Peter's Weekly Market Analysis

June 23, 2014

Commentary At-a-Glance

- All three of the major US indexes moved higher during the course of the previous week.
- NASDAQ has finally broken above its level seen back in March of 2014!
- Iraq seems to be falling further and further from peace.
- Fed Chair Janet Yellen has spoken—and said relatively nothing new.
- Economic news releases last week, on the whole, came in above expectations.

Market Wrap-Up

With positive manufacturing news, all three of the major US indexes pushed higher last week with the NASDAQ finally catching up to where it was back in early March. The move last week was done on high volume as investors seemed to take comfort in Federal Reserve Chair Janet Yellen's comments on Wednesday. Below are my standard charts with the key indexes represented by the green lines and the most recent trading channels or resistance levels on the three major indexes represented by the red lines:

The S&P 500 (upper left pane above) remains the strongest of the three major indexes on a year to date basis, but the NASDAQ (lower left pane) is quickly making up lost ground. We saw new all time highs on both the S&P 500 and the Dow last week with both indexes closing out the week at new highs. The big story of the week last week was the fact that on Wednesday the NASDAQ, riding on the heels of the Fed statement, finally broke back above the high level seen back in early March of this year. For a little perspective on how long this breakout has been coming, it took the S&P and the Dow 25 and 27 days, respectively, to break out and from new highs after the meaningful declines seen earlier this year. The NASDAQ took a full 73 days to perform the same feat. Where might the markets go from here? While the NASDAQ has quickly closed the gap, it looks like it may have moved a little too far too fast and a small pull back at this point would not be the least bit surprising. The Dow and the S&P 500, on the other hand, have been building support and momentum over the past few weeks and doing so in a steady manor, so they could conceivably continue to move higher. One big wild card to all of this is the fact that Iraq looks like it could be getting itself into a long and drawn-out conflict, which could impact global oil prices and, in turn, consumer spending around the world. One measure of risk that does not seem to care much about the situation in Iraq is the VIX, which just last week plunged down to a multiyear low following Chair Yellen's comments and several news stories about how the Iraqi army is regaining ground on the Islamic State in Iraq and Levant (ISIL).

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International News

International news last week focused on the situation in Iraq as ISIL continued to make headway in many regions of the country in their push south towards Baghdad. While there are some reports out about the Iraqi army making tactical offensive strikes against the group, it still seems like the blitzkrieg the ISIL is operating is working. Last week we saw some of the more notable religious leaders take up the cause, urging many Iraqis to take up arms against the intruders with the main voice being that of Shiite cleric Muqtada al-Sadr, a man who was very outspoken against the US back in 2008. Even the Grand Ayatollah Ali al-Sistani threw his opinion into the fold in a rare political statement during which he called on current Prime Minister Maliki to reach out to the religious minorities to see if he can forge a diplomatic end of the escalating conflict. This call came on the heels of US President Obama calling for a diplomatic end to the fighting and making a pretty clear case that the current mess is the problem of the current Iraqi government and no one else. President Obama, however, did announce that he is sending 300 "military advisers" into Iraq as well as a few Special Forces teams that are tasked with protecting the US interests within the country. The US also now has both unmanned and manned aircraft in the air over Iraq 24 hours a day, gathering information about who and what the US should strike if we do get involved militarily in the current conflict. Most at risk in this environment is the global oil supply and prices. While a short term fluctuation in the oil production coming out of Iraq could be easily handled with the world's oil stock piles, a long term conflict within Iraq, and in particular southern Iraq, could push the price of oil up meaningfully.

