



## Weekly Commentary August 16, 2010

### The Markets

Two weeks ago, the biggest surprise for investors was the disappointing July employment report and the subsequent positive reaction of the stock market, certainly not a scenario investors thought they were “gonna get”. This past week brought more surprises. The Federal Reserve acknowledged after its August 10, 2010 meeting that the United States economic recovery is growing more slowly than it had anticipated. While the acknowledged slowdown was treated as a surprise by many investors, what seemed lost in the shuffle was Chairman Bernanke’s statement during his July 21 semiannual Congressional testimony when he described the outlook for the U.S. economy as “unusually uncertain.” That earlier remark was a signal to us (and we certainly assume many others) that the Fed saw a more subdued outlook for near-term economic prospects, especially when one considered the stream of poor economic data that was unfolding at the time.

Then the Fed followed with a somewhat more downbeat assessment of the economy in its July 28 beige book release. In addition, investors don’t really know what they’re “gonna get” from the Fed’s plan to use the proceeds from its maturing mortgage holdings to buy more U.S. Treasury debt. One popular view is the Fed is at least alerting the market that it is prepared to take new measures, if needed, to stimulate growth. The other view is more ominous and speculates that monetary policymakers must know something that is much more serious for the economy than they are making public. The stock market’s reaction to the Fed’s statement and plan was confusing as it bounced around last Tuesday afternoon and then the Dow Jones Industrial Average (DJIA) plunged 2.5% the following day.

Other surprises last week were sobering comments from a bellwether technology company that some of its corporate customers are reluctant to spend. Europe returned as the lead story in various media after lowering its growth rate forecast and China reported weak imports and falling property prices. Weak U.S. second-quarter productivity, weak June wholesale inventories, higher-than-expected weekly jobless claims and a decline in retail sales (excluding autos and gas) added to the stock market’s woes. Added to that, many economists began reducing their second quarter gross domestic product (GDP) numbers, and in some cases, quite sharply. The S&P 500 finished down nearly 4% and the DJIA 3% for the week. All of these developments added up once again to talk of a double-dip recession. Hence, as we have been describing for several weeks, investors’ confidence is low, so buyers and sellers lack conviction and volatility continues to be the order of the day.

Through the “noise” of investors trying to figure out “what they were getting” last week, there was technical deterioration in the stock market. The major averages broke below their up-trends from the early July 2010 lows and below their 200-day moving averages. In addition, these indexes were turned backed from their June resistance highs. A contrary positive was investor sentiment rapidly swung again to the negative side. Some measures of sentiment and momentum reached levels that historically have been coincident with or at least near sizable rallies by stocks. For now, however, the market remains somewhat short-term extended and as we stated last Wednesday has started at least a short-term pullback. Earnings have passed as an influence,

and investors are focusing back on the economic data and the upcoming poor seasonal period for stocks. The burden is on the bulls to see if “buying the dip” is still alive.

An unknown is whether investor pessimism has become pessimistic enough to contain stocks to a short-lived pullback, or the market is in for a longer, deeper pullback.

### Index Performance Statistics – August 16

| Index   | Close    | Day Change | Day % Change | % YTD Change | 52 Wk % Change |
|---------|----------|------------|--------------|--------------|----------------|
| DJIA    | 10302.01 | -1.14      | -0.01        | -1.21        | 12.77          |
| NASDAQ  | 2181.87  | 8.39       | 0.39         | -3.85        | 13.00          |
| S&P 500 | 1079.38  | 0.13       | 0.01         | -3.20        | 10.17          |

Source: Bloomberg

\*Price return — does not include dividends

## U.S. Treasury, Mortgage Lenders Seek to Keep Federal Role in housing Fix

The Obama administration, looking to overhaul the U.S. mortgage-finance system, gathered support from lenders and the real estate industry for reducing, without ending, the government’s role in insuring loans. A limited government backstop “has a lot of traction,” said Michael Berman, chairman-elect of the Mortgage Bankers Association, in a Bloomberg Television interview after a Treasury Department conference in Washington to discuss proposals. “At either of the extremes -- either a full nationalization or a full privatization -- we’re not in the mainstream.”

