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Weekly Market Commentary by Emmett Wright

September 12, 2011

	Key Market Data		
	Week ending…		
	9/3/11	9/10/11	Change
Dow Jones Industrial Average Index	11,240.26	10,992.12	-2.21%
S&P 500 Index	1,173.97	1,154.23	-1.68%
NASDAQ Composite Index	2,480.33	2,467.99	-0.50%
10-Year Treasury Note Rate	2.000%	1.917%	-0.083 pct. pts.
NYMEX Crude Future (Barrel)	$86.45	$87.24	+0.91%
Euro/U.S. Dollar	$1.4206	$1.3657	-$0.0548

As if any further signs of investor uncertainty were needed, for the second week straight the Dow gained more than 250 points on a trading day in the first part of the week only to close with drops of more than 100 points on Thursday and 250 points on Friday as confidence waned and expectations, however unrealistic, went unfulfilled. This time around, they were disappointed by words from President Barack Obama, Benjamin Bernanke, and a man few had probably heard of when the week began, Jürgen Stark. What the three had to say – parsed, respectively, as not enough, nothing new and no confidence – added up to bring the Dow down once again.

The president spoke on Thursday before a joint session of Congress. And despite the drama over scheduling – the Republicans rejected his original request for a Wednesday session – there were signals going in that the GOP was on board to do something about jobs, in part because it became clear to members of both parties over the recent summer recess that voters were fed up with the strident tone in Washington and, more importantly, because job creation is far more of a hot button with voters than the debt ceiling.

In his speech, the president exhorted Congress to pass a $447 billion package of tax cuts and new spending that, he said, included a number of steps that, at one time or another, both parties have supported. The cornerstones of his proposal were an extension of the cut on payroll taxes and new public works programs. In the face of "an ongoing national crisis," he said, "you should pass this jobs plan right away" and "stop the political circus and actually do something to help the economy." He said the bill would be paid for by long-term spending cuts made by the new debt reduction super committee and noted that he would embrace more aggressive steps to shrink the deficit. And he made it clear that Congress can't do it alone: "Ultimately, our recovery will be driven not by Washington, but by our businesses and our workers. But we can help."

Though Republicans sat stony faced during the speech, afterward they were generally positive about the content – or at least the message. John Boehner (R - Ohio), the Speaker of the House, said, "The proposals the president outlined tonight merit consideration," a rave review from the GOP. And the House Majority Leader Eric Cantor (R - Virginia), who has had very few kind words of late for the president, said "We are going to work together. I think it's time to build consensus here." The president, for his part, hit the road to sell his plan to voters. And his first two stops? Virginia and Ohio, the home states of Mr. Cantor and Mr. Boehner.

Earlier in the day, it was Mr. Bernanke's turn at the podium. Though the Fed is not meeting until Sept. 21, and despite the fact that it has very few steps it can take with its benchmark rate at an all-time low and a portfolio worth trillions, investors seemed to have become convinced that action was imminent (the page-one headline in *The Wall Street Journal* on Thursday was "Fed Prepares to Act.") So they were disheartened when, speaking in Minneapolis, Mr. Bernanke merely said that he thought America's consumers were too pessimistic – as he put it, "exceptionally cautious" – about the state of the economy, which was concerning but not dire. That pessimism, he continued, was holding back consumer spending, the engine of economic growth. Speaking in Seattle, John Williams, the president of the Federal Reserve Bank of San Francisco added, "People are on the edge waiting for the other shoe to drop."

The budget cutting super committee had its first session last week and there was an indication of just how tough a job lies ahead when Senator Jon Kyl (R - Arizona) threatened to walk out if there was any discussion of defense cuts: "I'm off the committee if we're going to talk about further defense spending [cuts]," he said. Even so, there's recently been a subtle shift in the ground rules for cutting into the deficit. The president, both parties, presidential candidates, and members of the super committee all agree on one thing that would have been unthinkable a year or so ago: that Medicare, Medicaid and Social Security need to be overhauled. They may not feel, as candidate Rick Perry does, that Social Security is a Ponzi scheme and a "monstrous lie," but they do think that entitlements need to be reined in. As Representative Jeb Hensarling (R - Texas) said at the super committee's first meeting, the job was "primarily about the business of saving and reforming social safety-net programs that are not only failing many beneficiaries, but going broke at the same time."

From the stock market's standpoint, the worst blow of the week came on Friday. As grim as the outlook about the economy has been at home recently, the news out of Europe has been even more dire. Concern has been rising that one or more of Europe's banks may fail, setting off a Lehman-type crisis. And Greece, beset by strikes, is in even worse shape than before, if that's possible, and isn't expected to meet the deficit- and budget-cutting goals that were conditions of the first bailout, let alone the second, which means that it may not get its next bailout payment.

Meanwhile Finland, among other eurozone countries, has clouded the prospect of the second bailout that was expected to have been squared away by now. The latest blow came on Friday when Mr. Stark stepped down, without comment, from the executive board of the European Central Bank (ECB) three years before his term was up. A German, he had been among the board's most respected members and, in the opinion of many, its leading economic policymaker. But he has also been against the bond buying the bank has been engaged in of late to prop up Italy and Spain. His departure at such a crucial moment shook the confidence of investors who already had legitimate doubts about the state of the euro. With the head of the bank, Jean Claude Trichet, scheduled to step down at the end of October, the ECB is clearly in state of flux at a time when it can't afford to be.

