



Weekly Commentary April 26, 2011

The Markets

As it has for the last several weeks, the stock market once again remained resilient during the holiday-shortened week as it faced mounting challenges on both the domestic and international fronts. As we discussed last week, Standard & Poor's (S&P) made headlines when it lowered its ratings outlook on U.S. long-term government debt from neutral to negative. S&P stated there is one-in-three chance that it will lower the rating by 2013. In the accompanying statement, the rating agency said neither political party's budget plan does enough to fix the shortfall. S&P is also worried about whether the tensions between the two parties will allow for a long-term solution. Politically motivated or not, maybe S&P's announcement will have a beneficial long-term impact on getting lawmakers to work together and compromise. Investors weighed in with a knee-jerk negative reaction, and the stock market had its worst one-day performance since March 16 – the start of the latest rally – on April 18. By week's end, the losses had been erased and then some as the "Teflon" stock market again showed its resilience to negative news. Behind the catalyst of strong earnings reports, the major averages rebounded the next three days. The S&P 500 recorded its first gain in three weeks and pushed back above its 50-day moving average and closer to its February 2011 highs. The Dow Jones Industrial Average rose to a nearly three-year high.

Digging deeper into the budget issue, economists weighed in on the two political parties' plans to cut the country's debt. A *CNN Money* survey revealed that eight out of 18 economists polled said they believed neither the Democrats' nor the Republicans' deficit reduction plans were in the country's best interests. The critics said it is not the two plans' timeframe that matters but rather that neither plan seems to meet the standard of keeping the economy growing while cutting spending. Similar to what S&P would presumably like to see, the survey revealed that most economists preferred a third option that would likely be favorable for the stock market: compromise.

On the international front, more violence erupted in the Mideast during the long holiday weekend. Syrian security police loyal to President al-Assad battled with protestors. By Monday morning, tensions had escalated and the security forces were storming protestors with tanks. In Libya, U.S. Predator drones struck two different targets after NATO requested it to help its alliance make progress against the Libyan military. NATO forces stepped up their air strikes as well.

Investors shrugged off the chief of OPEC's statement that he expects crude oil to remain above \$100 per barrel until at least 2012. Last Friday, a story on Bloomberg News noted that President Obama said a Justice Department probe will examine the role of "traders and speculators" for possible fraud or manipulation in the oil and gasoline markets. This is one more worry for investors but not an unusual move when you have a run-up in price of the magnitude these two markets have experienced.

The Bank of Japan (BOJ) was more forthright than usual last Friday, conceding that the economy may contract in both the first and second quarters of this year. The BOJ governor vowed to take

action should conditions deteriorate further. Quoted in a weekend newspaper, he said taking expectations of continued power-supply disruptions from the nuclear crisis into account, supply constraints would likely continue into August. Earlier this month he hoped that the supply-chain problems would be resolved by June or July.

With renewed unrest in the Mideast, high oil prices that are showing no signs of abating at this time and further possible slowing economic growth out of Asia, the wall of worry seems to be growing ever higher. The budget battle will continue for months, and we believe Federal Reserve Chairman Bernanke's first press conference following its open market committee meeting Wednesday will just add to the uncertainty. Finally, the favorable-seasonality window is rapidly closing as the historically best six months of the year end in April. The question is when does the wall become too high for investors to climb? Unfortunately, nobody knows the answer.

It remains a trading range-market since the February highs, but as we stated last week, the stock market continues a clever balancing act between growing uncertainties and resilience. Probabilities are growing for the market to tip in one direction in the near future.

Index Performance Statistics – April 26

Index	Close	Day Change	Day % Change	% YTD Change	52 Wk % Change
DJIA	12595.37	115.49	0.93	8.79	14.59
NASDAQ	2847.54	21.66	0.77	7.37	15.22
S&P 500	1347.24	11.99	0.90	7.12	13.82

Source: Bloomberg

*Price return — does not include dividends

Geithner Says U.S. Needs 'Credible Strategy' for Deficits

Treasury Secretary Timothy F. Geithner said the U.S. needs a "credible strategy" to reduce its budget deficits over time, without moving too quickly and choking off economic recovery.

"You have to commit to bring the budget deficit down to a level that will put our overall debt burden on a declining path as a share of the economy," Geithner said today in remarks at the Council on Foreign Relations in New York. The Obama administration wants to move onto that path by about 2015, he said. The "biggest mistake" that countries have made coming out of a crisis is to shift too quickly rather than phasing in budget cuts over time, Geithner said.

