Weekly Commentary
May 24, 2010

The Markets

OK, folks, let's have a little test of your stock market IQ. The question is, what is the major 'bouncing ball' that we should all focus on as the main controlling factor in the stock market today? Your choices are: (1) the soft labor market, (2) the sluggish economic recovery, (3) the EU problems, (4) the general feeling of malaise about all politicians and a questioning mood about the future of our country, or (5) none of the above. Well, if you picked number 5, you get an A. Of course, we are grading the exam, so we can say what is correct. So what really is the major bouncing ball? In our opinion, it is the fact that the S&P 500 leaped up about 80% from intraday lows to highs in only 14 months. Yes, we rose from very depressed levels, but an 80% rise wouldn't be bad over an eight-to-10 year period. To jump that much, a lot of money had to be spent and a lot of energy expended.

Such a big advance is a good thing, but it does have implications for the rest of the year. Our opinion after the big rally was that the market would still probably end the year higher, but in a step-ladder fashion. Barring some really good and surprising news, the market will probably have nervous up-and-down cycles that will be scary on the downside and create glee on the upside. So how does an investor handle such a market environment? Most critical, continue to be bullish about the big picture. Recent economic data show the economy continues to recover from recession. The April index of leading economic indicators did dip 0.1%, the first decline in 12 months. This does not indicate a recession is coming but does probably mean that the economy will cool off a bit in the second half. We still believe GDP will be up about 3 1/2% for the year. Also very positive for the longer term is that inflation and interest rates remain very low. These plus the very reasonable overall market price/earnings multiple are the main fundamental reasons we have remained bullish.

In our Market Commentary last week, May 18, we advised investors who had not come off the sidelines to withhold new buying. We felt the market was too short-term extended. Well, to point out how volatile our now churning market can be, the S&P 500 dropped 5.6% during the first four days of last week before bouncing back Friday. For most long-term investors, we first advise holding selected stocks and, second, not watching the stock market's daily bumps and grinds. For more aggressive investors, we advise buying dips in the market and not chasing flips back up. The stock market is nervous, and that's why we look for several months of an up-and-down market. We do not believe it is nervous because of our exam answers one through four. We believe it is nervous, and thus subject to quick mood shifts, due to the fact a big bet (80% rally) has already been made. OK, no one gets a failing grade, and we admit our answer may not be correct. But it's the power of the pen, and the pen is in our hand.

Index Performance Statistics – May 24

Index	Close	Day Change	Day % Change	% YTD Change	52 Wk % Change
DJIA	10066.57	-126.82	-1.24	-3.47	21.62
NASDAQ	2213.55	-15.49	-0.69	-2.45	30.82
S&P 500	1073.65	-14.04	-1.29	-3.72	21.04

Source: Bloomberg
**Price return — does not include dividends*

North Korea Severs Ties with South Over Ship Sinking Accusation

North Korea said it will sever all ties with South Korea and expel the South's workers from a joint industrial zone as "punishment" for accusing it of sinking a warship and killing 46 South Korean sailors. "There is no need to show any mercy or patience for such confrontation maniacs," the official Korean Central News Agency reported late yesterday, citing the Committee for the Peaceful Reunification of Korea. North Korea will "abrogate the agreement on non-aggression" and handle all issues with South Korea under wartime law, the group said.

North Korea will cut off all communication links, ban passage of South Korean ships and airlines through its territories and resume propaganda broadcasts across the border, KCNA said. The communist country earlier yesterday warned of military action in the disputed maritime area off the peninsula's west coast after accusing the South of violating its territory in the zone. North Korea's statement added to perceptions of increased tension on the Korean peninsula following the March 26 sinking of the 1,200-ton Cheonan, which a multinational team concluded on May 20 was caused by a North Korean torpedo. North Korean leader Kim Jong I1 told the military to be combat-ready in a message that coincided with the announcement, a Seoul-based dissident group reported, prompting the Korean won to weaken 3 percent against the dollar and the Kospi stock index to fall to the lowest in more than three months yesterday.