All of this came as outsiders and insiders alike were calling for more decisive action. For example, the Organization for Economic Cooperation and Development (OECD) said, "The sovereign debt crisis in the euro area could intensify again," urging banks to recapitalize and the eurozone to be more proactive in addressing its problems. And Christine Lagarde, the head of the

International Monetary Fund, said it was a "dangerous phase" and "countries must act now and act boldly." (The OECD also lowered its GDP estimates for the United States to 1.1% in the third quarter and 0.4% in the fourth, compared to the 2.9% and 3% predicted in May.)

Germany, among other countries, is still pushing for a harder line with Greece, indicating that it will be on its own if it doesn't meet the terms of the first bailout. Wolfgang Schaüble, the German finance minister, said that Greece would only get its money "if Greece actually does what it agreed to do," and he added that if Greece is having trouble getting credit, "That's Greece's problem." On Wednesday Mark Rutte, the prime minister of the Netherlands, suggested that countries getting aid should either turn over control of their budgets or leave the eurozone until their financial affairs are in order (as it stands, member countries can't be expelled.)

One step being considered is the creation of a central financial authority with more control over all of the 17 member countries. Right now, almost any step requires unanimity which is why Finland has been able to hold up the second bailout, leading Mr. Trichet to conclude, "The crisis has clearly revealed the need for stronger economic governance." However, Germany, among other countries, is wary of any idea that might compromise its financial independence.

Earlier in the week, both investors and the markets in Europe were given a boost when Germany's Constitutional Court upheld the legality of the bailouts which had been challenged by some German lawmakers, economists and business execs. After the vote, Chancellor Angela Merkel said the ruling "absolutely confirmed" the way she has addressed the debt crisis, adding, "Germany's future is inseparable from Europe's future." The court also said that in the future Merkel needs permission from parliament's budget committee when she takes on financial burdens. The next date to watch is Sept. 29 when Germany's parliament will vote on the proposal to increase the bailout fund. It's expected to pass, but members of Chancellor Merkel's party are starting to defect, and it would be a political embarrassment for her if she has to rely on opposition parties to carry the vote.

In Italy, where Prime Minister Silvio Berlusconi has been accused of trying to whittle down the austerity program he unveiled in April, the Senate moved to approve the still mostly intact plan to balance Italy's budget by 2013 – Italy's national debt is 120% of GDP, the second highest in the eurozone after Greece. It was a confidence vote for Berlusconi and therefore had the package failed to pass it would have meant the end of his government; it passed by a vote of 165 to 141. The plan still has to be approved by the lower house where the government has an even narrower majority.

In other economic news, the Institute for Supply Management said that its index for service companies, which accounts for about 86% of the nation's jobs, was higher than expected but still soft, rising to 53.3 in August from 52.7 in July. In news that no doubt pleased Mr. Bernanke, consumer credit rose to $11.96 billion in July from a revised $11.35 billion in June, the largest gain since April 2008. And the trade gap in July was $44.8 billion compared to $51.6 billion in June.

The Fed's Beige Book report said that five of its 12 regions showed modest growth in late July and August while the seven others were sluggish (the previous survey had slower growth in eight regions.) Consumer spending increased in most regions, largely because of auto sales, outside of which there was little action.

The World Economic Forum announced that the United States fell in the ranks of global competitiveness for the third year in a row, dropping from fifth place to sixth. We were last on top in 2008 – Switzerland now holds that spot, followed by Singapore, Sweden, Finland and Germany. China, at number 26, was the highest ranked developing economy. U.S. Postmaster General Patrick Donahoe said, “If Congress doesn’t act, we will default,” as this month the United States Postal Service has to pay out billions it doesn’t have. The deficit will hit $9.2 billion this year and Mr. Donahoe said he’s weighing such steps as not delivering on Saturday, shutting down offices and laying off thousands of employees despite a no-layoff clause in the union’s contract. Later in the week, the president proposed putting off the upcoming payment for 30 days, but the fact remains that the Internet and cell phones are making snail mail all but obsolete, and certainly unprofitable.

The ECB, Bank of England, South Korea, Indonesia, Malaysia and the Philippines all took a wait-and-see stance by leaving their benchmark rates unchanged. Mr. Trichet observed that the recent slowdown had led to “enormous” economic uncertainty and he didn’t see the bank raising its rate any time soon. Usually cool and calm, he also lashed out at those who claimed the bank had acted prematurely in raising rates twice this year, bellowing, “We have delivered price stability impeccably – impeccably!”

Finally, European investors have been running to the Swiss franc the way Americans have been bailing into Treasurys, which has been hurting Swiss exporters and tourism, so Switzerland’s central bank decided to cap the value of the franc against the euro by buying euros.

A look ahead

This week there will be a number of unglamorous but important releases, including the latest on the producer and consumer price indexes, retail sales, business inventories, industrial production and capacity utilization. But all eyes – and ears – will remain on Congress, to see if it can actually make some progress on the jobs front; on the Fed, to see if it will indeed act; and on the eurozone, to see if anything can be done about the current morass.

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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.

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 Organization for Economic Cooperation and Development (OECD) is an international economic organization of 34 countries founded in 1961 to stimulate economic progress and world trade.

The International Monetary Fund (IMF) is the intergovernmental organization that oversees the global financial system by following the macroeconomic policies of its member countries, in particular those with an impact on exchange rate and the balance of payments.

The Institute for Supply Management is a not-for-profit U.S. association for the benefit of the purchasing and supply management profession, particularly in the areas of education and research.

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 World Economic Forum is a Swiss-based, non-profit organization committed to improving the state of the world by engaging business, political, academic and other leaders.