Weekly Commentary
August 2, 2011

The Markets

The dog days of late July and early August are typically a slow, largely uneventful period for financial markets. But not this year as the airwaves were firing on all cylinders as the high-stakes spectacle continued in Washington, D.C., as Congress worked down to the wire to meet the Treasury Department's August 2 deadline for raising the debt ceiling to avoid the U.S. government running out of money to pay its bills. Debt-ceiling increases, as many have noted, historically have been routine business but are now a media focal point and catalyst for voter and financial-market angst. This act is over, but before we all get too comfortable, remember that old saying: The devil's in the details. In this case, the plan says that the nation could be forced into a replay of the drama by November, when the next round of savings, to be proposed by a bipartisan committee, must be determined. Also, there is still a risk that credit agencies could downgrade the U.S. debt.

What a difference one short week can make. The major stock averages were closing in on new post-March 2009 highs. This was impressively taking place in the face of an ongoing U.S. economic slowdown, the European debt crisis, the end of the Federal Reserve's quantitative easing and, of course, the debt-limit/budget-deficit impasse. Now the Dow Jones industrials are coming off their worst week in more than a year; the blue-chip index lost 4.2% and declined for the sixth straight day on Monday. The S&P 500 index dropped 3.9%, and gold rose to an all-time high as risk was avoided and investors ran toward the safe-haven metal. The debt-ceiling debate, which often appeared simultaneously fast-paces and futile, increased investors' uncertainty, and the knee-jerk reaction was to head to the exits.

Last week's economic news was highlighted (low-lighted) by Friday's dismal initial reading on second quarter gross domestic product (GDP) growth at just 1.3%. The data also revealed that the economy has grown weaker than expected through the current recovery. The first-quarter GDP reading was revised to just +0.4%. Revisions for the 2007-2009 period showed that the recession was deeper than previously thought and the recovery weaker. As was quickly pointed out Friday and detailed in many financial publications over the weekend, the new data helped explain some of the job market's dismal progress since 2008. Adding to the economic woes, the Fed's Beige Book revealed that growth slowed in eight of the 12 regions, doubling the previous survey's number. Not surprisingly, the housing market stayed weak, and reports of loan demand were more mixed. On Monday, a reading of U.S. manufacturing showed the slowest activity in two years.

The market's short-term direction is particularly difficult to forecast right now. For example, on the one hand, The Chicago Board Options Exchange (CBOE) Volatility Index, or VIX – a measure of investor fear – jumped more than 40% this past week, which could indicate the market is heading toward a sustained rally if it continues moving in this direction. On the other hand, the latest Investors' Intelligence poll showed bullish sentiment increased to 49.5% and bearish sentiment is at 21.5%, which may indicate a further market pullback.

The early action this week started with a very brief rally on Monday morning in reaction to congressional leaders coming to an agreement with the president on Sunday night. Attention has now quickly turned back to the slow-growth economy and, to a lesser extent, the positive second-quarter earnings. The market has shown plenty of resilience through a long list of uncertainties, and we will continue down a choppy, volatile road, but with the debt-ceiling crisis off the table – temporarily at least – one major roadblock has been removed.

The S&P 500 Index has violated its 50- and 200- day moving averages in recent sessions. On Tuesday, the trend-line from the March 2009 low was also broken in the 1,285 area. Next important support levels for the index are now 1250, then 1,230-1,220 and 1,200.

Index Performance Statistics – August 2

Index	Close	Day Change	Day % Change	% YTD Change	52 Wk % Change
DJIA	11866.62	-265.87	-2.19	2.50	11.57
NASDAQ	2669.24	-75.37	-2.75	0.62	16.89
S&P 500	1254.05	-32.89	-2.56	-0.29	11.92

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

Debt Deal Compromise to Spark More Debates

President Barack Obama's signature on a bill raising the debt limit sealed a compromise that averted a U.S. default even as it did nothing to narrow the gulf between Republicans and Democrats over tax increases and spending cuts. The measure postpones the thorniest fiscal dilemmas for later this year when the 2012 election campaign will intensify. A panel of lawmakers must push through a $1.5 trillion debt- reduction package by year's end -- or risk automatic spending cuts across the government, including defense and Medicare.

