

WEEKLY MARKET COMMENTARY

The major American stock indexes are now two for two in 2012 -

in the black for both weeks of the new year. Whether they can make it three straight will hinge on the reaction this week to what happened after the markets closed on Friday, though rumors had already been swirling: Standard & Poor's downgraded the credit ratings of nine, count 'em nine, European countries. Two of them, France and Austria, lost their prized AAA status, while two others economies are on the ropes and under scrutiny. Italy and Spain, were both downgraded by two notches, Italy from A to BBB+ and Spain from AA- to A. The other five countries to be downgraded were not exactly the eurozone's economic powerhouses: Cyprus, Malta, Portugal, Slovakia and Slovenia. Germany, which has also been put on alert, held onto its AAA rating.

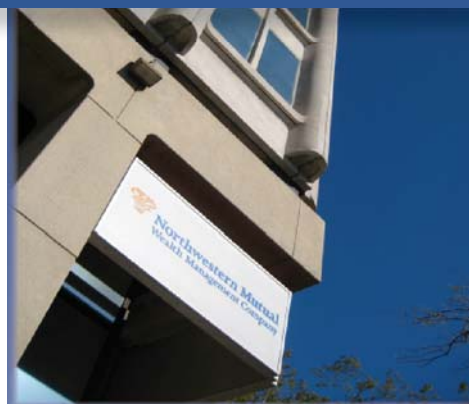
Standard & Poor's had put all of the countries that use the euro on alert in December because of their failure to aggressively take on the problems plaguing the currency, a theme it reiterated on Friday, saying, "Today's rating actions are primarily driven by our assessment that the policy initiatives that have been taken by the European policymakers in recent weeks may be insufficient to fully address ongoing systematic stresses in the eurozone."

But while expected, the downgrades are still painful and may raise the cost of borrowing for some of the countries on the brink – about \$1 trillion in debt has to be refinanced this year in Europe. France's president Nicolas Sarkozy had tried to soften the blow for some time by admitting it was inevitable, but with a presidential election on the calendar this year, the opposition party wasted no time in attacking him, saying he had presided over "the degradation of France." France is the second largest economy in Europe and thus the second biggest contributor to the bailout fund, and on Monday Standard & Poor's lowered the fund's AAA rating by a notch.

In Germany, meanwhile, Chancellor Angela Merkel's response was to use the downgrades as a way to push the plan announced in December for greater integration and further oversight that she engineered: "We are now challenged to implement the fiscal pact quickly," she said.

The good news was that last week Spain and Italy's bond sales went better than expected. On Thursday, Italy and Spain completed successful bond sales, with Italy selling 12-month bills with a yield of 2.735%, less than half of what it had to pay in December, while Spain sold twice as much as planned and also saw lower yields. Italy had another bond sale on Friday and, despite the downgrade, it again paid lower yields than it had in December.

Germany's economy gained 3% last year, the strongest of any of the European nations, but it suffered a slowdown in the fourth quarter when the economy was down 0.25%, a sign that some see an ill omen for 2012, as if any more ill omens were needed. Even so, the sale of German bonds last week was an indication of investor confidence as the yield on the six-month



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Key Market Data

week ending...	12/30/11	1/6/12	Change
Down Jones Industrial Average Index	12,359.92	12,422.06	+0.50%
S&P 500 Index	1,277.81	1,289.09	+0.88%
NASDAQ Composite Index	2,674.22	2,710.67	+1.36%
10-Year Treasury Note Rate	1.961%	1.853%	-0.108 pct. pts.
NYMEX Crude Future (Barrel)	\$101.56	\$98.70	-2.82%
Euro/U.S. Dollar	\$1.2719	\$1.2677	-\$0.0042

bonds it sold was -.0122%. In other words, investors were willing to take a loss in exchange for safety.

And just to further complicate matters, it looks as if Greece's plans to renegotiate the terms of its debt by 50% fell through, a major concern as earlier in the week Merkel said the second round of bailout money promised back in October will not be paid out until Greece has completed that plan. Greece has said that enough bills will come due in March to bankrupt it if the bailout payment is not made. Welcome to the first salvo in brinksmanship 2012.

