



Weekly Commentary May 3, 2011

The Markets

There was plenty of pomp and circumstance last week in England, Washington and the stock market. The royal wedding captured the imagination of millions seeking to capture a glimpse and feel a part of all the hoopla that can befit only royalty. In Washington, Fed Chairman Ben Bernanke held a much anticipated press conference, and many stock averages broke out to new multi-year highs.

The press conference was a big focus, and for good reason as it was the first ever in the Fed's 98-year existence. For all the hype, however, it was largely uneventful. In our estimation, Bernanke did a good job. Translated – he did not slip up on any questions nor reveal anything confidential that could not be captured in the Fed's statement that preceded the press gaggle. We believe the biggest news for investors was just getting the uncertainty associated with the historic event out of the way. The statement following the two-day meeting revealed there are no plans for a quantitative easing part three (QE3), not a surprise, but also it is reasonable to conclude that the Fed has no plans on removing monetary stimulus anytime soon. Policymakers intend to complete the current \$600 billion QE2 by the end of June but will keep on reinvesting proceeds from maturing securities. This is, in effect, further easing on a more modest scale, and the media have dubbed it with the name of QE2.5.

The Fed did its best to appease investors by saying it does not foresee any significant impact on the financial markets or the economy after QE2's completion. It noted in its official statement that a pickup in inflation would likely be short-lived and that long-term inflation expectations are "still subdued." Also kept in the statement's language was a sentence indicating that exceptionally low interest rates would be likely for an "extended period of time." When pressed on what "extended" meant in Bernanke's press conference, he said at least a couple of meetings, which translates roughly to four to five months.

Stocks finished off April by recording their best month of the year. First-quarter earnings reports got off to a sluggish start, but the results during the past two weeks picked up sharply and provided fuel for the bull market: On Tuesday, the S&P 500 and NASDAQ joined the Dow Industrials in breaking out above their February highs. This followed the two-month-plus trading ranges that we have been discussing in recent commentaries. The stock market had continued a balancing act between its resilience and close proximity to its February highs on the one hand versus a long list of international and domestic worries on the other that have kept a lid on the market. The scale has not been tipped to the positive side. Among the averages recording multi-year highs, as the weekend edition of *The Wall Street Journal* pointed out, were small-cap companies and commodities, which are particularly sensitive to an accelerating economy, and transportation stocks, which reflects a pickup in the movement of goods – a positive sign for the economy.

Seasonally, April ended the historically strongest six-month period of the year, and the market now has entered the weakest six months, which ends in October. Like any other cycle or indicator, this one does not have a perfect record and cannot be relied on solely for investor decisions. The past two six-month periods fit with the seasonality. The just completed six months were quite positive while the period between May-October 2010 was spent mostly in a correction

in a bull market. In the May-October 2009 period, however, the market rose strongly as the bull market got underway in March 2009.

We see the market moving modestly higher as ample liquidity, strong corporate earnings and in-place momentum after last week's breakouts for the averages fuel further gains.

Index Performance Statistics – May 3

Index	Close	Day Change	Day % Change	% YTD Change	52 Wk % Change
DJIA	12807.51	0.15	0.0	10.62	17.21
NASDAQ	2841.62	-22.46	-0.78	7.11	17.22
S&P 500	1356.62	-4.60	-0.34	7.87	15.59

Source: Bloomberg

*Price return — does not include dividends

Morgan Stanley, Goldman Sachs Counter Bearish Gross on U.S. Debt

Morgan Stanley and Goldman Sachs Group Inc. are dropping bets against Treasuries. Economic growth is falling short of forecasts and market participants may need to reduce their yield predictions, Jim Caron, the New York-based global head of interest-rate strategy at Morgan Stanley, wrote in a report yesterday. Goldman Sachs cited Federal Reserve comments and a slower-than-forecast pace of inflation in a report the same day.

A rally in Treasuries is confounding traders and economists who predicted yields would rise as the economy improved. The opposite has happened as data showed gross domestic product growth slowed and housing market is struggling to rebound. Bill Gross, who runs the world's biggest bond fund at Pacific Investment Management Co., said he is sticking to his bearish view on U.S. debt.