The Obama administration is seeking advice on how to rebuild a system at the center of the 2008 credit crisis. Some Republicans have sought to abolish Fannie Mae and Freddie Mac, the main sources of U.S. mortgage financing. Yesterday, Bill Gross, who runs the world’s biggest bond fund at Pacific Investment Management Co., said the U.S. should consider “full nationalization” of the system. “To suggest that there’s a large place for private financing in the future of housing finance is unrealistic,” Gross said at the meeting. “Government is part of our future. We need a government balance sheet. To suggest that the private market come back in is simply impractical. It won’t work.”

Fannie Mae, based in Washington, and Freddie Mac of McLean, Virginia, have drawn almost \$150 billion in Treasury aid since September 2008, when they were seized by the government amid soaring losses on mortgage investments. The U.S. has promised unlimited support for the two companies. Including Ginnie Mae, the government insured almost 97 percent of U.S. mortgages in 2009, according to Inside Mortgage Finance.

## Last Week

Concerns the economic recovery is slowing smacked the bulls to their knees this week. Stocks fell from their highest level since May due to cautious comments in the Fed statement following Tuesday's FOMC meeting. Specifically, the Fed said because the economic rebound is "more modest in the near-term than has been anticipated," it would restart its stimulus efforts by reinvesting principal payments of mortgage securities it owns into Treasuries. Despite the Fed's continued pledge to do what it takes to spur the economy, investors remained fearful of a double-dip recession after receiving disappointing trade data and weekly jobless figures. News out of China added to the uncertainty with the country's reported slower industrial production, retail sales and loan growth. The result was largest 3-day decline in the S&P 500 index since the rally began on July 2 and a 3.4% loss for the week heading into Friday's trade.

The Fed's cautious tone brought bids to bond land. The \$74 billion Treasury refunding went well as buyers lined up for all three auctions of 3-, 10- and 30-year paper. Buyers also focused their attention on the 2- to 10-year range as it is the area where the Fed will be purchasing Treasuries to try to stimulate the economy. Corporations continued to come to market with new issues in an effort to take advantage of the current low rates and tight credit spreads. Of particular note, AAA-rated Johnson & Johnson (JNJ \$58.52) came to market on Thursday with offerings that set record coupon lows for 10- and 30-year debt.

Fears of a double-dip recession could be alleviated if we receive signs of economic improvement from next week's data releases. Of particular interest will be whether Wednesday's housing data shows the real estate market may be turning the corner. It would also be encouraging if the July Leading Indicators comes in with a positive reading after two straight monthly declines. Other data points worth keeping an eye on include scheduled updates on manufacturing, consumer confidence and inflation. In addition, speeches from Fed presidents Bullard, Evans and Kocherlakota should be monitored for additional indications of stimulus efforts by the government.

Despite earnings season winding down, there are several releases in the consumer discretionary sector next week that could restore the bulls' confidence. It is an especially busy week for the retailers with scheduled releases by Sears (SHLD \$67.31), TJX Companies (TJX \$41.74), Home Depot (HD \$27.61), Lowes (LOW \$19.74), Target (TGT \$51.81) and Wal-Mart (WMT \$50.43). After the disappointing results from Cisco (CSCO \$21.43) this week, focus will be on the commentary from tech bellwethers Dell (DELL \$11.99) and Hewlett-Packard (HPQ \$41.14) as well as Applied Materials (AMAT \$11.16), Marvell (MRVL \$14.66) and Agilent (A \$27.53). Rounding out the list of notable earnings releases expected next week include Deere (DE \$65.53), Sysco (SYY \$30.21), J.M. Smuckers (SJM \$57.93), Heinz (HNZ \$45.30) and Hormel Foods (HRL \$42.69).

## Weekly Focus – Think about it

“Fun is like life insurance; the older you get, the more it costs.”

~ Kin Hubbard

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.
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- \* The Markets prepared by Scott Marcouiller, Chief Technical Market Strategist, Wells Fargo Advisors 8/17/10.
- \* US Treasury, Mortgage Lenders: cited by Lorraine Woellert Bloomberg 8/17/10
- \* Last Week cited from Dean Meehan, Market Analyst, Wells Fargo Advisors 8/13/10.
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