

Weekly Commentary

October 12, 2009



The Markets

As the old song goes, “what a difference a day makes,” but in this case let’s say a week. Just a week ago, we introduced a new stock-market barometer, the “sleep” indicator. We rated the indicator bullish, as we had slept poorly due to lots of economic problems and two weeks of a market correction. In the stock market, it is usually a good thing when you are nervous and a bit gloomy. In just one short week, the “sleep” indicator has changed, as we have been sleeping like the proverbial “log”; and that is worrisome. So why such comfort and peace of mind? Most critically, the DJIA made a new 2009 high on Friday and was up a big 4% for the week. Also, the economic news was pretty comforting as the September ISM non-manufacturing index increased to 50.9. A reading over 50 means that more purchasing managers say that their service-sector business is expanding rather than contracting.

Reducing the need to count sheep was that September chain store sales increased 0.1% from a year ago, the first positive year-to-year change in 13 months. Also helping to remove sheep was the August trade deficit, which declined to \$30.7 billion from \$31.9 billion in July. In the stock market, sometimes good is bad and at other times bad is good. In a stock market already up over 60% since the March 9 lows, too many good market things and too much sound sleep are worrisome. We thus believe that it is time to add some caution to our long-standing optimism about this bull market. Yes, the U.S. economy is doing better, but it remains very fragile. There is a big risk that oil prices will leap up if there is anticipation of some conflict with Iran. If so, our fragile economy would likely soften again. Also, the very soft labor market says the consumer, and thus overall economic growth, will not be strong in 2010.

We believe the quick change in our “sleep” indicator, and of course, the many economic and political uncertainties, call for an adjustment to our bullish posture. We believe the following make investment sense at this time: (1) add some caution to our positive outlook, (2) look to buy pullbacks and not chase strength, (3) assume the market will not continue its dramatic leap upward, but will advance much more modestly, as in a stair-step fashion (4) hold some cash reserves, and (5) remember that the market is currently ignoring the fragile economy, Iran, the health bill, the dollar collapse, Afghanistan and the problems between President Obama and General McChrystal. The mood may stay rosy for a long time, but let’s have some insurance in the form of cash reserves just in case it doesn’t. Dow 10,000 is an upside magnet, and decent third-quarter earnings could also help very short-term. A normal 10% or so correction would hurt our sleep pattern but be healthy for the stock market

Index Performance Statistics – October 12

Index	Close	Day Change	Day % Change	% YTD Change	52 Wk % Change
DJIA	9885.80	20.86	0.21	12.64	5.31
NASDAQ	2139.14	-0.14	-0.01	35.64	15.99
S&P 500	1076.19	4.70	0.44	19.15	7.26

Source: Bloomberg

*Price return — does not include dividends

Treasuries Rise on Speculation Rates Stay Low, Dollar Falls

Treasuries rose for the first time in three days on speculation the dollar's decline will spur demand from foreign investors as the Federal Reserve keeps interest rates at a record low through late 2010. Today's rally follows the biggest weekly decline in Treasuries in two months and comes as the dollar slid to the weakest level against the euro since before the bankruptcy of Lehman Brothers Holdings Inc. Fed Bank of St. Louis President James Bullard said yesterday that a falling unemployment rate is a precondition for an increase in the target interest rate from near zero.

"A decline in the dollar makes Treasuries cheaper, said Michael Pond, an interest-rate strategist in New York at Barclays Plc, one of 18 primary dealers that trade with the Fed. "That could encourage some buying. If that trend is expected to continue, then foreign investors should expect a decline in the value of their foreign holdings." The yield on the 30-year bond fell seven basis points to 4.16 percent at 11:22 a.m. in New York, according to BGCantor Market Data. The 4.50 security due August 2039 increased 1 9/32, or \$12.81 per \$1,000 face amount, to 105 25/32. The yield rose 23 basis points last week, the most since it gained 31 basis points over the five days ended Aug. 7. The Dollar Index, which IntercontinentalExchange Inc. uses to track the greenback against the currencies of six major U.S. trading partners, dropped as much as 0.5 percent to 75.738, the lowest level since Aug. 11, 2008.

Last Week

This week the bulls got back to work as the market rebounded from its recent pullback. Spurring the reversal were renewed signs of economic recovery as the Reserve Bank of Australia unexpectedly raised its benchmark rate citing the worst of the economic crisis down under had passed. Because of the improved outlook, commodities rallied while the dollar and bonds declined. Other positives on the economic front included better than expected weekly initial jobless claims numbers and same store sales reports by most retailers. Investors were also encouraged by the good start to earnings season with Alcoa posting an unexpected profit and Pepsi topping analyst projections.

Despite this week's action, the debate continues between bulls and bears over whether the rise off the March low is the start of a new bull market or a rally in a secular bear market. The opinion of Wells Fargo Advisors Macro Strategist Gary Thayer is the more likely outcome favors the bulls. Thayer believes the economy may have bottomed in June and has turned up slightly since then. However, he warns that the economy remains vulnerable to a setback given its weakened state from the recession. Furthermore, Thayer thinks the economy needs more time to heal in order to sustain the recovery. He also notes that it is natural for sentiment and the market to move ahead of reality. This can result in periods of market consolidation or contraction as investors wait for more signs of improvement. That said, Thayer believes the stock market is likely to rally further, as long as the economy can avoid any unexpected complications and we receive additional evidence of a healthy recovery that is progressing. Next week could provide evidence of the health of the recovery as we get another round of monthly releases on inflation, manufacturing and the consumer.

Although the schedule of earnings releases does not really heat up until the week of October 19, we will still have plenty of companies of interest painting the tape with 6 Dow Industrials and 25 companies from S&P 500 due to report next week. Overall, current projections are for about a 24% year-over-year decline in profits for the S&P 500 index, according to Thomson Reuters. If

this comes to fruition, it would extend the record of consecutive quarterly drops to nine. However, investors will look for a repeat of the second quarter when over 70% of companies posted profits above consensus projections. Those companies scheduled to report next week that could have implications for the rest of earnings season and the market include Johnson & Johnson, Altera, CSX Corp, Intel, Advanced Micro Devices, Google, IBM, Abbott Labs, JP Morgan, Bank of America, Citigroup, Goldman Sachs and General Electric.

Weekly Focus – Think about it

“Without a sense of urgency, desire loses its value.”
~ Jim Rohn

Best Regards,

Jim, Aaron & Angela
Kennedy Financial Services

Securities & Advisory Services offered through VSR Financial Services, Inc.
A Registered Investment Adviser and Member FINRA/SIPC
Kennedy Financial Services is Independent of VSR.

- * 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 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 10/13/09.
- * Treasuries Rise on Speculation: cited from Bloomberg by Susan Walker 10/13/09
- * Last Week cited from Dean Meehan, Market Analyst, Wells Fargo Advisors 10/9/09.

* 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.