of tasks, one of which is a bill that would extend the two percent decrease in payroll taxes that was implemented two years ago that is set to expire at the end of this year. If the payroll tax break is allowed to expire, it would mean a direct cut of two percent to disposable income for the working Americans who are already pinched by increasing costs on everyday items. While there are disagreements on Capitol Hill, there have been a few changes that have been made public about the workings of the secretive Super Committee who's deadline is fast approaching. The grand bargain now seems like it is farther away than ever before after a letter was sent last week from a

large bipartisan group of House members (100 in total) asking the Super Committee to push forward with a much bigger goal in mind than the initial \$1.2 trillion in cuts. There is also rumbling that Republicans may go along with closing some of the loopholes in the tax code that before they considered to be akin to increasing taxes. This type of compromise is exactly what the super committee was designed to negotiate, and now it is a waiting game to see what they come up with. In the end they will likely come up with a plan, but it will probably be close to midnight, November 22nd, and the plan will likely just say that cuts need to be made by “X” number of dollars. The actual cuts being made will likely be kicked out to another committee that will actually have to do the heavy lifting.

Market Statistics: All three of the major US indexes moved lower over the course of last week as uncertainty about the Euro zone permeated the markets. For the week the technology-heavy NASDAQ turned in the best performance after experiencing a decline of 1.86 percent, while the primarily blue-chip Dow declined by 2.03 percent. The broadly based S&P 500 experienced a decline of 2.48 percent during the week as financials in particular were hard hit at the onset of the week. The best-performing sector of the markets was utilities, which declined 0.09 percent. The worst-performing equity sector was the global financial sector, which decreased by 7.45 percent as investors worried about how large losses in Europe would hurt banks. Fixed-income investments had a great week, with the long end of the Treasury curve (20+ years) increasing by 4.5 percent while the shorter end of the curve also experienced a bit of an increase. Commodities moved higher, with the GSCI Commodity Index advancing by 0.18 percent; oil advanced by 1.01 percent, while the overall energy sector saw a decline of 2.41 percent. The metals saw mixed results last week as Gold advanced by 0.73 percent while Silver declined by 3.12 percent and Copper declined by 4.77 percent. The US dollar saw a major advance of 2.60 percent against a basket of international currencies as currency investors continue to be wary of the situation in Europe. On the international investing front, the best return was found in the China with the Shanghai Composite Index increasing 2.22 percent. Globally, the worst-performing index was in the Netherlands with the Amsterdam Index declining by 6.91 percent. With the VIX (green line below) experiencing a drop of nearly 22 percent two weeks ago while breaking down through a level of resistance (red line below), some investors thought that volatility would continue to move lower. From a technical charting standpoint this theory would have been correct, but charting does not always work and last week was an example of this. The VIX spiked higher by 23 percent last week on the uncertainty surrounding Europe. As can be seen on the chart below, the VIX moved back into its previous trading range early on in the week and then slowly worked its way back down.



For the trading week ending on 11/4/2011, returns in FSI's models were as follows:

	<u>Last Week</u>	<u>YTD</u>	<u>Since 12/31/07</u>
Aggressive Model	-0.92 %	-7.17 %	-7.90 %
Growth Model	-0.63 %	-6.43 %	-5.05 %
Moderate Model	-0.29 %	-4.75 %	-0.66 %
Income Model	-0.21 %	-2.82 %	(Insufficient Data)
S&P 500 (benchmark)	-2.48 %	-0.35 %	-14.65 %

Over the course of last week we made no changes to our models. We currently remain invested in relatively low volatility equity sectors of the market such as utilities and consumer products as well as a few sectors of the market that have been showing a lot of strength such as midcaps, energy and high yield bonds. Throughout last week we saw our models perform exactly as we would have liked and expected; giving up less than the markets on downward moving days and participating in much of the upside on days that the market increased in value. If you have any questions about how you are currently invested or would like more information about our models please contact our office for more information.

Economic News: Last week was full of economic news releases, most of which were neutral in the effect on the overall market. The week started out on Monday with the release of the Chicago PMI for the month of October which came in very close to market expectations at 58.4. This number is an indication that manufacturing is still expanding in the greater Chicago area and was a positive sign for the overall economy as other releases of manufacturing data over the past few weeks have not been as positive. On Tuesday, the first day of November, the ISM Index was released and missed market expectations, but not by much, so it was a non market moving event, especially in light of what was going on in Europe. Construction spending for the month of September was also released on Tuesday and came in slightly weaker than the market had been expecting but it too was not weak enough to cause a panic. Auto sales were released throughout the day on Tuesday and in the end the total number of auto sales beat market expectations with 13.3 million vehicles sold during October. This is a very positive sign for the economy as cars are something that do not typically sell well if the US Consumer thinks that we are heading into a recession. On Wednesday November 2nd the Challenger Job Cuts data for the month of October was released and came in above market expectations at 110,000 jobs having been created during the month. This release gave some investors hope that the unemployment rate to be released on Friday by the government might beat market expectations. Later on Wednesday, Federal Reserve Chairman Ben Bernanke made the FOMC interest rate announcement of no change to the current 0-0.25 percent range. The chairman also held a press conference after the announcement during which he answered many questions from the media. While there was no real new information released, he did reiterate that the Fed was ready for action if need be and that they were watching the situation in Europe very closely. This combined with the downgrade in the outlook for the US economy for the remainder of 2011 and all of 2012 led many speculators to think that another round of quantitative easing is not far away and that it will likely target the US mortgage market. On Thursday the standard weekly jobs related figures were released with initial jobless claims falling surprisingly below the all important 400,000 level to 397,000. While this was seen as good news, continuing jobless claims came in slightly above market expectations, somewhat negating the positive initial claims figure. Later on Thursday

was the release of the ISM Services Index for the month of October, which came close to market expectations at 52.9 and was, therefore, a non market moving event. On Friday November 4th after much anticipation, the unemployment rate according to the US government was released for the month of October. The unemployment rate was shown to have declined by one tenth of a percent down to 9.0 percent during the month, which was seen as very positive and unexpected. Some of the excitement was dampened a little bit however by the nonfarm payrolls and nonfarm private payrolls figures, both of which missed market expectations. Overall, the data released throughout the week was neutral with a few exceptions that were positive and negative for the markets.

This week is a very slow one for economic news releases. The week starts out on Monday with the release of Consumer Credit for the month of September which is expected to show an expansion of \$5 billion. On Wednesday November 9th Wholesale Inventories for the month of September are set to be released with expectations that they increased by 0.5 percent in a gear up for the Christmas season. On Thursday the standard weekly jobs-related figures are set to be released with markets expecting initial jobless claims having increased by 3,000 up to 400,000 (we could see something better than 400,000 very easily on this release). Continuing jobless claims are also expected to have increased slightly up to 3,700,000 during the course of the previous week. If we see both of these figures beat market expectations and move lower than last week's release this would be seen as a very positive sign for the US economy as a whole as we would have started a possible trend downward on unemployment. Wrapping up the day on Thursday is the release of the Treasury budget for the month of October, which is expected to be a negative \$105 billion, and which is actually much better than September's reading of -\$140 billion. Wrapping up the week on Friday is the release of the University of Michigan Consumer Sentiment Index for the month of October which is anticipated to show a slight increase. Peppared in throughout the week we will also see a wide range of members of the Federal Reserve speaking publicly about the current situation in the US and the world. These speeches will undoubtedly hold more weight in the market than the scheduled releases and could give some additional insight into what the Fed is expecting moving forward.

Have a great week,
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