



Weekly Commentary December 20, 2011

The Markets

In total, 2011 has been a challenging year as rising inflation and rising interest rates early in the year hit at the same time that other events, particularly the escalating European debt problems, eroded investor confidence. With only a few weeks remaining in 2011, the stock market could end the year close to the same level that it started the year. Of course, the stock market has not been unchanged all year. On the contrary, volatility experienced during the past 12 months continues to make investors cautious, especially with the unresolved European debt crisis still creating uncertainty.

As 2011 comes to a close, investors are probably disappointed and thankful at the same time. Earlier this year, the stock market was up more than 100% from the lows in March 2009. But, as the year progressed, the market took back more than 20% of those gains, disappointing many investors. Fortunately, the market is finishing the year on a better tone. Consequently, investors are also probably thankful that the global economy has avoided the worst-case scenario of a financial meltdown because of Europe's sovereign debt crisis.

Over the summer, a confluence of events, including the end of quantitative easing, the escalation of the European debt problems and the downgrade of the U.S. sovereign debt rating made many investors worry about a repeat of the 2008 bear market. Many investors decided to sell first and wait for answers later. This flight to safety pushed short-term Treasury interest rates down to zero percent while the U.S. stock market declined more than 20%.

Of course, the stock market dropped significantly in 2008 as the U.S. economy was in recession and corporate profits were falling that year. This year, however, the economy and corporate profits are still growing as the United States is not in recession, a very different scenario from what we currently find in European countries.

In 2008, earnings dropped sharply and so did the market. This year, we see that earnings advanced while the market declined. Of course, past performance does not guarantee similar results. Nevertheless, this year's market weakness, at the same time operating earnings were hitting new all time highs, has created good value in the stock market. Unfortunately, many risk-averse investors were looking for safety this past year, not attractive valuations. Consequently, the stock market still incurred a substantial correction even though the economy and profits were rising.

The history of the 2008 financial crisis suggests that policy makers only need to restore confidence, not resolve all problems, in order to stabilize the financial markets. Recent market action suggests we are not at that point yet in the European crisis. However, we may be getting closer. In the meantime, the global economy remains at risk due to the problems in Europe.

Index Performance Statistics – December 20

Index	Close	Day Change	Day % Change	% YTD Change	52 Wk % Change
DJIA	12103.58	337.32	2.87	4.54	4.95
NASDAQ	2603.73	80.59	3.19	-1.85	-2.39
S&P 500	1241.30	35.95	2.98	-1.30	-1.06

Source: Bloomberg

*Price return — does not include dividends

Paychecks to Shrink Without a Deal in Congress

Paychecks for 160 million workers will be reduced in January unless lawmakers break a stalemate that could dent U.S. economic growth and poses political difficulties for a Congress with low public approval ratings. President Barack Obama urged House Speaker John Boehner during a phone call today to allow a vote on Senate legislation for a two-month extension of a payroll tax cut, saying it was the “only option,” White House press secretary Jay Carney said.

The president also called Senate Majority Leader Harry Reid, who like Obama seeks a short-term tax cut to give lawmakers time to work out differences over how to pay for it. Boehner and the Republican-controlled House voted 229-193 yesterday, with no Democratic support, to reject the two-month bipartisan Senate measure and call for a yearlong extension of the tax cut.

The roll call was structured in a way that let lawmakers vote “yes” in an effort to avoid the appearance that Republicans were vetoing a tax cut and violating a bedrock principle of the party. The House maneuver allowed it to move directly to a conference committee with the Senate that Reid, a Nevada Democrat, had already rejected. The two congressional leaders kept up the pressure on each other today while showing no intention of making concessions. Boehner, an Ohio Republican, met with eight House Republicans chosen to negotiate a resolution and demanded that Democrats name lawmakers to join the deliberations.

Last Week

Stocks stumbled heading into the home stretch of 2011 as Europe continued to hang over investors. German Chancellor Angela Merkel added fuel to the sovereign debt fire after acknowledging that there is no easy and fast solution to the crisis. With these seeds of doubt planted, the cost of insuring against default on European sovereign debt approached a record and the euro broke below the psychological \$1.30 level against the U.S. dollar for the first time since January. The FOMC also added to the fray. On the plus side, policy makers noted the U.S. economy continues to expand at a moderate pace, but they refrained from outlining plans for additional quantitative easing. While the policy news was disappointing, Thursday’s data cocktail kept fears of a U.S. double dip at bay. U.S. jobless claims fell to 366,000, the fewest since May 2008, and two reports showed manufacturing in the New York and Philadelphia regions expanded more than forecast in December. However, a slight pickup in producer prices and the

first industrial production decline in seven months kept traders from getting carried away. As closing time approaches, the S&P 500 was looking at a weekly loss, setting the index up for a yearly decline of over 3%, as of Thursday's close.

As stocks got bounced, bondland partied on. Investors sought refuge which boosted demand at the Treasury's auctions of 3-, 10-, and 30-year bonds, totaling \$66 billion of government paper. As a result, the longer end of the curve broke through the yield thresholds as the 10-year yield touched 1.86%, its lowest level since early October, and the 30-year fell to 2.89%. In an effort to avoid selling debt during the holiday-shortened weeks, next week will also be garnered with debt offerings. The Treasury will auction off 2-, 5, and 7-year notes for a total issuance of \$99 billion. Risk aversion brought a selloff in commodities. Crude oil fell below \$95 a barrel as OPEC agreed to raise its production target for the first time in three years. Dollar strength sent gold bugs scurrying and pushed the yellow metal below its 200-day moving average for the first time since January 2009.

Economic data will be relatively heavy next week ahead of the Christmas holiday. Third-quarter GDP is expected to remain at 2.0% in the latest revision. Housing starts, existing and new home sales for November are all expected to show a slight improvement. November Durable Goods Orders may show an uptick on Thursday. Personal Income and spending will hit the tape that day as well as will the final reading on the University of Michigan's consumer confidence index. Earnings reports and preannouncements will also be a focal point given this week's miss from Best Buy (BBY \$23.36) and a disappointing forecast from Intel (INTC \$23.50). Technology will be in the crosshairs with quarterly results expected from Adobe (ADBE \$27.35), Jabil Circuits (JBL \$19.51), Micron (MU \$5.55), Red Hat (RHT \$46.23) and Tibco Software (TIBX \$23.65). The spending appetite of the consumer will be tested with CarMax (KMX \$30.05), Carnival (CCL \$33.07), Nike (NKE \$94.08), Walgreens (WAG \$34.11) and American Greetings (AM \$16.60). Cintas (CTAS \$30.00) and ConAgra (CAG \$25.55) will also bring their bottom lines.

Weekly Focus – Think about it

“Whoever said money can't buy happiness simply didn't know where to go shopping.”
~ Bo Derek

Best Regards,

Jim, Aaron & Angela
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