

## INSIDE THIS ISSUE

- 1 Perspectives
- 2 Summary of Indexes
- 3 Market Movers
- 4 Fundamentals & Indicators
- 5 Index Chart & Analysis

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***“...corporate earnings  
continue to beat  
expectations at a greater  
than normal pace.”***

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## Perspectives

Wall Street has many sayings that rule the group think of traders. “Sell in May and go away” is one that has withstood the test of time and is marked by the beginning of the weakest period for stocks. Investors would have done well by reducing exposure in May of four of the past five years. This frequency of springtime losses has created a Pavlovian response among traders who started to turn this phenomenon into a self fulfilling prophecy.

The fear of such a sell off was one of the reasons cited for the pull back that started at the end of March and ran through half of April. The idea was that sellers wanted to get ahead of the impending stampede and took profits early. It seemed like a smart move to many traders. Stocks had a fantastic first quarter and Europe’s annual sovereign debt problems were heating up again, this time with Spain instead of Greece. Investors who trade on emotion saw the annual

perfect storm brewing again. However, 2012 could be different. The past few years have had other outside influences that have yet to occur in 2012. Oil spiked early one year which sapped consumers’ discretionary spending ability. The Japanese earthquake and tsunami hit another year. Last year, the US lost its top notch credit rating and Greece’s debt drama played out for months with an eventual default.

So far in 2012, the world’s largest economic countries have not been hit by a natural disaster. Spain’s interest rates are rising (and debt prices are falling), but they are not yet to levels that indicate a panic. Although getting closer to untenable levels, Spain can still service its debt and is not close to defaulting this year. In other words, the same pattern is not unfolding in 2012 and that means stocks are not destined to follow their previous paths sharply lower either. A more likely scenario is that stocks stay range bound for the warmer months with any dips of 5-7% being bought as the value seekers take control. By this fall, when Wall Street returns from their summer vacations, the bulls will be ready for another leg higher in the current bull market.

Bears will point to the fact that England and Spain officially moved into recession territory as of their latest GDP reports. A recession is defined by two quarters of declining GDP. This is not news for investors who have been watching the markets for the past year. This slow down was seen coming many months ago and is built into stocks’ prices to some extent. This is one of the reasons the market’s P/E ratio is still below average. Investors were not willing to bid up stocks when a recession of unknown size was pending for such a large segment of the world’s economy.

Macro-economic fundamentals have started to ease in the US, but still show expansion, albeit at a less than ideal pace. However, corporate earnings continue to beat expectations at a greater than normal pace. If corporations can continue to issue strong earnings results and employment continues improve, even at a slow pace, the US should avoid another recession in the near term and stocks should not see more than a 10% correction through 2012 and into 2013. Europe’s recession should be nearing its end within six to nine months if it follows historical patterns. Their renewed expansion should hit at the time when the US recovery is in need of another catalyst to continue its push higher.

The path to new market highs will be not be in a straight line. Stocks will be primed to resume the bull market after an overdue consolidation period. That will be the time when retail investors finally return to buying stocks en masse. The move higher with strong volume will feed on itself and will offer strong gains for those who invested early enough. When volume reaches a frenzy at the same time as stocks are at new highs the institutional bulls will once again step back from buying and that will be the time to sell, not this summer. This is a pattern that repeats with every cycle. Investors have no reason to think this time will be different.

## Summary of Indexes

Courtesy of Morningstar.com

| Name                        | As of Date | YTD   | 1-Year | 3-Year | 5-Year |
|-----------------------------|------------|-------|--------|--------|--------|
| <b>US Stock Indexes</b>     |            |       |        |        |        |
| DJ Industrial Average TR    | 5/4/2012   | 7.58  | 5.28   | 18.88  | 2.44   |
| NASDAQ Composite PR         | 5/4/2012   | 13.48 | 4.53   | 18.79  | 2.82   |
| Russell 2000 TR             | 5/4/2012   | 7.32  | -3.57  | 17.57  | 0.38   |
| S&P 500                     | 5/4/2012   | 9.61  | 3.85   | 17.13  | 0.27   |
| S&P MidCap 400              | 5/4/2012   | 10.29 | -1.09  | 20.10  | 3.10   |
| <b>Global Stock Indexes</b> |            |       |        |        |        |
| Developed World (Ex-US)     | 5/3/2012   | 8.54  | -12.72 | 13.42  | -3.53  |
| Emerging Markets            | 5/3/2012   | 11.70 | -11.47 | 18.43  | 3.86   |
| <b>Bond Indexes</b>         |            |       |        |        |        |
| Core Bond                   | 5/3/2012   | 1.64  | 7.89   | 6.78   | 6.71   |
| Intermediate Core Bond      | 5/3/2012   | 2.12  | 7.31   | 6.32   | 6.87   |
| Long-Term Core Bond         | 5/3/2012   | 1.67  | 16.89  | 12.61  | 9.47   |
| Short-Term Core Bond        | 5/3/2012   | 0.81  | 2.14   | 3.19   | 4.22   |

