



Weekly Commentary September 21, 2009

The Markets

The question we are asked most often is, how has this market been able to rally so much despite a ton of problems and uncertainties? One simple answer is “who knows?,” but don’t fight it. We fully understand why most investors are very skeptical about market action since the lows made March 9; the main reason is that most missed it. The next question is, what should investors on the sidelines do now? Are some folks too bullish relative to reality, or are the bears too bearish? The facts are these: The DJIA rose to an 11-month high last week, and the S&P 500 is up a dramatic 58% from its March 9 lows. That is reality, a fact, and can’t be disputed. What is not for sure is whether the optimists or the pessimists have it right about the stock market at current levels and the outlook for the economy in 2010.

Most economists are looking for a moderate rate of economic growth next year, in the 2.4% range. Federal Reserve Chairman Bernanke said last week that economic growth may not be strong enough to quickly reduce the jobless rate. Some bears are looking for the recession to have a double dip in 2010, and a few economists believe that after such a severe recession, the economy will be quite strong. Folks, we are talking about the future, and no one knows for sure what the future holds. We know there will be some rate of economic growth, some level of interest rates and some increase in corporate earnings, but there is no way to know for sure what those fundamentals will be. Hopefully, we can all make intelligent guesses. The big problem is that on top of those unknowable fundamentals, we will also have a number of totally unpredictable developments affecting the economy and the overall mood of investors.

The drift of our thoughts is pretty easy to understand – there is no way the fundamental outlook can tell us if investors are too bullish or too bearish. So what can mere mortals do, and how do we make sound investment decisions? Of course, it is important to try to understand the economic trends in place; they are positive and continue to support our opinion that the economy is transitioning into recovery. August retail sales rose 2.7%, the largest monthly increase since January 2006, and industrial production increased 0.8%, better than expected. Inflation remains benign as the August core producer price index - excluding food and energy - increased just 0.2%. In our opinion, the best guide to the future of the stock market is the action of the market itself. The stock market is acting very well, better than the current environment, so we remain bullish and believe the majority is too bearish. The stock market needs a breather, and in fact, one is overdue. We believe the message of the market is that any pullback from this level of the market will be modest and measured in days, not weeks. It is a mistake to over-intellectualize the stock market because it is an emotional animal more than a fundamental one.

Index Performance Statistics – September 21

Index	Close	Day Change	Day % Change	% YTD Change	52 Wk % Change
DJIA	9778.86	-41.34	-0.42	11.42	-11.23
NASDAQ	2138.04	5.18	0.24	35.57	-1.88
S&P 500	1064.66	-3.64	-0.34	17.87	-11.80

Source: Bloomberg

*Price return — does not include dividends

FDIC Considers Borrowing Cash from Banks

Tired of the government bailing out banks? Get ready for this: officials may soon ask banks to bail out the government.

Senior regulators say they are seriously considering a plan to have the nation's healthy banks lend billions of dollars to rescue the insurance fund that protects bank depositors. That would enable the fund, which is rapidly running out of money because of a wave of bank failures, to continue to rescue the sickest banks.

The plan, strongly supported by bankers and their lobbyists, would be a major reversal of fortune. A hallmark of the financial crisis has been the decision by successive administrations over the last year to lend hundreds of billions of taxpayer dollars to large and small banks.

Last Week

Stocks moved higher and bonds fell as the economic data showed further improvement and Bernanke suggested the recession has very likely ended. Specifically, investors were encouraged this week by the better than expected August retail sales, housing and manufacturing data. In addition, comments by Warren Buffet stating he feels fine buying stocks right now offset disappointing earnings tallies by Oracle and FedEx. As a result, the major indices advanced for a second straight week and continued to buck the historical trend of September being the worst performing month of the year.

Although Bernanke believes the recession is likely over, he also included the caveat the recovery could take time. This is consistent with Wells Fargo Advisors Macro Strategist Gary Thayer belief the most likely scenario of a modest U-shaped recovery. Therefore, the release of the statement following the FOMC meeting on Wednesday will be of interest to investors for additional insight into what the Fed sees going forward. On the data front, the notable releases to watch next week include the August leading indicators, new and existing housing sales, durable goods orders, and consumer sentiment readings.

The third quarter ends in about a week and a half and earnings season will be upon us before we know it with Alcoa kicking things off on Oct. 7. Currently, consensus expectations are for the third quarter to have a negative year-over-year earnings growth of 22%, according to Thomson Reuters. If analyst projections are correct, this would be the ninth consecutive quarter of negative

growth for corporate profits. The silver lining is that earnings comparisons should get easier and the rate of decline is projected to be at a slower pace vs. recent quarters. This can be seen at the sector level as the financials are expected to show the largest earnings growth in the S&P 500 index. Next week there are several earnings reports expected that will be of interest to investors. The list of notable companies include Lennar, ConAgra, Carnival FactSet, Autozone General Mills, Bed Bath & Beyond, Cintas, Paychex, Research in Motion, McCormick and KB Home.

Weekly Focus – Think about it

“Five years ago, we thought of the Web as a new medium, not a new economy.”
~ Clement Mok

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.
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