"We have recently turned neutral from bearish on bonds," Caron wrote. "We are also tactically looking to buy bonds if yields rise. Consensus forecasts for yields are at risk." Treasuries returned 1.2 percent in April, the most since August, based on Bank of America Merrill Lynch data. Ten-year yields fell to a six-week low of 3.23 percent today, according to data compiled by Bloomberg. The notes yielded 3.24 percent as of 7:35 a.m. in London. Morgan Stanley and Goldman Sachs, two of the 20 primary dealers authorized to trade directly with the Federal Reserve, both said in their reports they may turn more bearish later.

Last Week

This week the bulls got into gear to spur a month-end rally. Steering the market north were positive earnings results by bellwethers including 3M (MMM \$97.23), United Postal Service (UPS \$74.81), Ford (F \$15.50) and Amazon.com (AMZN \$198.07). Johnson & Johnson (JNJ \$65.38) announcing it would acquire Synthes (SYST.VX CHF 140.35 Swiss Francs) for \$21.9 billion along with a dividend boost and Exelon's (EXC \$42.18) bid to buy Constellation Energy (CEG \$36.26) for \$7.9 billion helped the bulls keep pace. In his first-ever post-Federal Open Market Committee meeting press conference, Fed Chairman Ben Bernanke suggested the end of quantitative-easing and inflation would not have a significant impact on the economy helped investors to turn a blind eye to the Fed lowering its GDP forecast. However, his comment that rising commodity prices are "transitory" could not stop speculation of future inflation. Gold pushed to a new record high and silver rallied to levels not seen since the Hunt Brothers attempted to corner the market. With this week's % advance through Thursday, the S&P 500 index is up % for April with one trading day left in the month. Year-to-date, the index has risen % to its best levels since June 2008.

After some initial bumps in the road, first-quarter results have been generally positive. With more than half of the companies in the S&P 500 reporting to date, 75% have posted profits ahead of the consensus estimates, according to Bloomberg. As a result, the expected year-over-year earnings growth rate for the quarter has risen to 15.8% from 12.2% while estimates for top-line growth have improved to 8.7% from 7.6%. The adventure of earnings season continues as May gets under way with more releases on tap next week. With the price of oil trading above \$112/bbl, earnings out of the energy patch from Transocean (RIG \$72.18), Chesapeake Energy (CHK \$33.22), Anadarko Petroleum (APC \$78.64), Marathon Oil (MRO \$52.61), Sunoco (SUN \$42.29) and Williams Companies (WMB \$32.66) will be of interest. Following the Exelon (EXC \$42.18) bid for Constellation Energy (CEG \$36.26), profit tallies of utilities Edison International (EIX \$39.46), Duke Energy (DUK \$18.68), PG&E (PCG \$46.26), and NRG Energy (NRG \$23.93) will garner attention. Results produced by Kellogg (K \$56.84), Clorox (CLX \$69.79), Avon Products (AVP \$29.39), Archer-Daniels Midland (ADM \$36.34), Whole Foods (WFMI \$62.44), CVS Caremark (CVS \$36.25), Fortune Brands (FO \$64.90) and Sara Lee (SLE \$19.16) will be watched for clues on the economy and inflation. Other potential market-moving earnings releases to grace next week's tape include American International Group (AIG \$31.80), CenturyLink (CTL \$40.42), Automatic Data Processing (ADP \$36.34), Visa (V \$77.66), MasterCard (MA \$274.70), MEMC Electronic (WFR \$11.15), Airgas (ARG \$69.00), Pfizer (PFE \$20.83) and Time Warner (TWX \$37.23).

Investors also will need to monitor next week's economic reports to gauge whether the market continues a road to recovery or takes a detour. Points of interest along the way to Friday's employment report include updates on construction, vehicle sales, personal spending and income, and manufacturing. On the job front, nonfarm payrolls for April are projected to increase by 180,000 jobs while the unemployment rate is expected to hold steady at 8.8%. The March consumer credit report is expected to tick lower, as consumers continue to shore up their balance sheets. In addition to next week's data, the Fed hits the open road with scheduled speeches from Fed head Bernanke and regional presidents Thomas Hoenig, Dennis Lockhart, Charles Evans, Narayana Kocherlakota, William Dudley and newly appointed John Williams.

Weekly Focus – Think about it

“Democracy is necessary to peace and to undermining the forces of terrorism.”
~ Benazir Bhutto

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 5/3/11.
- * Morgan Stanley, Goldman Sachs Counter.: Wes Goodman, Bloomberg 5/4/11
- * Last Week cited from Dean Meehan, Market Analyst, Wells Fargo Advisors 4/29/11.
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