## Market Movers

- Spain debt prices fell further which increased their yields.
- China's manufacturing activity continued to contract in April and the country's GDP reading came in below expectations at 8.1% year over year versus 8.4%.
- Budget talks in the Netherlands broke down which could hinder future progress of austerity measures.
- Spain, Italy, France, Greece and Germany all released data showing their respective PMI are showing contraction. Spain, Italy and Greece's poor readings were expected, but France and Germany had greater declines than anticipated for the countries that are supposed to be the stable ones within the European Union.
- Apple's (AAPL) earnings surprised to the upside and gave the markets a lift. Only a company the size of Apple can influence a multiple indexes.
- Francois Hollande won the presidential election in France to oust Nicolas Sarkozy. The Socialist party candidate, Hollande, is against the austerity measures that much of Europe is facing. Such change in power and reform plans will help to create a jittery market in the coming days.
- According to exit polls, Greece's pro-bailout parties are at risk of losing power. This, coupled with Sarkozy's departure, will increase uncertainty throughout the euro zone and could cause the markets to move another leg lower.

## Fundamentals & Indicators

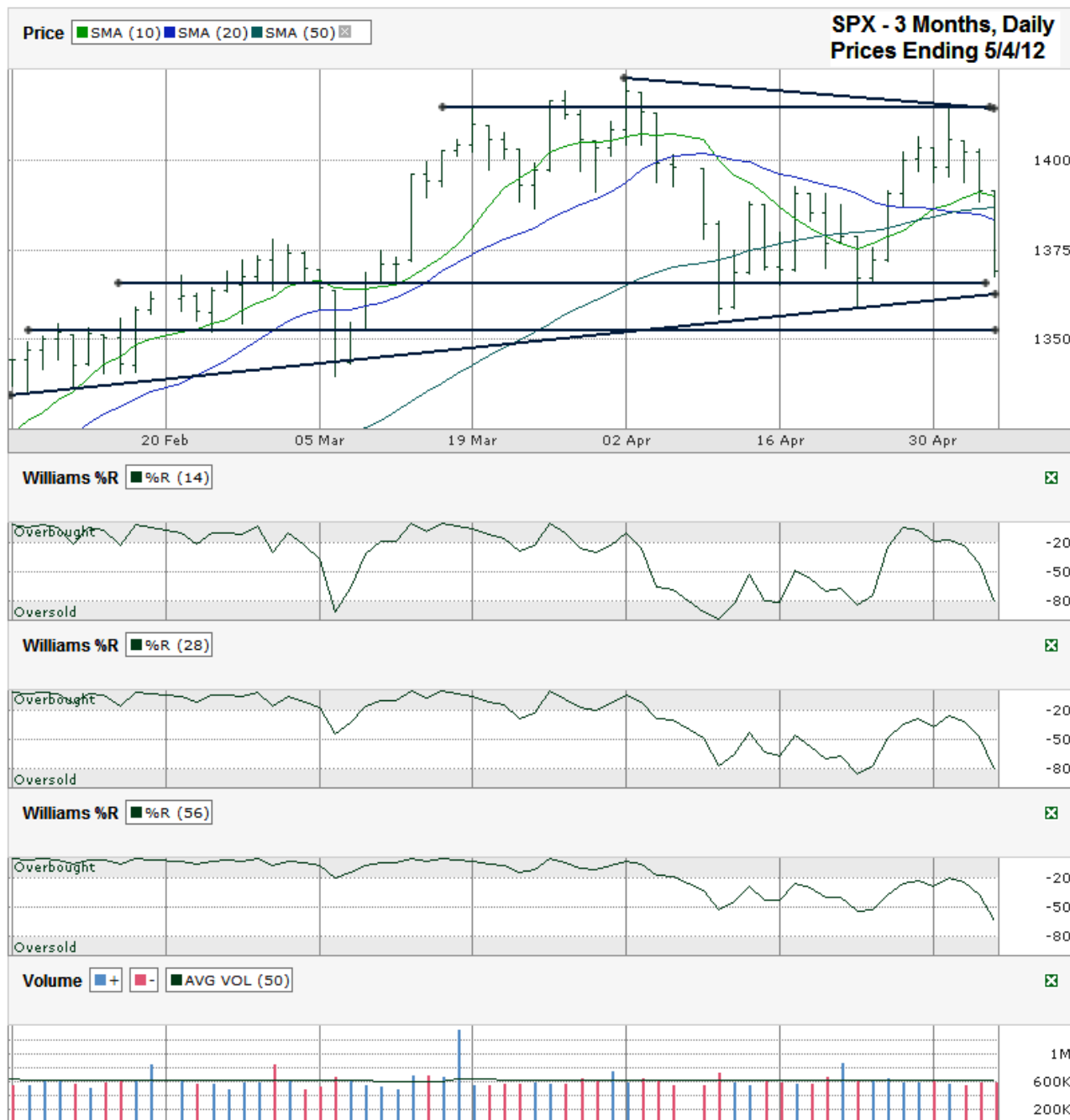
- The Producer Price Index (PPI) for finished goods was unchanged in March, largely due to the 2.0 percent drop in gasoline prices.
- Consumer prices increased by 0.3% during March after overall prices increased by 0.4% in February.
- Core consumer prices climbed by a tepid 0.2% after a 0.2% increase in February.
- Retail sales results for March rose 0.8%, beating the 0.3% increase that was expected. Excluding autos, retail sales were up 0.8% in March ahead of the consensus call for a 0.6% increase.
- The Empire Manufacturing Survey fell to 6.6 in April from 20.2 in March. This came as a big disappointment when compared to the anticipated reading of 17.5.
- Housing starts hit an annualized rate of 654,000 units in March. This was down from February's downwardly revised rate of 694,000 units and less than the pace of 700,000 units that many analysts were looking for.
- Building permits for March improved to a rate of 747,000 from 715,000 in the prior month. This was better than the forecast rate of 710,000.