President Barack Obama has offered the outlines of a plan to reduce the debt by \$4 trillion over 12 years through a combination of spending cuts and tax increases. House Budget Committee Chairman Paul Ryan, a Wisconsin Republican, has proposed cutting spending by \$6 trillion over a decade in part by privatizing Medicare and capping Medicaid spending. Republicans reject Obama's push for tax increases on the wealthiest Americans.

Geithner also said oil prices have become an obstacle to growth for the U.S. economy, which is otherwise set to accelerate. "We started the year with a little less momentum," Geithner said.

"We've got some new headwinds." Growth of between 3 percent and 4 percent over the next two years is a "reasonable expectation," he said. While unemployment remains elevated, "the economy is definitely healing."

Last Week

Bulls suffered a case of the "Mondays" as stocks slumped in the opening session this week after Standard & Poor's revised its outlook for U.S. sovereign debt to negative from stable. Europe and Asia woke up on the wrong side of the bed. The increased likelihood Greece would need to restructure its debt rattled the periphery while another round of rate hikes by the People's Bank of China fed inflation fears. Just as it appeared the market was in for another week of declines, positive earnings by bellwethers such as Johnson & Johnson (JNJ \$64.39), Freeport-McMoRan (FCX \$53.30), United Technologies (UTX \$85.90), Intel (INTC \$21.41) and Apple (AAPL \$342.41) provided the bulls with a jolt of caffeine, boosting stocks higher. It was also encouraging to see positive housing data and a warm reception to Spain's debt offering. As a result, the S&P 500 climbed back into the green for April heading into the final week of the month.

It might be wise for investors to use the long weekend to get some rest, as next week's calendar is booked full of earnings and economic data. After an inauspicious start, first-quarter earnings results have improved with the scorecard showing 79% of companies in the S&P 500 index coming in ahead of analyst projections, according to Bloomberg data. If the index is to break above the Feb. 18 high, bulls will want to see the streak of earnings beats remain above the historical average of 60%. Industrials will be in focus next week with profit tallies expected from sector bellwethers 3M (MMM \$93.76), Northrop Grumman (NOC \$61.83), Owens-Illinois (OI \$29.94) and Caterpillar (CAT \$108.28). Investors will also likely want to see a continuation of tech's generally strong start to earning season with positive results out of Netflix (NFLX \$244.43), Amazon.com (AMZN \$183.87), eBay (EBAY \$31.76), Akamai (AKAM \$39.94) Xilinx (XLNX \$31.72) and Microsoft (MSFT \$25.76). With higher oil prices, Exxon Mobil (XOM \$85.65), BP (BP \$45.91), ConocoPhillips (COP \$79.99), Chevron (CVX \$107.81) and Royal Dutch Shell (RDSA \$74.15) will garner attention. Other potential market-moving earnings scheduled next week include AFLAC (AFL \$53.22), Ford (F \$15.09), UPS (UPS \$72.71), Coca-Cola (KO \$67.85), PepsiCo (PEP \$67.33), Procter & Gamble (PG \$63.72), Sprint Nextel (S \$4.80), Starbucks (SBUX \$36.89) and Colgate-Palmolive (CL \$81.27).

On the economic front, the Fed will take center stage with Wednesday's Federal Open Market Committee (FOMC) meeting followed by Chairman Bernanke's media appearance to discuss the Fed's economic outlook. In addition to the Fed commentary, markets could toss and turn if the initial reading of first-quarter GDP on Thursday shows the economy is growing slower than the annualized 1.8% that Wall Street expects. Another round of housing data hits the tape with updates on new and pending home sales as well as the Case/Shiller Home Price index. Readings on consumer confidence, personal spending and income will be watched closely as will the manufacturing data which includes the March durable goods orders and regional reports from Richmond, Dallas and Chicago. After Standard & Poor's downgrade of the outlook for U.S. debt, it will be interesting to see how the Treasury auctions of 2-, 5- and 7-year government paper fare next week.

Weekly Focus – Think about it

“Domestic inflation reflects domestic monetary policy.”
~ Martin Feldstein

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 4/26/11.
- * Geithner Says U.S.: Rebecca Christie & Ian Katz Bloomberg 4/26/11
- * Last Week cited from Dean Meehan, Market Analyst, Wells Fargo Advisors 4/21/11.
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