



Weekly Commentary June 7, 2011

The Markets

June picked up right where May left off with another weekly stock market slide. It has now been five straight down weeks for the DOW Jones Industrial Average (DJIA) and S&P 500. That is the worst performance for these indexes in terms of the number of weeks of decline since July 2004 and July 2008, respectively, last week we said let's give June a try after the markets dreary May performance, which certainly did not bring investors many flowers. Maybe we should take the old advice: Be careful what you wish for. Now, we have entered June and are further into the year's second seasonally weakest months, since 1950, the month has ranked as the year's third worst, according to the *Stock Trader's Almanac*, and had returned virtually a flat performance. The selling since the April 29 highs in the major stock indexes accelerated last week and was the worst performance since this decline began. The DJIA and S&P 500 now stand -5.6% and -5.7%, respectively, below their April 29 highs (through the June 6 closes). The selling in mid- and small cap stocks has been slightly greater.

Congress is increasingly taking the spotlight as it plays games with the debt ceiling limit. Last week, the House of Representatives voted down a measure that would have raised the limit by more than \$2.4 trillion. Republicans said they would vote against increasing the limit unless it is linked to substantial spending cuts and real budgetary reforms. Democratic critics called the vote risky political theater. In any event, it highlighted the battle ahead in Washington and the political games that will be played. It brings to mind what happened in April when both sides pushed the deadline to the final hour before agreeing on a compromise to prevent a government shutdown.

Moody's jumped into the fray last week and said that there is "no progress on increasing the statutory debt limit in coming weeks," it expects to place the US government's ratings under review for possible downgrade due to the very small but rising risk of a short-lived default. This follows Standard & Poor's April revision of its outlook on long-term government debt for neutral to negative. Former Federal Reserve (Fed) Chairman Alan Greenspan also weighed in on the issue and warned all involved of the graveness of the situation and the absolute necessity not to forfeit on any Treasury issues, even if for only a few days. We ultimately believe the August 2 deadline will be met but with drama and volatility for the stock market as the political posturing goes back and forth.

The economic news as a whole did not get any better last week, and Wells Fargo Advisors' Advisory Service Group's Marco Strategy team said it confirmed the US expansion has slowed down. In the housing sector, the March S&P/Case Shiller index of home prices fell last Tuesday to its lowest level since March 2003. The Conference Board's May consumer confidence index decreased to its lowest reading since November 2010. Much of the blame went to higher gasoline prices. After a string of weak regional reports on manufacturing, the May Institute for Supply Management (ISM) manufacturing index was reported well below expectations and had its biggest monthly drop since 1984.

Grabbing the most attention, however, were the employment numbers. May's nonfarm payrolls increase of only 54,000 jobs, the fewest since September 2010, followed the shortfall in the ADP employment numbers, which showed only 38,000 private sector jobs were added. Jobless claims were reported above 4000,000 for the eighth straight week. The fall-out was three major firms

cutting their growth forecasts for the balance of 2011. The disappointing news has already raised the chorus for the Fed to institute a quantitative easing part three (QE3) program to help stimulate economic activity. We are quite skeptical that this would occur given Fed's officials' recent statements. Most importantly, Chairman Bernanke said in his first-ever press conference in late April that the risk-return trade-off of not as favorable now and the bar for further extraordinary measures is higher than before. We believe it would take several months of poor economic data and a precipitous fall in stock prices before some type of QE3 would occur.

Stocks have continued to show a little more vulnerability to news and negative developments in recent months relative to the smooth sailing up to the February 2010 highs. The euro-zone and US debt worries, the economic slowdown, the end of quantitative easing part 2 (QE2), and the fact that stocks have come a long way with minimal pullbacks entitle the market to the current sluggish period. In addition, we believe investors have entered a waiting period to see how weak the economic data may get and what QE2's end will look like. The stock market averages have broken below some widely watched levels recently, which we believe has encouraged more selling. We expect this pullback to continue but believe it will result in only modest further downside.

Index Performance Statistics – June 7

Index	Close	Day Change	Day % Change	% YTD Change	52 Wk % Change
DJIA	12070.81	-19.15	-0.16	4.26	21.44
NASDAQ	2701.56	-1.00	-0.04	1.84	24.46
S&P 500	1284.94	-1.23	-0.10	2.17	20.99

Source: Bloomberg

*Price return — does not include dividends

Bernanke Says 'Uneven Recovery Still Needs Stimulus

Federal Reserve Chairman Ben S. Bernanke said the "frustratingly slow" U.S. recovery warrants sustained monetary stimulus while predicting that growth will gain speed in the second half of the year. "The economy is still producing at levels well below its potential; consequently, accommodative monetary policies are still needed," Bernanke said yesterday in a speech in Atlanta. At the same time, the Fed "will take whatever actions are necessary to keep inflation well controlled," he said.

Bernanke said consumer spending is being held back by an unemployment rate that rose to 9.1 percent last month, a drop in home values and tight credit. Growth is likely to pick up as fuel prices moderate and factory disruptions ease as factories in Japan recover from an earthquake and tsunami, he said. Stocks and bonds fell as some investors interpreted the comments as a signal that the Fed is unlikely to deploy a new round of bond purchases to bolster the economy.

"He's saying monetary policy is on course and right on, and there's no need to change at this point," said Sung Won Sohn, an economics professor at California State University- Channel Islands and former chief economist at Wells Fargo & Co. "The implication is not only will there be no change, but a third round of quantitative easing is not likely to come." Treasury two-year note yields dropped two basis points, or 0.02 percentage point, to 0.4 percent yesterday in New York,

the lowest level this year. The Standard & Poor's 500 Index fell 0.1 percent to 1,284.94 after rallying as much as 0.8 percent.

Last Week

The dawn of June cast a bearish shadow over the corner of Broad and Wall. Stocks slipped as a downpour of weaker economic data washed out Tuesday's rally driven by the possibility of a forthcoming solution to Greece's debt debacle. A lower-than-expected ADP employment spurred concern that Friday's job figures may come in below expectations. Disappointing monthly reports on manufacturing and auto sales as well as consumer confidence falling to a six month low, sent bulls to seek shelter in bond land, helping to push the 10-year Treasury note yield below 3%. Adding to the maelstrom of uncertainty was Moody's downgrade of Greece's credit rating and increased forecast of a chance for a debt default. Although the S&P 500 index sits at six-week lows, it remains up 4.0% year-to-date.

If the market is to avoid a June swoon, investors need to get more encouraging news from next week's updates on consumer credit and confidence, wholesale inventories, the trade deficit as well as advanced retail sales. Also garnering attention will be what the Fed has to say about the slowing economy. In addition to Wednesday's Beige Book report, there will be speeches from Fed head Bernanke as well as regional presidents Plosser, Fisher, Lockhart, Hoenig and Yellen. The energy patch could see some action with OPEC meeting in Vienna to discuss output quotas. With the recent rally in Treasuries, it will be interesting to see the appetite for auction of the \$66 billion of 3-, 10- and 30-year government paper.

Weekly Focus – Think about it

"I believe in the dollar. Everything I earn, I spend"
~ Joan Crawford

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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- * You cannot invest directly in an index.
- * Past performance does not guarantee future results.
- * The Markets prepared by Scott Marcouiller, Chief Technical Market Strategist, Wells Fargo 6/7/11.
- * Bernanke Says 'Uneven' Recovery: Caroline Salas & Steve Matthews, Bloomberg 6/8/11
- * Last Week cited from Dean Meehan, Market Analyst, Wells Fargo Advisors 6/3/11.
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