



Weekly Commentary March 1, 2011

The Markets

Geopolitical concerns were center stage last week, and stocks were controlled by the crude oil market. Violence exploded in Libya as Colonel Moammar Gadhafi clung to power, but his days are numbered in our opinion. He is facing a significant number of loyalists who are turning against him, and the United Nation's Security Council has stepped in and passed a sanctions resolution against Libya. The United States and European Union have also worked closely to freeze assets Gadhafi, his family and other senior Libyan officials control.

Investors were reintroduced to volatility and pullbacks for the major averages as the Middle East crisis spread and caused a disruption in oil supplies. Oil prices spiked nearly 10%, briefly rising above \$100 per barrel to their highest prices in more than two years. We do not believe the spike will derail the bull. That would occur if investors' expectations that the rise in prices was going to be sustainable grew. However, the fear of rising oil prices will be ongoing, and it was reflected in a spike in the Chicago Board Options Exchange Volatility Index (VIX) – a measure of investor fear. The index jumped more than 25% on Tuesday, February 22 alone and had a two-day jump of more than 30%. In the Tuesday-Thursday period, the Dow Jones Industrial Average and S&P 500 fell approximately 2.5% while the decline in the NASDAQ composite was nearly 4%. Mid- and small-cap averages fared even worse. Stability was restored later in the week as the International Energy Agency and Saudi Arabia of Libyan oil provided to the market. This served as a relief valve for oil prices and helped stocks stabilize and lift since last Thursday.

Although economic data were pushed to the background last week and didn't have much impact on trading, some of it was important. Fourth-quarter GDP was revised down to 2.8% from 3.2%, but consumption grew at a slightly faster pace versus a year ago, and business investment continued its double-digit growth rate. In addition, the final February University of Michigan consumer sentiment index rose to its highest reading since January 2008. Weekly jobless claims fell back below the 400,000 level. The positive implication for stocks, in our opinion, is that once investors refocus on the fundamentals, these data will provide a good floor underneath the market.

On this note, in a Monday speech, New York Fed President William Dudley said the "considerable brighter" economic outlook isn't yet reason for the central bank to withdraw its monetary stimulus. He said, "We provided additional monetary policy stimulus via the asset purchase program in order to help ensure the recovery did regain momentum." Dudley emphasized that the U.S. economy is still vulnerable and the Fed cannot afford to become overly optimistic about the growth outlook because of the long healing process that's necessary after the financial crisis. Part and parcel, he suggested that the economy can be allowed to grow rapidly for quite some time before there is a real risk to underlying inflation. The recent rise in energy and other commodity prices, however, does require more vigilance on the Fed's part to communicate effectively to the marketplace about its objectives and ability and willingness to withdraw stimulus before inflation becomes troublesome.

Stock market pullbacks help remove short-term excesses, and last week was no exception as some of the overbought condition was worked off. The American Association of Individual Investors sentiment poll, a contrary indicator, showed a sharp decrease in the level of bullishness and an increase in bearishness. After rising to a ratio of nearly four bulls for every one bear just nine weeks ago, bulls and bears are now equal after the impact on individual investors' psyches

of Tuesday's and Wednesday's pullback. A bearish factor, however, has been the decline in short interest, which has fallen to its lowest level since 20007. This removes potential buying power if stock prices continue to climb. The New York Stock Exchange cumulative advance/decline line also suffered a pullback, and it will be important for this indicator to reach new highs and confirm new highs for the stock market indexes, which we expect will occur because we still believe there is plenty of sidelined cash to get into the market. On this note, nearly \$40 billion of funds have flowed into stocks since the beginning of the year. A weekend article in *The Wall St. Journal* highlighted that it is an ominous sign that the "Johnnies come lately" are now committing funds to the market after its nearly two-year rise and a doubling in prices. We generally agree that it is not a good sign but are not overly concerned at this point because the amount flowing into stocks is not even close to what flowed out in 2008-2010. In other words, there are still plenty of timid souls on the sidelines with the potential to fuel the market.

