Weekly Commentary
June 28, 2011

The Markets

The stock market continues to trend higher since emerging from its March 2009 lows. But it has recently entered a more sluggish phase. Sharp rises are characteristic of the bull market's initial dynamic phase as investors begin to look beyond the economic recession to better times ahead. The current cycle fits squarely with the typical historical pattern with the S&P 500 increasing in price from the March 2009 low to the April 2011 high. It also experienced only one pullback of significance during the two-year period: 16% in the spring to summer 2010 period as the Federal Reserve's quantitative-easing-part-one (QE1) program came to a conclusion.

In addition, the average stock has outperformed the market-cap-weighted indexes. The Value Line Arithmetic Composite (an index that equally weights each of its 1,700 component stocks) rose more than 200% between March 2009 and April 2011. In recent months, however, progress has been more sluggish, and we expect the inertia to continue during the mid-phase of the cycle. For perspective, the Dow Jones Industrial Average (DJIA) has swung in a range as wide as 1,300 points from mid-February to mid-June, yet the index has made no net progress. This is indicative of a fatigued market that's facing more uncertainty, including the Japanese disaster, Chinese growth concerns, inflation, U.S. budget and debt worries, rising commodity prices, renewed European debt concerns, high U.S. unemployment, the housing debacle, and, of course the Fed's quantitative-easing-part-two (QE2) end.

The New York Stock Exchange cumulative advance/decline (A/D) line is a measure of whether most stocks are going up or down. This performance measure has shown a few divergences from the more popular stock market indexes. Although the A/D line did hit a new high along with the popular indexes in February, it failed to confirm the indexes' new highs in late April. Instead, it peaked in early April, and a series of lower highs have been measured in the A/D line since that period. While this signifies a negative divergence and deteriorating momentum, it may only represent just one signal of a short-to-intermediate-term top rather than a major top.

Regarding investor sentiment, surveys are showing a more mixed picture. These surveys are contrary indicators, and thus a high degree of bullishness has historically been associated with stock market pullbacks. Measured by the Investors' Intelligence (II) Survey, investor sentiment increased to a high level in April, indicating increased complacency. Specifically, the weekly percentage of bulls rose to an extreme of 57% in early April whereas bears fell to just 16%. Alternatively, the American Association of Individual Investors (AAII) survey has shown a slightly different picture. The bullish percentage peaked and bearish percentage troughed at extremes last December. Mutual fund flows suggest that investors are still cautious. According to the Investment Company Institute (ICI), stock mutual funds experienced $39 billion of outflows in 2009 and $96 billion of outflows in 2010. However, ICI's estimates through mid-May 2011 indicate there has been only a net $13 billion inflow. This is still historically low, which indicates a lingering hesitancy by individuals to return to equities in big numbers.

The VIX indicator or "fear gauge" – the label given to the Chicago Board Options Exchange (CBOE) Volatility Index – measures how much investors are willing to pay for options to protect against stock market declines. This gauge has recently been hovering at low levels similar to those seen in April 2010 and February 2011 before a corrective phase in stock prices occurred. Its current level has historically accompanied periods of sideways to declining prices that removed some of the excesses from the marketplace.

Finally, seasonality is working against stocks as the market is in the midst of its historically weak six-month period of the year between May and October. So far, the poor seasonal period has been living up to its reputation.

Psychologically, the greatest impact that QE2's conclusion will have for the stock market depends on how the Fed adjusts monetary policy through the year's second half. We believe stock market expectations are for a slow and deliberate process, which is consistent with public statements from the majority of monetary policymakers – including Chairman Ben Bernanke – who have indicated that they believe it will be quite some time before the Fed backs away from its easy monetary policy. A negative scenario could ensue if the Fed were to abruptly indicate that asset sales and tightening were imminent. We believe the probability of this scenario is low. If it does happen, however, it would be upsetting to equity markets. Whatever happens, we expect that, later this year, investors will start to anticipate the beginning of interest-rate hikes, and historically stocks have behaved sluggishly as investors start to brace for and react to a new cycle of higher interest rates.