That means the disputes that prolonged negotiations on the debt limit will be refought. The stakes were underscored hours after Obama signed the bill when Moody's Investors Service said it may downgrade the U.S. credit rating for the first time on concern fiscal discipline may ease and the economy may weaken. In addition, China, the largest foreign investor in U.S. government securities, joined Russia in criticizing American policy makers for failing to ensure that U.S. borrowing is reined in.

Obama, who pressed unsuccessfully during the talks for a "balanced approach" to shrink deficits with tax increases and spending cuts, said the panel must put both on the table.
"We can't balance the budget on the backs of the very people who have borne the brunt of this recession," he said in the White House Rose Garden yesterday. "Everyone's going to have to chip in. That's only fair. That's the principle I'll be fighting for during the next phase of this process."

Last Week

With friends like these, who needs enemies? With the Aug. 2 deadline looming large, stocks stumbled this week as Democrats and Republicans failed to reach an agreement to raise the debt ceiling. Disappointing readings on the economy added to the unfriendly tone of the market. Specifically, June durable goods orders missed the mark while the Fed's Beige Book showed the pace of economic activity slowed in 8 of its 12 regions. These events overshadowed the overall positive results of second-quarter earnings season. As a result, the S&P 500 index shed 3.3% for the week to send its performance for July into the red by 1.5% going into the final trading day of the month.

The bears won the battle this week, but the bulls remain hopeful to win the war. In addition to an amicable solution to the debt ceiling debate before Tuesday's deadline, it would be helpful to get positive news on the economy. Headlining next week's data releases is Friday's employment reports. Non-farm payrolls are projected to show 100,000 jobs were added in July but the unemployment rate holding steady at 9.2%. After falling below 400,000 for the first time since April, the weekly initial jobless claims will likely receive additional attention. In addition to the employment data, we'll receive updates from the ISM on the manufacturing and service sectors, factory orders and construction spending and income as well as the July vehicle sales.

As hostility in Washington casts a pall over markets, second-quarter earnings season continues to be a friendly face for bulls. To date, two-thirds of the companies in the S&P 500 index have reported results with 77% besting consensus projections, according to Bloomberg. Overall, the forecasts call for top-line growth of 10.1% and earnings to rise 17.0% compared to a year ago. Next week, earnings season comes to a crescendo as profit tallies from 110 companies in the index are scheduled to hit the tape. Notable releases on the calendar include results from Archer Daniels Midland (ADM $30.81), Coach (COH $64.40), Emerson (EMR $49.62), NYSE Euronext (NYX $33.60), Pfizer (PFE $19.36), Clorox (CLX $72.60), MasterCard (MA $306.90), Time Warner (TWX $35.76), MEMC (WFR $7.49), Williams Companies (WMB $31.79), Apache (APA $124.63), CVS Caremark (CVS $36.42), Edison International (EIX $38.60), PG&E (PCG $42.04), American International Group (AIG $28.94), Kraft (KFT $34.59), priceline.com (PCLN $522.29), Proctor & Gamble (PG $61.92) and Viacom (VIA.B $48.88).

Weekly Focus – Think about it

"He who tampers with currency robs labor of its bread."
~ Daniel Webster

Best Regards,

Jim, Aaron & Angela
Kennedy Financial Services

* 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 Scott Marcouiller, Chief Technical Market Strategist, Wells Fargo 8/2/11

* Debt Deal Compromise: Julie Hirshfeld Davis, Bloomberg 8/3/11

* Last Week cited from Dean Meehan, Market Analyst, Wells Fargo Advisors 7/29/11.

* 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.