Finally, there was some dissension in the ranks when Mario Monti, Italy's new prime minister, visited Merkel in Berlin and said in a newspaper interview that austerity plans were crippling his nation and turning Italians against Germany, which was coming to be seen as "the ringleader of EU intolerance." Monti urged greater involvement by the European Central Bank, which has remained on the sidelines but which did hold its benchmark interest rate at 1% last week, with the bank's president Mario Draghi saying the ECB is "ready to act" if the downturn gets worse, though he felt there had been "tentative signs of stabilization."

Back in the United States, President Obama took advantage of Congress still being on recess – its members return this week – to announce some moves of his own. First, he said he's planning to introduce tax breaks for firms that keep jobs in the United States and take them away from companies that ship jobs abroad, a plan he dubbed "insourcing."

Then he threw a gauntlet down by adopting a plan that the GOP has been advocating for years: shrinking the size of the federal government. He challenged Congress to give him the power to combine and streamline federal agencies to save money, including a congregation that would take the place of the Commerce Department. Congress would then approve or reject his moves in an up-and-down vote. "No business or nonprofit leader would allow this kind of duplication or unnecessary complexity in their operations," he said.

Lastly, the White House notified Congress that it was nearing the debt ceiling limit, giving Congress 15 days to act or else there will be an automatic increase of \$1.2 trillion. Even if Congress votes down the increase, according to terms negotiated last August the president can veto the move and raise the debt ceiling, but that doesn't mean both sides won't take advantage of the moment to take potshots at one another.

On the election front, Mitt Romney is emerging as the clear frontrunner for the Republican presidential nomination after winning handily in New Hampshire, which means that taxing millionaires will become a featured topic between the two parties as the election nears.

In other economic news, the Thomson Reuters/University of Michigan consumer confidence index hit an eight-month high, rising from 69.9 to 74, its highest point since May.

Earnings season began on a down note when Alcoa posted its first net loss since the first quarter of 2010. S&P 500 companies, which have beat analysts' estimates for 11 quarters straight, are expected to report an average increase in per-share earnings of 6% for the fourth quarter, according to Bloomberg. For the record, S&P 500 companies paid \$240.6 billion in dividends in 2011, up from \$205 billion in 2009, and the estimate for 2012 is \$252 billion.

The Fed's Beige Book for December showed more of the same: economic improvement at a "modest to moderate pace" in the Fed's 12 regions, but still no breakthrough with jobs or housing.

The Fed also reported that consumer borrowing jumped \$20.4 billion in November, the largest gain since November 2001 as the seasonally adjusted annual rate reached 9.9%. Consumers used the money to buy cars and holiday gifts, and some see it as a sign of growing consumer confidence as it was the third straight month of growth. On the flip side, consumers saved 3.5% of their income in November, the lowest total since December 2007 – the rate rose as high as 5% during the depths of the recession.

And the Fed turned over \$76.9 billion in profits to the Treasury, the second highest total ever – the highest was last year's \$79.3 billion. Most of the total, 97%, was generated by interest payments on the Fed's portfolio of investments, which includes the \$2.5 trillion in Treasuries and mortgage-backed securities purchased to shore up the economy during the recession.

The Labor Department reported that first-time jobless claims were up to 399,000, the highest figure in six weeks.

The Commerce Department said that retail sales in December were up but only 0.1% (after a revised 0.4% in November), their weakest pace in seven months. The Commerce Department also reported that wholesale inventories rose 0.1% in November and sales at the wholesale level improved 0.6%.

Some economists tweaked their predictions for fourth quarter growth after it was announced that the trade deficit hit a five-month high of \$47.8 billion in November.

And Freddie Mac and Fannie Mae are expected to announce a plan whereby out-of-work homeowners would be able to defer payments for as long as a year if they remain jobless.

Finally, in a report issued last week, the World Economic Forum struck a particularly ominous note, saying that unless the global income disparity and government deficits were addressed in the next decade, there would be a "dystopian future for much of humanity."