Index Performance Statistics – March 1

Index	Close	Day Change	Day % Change	% YTD Change	52 Wk % Change
DJIA	12058.02	-168.32	-1.38	4.15	15.88
NASDAQ	2737.41	-44.86	-1.61	3.19	20.02
S&P 500	1306.33	-20.89	-1.57	3.87	16.81

Source: Bloomberg

*Price return — does not include dividends

Bernanke Signals No Rush to Tighten When Asset-Buying Ends

Federal Reserve Chairman Ben S. Bernanke signaled he's in no rush to tighten credit after the Fed finishes an expansion of record monetary stimulus, seeing little inflation risk and still-slow job growth. A surge in the prices of oil and other commodities probably won't generate a lasting rise in inflation, Bernanke told lawmakers yesterday in semiannual testimony on monetary policy. A "sustained period of stronger job creation" is needed to ensure a solid recovery, and the Fed's benchmark rate will stay low for an "extended period," he said.

The comments suggest Bernanke will keep the Fed on course to complete \$600 billion of Treasury purchases through June under the second round of so-called quantitative easing. He pledged to act if higher commodity prices persist, spurring inflation and increasing inflation expectations. "Things will not change materially with regards to monetary policy in 2011 and perhaps heading out into 2012," said Brian Levitt, New York-based economist at OppenheimerFunds Inc., which manages \$182 billion.

"They will complete Quantitative Easing 2, and the fed funds rate will remain effectively at zero for the rest of the year." Bernanke said yesterday that stable labor costs and the impact of commodity-price gains in recent decades indicate that the U.S. should expect a "temporary and relatively modest increase" in consumer prices. "If you look at the history of commodity prices, they tend to be significantly more volatile than other prices," said Ward McCarthy, chief financial economist at Jefferies & Co. in New York, in an interview on Bloomberg Television's "Street

Smart.” Bernanke will probably “sit back for a while and make sure that it doesn’t spread to the general price level.”

Last Week

Bulls were slowed down this week as heightened civil unrest in the Middle East and North Africa weighed on markets. Political turmoil in Libya fueled a meaningful pickup in risk aversion and sent crude oil prices surging to two-year highs while gold moved back above \$1,400 an ounce. In addition, another round of hawkish commentary from European Central Bank and U.K. officials inflated investor speculation of further interest rate hikes, which drove the dollar to a three-week low versus the euro. Conversely, February consumer confidence jumped to the highest level since 2008, but investors remained jittery as they digested a handful of weak earnings reports, disappointing housing data and a GDP number that showed a slow-down in growth. Going into Friday’s open, the S&P 500 index has given up most of February’s gains but remains in the green by 3.85% for the year.

Next week’s calendar of economic releases could help speed things up. Of particular importance is the release of the February employment reports on Friday. Consensus expectations are looking for the unemployment rate to tick up to 9.1% from 9% in February and non-farm payrolls to increase by 147,000. Leading up to the employment report, we will get monthly updates on personal spending and income, manufacturing, vehicle sales, and productivity. Along with the data, investors will likely pay attention to next week’s Fed action, particularly Chairman Bernanke’s semi-annual monetary policy update to Capitol Hill. In addition, speeches from regional Fed presidents Dudley, Rosengren, Hoenig, Lockhart and Kocherlakota will grace the tape, as well as Wednesday’s release of the Beige Book survey of business activity in the twelve Fed districts.

On the earnings front, reports continue to exceed analyst expectations as the fourth-quarter season nears completion. Of the 420 companies in the S&P 500 index that have reported results as of Tuesday’s close, 71% have beaten consensus earnings expectations, setting the stage for a seventh straight quarter with over 70% earnings beats. For next week’s calendar, most of the scheduled releases come from the retail, energy and utility sectors. The notable companies on tap to report include AutoZone (AZO \$253.25), Staples (SPLS \$20.71), Costco (COST \$72.98), BJ’s Wholesale (BJ \$47.94), Kroger (KR \$22.97), Fresh Del Monte (FDP \$26.98), PetSmart (PETM \$39.63), HJ Heinz (HNZ \$49.57), Foot Locker (FL \$19.03), Canadian Natural Resources (CNQ \$47.83), Range Resources (RRC \$52.09) and Edison (EIX \$35.80).

Weekly Focus – Think about it

“Cycles of shortage and surplus characterize the entire history of oil.”
~ Daniel Yergin

Best Regards,

Jim, Aaron & Angela
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- * The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks.
- * The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.
- * Bloomberg is the source for any reference to the performance of an index between two specific periods.
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- * Past performance does not guarantee future results.
- * The Markets prepared by Scott Marcouiller, Chief Technical Market Strategist, Wells Fargo Advisors 3/1/11.
- * Bernanke Signals No Rush: Scott Lanman, Bloomberg 3/1/11
- * Last Week cited from Bryan Piskorowski, Market Analyst, Wells Fargo Advisors 2/25/11.
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