



Market Perspectives

A Glance At How The World Affects You!

February 6, 2012

Employment Report Gaining Strength, Housing Dips

Since year end 2011, the S&P 500 has been in a steady climb and recently wrapped up the best January performance since 1997; that year the index recorded a 6.1% gain in January. The 4%-plus gain in the first month of 2012 gained ovation from investors and the momentum appears to be continuing. What is goosing the market so far this year, and for that matter since October 2011?

Depending on the investor's point of view, there are a range of drivers; fundamentals, international disorder and the unexplained. On the fundamental front, investors with a domestic inclination can point to the generally improving tone of economic data or the generally solid 4Q11 earnings season. Those investors with a more international bent can point to more hopeful signs from Europe. While the European soap opera seems to be far from concluded, EU leaders did sign a pact on 1/30/12 that ostensibly strengthens accountability of member nations and vigilance by EU officials. Greece is far from fixed but bailouts will likely occur and temporarily appease markets. In spite of risking moral hazard and Greece renegeing on promises to curb spending, the story out of Europe continues to be more of the same thing we have heard for a few years now. Finally, those looking for supernatural signs have their choice of several superstitions: the super bowl predictor (NFC wins are good), the January effect (if January is positive, the remainder of the year will be positive), the Presidential Cycle, and don't forget, this is a "Leap Year".

The data has been pretty mixed, actually, at least in the very recent past.



Domestic economic data in the fourth quarter of 2011 was more unambiguously strong. In particular, after a bumpy first nine months of 2011 for job creation, the fourth quarter delivered a set of nice employment gains: 112,000 in October, 110,000 in November, and 200,000 in December. In the latest report (2/3/12) the employment situation continued to improve by an unexpected 243,000 new positions, thus dropping the unemployment rate to 8.3%; the lowest since 2008. While this headline was well-received, there is concern that the number is not accurate due to 1.2m unemployed that are no longer looking for work. Even so, the report is positive and points to further U.S. expansion. The declining trend in unemployment claims and the historically low inventory-to-sales ratio implies additional jobs could be on the way.

Investors came into January in a happy mood with the assumption that consumers shared their sunny outlook. The reality has been a bit more clouded. Early in the month, investors were surprised when December retail sales delivered only a modest 0.1% gain, against expectations of a 0.5% advance. Excluding auto sales, this measure was actually down 0.2%, signaling that Santa had not been as generous in the prior month as many assumed. We also saw some upside surprises in initial unemployment claims, such as in the 1/7/12 week.

The downward trajectory in this measure in the fourth quarter was a particularly positive sign and rally driver.

All news can't be good and that mantra was underscored as investors sought to put a wrapper on a positive January market month, the Case-Shiller index (reported on 1/31/12) indicated that problems in the housing sector are still with us. Roughly 19 of the 20 metro areas tracked by the index fell in November for a third consecutive month. Year-over-year declines in housing prices are worst in cities that have already been severely affected; including Atlanta, Tampa and Las Vegas. Only a handful of markets have avoided further downturn and none are immune. Foreclosures have slowed but remain a significant drag on the real estate sector; 2012 marks that fifth year of deterioration. Falling home prices are boosting home sales from depressed levels and realtors are cheering the opportunity but homeowners are trapped with negative equity and limited resale options.

Overall, recent indicators show the economy improving with one exception; home prices continue to fall and that could force additional foreclosures and pressure on financial institutions. Despite weakness in home prices, the construction sector is improving as spending jumped another 1.5% in December. Manufacturing is regaining some of its momentum and could be doing better than suggested by the latest report based on solid gains in production worker hours. Last week's unemployment numbers provided solid proof that the consumer sector is moving in the right direction; that assumes the report is accurate.

A Recap of Last Week: Equities posted strong gains this past week with lift especially strong after Friday's employment situation report. However, the week started on a modest down note on worries that European officials could not nail down a debt reduction deal for Greece.

Stocks were mixed Tuesday on disappointing economic news on soft consumer confidence and a drop in home prices.

Wednesday saw equities post solid gains after a moderately strong ADP employment report and better-than-expected ISM manufacturing and construction outlays. Motor vehicle sales were healthy and supported stocks. Also, comments on progress on debt by Greek Finance Minister Evangelos Venizelos added lift to markets. Shares were mostly up Thursday on a sizeable decline in initial jobless claims.

But the big surge for equities came Friday as nonfarm payroll employment jumped far above expectations and even above the upper range of the consensus. And the unemployment rate dipped to 8.3 percent—the lowest rate since February 2009.

The Bottom Line: For the market to carry its January strength across February, additional positive data will be required. The latest jobs report gave stocks a prodigious blow to the upside thus confirming the heralded "Golden Cross"; a technical formation that some believe has magic properties for stocks. This golden cross occurs when the 50-day moving average crosses above the 200-day moving average; investor's infer that enthusiasm towards stocks is accelerating. In our opinion, you can't count on technical crosses of any type to drive the market higher. Rather, momentum must come from solid fundamen-

tal data and improving growth around the globe. The sovereign debt crisis has been percolating on the back burner during the strong November-January market run and is now looking ready to boil over once more. Greece remains obstinate when it comes to austerity and the Troika remains averse to writing checks without a promise of fiscal responsibility. Portugal could be next in terms of needing a second dose of bailout money and that could easily turn into this year's Greece. We have said since late 2011 that Europe's debt crisis will continue to cause volatility for several years. Almost effortlessly, markets have moved higher since last

October on a combination of euphoria and "not as bad" economic data. Consequently, overbought conditions are reaching extreme levels which sets up an eventual profit taking in preparation for another rally. Our portfolios are well positioned to take advantage of such a move following our recent adjustment; raising an additional 10% cash allowed us to protect profits as markets have reached highs that have not been seen in more than a year. Furthermore, these profits will be used for reinvestment as stocks prices become more attractive.

A Look at This Week: The upcoming week's highlights are on Friday as the international trade report along with consumer sentiment will be tracked closely by manufacturers and traders alike. Traders will be looking to see if sentiment gets a lift after Friday's positive employment data. Consumer credit (Tuesday) and weekly jobless claims (Thursday) wrap up the week. A number of major companies will be reporting earnings this week and that could provide additional thrust for the bulls.

Best Regards,

Phillip L. Clark, RFC

President/CEO

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