A Look Ahead

This will be a short week, as the market was closed on Monday in observance of Martin Luther King Jr.'s birthday. But Congress will be back at work on Tuesday and begin anew the business that it concluded, noisily, just before the holiday recess: renewing the Social Security payroll tax cut which will now expire on Feb. 29. In addition, there will be updates on the producer and consumer price index, industrial production and capacity utilization, and housing starts, building permits and existing home sales.



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Please remember that all investments carry some level of risk, including the potential loss of principal invested. Indexes and/or benchmarks are unmanaged and cannot be invested in directly. Returns represent past performance, are not a guarantee of future performance and are not indicative of any specific investment. Diversification and strategic asset allocation do not assure profit or protect against loss. Although stocks have historically outperformed bonds, they also have historically been more volatile. Investors should carefully consider their ability to invest during volatile periods in the market. The securities of small capitalization companies are subject to higher volatility than larger, more established companies and may be less liquid. Bond investors should carefully consider risks such as interest rate risk, credit risk, securities lending, repurchase and reverse repurchase transaction risk. Greater risk is inherent in investing primarily in high yield bonds. They are subject to additional risks, such as limited liquidity and increased volatility. There is an inverse relationship between interest rates and bond prices. Investing in foreign securities is subject to certain risks not associated with domestic investing such as currency fluctuations and changes in political and economic conditions.

All index references and performance calculations are based on information provided through Bloomberg. Bloomberg is a provider of real-time and archived financial and market data, pricing, trading, analytics, and news.

The Dow Jones Industrial Average Index® is a price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Standard and Poor's 500 Index® (S&P 500®) is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Standard & Poor's offers sector indices on the S&P 500 based upon the Global Industry Classification Standard (GICS®). This standard is jointly maintained by Standard & Poor's and MSCI. Each stock is classified into one of 10 sectors, 24 industry groups, 67 industries and 147 sub-industries according to their largest source of revenue. Standard & Poor's and MSCI jointly determine all classifications. The 10 sectors are Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Telecommunication Services and Utilities.

The NASDAQ Composite Index® Stocks traded on the NASDAQ stock market are usually the smaller, more volatile corporations and include many start-up companies.

NASDAQ - National Association of Security Dealers Automated Quotations. The NASDAQ is a computer-operated system owned by the NASD that provides dealers with price quotations for over the counter stocks.

The 10-year Treasury Note Rate is the yield on U.S. Government issued 10-year debt.

NYMEX Crude Future is the futures price on a barrel of oil on the New York Mercantile Exchange.

Euro/U.S. Dollar is the currency exchange rate between the Euro and the U.S. Dollar.

Bear market calculations and interpretations are derived from data supplied by Ned Davis Research, Inc.

The European Central Bank (ECB) is the institution of the European Union (EU) which administers the monetary policy of the 17 EU eurozone member states.

The Federal Reserve Beige Book is published eight times per year and includes anecdotal information on current economic conditions in its 12 districts through reports from Bank and Branch directors and interviews with key business contacts, economists, market experts and other sources.

The University of Michigan Consumer Sentiment Index is a consumer confidence index published monthly by the University of Michigan and Thomson Reuters. At least 500 telephone interviews are conducted each month of a United States sample. 50 core questions are asked.

Alcoa is the world's leading producer of primary aluminum and fabricated aluminum, as well as the world's largest miner of bauxite and refiner of alumina.

Freddie Mac is a stockholder-owned corporation chartered by Congress in 1970 to create a continuous flow of funds to mortgage lenders. Freddie purchases single-family and multi-family residential mortgages and mortgage-related securities, which it finances primarily by issuing mortgage pass through securities and debt instruments in the capital markets.

The Federal National Mortgage Association, doing business as Fannie Mae, buys and holds mortgages, and issues and sells guaranteed mortgage-backed securities to facilitate housing ownership for low to middle-income Americans. The Company was chartered by the U.S. Congress but went public in 1970.

The World Economic Forum is an independent international organization committed to improving the state of the world by engaging business, political, academic and other leaders of society to shape global, regional and industry agendas.

The U.S. Department of Labor Consumer Price Indexes (CPI) program produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

The U.S. Department of Labor Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services.