



Weekly Commentary January 4, 2010

The Markets

Will the year 2010 prove to be a boom or bust period for the stock market? Our answer is yes. The stock market always goes through boom and bust periods. The only question is whether these periods will be mini, maxi or moderate cycles. Last year's market action was exceptional. After a maxi-bust early in the year, the DJIA rose 20% for the fiscal year and 61% from the lows made on March 9. A repeat of this type of bust and boom market is very unlikely in the second year of a bull market and economic recovery. The past decade was not generally a good one for stockholders, and two events will have very long-term implications – Sept. 11, 2001 and the severest recession since the Great Depression. Of course, the new decade holds many serious problems that we know about and certainly other situations, both good and bad, lay ahead.

Last week, we discussed the fact that we believe the best way to try to predict the always-uncertain future is to attempt to understand the trends in place and assume they will last forever, until they change. We believe the U.S. economy started a modest recovery in the third quarter of 2009, and we expect that trend to continue. If we can avoid any major unexpected shocks, the economy should be able to grow moderately in 2010. This is an argument for a moderate rise in the stock market or, sticking with our theme, a mini-boom. The outlook for corporate earnings is very positive as comparisons with last year will be easy, and companies have reduced overhead and labor costs substantially. For the stock market to rise from a mini to a moderate boom, it would probably require a solid increase in corporate revenues resulting from a stronger labor market.

The outlook for inflation is positive as the consumer price index is expected to be in the 2.0% area. We expect the Federal Reserve to keep interest rates very low throughout most or all of 2010. This is another argument for a "mini-boom" in the stock market. The overall market valuation still appears reasonable. The S&P 500 is selling at 14 times a popular estimate of \$80.00 a share for the S&P 500 by year-end, and interest rates offered by fixed income investment are not very competitive. The New Year holds several uncertainties that could cause a mini or maxi-bust for the stock market. Domestically, the biggest problems appear to be high unemployment and commercial real estate issues. The geopolitical environment is very dangerous, and domestically, we remain a nation suffering from extreme divisiveness in Washington and among our people. In the stock market, the economy rules and thus we continue to look for a moderately higher stock market in 2010, disrupted by normal corrections. Our new year's wish is for freedom to reign – if it does, our nation can survive the myriad problems and prosper.

Index Performance Statistics – January 4

Index	Close	Day Change	Day % Change	% YTD Change	52 Wk % Change
DJIA	10583.96	155.91	1.50	1.50	18.22
NASDAQ	2308.42	39.27	1.73	1.73	41.79
S&P 500	1132.99	17.89	1.60	1.60	22.16

Source: Bloomberg

*Price return — does not include dividends

Markets Ahead of Reality on Fed Boost, Pimco Says

Financial markets are ahead of reality by pricing in three interest-rate increases by the Federal Reserve this year, according to Richard Clarida of Pacific Investment Management Co. The central bank is unlikely to lift its target rate for overnight loans between banks from a range of zero to 0.25 percent until late 2010 or 2011, Clarida, a global strategic adviser to Newport Beach, California-based Pimco, said in a Bloomberg Television interview. Policy makers want to see a sustained improvement in the labor market before raising rates, he said.

“The Fed has never hiked until they have seen a sustained decline in unemployment,” Clarida said. “By the Fed’s own forecast, that is at least one year away.”

Policy makers will increase the benchmark rate to 0.5 percent in the third quarter and to 0.75 percentage point by the end of the year from the current range of zero to 0.25 percent, according to the weighted average of 73 forecasts compiled by Bloomberg.

Fed Chairman Ben S. Bernanke and his colleagues, who in December 2008 lowered the central bank’s overnight-loan target rate to virtually zero, flooded the economy with more than \$1 trillion in the largest monetary expansion in U.S. history. The Fed’s balance sheet more than doubled to \$2.24 trillion in the last two years.

Last Week

It was a quiet week on Wall Street. With little in the way of data, it appeared many investors decided to sit on the sidelines into the New Year. As a result, the S&P 500 was essentially flat for the week by Wednesday’s close. Heading into the final trading session of 2009, the index was up 24.6% for the year and 64.8% from the March low.

Therefore, the champagne should taste better than it did this time last year following the worst annual performance for the market since 1937. However, the celebration will be short-lived as the scoreboard at the corner of Broad and Wall resets back to zero on Monday. The start of a new year also means that it is time to watch for the “First Five Days” indicator. According to the Stock Trader’s Almanac, the cumulative performance of the first five trading days of the S&P 500 historically has been an early detection signal for the direction of the index for the year. Possibly setting the tone to the start of the year is the full slate of economic data due out next week.

Leading into Friday's employment report will be updates on manufacturing, housing and vehicle sales. As for the employment situation, economists are projecting the non-farm payrolls to be unchanged for December and for the unemployment rate to remain at 10%. Along with the release of the FOMC Meeting minutes on Wednesday, there will a number of speeches by Fed officials for investors to speculate on its plans to reduce stimulus measures as the economy improves. On the earnings front, it will be quiet until the unofficial start of fourth-quarter releases kicks off with Alcoa reporting on January 11. Of the limited number of companies scheduled to post results next week, the notable reports will come from agricultural chemical makers Mosaic and Monsanto, homebuilder Lennar, retailers Family Dollar and Bed Bath & Beyond and spirit maker Constellation Brands.

Weekly Focus – Think about it

"A business with income at its heels, furnishes always oil for its own wheels."
~ William Cowper

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.
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- * 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 1/5/10.
- * Markets Ahead of Reality: cited from Bloomberg Erik Schatzker & Cordell Eddings 1/5/10
- * Last Week cited from Dean Meehan, Market Analyst, Wells Fargo Advisors 12/29/09.
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