

Weekly Commentary

January 10, 2011

The Markets

2010 is now history and it caps a wild three-year ride in the financial markets.

We ended 2007 near all-time record highs in the U.S. stock market, but then the wheels fell off. In 2008, markets fell dramatically and the world economy nearly imploded. In 2009, we realized that the world was not going to end and markets began to recover. In 2010, things started to stabilize and return to some level of “normalcy.” As the chart below indicates, 2010 was a solid year in the equity markets and a strong year for gold, commodities, and real estate.

But, it wasn’t smooth sailing by any stretch of the imagination. Here are a few of the year’s key events, according to *The Wall Street Journal*:

- On May 6, the Dow Jones Industrial Average plunged nearly 1,000 points in a matter of minutes and then turned around and finished the day with a loss of “just” 348 points. A report released later in the year said a combination of factors led to the plunge including a large hedging trade made by a mutual fund company. It exposed the still fragile state of the markets.
- Several days later, the European Union agreed to a massive \$955 billion bailout plan for euro-zone economies in an effort to prevent a sovereign debt crisis from imperiling the world economy. It led to a 404 point jump in the Dow the next trading day.
- In the mid-term elections, the Republican Party won control of the House while Democrats retained control of the Senate. The election results suggest policy changes may be forthcoming that could affect the markets and the economy.
- In November, the Federal Reserve announced that it would start another round of “quantitative easing” and buy \$600 billion of government securities. This program was designed to “rev up the economy.”
- To put an exclamation point on the end of the year, the president announced a deal on December 7 to extend the Bush-era tax cuts, reduce payroll taxes for a year, extend jobless benefits, and set the estate tax at 35%.

Taking a page from the “six-word memoir” idea, these six words might be an apt description of the year just passed...bailouts, flash crash, stimulus, politics, hope.

Data as of 12/31/10	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	0.1%	12.8%	12.8%	-5.0%	0.1%	-0.5%
DJ Global ex US (Foreign Stocks)	1.3	10.6	10.6	-6.9	2.7	3.8
10-year Treasury Note (Yield Only)	3.3	N/A	3.8	4.0	4.4	5.1
Gold (per ounce)	2.2	27.7	27.7	19.0	22.4	17.9
DJ-UBS Commodity Index	2.2	16.7	16.7	-4.2	-1.0	3.5
DJ Equity All REIT TR Index	1.8	27.7	27.7	0.8	3.2	10.8

Notes: S&P 500, DJ Global ex US, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.

Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable or not available.

NOBODY CAN ACCURATELY PREDICT THE FUTURE, but that does not stop financial seers from trying. Here are a few “surprise” predictions for 2011 from longtime industry veteran Byron Wien, who is currently Vice Chairman, Blackstone Advisory Partners. Wien believes these have a greater than 50% chance of occurring:

1. Working Americans get in a better mood, real Gross Domestic Product rises close to 5%, and the unemployment rate drops below 9%.
2. Rising government debt weighs on the bond market and the yield on the 10-year U.S. Treasury approaches 5%, which is up from its 2010 close of 3.3%.
3. Encouraged by renewed economic momentum the Standard & Poor's 500 rises close to its old high of 1,500.
4. The price of gold rises above \$1,600 as investors across the world place more of their assets in something they consider “real.”
5. Rising standards of living in the developing world seriously increase the demand for agricultural commodities. The price of corn rises to \$8.00, wheat to \$10.00, and soybeans to \$16.00.
6. Continuing demand from the developing world and a failure to bring onstream new supply causes the price of oil to rise to \$115 per barrel. The higher price at the pump fails to discourage driving, increase sales of hybrid vehicles, or cause Congress to initiate conservation measures.

Market forecasts are notoriously inaccurate, but a January 8 *Wall Street Journal* article gave these “forecasting pointers” for improving your odds. First, limit your forecast to no more than three to six months ahead. Get much past that and you lose your potential edge. Second, listen to the market. “In most cases, long-term averages of past returns – while far from perfect predictors – are probably a better guide than long-term forecasts of future returns,” according to the *Journal*. Third, take the average of many different forecasts to come up with your own. By averaging several different forecasts from independent sources, the individual errors will often offset each other, leaving you with a better forecast.

As for Wien, last year, only one of his 10 “surprises” was unequivocally accurate. One year from now, we'll know if he improves upon that modest 10% hit rate.

Weekly Focus – Think About It

“It is not really necessary to look too far into the future; we see enough already to be certain it will be magnificent. Only let us hurry and open the roads.” – *Wilbur Wright*

Respectfully,

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P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you would like us to add them to the list, please reply to this e-mail with their e-mail address and we will ask for their permission to be added.

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* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.

* The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks.

* The DJ Global ex US is an unmanaged group of non-U.S. securities designed to reflect the performance of the global equity securities that have readily available prices.

* Gold represents the London afternoon gold price fix as reported by the London Bullion Market Association.

*The DJ Commodity Index is designed to be a highly liquid and diversified benchmark for the commodity futures market. The Index is composed of futures contracts on 19 physical commodities and was launched on July 14, 1998.

*The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market.

*The DJ Equity All REIT TR Index measures the total return performance of the equity subcategory of the Real Estate Investment Trust (REIT) industry as calculated by Dow Jones.

* The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.

*Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.

* Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.

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* You cannot invest directly in an index.

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