Index Performance Statistics – June 28

Index	Close	Day Change	Day % Change	% YTD Change	52 Wk % Change
DJIA	12188.69	145.13	1.21	5.28	23.49
NASDAQ	2729.31	41.30	1.53	2.88	27.83
S&P 500	1296.67	16.57	1.29	3.10	24.53

Source: Bloomberg
**Price return — does not include dividends*

BofA Agrees to $8.5 Billion Deal on Soured Mortgages

Bank of America Corp. (BAC), the biggest U.S. bank, agreed to pay $8.5 billion to resolve claims over soured mortgages after bondholders including BlackRock Inc. (BLK) demanded refunds. The company rose as much as 6.7 percent in New York trading. The settlement will contribute to a second-quarter loss of $8.6 billion to $9.1 billion, or 88 cents to 93 cents a share, the Charlotte, North Carolina-based bank said today in a statement. Bank of America also said it's adding $5.5 billion to a liability reserve for future loan-repurchase demands and will record $6.4 billion in other charges including legal costs and a writedown of mortgage-unit goodwill.

"This is progress in that it puts some parameters around what the total loss will be," said Marty Mosby, a Nashville, Tennessee-based analyst at Guggenheim Securities LLC, which manages more than $100 billion, including Bank of America shares. "It's not a great thing to pay this much, but it's not the worst-case scenario either." Investors, which also include Pacific Investment Management Co. and the Federal Reserve Bank of New York, demanded in October that Bank of America repurchase home loans that had been packaged into bonds by Countrywide Financial Corp., which it acquired in 2008. The settlement covers 530 mortgage trusts with an original loan balance of $424 billion, the bank said.

Last Week

Risk on. Risk off. Bulls did their best to break free from their furry foes' kung fu grip this week. Early action saw stocks extend their recent rally on hopes of a short-term solution for Greece to avoid defaulting on its debt. Bears staged a counter attack fueled by the Fed's dour outlook on the economy. Specifically, the central bank cut its 2011 and 2012 forecasts for GDP and unemployment as the recovery is somewhat slower than expected. In addition, Fed head Bernanke reiterated the plan to end QE2 stimulus measures at the end of the month. Jitters of the Euro zone's debt woes impact on the financial system coupled with Thursday's disappointing weekly jobless claims report knocked the bulls down hard. However, passage of Greek austerity measures helped the market recover most of the day's losses to put the S&P 500 index back on track to avoid another weekly decline.

As of Thursday's close, June's swoon of a 4.6% decline by the S&P 500 index had chopped the year-to-date gain to 2.1%. The bulls will look to stay on their feet next week, provided they get some help from the economic data. Kicking things off will be the May reports on personal income and spending. Providing insight on the attitude of the average American will be Tuesday's release of the June consumer confidence and another look at the June University of Michigan confidence report on Thursday. Housing is expected to remain punk with Wall Street estimates calling for declines in the Case/Shiller and pending home sales reports. National and regional updates on manufacturing will garner attention. In addition to the data, St. Louis regional president Bullard's speech on quantitative easing will be on radar for clues as to what may be the Fed's next move.

Next week marks the end of the second quarter, which means earnings season is right around corner. Current expectations are for S&P 500 index earnings to rise 13.5% and revenues to increase 10.2% on a year-over-year basis. Leading the growth of the index's bottom line are the materials with an increase of 46.2% followed by a 40.6% year-over-year rise by the energy patch. Scheduled releases from the likes of Nike (NKE $82.19), Family Dollar (FDO $53.09), General Mills (GIS $37.19), Monsanto (MON $66.57), McCormick (MKC $49.95), Constellation Brands (STZ $21.06) next week could set the tone for the upcoming reporting season that begins in earnest with Alcoa's (AA $15.28) release on July 11.

Weekly Focus – Think about it

"The empires of the future are the empires of the mind."
~ Winston Churchill

Best Regards,

Jim, Aaron & Angela
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* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.

* 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.

* Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.

* This commentary should not e consider individual investment advice and you should consult your financial professional before making any investment decision.

* You cannot invest directly in an index.

* Past performance does not guarantee future results.

* The Markets prepared by Brian S. Wesbury, Chief Economist, First Trust 6/28/11.

* BofA Agrees to $8.5 Billion: Hugh Son, Bloomberg 6/29/11

* Last Week cited from Dean Meehan, Market Analyst, Wells Fargo Advisors 6/24/11.

* The opinions expressed here reflect the judgment of the authors as of the date the report and are subject to change without notice.

* This report was prepared by VSR Financial Services, Inc. Wealth Management Department.