



Weekly Commentary October 18, 2011

The Markets

Two weeks ago, the U.S. stock market was making new lows for this year, and investors were very pessimistic. The outlook appeared grim because it was difficult to see any way to resolve global economic and financial problems. Fortunately, policymakers have taken more action to restore confidence. At the same time, the economic data does not look as bad as many investors expected.

On the European front, investors got a bit of a reprieve from daily negative news as all the European currency union governments ratified the expansion of the European Financial Stabilization Fund (EFSF), providing more ammunition to deal with the European financial crisis. In addition, European policymakers agreed to a meeting on October 23 to address the evolving crisis. At this meeting, policymakers are expected to agree to provide additional funds to Greece and discuss losses for Greek government bond holders. Leaders are also expected to reveal plans to recapitalize the European banks, and potentially expand the way the EFSF is used to fight the financial crisis.

On the economic front, global stock markets recovered after the September U.S. jobs report was better than analysts anticipated, and September retail sales increased at a healthy pace despite the shock to confidence this summer. The prospects for Europe will be impacted by what happens elsewhere around the globe. European problems will be less severe if the United States and other major economic powers avoid recession and continue to buy European goods and services. Alternatively, European problems would be much worse if the rest of the world goes into recession and reduces purchases of European products.

The U.S. government is scheduled to release its first estimate of third quarter economic growth later this month on October 27. Given only partial data for the three months ended in September, it looks like inflation-adjusted gross domestic product (GDP) may have increased at the fastest pace of the year during the summer. In other words, the U.S. economy appeared to hold up much better than confidence did during the third quarter.

The recovery in global equity markets during the early part of October is a welcome relief for many investors after the big declines in August and September. In fact, last week's rally in the S&P500 was the best weekly gain in about two years. It is too early to say that the correction in the equity market is finished. Investors could be easily disappointed again if European leaders do not reveal substantial plans to resolve the European debt crisis. Therefore, the equity markets could remain volatile until investor confidence is more stable.

Index Performance Statistics – October 18

Index	Close	Day Change	Day % Change	% YTD Change	52 Wk % Change
DJIA	11577.05	180.05	1.58	0.00	5.45
NASDAQ	2657.43	42.51	1.63	0.17	9.05
S&P 500	1225.38	24.52	2.04	-2.57	5.10

Source: Bloomberg

*Price return — does not include dividends

Housing Starts in U.S. Rise 15%, Beat Forecast

Builders began work on more U.S. homes than forecast in September on rising demand for apartments and condominiums as more Americans become renters. Housing starts climbed 15 percent to 658,000 houses at an annual rate, the most since April 2010, Commerce Department figures showed today in Washington. The median forecast in a Bloomberg News survey called for a 590,000 pace. Beginning construction of multifamily dwellings surged to the highest since October 2008.

Building permits, a proxy for future construction, declined to a five-month low, indicating foreclosures that are adding to the supply of unsold homes and depressing property values may continue to hold back developers. Housing's limited rebound is among reasons Federal Reserve policy makers last month announced more unconventional measures to boost demand and spur job growth. "Even with modest job growth, we're seeing increasing household formation, and that's really boosting demand for apartments," said Ryan Sweet, a senior economist at Moody's Analytics Inc. in West Chester, Pennsylvania. "What's worrisome is the slide in permits. It's kind of a mixed bag."

Housing starts estimates ranged from 560,000 to 643,000 in the Bloomberg survey of 75 economists. August's pace was revised to 572,000 from a previous estimate of 571,000. Home construction totaled 554,000 units in 2009, the fewest since record-keeping began in 1959.

Last Week

Bulls donned their rally caps as we head into the final innings of 2012. This week felt like the good old days as stocks rose amid signs European leaders are ready to step up to the plate to solve the debt crisis. Specifically, German Chancellor Angela Merkel and French President Nicolas Sarkozy pledged a plan to address the region's bank and credit crisis by the G-20 summit on Nov. 3. It was also encouraging that the market held up after Slovakia's whiffing on its first attempt to pass the increase of the European Financial Stability Facility (EFSF). After hustling for seven straight days, a round of profit taking made the scene. Concerns the bulls may have gone too far too fast came after the September FOMC meeting minutes showed that some members expressed concern about the "considerable uncertainty" U.S. economic growth will pick up. In addition, third-quarter earnings season got off to a slow start with disappointing profit tallies from Alcoa (AA \$10.10) and J.P. Morgan (JPM \$31.60). However, after Friday's better-than-expected import prices and retail sales reports, the S&P 500 index appeared ready to extend its recent rally that put the index up 4.1% on the week and 11.99% from the Oct. 4 intra-day low as of Thursday's close.

After being red hot during the summer, bond land has entered into a bit of a slump. Treasuries declined amid optimism over a resolution to the Euro zone's debt woes sent treasury prices lower. Since hitting a record low yield of 1.67% on Sep. 23, the benchmark 10-year Treasury note saw its yield rise to 2.27% before settling at 2.18% at the end of Thursday's session. Over in the commodity pits, crude oil gave back gains after the International Energy Agency cut its demand forecast for 2012 and a report by the U.S. Department of Energy showed more supplies than analysts projected. In the metal complex, gold gave back some of its recent gains after the dollar rallied on a report Chinese exports grew at the slowest pace since May.

Next week features a full line up of economic data. Investors will look for encouraging readings on manufacturing, housing and inflation. Providing updates on overall economic activity will be releases of the Beige Book on Wednesday and leading indicators index on Thursday. In addition to its Beige Book report, the Fed will host a conference in Boston. Of particular interest will be Chairman Bernanke's speech on Tuesday for indications the economy won't experience a collapse like the Red Sox's season. In addition to Bernanke, regional presidents Evans, Lacker, Lockhart, Rosengren, Bullard, Pianalto, and Kocherlakota are scheduled to speak throughout next week.

Third-quarter earnings season kicks into high gear with 99 S&P 500 and 13 Dow Jones Industrial Average companies due to report next week. J.P. Morgan's disappointing earnings and cautious outlook has likely lowered the bar for scheduled releases by piggy banks Citigroup (C \$27.64), Bank of America (BAC \$6.22), Goldman Sachs (GS \$96.15) and Morgan Stanley (MS \$15.14). However, Google's (GOOG \$558.61) earnings beat could foreshadow positive profit tallies out of tech giants Apple (AAPL \$408.32), Intel (INTC \$23.38), International Business Machines (IBM \$186.82), Microsoft (MSFT \$27.17) and EMC (EMC \$22.72). Market action could also be influenced by profit tallies due out from bellwethers General Electric (GE \$16.22), Halliburton (HAL \$35.02), Schlumberger (SLB \$67.20), Johnson & Johnson (JNJ \$64.23), AT&T (T \$29.10), Verizon (VZ \$37.02), McDonalds (MCD \$89.31), Coca Cola (KO \$67.40), and Freeport McMoRan (FCX \$35.24).

Weekly Focus – Think about it

"It's no fun to protest on an empty stomach."
~ Michael Bloomberg

Best Regards,

Jim, Aaron & Angela
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- * 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.
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