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AND THAT'S THE WEEK THAT WAS...

For the Week Ended August 20, 2010

Market Matters...

Market/Index	Year Close (2009)	Qtr Close (06/30/10)	Previous Week (08/13/10)	Current Week (08/20/2010)	YTD Change
Dow Jones Industrial	10,428.05	9,774.02	10,303.15	10,213.62	-2.06%
NASDAQ	2,269.15	2,109.24	2,173.48	2,179.76	-3.94%
S&P 500	1,115.10	1,030.71	1,079.25	1,071.69	-3.89%
Russell 2000	625.39	609.49	609.49	610.78	-2.34%
Global Dow	1,984.48	1,710.71	1,827.75	1,811.48	-8.72%
Fed Funds	0.25%	0.25%	0.25%	0.25%	0 bps
10 yr Treasury (Yield)	3.85%	2.95%	2.69%	2.61%	-124 bps

As quarterly earnings season winds down, companies continue to report favorable results (though cost-cuts clearly have had greater impact on the numbers than revenue gains). Additionally, confidence has returned to the boardrooms as management spends its hard-earned “cash-on-the-sidelines” and a deal-making (risk-taking) mentality has again resurfaced. (Those 0%-ish money markets just don’t look very attractive these days.) Together, these factors should contribute to enhanced investor enthusiasm that leads equities higher. Unfortunately, “would haves,” “should haves,” “could haves” are not always based in reality, and investors spent another restless week worried about the recovery and shunning certain risky assets for the safe-haven of treasuries.

Retailers and techs dominated the earnings calendar and analysts looked for signs of increased consumer activity. **Wal-Mart** reported strong international operations, though its domestic biz struggled and US same-store sales dropped for the fifth straight quarter. **Home Depot** posted an increase in store traffic and even raised guidance for the year, though rival **Lowes** offered a more cautious outlook, despite the almost double-digit gain in earnings. Meanwhile, **Gap** confirmed its expectations for a profitable year and added to its share buyout program, a sign management may believe its stock to be undervalued. **HP** and **Dell** both benefited from improving IT demand though internal management issues haunted the companies and hindered their stock prices.

Shifting to M&A transactions, the \$2 trillion in cash sitting on corporate balance sheets (earning virtually nothing) has prompted execs to seek alternatives uses. Almost \$85 billion in deals was announced during the week, the strongest showing since late 2009. Australian mining company **BHP Billiton** has (aggressively) targeted fertilizer giant **Potash of Saskatchewan** to the (hostile) tune of \$39 billion. **Intel** will be buying security software company **McAfee** for over \$7.5 billion and Dell continues its path to diversification with the \$1.15 billion acquisition of data-storage company, **3Par**. Within financials, **First Niagara** is buying **New Alliance Bancshares** for \$1.5 billion and expanding its regional presence in the northeast. **GM** is moving forward with its IPO and plans to offer both common and preferred stock over the next few months as it begins to pay the government back some of that \$50 billion in bailout moneys.

Investors reacted to the (seemingly positive) earnings and transaction news with a collective yawn and continued to obsess over the lackluster recovery (that still remains a bona fide “recovery” just the same). Despite a mid-week two-day winning streak on the Dow, investors turned pessimistic on negative labor news (so what else is new?) and equities indexes ended the week flat to slightly lower. (“Optimistic” analysts point out that volume was incredibly light as traders wind down vacations). The yield on the benchmark 10-year even dropped to its lowest level since March 2009 on flight-to-quality trades and oil plunged to six-week lows on continued worries about the global recovery. As summer winds down (and vacations end), perhaps the boardroom confidence will become contagious and equity markets will reap the benefits as well?

Economic Calendar

Date	Release	Comments
August 17	Housing Starts (07/10)	Continued weakness after expiration of tax credit
	PPI (07/10)	1 st increase in 4 months
	Industrial Production (07/10)	Strong gain helped by auto sector
August 19	Jobless Claims (08/14/10)	Highest level since mid-November
	Leading Eco. Indicators (07/10)	Slight increase, though below expectations
The Week Ahead		
August 24	Existing Home Sales (07/10)	
August 25	Durable Goods Orders (07/10)	
	New Home Sales (07/10)	
August 26	Jobless Claims (08/21/10)	
August 27	GDP – revised (2 nd quarter '10)	

Throughout the week, investors failed to notice the “decent” earnings reports and transactional headlines and instead chose to focus on the “dire” economic news du jour. In reality, the “numbers behind the numbers” may not have been as ugly as perceived. While single-family housing starts in July fell to the lowest level in 14 months, overall activity increased as multi-family construction rose during the month. The declines had long been predicted following the end of the government tax-incentives for homebuyers. While the Philly Fed report depicted a drop in regional activity, the more comprehensive industrial production release indicated strong manufacturing gains in July and a sector rebound led by a resurgence from US automakers.

While much of the pricing-related water cooler discussions have focused on deflation as the true threat to the economy, PPI rose for the first time in four months amid higher food costs; even the core index climbed in July as well as sticker prices for cars and trucks are again on the rise (so much for “cash-for-clunkers”). Finally, leading economic indicators rose slightly in July after a drop in June. On the negative side, jobless claims unexpectedly increased to the highest level since mid-November 2009, though the numbers continue to be quite volatile as temporary summer jobs come to an end and part-time census workers are removed from the system. Looking abroad, China surpassed Japan as the world’s second-largest economy, and Germany raised its GDP projections as the country’s trade picture benefits from weakness in the euro.

Mortgage rates fell to new all-time lows (for the ninth consecutive week) and the most popular 30-year conventional loan product averaged just over 4.40% in the latest week. As borrowers continued to take advantage and refinance into lower rates, they are finding more than a few extra dollars in their pockets to put back to work in the economy (though many have chosen merely to save for now). Additionally, analysts are confident that the low rates will ultimately lead to enhanced demand for home purchases. Some feel that summer activity slowed because many buyers took advantage of the prior tax incentives early in the year, and others will be forced to act soon for fear that mortgage rates have no where to go but up in the near future. At the first sign of rising rates (perhaps a decent labor report, a Fed comment that doesn’t include the phrase “extended period,” or a move from a central bank abroad), those fence-sitters will rush to take advantage of the most attractive borrowing opportunities in a generation before it’s too late.

On the Horizon... Goodbye earnings season. Hello back-to-school and mid-term elections. Over the next few weeks, investors will shift focus from corporate earnings to retailers’ assessments of back-to-school shopping; they will be looking for signs that consumers actually spent more on number 2 pencils, Buzz Lightyear backpacks, and maybe even a laptop or two. Additionally, the daily news will be bombarded with political commentary about the election season and a potential transition in Congressional power from “tax and spend” to “lower taxes and deficit cuts.” (Sifting through the grandstanding and rhetoric will be the true challenge). GDP highlights the economic data as investors look to see if that 2.4% growth rate is revised (hopefully not much lower).

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