

Weekly Commentary August 17, 2009



The Markets

As a kid, we remember enjoying soups that had letters made out of noodles floating in the soup. They were called Alphabet Soup. The letters didn't add to the flavor, but fishing around for a specific letter helped even tasteless soups go down easier. Today, letters are much more difficult to deal with, and not all of them are tasty. "V", "W", and "U" refer to the most common projections by economists as to the type of economic recovery that will follow our apparently just-ending "Great Recession." Let's begin the discussion by stating that we certainly do not know for sure what the shape of the recovery will be, but we do have an opinion. Some see a V recovery that rises quickly from the ashes of the deep recession. The thinking is that consumers have pulled back spending dramatically due to the recession, and thus there is great pent-up demand for lots of goods and services. Also, inventories have been reduced substantially by corporations so production will come back strong. These are certainly reasonable thoughts that have been gaining popularity lately.

The W-type recovery "camp" believes that after a short economic recovery we will have yet another recession. As we stated last week, this fear is not unusual as recessions end. With interest rates and inflation very low and most Americans having suffered a great deal the past two years, we believe the odds on another quick recession are low. Also, our economy has a very impressive history of resilience. OK, so what about the kind of "middle-of-the-road" or U recovery? In a U recovery, the economy bottoms out over a few months and then turns up moderately, but in a step ladder fashion. This represents kind of a "Steady Eddie" economic recovery, that doesn't excite folks but can be sustainable and can build more strength down the road.

At this time, a U recovery makes the most sense to us. Yes, consumers have a great deal of pent-up demand but the labor market, if it follows history, will stay soft for another year or so. Thus, consumer spending will probably not boom anytime soon. Back-to-school sales are already dragging. Also, most folks are feeling poorer due to much lower home prices, and this problem doesn't appear to be going away near-term. The financial markets have unfrozen, but still are not functioning normally. The Federal Reserve will likely start pulling back some of its heavy monetary stimulus by year-end. So a U recovery seems most likely to us. However, there are tons of things going on in Washington and the world that could alter our opinion – stay tuned. If it is to be a U or V, the stock market should do OK. Some of this uncertainty is why the S&P 500 is selling at a very reasonable 13.5 times an estimate of \$73.00 per share for its 2010 earnings. If it's to be a W recovery, the stock market has trouble ahead. However, the positive performance by the stock market during its August "time-out" is a strong argument for the U or the V. We continue to favor cyclicals, technology and pharmaceuticals, as we believe an eventual health bill will be much more moderate than the current version that has turned town halls into town brawls.

Index Performance Statistics – August 17

Index	Close	Day Change	Day % Change	% YTD Change	52 Wk % Change
DJIA	9135.34	-186.06	-2.00	4.09	-20.42
NASDAQ	1930.84	-54.68	-2.75	22.44	-20.11
S&P 500	979.73	-24.36	-2.43	8.47	-23.38

Source: Bloomberg

*Price return — does not include dividends

Obama Still Prefers Public Option, White House Says

The White House wants to make something perfectly clear: The public option is still on the health care negotiating table. "The goal is choice and competition" among health insurance plans, spokesman Robert Gibbs told reporters this morning. "The preference is the public option." Gibbs denounced reports that the administration may drop its support for a publicly funded insurance option because of intense opposition. He attributed the reports to a media "overreaction" after the comment by Health Secretary Kathleen Sebelius that a public option is not "essential" to a health care plan.

Obama himself stoked commentary with his statement Saturday that "the public option, *whether we have it or we don't have it*, is not the entirety of health care reform."

Whether the White House was sending signals or not, liberal Democrats made their own position very clear: The public option is essential to any health care plan designed to cover all Americans. Yet Sen. Kent Conrad, D-N.D., says there aren't the votes for it in the Senate. Republicans and some conservative Democrats describe the public option as a gateway to a government-run, single-payer plan.

Bottom line: It's tough to negotiate a complex piece of legislation in public. The administration obviously doesn't want to deal through the media or drop a key provision before Congress returns from August recess.

Last Week

This week it was Woodstock on Wall Street for the bulls as the Summer of Love for stocks continued. Despite concerns that equity valuations may have gotten ahead of the improving economy, the market was able to recover into positive territory by Thursday's close. The FOMC provided an encore, alleging the recession is ending and Wall Street sang along. A large hedge fund that profited from the credit crisis revealed it had recently been buying stocks in the financial sector, bringing bids to banks which had been dealt some blows from the analyst community earlier in the week. A better than expected earnings report from Wal-Mart was able to offset a decline in the July retail sales figures.

With the market now up almost 50% from the March low, there is growing skepticism that the Summer of Love will last. The S&P 500 index now trades above 18 times estimated earnings for this year, its highest multiple since December 2004. We have seen an increasing number of market experts change their bearish tune and the recent weekly sentiment survey by the American Association of Individual Investors showed 50% of investors are bullish. This would suggest that the market could experience a period of consolidation/contraction. If this were to occur, the Wells Fargo Advisors Market Analysis team believes this would present a buying opportunity for equities.

If the rally is to continue, we will likely need an encore of positive economic data next week. This includes updates on housing, inflation and manufacturing. However, Thursday's release of the July Leading

Indicators index will be of particular interest to investors for further signs the recovery is just around the corner. In addition to the economic data, there will be several Treasury auctions throughout the week and Fed Chairman Bernanke will be in Jackson Hole, Wyoming to speak at the Kansas City Fed's annual conference. On the earnings front, scheduled reports of note come from retailers Home Depot, Lowe's, Target, Sears and PetsMart, PC maker Hewlett-Packard, agricultural equipment maker Deere and consumer staple names HJ Heinz, Hormel and Flowers Foods.

Weekly Focus – Think about it

“The trouble with government regulation of the market is that it prohibits capitalistic acts between consenting adults.”

~ Robert Nozick

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.
- * Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.
- * This commentary should not be considered 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 Al Goldman, Chief Market Strategist, Wells Fargo Advisors 8/18/09.
- * Obama Still Prefers Public Option: cited from AP by David Jackson 8/18/09
- * Last Week cited from Dean Meehan, Market Analyst, Wells Fargo Advisors 8/14/09.
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