Last Week

Europe's financial woes fanned the flames of the bears as investors remained skeptical surrounding the region's attempt to bring its credit crisis under control. Adding fuel to fire was Germany's ban on naked short-selling of government bonds and financial companies. Although similar actions were taken by the U.S. during our credit crisis, the move by Chancellor Merkel sparked concerns that the increased regulation could weigh on the budding global recovery. Not helping matters has been the overhang created by China's attempts to curb its growth and the anticipated passing of the financial reform bill. As a result, the bull's chances to extend last week's relief rally went down in flames with stocks and commodities down on the week as bonds caught bids.

The strategy of “Sell in May and Go Away” has worked well so far with the S&P 500 index down 9.7% month-to-date and 12% from the April 23 high as of Thursday’s close. However, several technical indicators suggest the stocks may be oversold. The recent Investors’ Intelligence poll, which is a contrarian sentiment indicator, showed the percentage of bulls declined to 43.8% from 47.2% last week and the recent high of 56%. The number of bears remained unchanged at 24.7% whereas those expecting a market correction increased to 31.5% from 28.1%. Another indication of an oversold market is that the number of stocks in S&P 500 index trading below their 50-day moving average has increased to the highest level since March 2009. Although this doesn’t mean the market can’t move lower, investors should keep an eye on the bearishness moving to greater extremes when looking for a bottom.

Accompanying this week’s market decline was a mixed bag of economic data. Better-than-expected housing starts and inflation reports were offset by an increase in foreclosed home inventory as well as disappointing manufacturing and weekly jobs figures. Also, the leading indicators index fell for the first time in a year. Although the data was a disappointment, the Fed provided a silver lining to the economic picture in the release of the April 28 Federal Open Market Committee (FOMC) meeting minutes. In addition to raising 2010 growth expectations to 3.2%-3.7% from 2.8%-3.5%, the Fed reduced its forecasts for inflation and unemployment. The Fed could provide additional positive economic commentary next week with Chairman Bernanke and Philadelphia President Plosser presenting at a conference hosted by the Bank of Japan and St. Louis President Bullard speaking in both London and Stockholm.

In addition to the Fed speak there are several economic reports that could re-ignite the bulls. Specifically, investors will look for signs of improvement in housing from the April New and Existing Home Sales and March Case/Shiller data. On the manufacturing front, Wednesday’s release of the April Durable Goods Orders is expected to show an increase of 1.3% versus the prior month’s decline. There will also be a lot of attention on the consumer with Personal Spending & Income as well as the Consumer and University of Michigan confidence readings slated to hit the tape. The second look at first-quarter GDP due out on Thursday is projected to be revised upward to 3.4% from the initial 3.2% reported last month.

The release of Wal-Mart’s results on Tuesday marked the unofficial end to the first quarter earnings season. Overall, profits came in better than expected with 76% of companies in the S&P 500 index beating consensus earnings estimates, according to Thomson Reuters. In addition, 66% of the index constituents exceeded Wall Street’s top-line projections. While the number of earnings reports dies down, releases by retailers AutoZone, J.Crew, Costco and Tiffany’s will be of interest. Along with the housing data, Toll Brothers will post results that could provide additional information on the sector. The sun also will shine on the alternative energy space as Yingli Green, Trina Solar and Solarfun Power are scheduled to post profits. Rounding out the list of notable company’s on next week’s earnings calendar include Heinz, Campbell Soup, Take-Two Interactive, Verifone, Novell, Net-App and TiVo.

Weekly Focus – Think about it

“Some debts are fun when you are acquiring them, but none are fun when you set about retiring them.”
~ Ogden Nash

Best Regards,

Jim, Aaron & Angela
Kennedy Financial Services

* 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 e consider 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 5/25/10.

*North Korea Severs Ties: cited by Bomi Lim & Nicole Gaouette - Bloomberg 5/25/10

* Last Week cited from Dean Meehan, Market Analyst, Wells Fargo Advisors 5/21/10.

* 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.