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National News

National news last week was a buzz about the Federal Reserve rate statement and Fed Chair Yellen's press conference, both of which occurred on Wednesday. The Fed statement on interest rates held almost nothing new as there were very few changes between the March statement and the current one. For a visual look at what actually changed in the statement, please see this link at the Wall Street Journal http://blogs.wsj.com/economics/2014/06/18/parsing-the-fed-how-the-statement-changed-39/ In a nut shell, the Fed kept the Tapering program on schedule (taking the bond buying down from $45 billion per month down to $35 billion per month), lowered their growth projections for the US and lowered their target Longer Run interest rate. The $10 billion cut in the tapering program was well telegraphed to the markets and came as no surprise to anyone watching the Fed. At the current run rate, the tapering program will likely draw to a

close some time during the fourth quarter of 2014, at which time the markets will be watching for signs of when interest rates may start to rise. Based on the latest Fed statement the Fed funds rate is now expected to be 1.2 percent during 2015 and 2.5 percent by the end of 2016, as opposed to the March projections of 1.125 percent and 2.4 percent, respectively. But this was not what caught the attention of Wall Street. The attention grabbing was done by the downgrade of the US economic growth expectations for 2014. In the March projections GDP for 2014 was expected to grow between 2.8 and 3.0 percent, but in the latest projections these numbers have been revised down to between 2.1 and 2.3 percent growth. Much of the decline is being blamed on the greater than expected negative impact of weather on the US economy during the first quarter of the year. But there is more going on with the GDP figure than bad weather as there was one other very small change to the projections that seems to have been overlooked by the majority of Fed watchers. The longer run GDP figure for the US saw the lower end of its range lowered from 2.2 down to 2.1 percent, while the upper bound stayed the same at 2.3 percent. While a 0.1 percent decline in GDP may seem trivial, with the GDP figure above $16 trillion, that decline in growth of GDP is worth as much as $160 billion dollars per year, which is far from pocket change. The drop off is more than the total GDP of countries such as Romania, Vietnam and Hungary, according to the latest figures published by the World Bank. On a slightly more positive note, the unemployment rate projections were lowered for 2014 through 2015 as the US seems to slowly be getting back on track to full and normal employment. In the end, it would have been nice to get a little bit more clarity as to what Chair Yellen is thinking, but she did not give any more or any less than was expected; she has come a long way in a short amount of time in terms of her ability to utilize Fed speak.

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Market Statistics

Equities

Last week was a positive week for the major indexes in the US, as all three indexes moved higher on strong volume:

Index	Change	Volume
S&P 500	1.38%	++
NASDAQ	1.33%	+
Dow	1.02%	+

For a summer week it is somewhat unusual to see such high volume and a price move greater than 1 percent on all three of the major US indexes.

When looking at sectors, the following were the top 5 and bottom 5 performers over the course of the previous week:

Top 5 Sectors	Change
Medical Devices	4.01%
Biotechnology	3.25%
Pharmaceuticals	3.13%
Utilities	2.96%
Oil and Gas Exploration	2.89%

Bottom 5 Sectors	Change
Telecommunications	0.04%
Aero Space and Defense	0.36%
Technology	0.43%
Financials	0.50%
Semiconductors	0.62%

One interesting sector last week was the Utilities sector, which saw the fourth best performance of the week despite it being one of the most defensive sectors of the financial markets. Some of this move was likely due to the continuing rise in the cost of energy as uncertainty over the situation in Iraq remains very high.

Fixed Income

Fixed-income investments were mixed last week as the global financial markets continue to try to make sense of central bankers' speeches around the world:

Fixed Income	Change
Long (20+ years)	-0.31%
Middle (7-10 years)	-0.03%
Short (less than 1 year)	-0.01%
TIPS	0.68%

In currencies, the US dollar was down 0.46 percent against a basket of international currencies. The Canadian dollar was the strongest currency of the week, gaining 0.90 percent against the US dollar with a lot of volume trading on the currency.

Commodities

Commodities were mixed last week as metals performed well and oil moved a little:

Metals	Change
Gold	2.88%
Silver	5.87%
Copper	3.63%

Commodities	Change
Oil	0.12%
Livestock	-0.90%
Grains	0.66%
Agriculture	0.29%

The overall Goldman Sachs Commodity Index increased by 1.30 percent, while the Dow Jones Commodity Index was up 1.32 percent for the week. Oil had a bit of a wild ride last week coming off the very large increase two weeks ago on the fighting in Iraq; it seemed to settle down a bit last week. Most of the downward move in oil was due to the US saying that it may take actions in Iraq to support the government, but this seems to be falling by the wayside as several religious leaders are now calling for a new government to replace the existing one in Iraq.

