



Weekly Commentary May 24, 2011

The Markets

When you think about it, “the end” is pretty popular right now. One radio broadcaster made the ultimate prediction – the end of the world, which was supposed to begin Saturday, May 21. Well, we’re still here, and as one ESPN television anchor said, “The Mayans are next on the clock with their prediction for the end of the world in 2012.” It also seems the stock market has ended spring early and started summer with a lull.

Stocks limped through the past week, and Friday’s nearly 100-point drop in the Dow Jones Industrial Average (DJIA) assured the third straight down week for the blue-chip index. The S&P 500 and NASDAQ followed the downward trend. Many financial publications noted that it was the first time stocks fell for three weeks in a row since last August when the Federal Reserve (Fed) began the \$600 billion quantitative easing part 2 (QE2) stimulus program. All three indexes have now declined more than 3% for the month.

Economic news was weaker than expected last week. April industrial production was flat. Reports on housing starts and existing home sales were weaker than expected. Two regional manufacturing indexes revealed a sharp slowdown in activity during May, and leading economic indicators declined for the first time in nine months.

Another “end” recently discussed has been QE2’s scheduled completion at the end of June. A Reuters’ survey of analysts and fund managers last week revealed that the expectation is that stocks, bonds, gold and the euro will fall in the three months following QE2’s end. The overriding conclusion was that with the Fed no longer supporting the market, investments that have been profitable since last August will decline and rattle confidence in the shaky economic recovery. Respondents believe that markets will be more vulnerable to concerns, including Europe, China and the U.S. jobs market, that investors have been largely overlooking thanks to the Fed’s backstop.

Two Fed officials weighed in last week and gave the impression that it would be quite some time before the Fed would back away from its easy monetary policy. New York Fed President Dudley said the U.S. economy has a considerable ways to go before the Fed satisfies its dual full employment and price stability mandate. He went on to say that while rising headline inflation figures are “troublesome,” overreacting by raising interest rates would risk “bad consequences” for economic activity and employment. Chicago Fed President Evans stated may of the same arguments and added that still high unemployment is keeping inflation under wraps.

The week was not filled with much good news to rally around. Greece’s debt situation weighed on stocks as the European Central Bank (ECB) threatened to stop funding Greek banks if the country restructured its debt. It was widely reported that the ECB was worried that a move would raise worries about Greek banks and those elsewhere in the euro zone that are loaded up on Greek and other peripheral debt. Meanwhile, other euro-zone countries are open to Greece doing more to meet its deficit targets. Fitch cut Greece’s debt ratings by three levels to “highly speculative.” Similarly, Standard & Poor’s reduced Italy’s outlook to negative from stable. Adding to the uncertainty for stock-market investors, St. Louis Fed President Bullard said the European sovereign-debt crisis has surpassed rising oil prices to become the biggest risk to the economic outlook in the United States.

Well, it seems that investors have taken the old “sell in May” adage to heart, as evidenced by stocks’ sluggish performance this month. The Friday-Monday (May 20 and May 23) drop of more than 225 DJIA points demonstrated that the market is a little more vulnerable now that earnings season has passed, the economic data are going through a soft patch, and investors remain concerned about QE2 ending and the euro-zone debt crisis escalating. These uncertainties are calling into question our expectation for stocks to break out to new highs, even though the indexes sit just a little more than 3% below those highs. We will stay flexible and give the market the benefit of doubt a little longer, but our conviction is decreasing that a short-term rally of any consequence is at hand. What we do believe with much conviction is that we are not near “the end” of the bull market.

Index Performance Statistics – May 24

Index	Close	Day Change	Day % Change	% YTD Change	52 Wk % Change
DJIA	12356.21	-25.02	-0.20	6.73	23.03
NASDAQ	2746.16	-12.74	-0.46	3.52	24.21
S&P 500	1316.28	-1.09	-0.08	4.66	22.56

Source: Bloomberg

*Price return — does not include dividends

AIG Share Sale Raises \$8.7 Billion for Treasury, Insurer

The U.S. Treasury Department and American International Group Inc. (AIG) raised \$8.7 billion in a share offering, bringing the insurer a step closer to independence after its 2008 bailout. The Treasury sold 200 million shares yesterday at \$29 each, compared with the closing price of \$29.46 on the New York Stock Exchange. The government, which retains a majority stake, needs to sell shares at an average of about \$28.73 to recover a \$47.5 billion investment. AIG disposed of 100 million shares, raising \$2.9 billion, according to a statement from the company.