International Performance

Last week saw a mixture of positive and negative performance when looking at the global financial markets, with the split being between the developed and emerging markets. The best performance of the global indexes was in the Netherlands with the Amsterdam index gaining 0.89 percent. The worst performance last week was found in China with the Shanghai based Se Composite Index giving up 2.13 percent.

Volatility

Just when I thought the VIX was moving in the correct direction toward a higher and more reasonable level, the VIX reversed course and fell like a rock. Last week the VIX moved lower by 10.92 percent; much of the decline may be attributed to a decline of more than 12 percent on Wednesday last week following the press conference and interest rate announcement by Fed Chair Janet Yellen. With such a weekly decline we are now back at levels of the VIX not seen since February of 2007. When looking at the current level of 10.85, the S&P 500 is expected to move by about 3.1 percent over the course of the next 30 days and, as always, the direction of the move is unknown.

Performance

For the trading week ending on 6/20/2014, returns in FSI's hypothetical models* (net of a 1% annual management fee) were as follows:

	Last Week	Year to Date
Aggressive Model	1.54 %	2.55 %
Aggressive Benchmark	*0.89 %*	*4.59 %*
Growth Model	1.34 %	3.69 %
Growth Benchmark	*0.69 %*	*3.61 %*
Moderate Model	1.12 %	4.49 %
Moderate Benchmark	*0.50 %*	*2.62 %*
Income Model	1.08 %	5.42 %
Income Benchmark	*0.24 %*	*1.37 %*

**Model performance does not represent any specific account performance but rather a model of holdings based on risk levels that are like our actual holdings, the hypothetical models are rebalanced daily to model targets.*

We made no changes to our models over the course of the previous week as many of our positions seem to be moving back into favor with the markets rotating around as they struggle for direction in this low volume environment. We continue to watch sectors of the market such as biotechnology and healthcare for an entry point, but they are currently trading in too wide of a trading range with volatility seemingly increasing within the sectors specifically.

Economic News

Week in Review

Last week was a typical summer week as far as the number of economic news releases, with the focus of the week being US manufacturing. In aggregate the economic news releases released last week came in better than the market was expecting as several key manufacturing and business activity indexes beat expectations:

Economic Impact	Date	Economic News Release	Date Range	Actual	Expectation
Positive	6/16/2014	Empire Manufacturing	June 2014	19.3	12.8
Slightly Positive	6/16/2014	NAHB Housing Market Index	June 2014	49.00	46.00
Neutral	6/17/2014	Housing Starts	May 2014	1001K	1028K
Slightly Negative	6/17/2014	Building Permits	May 2014	991K	1050K
Neutral	6/17/2014	CPI	May 2014	0.40%	0.20%
Neutral	6/17/2014	Core CPI	May 2014	0.30%	0.20%
Neutral	6/19/2014	Initial Claims	Previous Week	312K	313K
Neutral	6/19/2014	Continuing Claims	Previous Week	2561K	2638K
Positive	6/19/2014	Philadelphia Fed	June 2014	17.8	13.4

Data for table from Econoday.com, Bloomberg and Yahoo Finance

On Monday the 16th the Empire Manufacturing handedly beat market expectations, coming in at 19.3 versus expectations of only 12.8. The June reading of 19.3 was also an improvement from the May reading of 19.0. This is a positive development for the overall health of the US economy as the great New York area is a key geographic location for US manufacturing and many times is a leading indicator

of future economic activity for the rest of the country. Adding to the positive news on Monday was the release of the NAHB Housing Market index for the month of June, which also beat expectations, but by a lesser amount than the manufacturing index. On Tuesday more housing related information was released with the Housing starts and building permit figures for the month of May. Housing starts came in very close to markets expectations while building permits left some to be desired. Also released on Tuesday was the Consumer Price Index (CPI) for the month of May, which indicated that prices rose at four tenths of one percent. While this was above expectations, it was not so fast as to warrant the Fed stepping in to stop inflation. The CPI will be very interesting to watch in June as we could see the result of rising gas and energy prices push the figure higher than 0.4 percent. On Thursday the standard weekly unemployment figures came in reasonably close to market expectations and were a non-market-moving event. Wrapping up the week on Thursday was the Philadelphia Fed's Manufacturing Index, which, much like the Empire index earlier in the week, beat expectations and the May level of 15.4. With two strong manufacturing numbers in one week it was not surprising to see the financial indexes in the US advance as manufacturing is such a key component of growth within the US economy.

Upcoming Releases

With the end of a month and a quarter quickly approaching, this week has several key economic news releases that could impact the overall movement of the markets. The economic news releases that are potentially the most impactful are highlighted in green:

Date	Release	Release Range	Market Expectation
6/23/2014	Existing Home Sales	May 2014	4.80M
6/24/2014	Case-Shiller 20-city Index	April 2014	11.60%
6/24/2014	New Home Sales	May 2014	440K
6/24/2014	Consumer Confidence	June 2014	84
6/25/2014	Durable Orders	May 2014	0.40%
6/25/2014	Durable Goods - transportation	May 2014	0.40%
6/25/2014	GDP - Third Estimate	Q1 2014	-1.80%
6/26/2014	Initial Claims	Previous Week	310K
6/26/2014	Continuing Claims	Previous Week	2588K
6/26/2014	Personal Income	May 2014	0.40%
6/26/2014	Personal Spending	May 2014	0.40%
6/27/2014	University of Michigan Consumer Sentiment Index	June 2014	81.7

Data for table from Econoday.com, Bloomberg and Yahoo Finance

This week starts off on Monday with the release of existing home sales for the month of May, which is expected to be just shy of 5 million homes. Combine this release with the Case-Shiller index and new home sales, both released on Tuesday, and we should have a pretty good idea of the health of the US housing market. If all goes as planned we should see the US housing market slowly advancing as we move fully into the peak buying season in much of the country. One of the potentially most impactful releases of the week comes out on Tuesday, that being the Consumer Confidence Index for the month of June, which is expected to have increased by one point to 84. This seems pretty likely as the index loosely follows the University of Michigan's Consumer Sentiment Index and all indications for that index are pointing to a slight increase during June. On Wednesday the Durable goods orders figure for the month of May is set to be released and expectations are for orders to have picked up at a four tenths of a percent pace. A reading this close to zero could go either way, with hopes that it will stay above zero, indicating that orders are increasing. Later during the day on Wednesday the potentially most impactful release of the week is released, that being the third estimate of GDP in the US during the first quarter of 2014. This release has been problematic the last two months with each estimate significantly missing expectations to the downside. It seems the market has caught on to this game as the average estimate now is for the revision to come in at -1.8 percent all of the way down from the -1 percent last month. This seems to be a scenario where a bar has been set so low that it would be very surprising if the reading was worse than -1.8 and not very surprising to see something better than -1.8 percent. On Thursday the standard weekly unemployment figures are set to be released with expectations of little change in either figure over the previous two weeks.

Later during the day on Thursday personal income and spending are set to be released with both expected to be 0.4 percent. It would take a drastic deviation from expectations on these two releases for the market to take much notice, but stranger things have happened. On Friday the University of Michigan's Consumer Sentiment Index (final estimate) for the month of June is set to be released and is expected to show a slight improvement over the second estimate, but still stay very close to 81.2. In addition to the scheduled releases we also have a few Federal Reserve Officials making speeches this week and Treasury secretary Jack Lew making a speech on Tuesday, which will be very closely watched by Wall Street.

Have a great week.
Peter Johnson

"A referral from a client is a tremendous compliment and a huge responsibility that can never be taken lightly"

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