AIG, once the world’s largest insurer, is seeking private capital after a government rescue that swelled to \$182.3 billion, including Federal Reserve support. The Treasury in 2010 sold the last of its holdings in Citigroup Inc. (C) and reduced its ownership in General Motors Co. (GM) to a minority stake. New York- based AIG is the only insurer that hasn’t repaid its bailout. “Going out and standing on their own again is definitely what they want to do, and they’re beginning that process,” Cliff Gallant, a KBW Inc. analyst who rates AIG shares “underperform,” said in an interview. “The government can’t sell 90 percent in one swoop.”

The sales reduce the government’s AIG stake to about 77 percent from 92 percent. The Treasury plans subsequent sales to exit its AIG holding, a process that may take 18 months to two years, according to a person familiar with the matter, who declined to be identified because the discussions were private.

Last Week

Bulls recovered from an early slip to keep May from sliding away. Stocks extended recent losses as the tale of woe in the Euro zone took a tabloid turn. With Greece making headlines over its mounting deficit, the arrest of the International Monetary Fund’s Managing Director over the weekend further clouded an already murky situation. Disappointing housing and manufacturing

data helped push the major indices to their lowest level in a month. After stumbling out of the gate, the Brahma bull got a hand from the Fed. Minutes from its April FOMC meeting suggested that the end of QE2 wouldn't mean it would raise interest rates anytime soon. Markets also responded to a better-than-expected initial claims report while positive earnings from Dell (DELL \$16.33), Home Depot (HD \$37.39), Abercrombie & Fitch (ANF \$75.57) and Analog Devices (ADI \$42.31) offset stumbles by Hewlett-Packard (HPQ \$36.13) and Lowe's (LOW \$24.78) earlier in the week. Thermo Fisher's (TMO \$65.38) \$3.5 billion bid for Phadia AB coupled with the warm reception to LinkedIn's (LNKD \$94.25) IPO offset a negative leading indicators report and more dour news on the home front. The S&P 500 index steadied itself and moved back into positive territory going into Friday's trade.

As the market attempts to regain its footing, we will get enough economic data to keep traders in their seats before heading off to their Memorial Day weekend destinations. More housing data is on tap next week with reports on new and existing homes sales. The April durable goods report is projected to decline 2.0% down from March's 2.5% rise. Economists are projecting an improvement in 1Q GDP to 2.2% from the initial read of 1.8% while personal consumption is expected to improve modestly. Next week's speeches by regional Fed heads Bullard, Rosengren, Duke, Hoenig, Plosser and Kocherlakota could set the tone for market action heading into the three-day respite. Bond land will be busy with auctions of 2-, 5- and 7-year Treasuries totaling \$99 billion.

Another earnings season has slipped away. Looking at the final tally of results for the S&P 500 index, earnings have risen 19.9% year-over-year as 72% of companies posted results ahead of analyst projections, according to Bloomberg. At the sector level, materials and energy posted the strongest profit increases while utilities experienced only a modest growth. Next week's list of notable companies come from retailers, tech and consumer staples which includes Tiffany's (TIF \$70.26), Costco (COST \$83.85), Polo Ralph Lauren (RL \$136.10), Big Lots (BIG \$33.77), Applied Materials (AMAT \$14.32), Marvell (MRVL \$14.42), Campbell Soup (CPB \$35.34), Heinz (HNZ \$53.85) and Hormel (HRL \$30.26).

Weekly Focus – Think about it

“If we invest in the American people, the American people always bring this Nation a good return.”

~ Blanche Lincoln

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 5/24/11.
- * AIG Share Sale: Noah Buhayar, Bloomberg 5/25/11
- * Last Week cited from Dean Meehan, Market Analyst, Wells Fargo Advisors 5/20/11.
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