Please see Fundamentals & Analysis on page 3

*Continued from Fundamentals & Analysis from page 2*

- The Philadelphia Fed Survey for April fell to 8.5 from 12.5 in March.
- Existing home sales hit an annualized rate of 4.48 million units during March, down from the pace of 4.60 million units posted in February and less than the rate of 4.62 million units that had been anticipated.
- New home sales hit an annualized pace of 328,000 in March, better than the expected pace of 318,000.
- S&P/Case-Shiller Home Price Indices for February showed annual declines of 3.6% and 3.5% for the 10- and 20-City Composites, respectively. The index is at its lowest level since October 2002. Of the 20 cities measured, 16 had negative readings and only three showed gains. Even with these declines, a growing number of analysts are calling for a housing bottom within the next 12 months.
- Total durable goods orders dropped by 4.2% during March. Economists were looking for a decline of only 1.7%. February numbers were revised lower to reflect an increase of 1.9%.
- Excluding transportation items, durable goods orders declined in March by 1.1%, which is worse than the 0.5% increase that was anticipated.
- The Fed forecasts that real GDP for 2012 will grow at a pace between 2.4% and 2.9%, up from the range of 2.2% to 2.7% that was issued in January. However, the Fed prediction for 2013 now was reduced for real GDP growth to range from 2.7% to 3.1%, down from the range of 2.8% to 3.2%, while the range for growth in 2014 is expected to range from 3.1% to 3.6%, down from 3.3% to 4.0%. Longer run growth is still expected to range from 2.3% to 2.6%. Inflation estimates for the next couple of years are capped at 2.0%.
- The Federal Open Market Committee (FOMC) indicated in its Policy Statement that inflation has increased, but the outlook for inflation over the medium run remains subdued. Based on this stance, the FOMC kept its fed funds rate at 0.00% to 0.25%, and expects exceptionally low levels of the fed funds rate at least through late 2014.
- Pending home sales spiked by 4.1% during March. That was far better than the earlier consensus calls for a 0.5% increase
- The advance GDP reading showed the economy grew at a 2.2% rate in the first quarter when an increase of 2.5% had been expected. The first quarter chain deflator reportedly increased by 1.5%, which is less than the 2.2% increase that was broadly anticipated. The first quarter Employment Cost Index increased by 0.4%, close to the 0.5% increase that was forecasted.
- Personal spending increased by 0.3% during March. This was slower than the 0.5% increase that was expected. The smaller-than-expected increase came despite a stronger-than-expected pickup in personal income, which increased by 0.4% when a 0.2% increase had been widely anticipated.
- Core personal consumption expenditures (PCE) increased by 0.2% month over month.
- Chicago Purchasing Managers Index (PMI) came in at 56.2, well below an expected reading of 60.0.
- The ISM Manufacturing Index proved to be one of the few pleasant surprises for bulls when the April reading improved to 54.8 from 53.4 in the prior month, while economists were looking for a decline to 53.0.
- Monthly construction spending numbers increased by 0.1% in March, below an anticipated 0.5% increase.
- The ISM Non-Manufacturing Index for April decreased to 53.5 from 56.0 March. Earlier predictions targeted a smaller drop to 55.5.
- Nonfarm payrolls for April increased by 115,000, which was short of the 162,000 much of Wall Street expected. The unemployment rate fell 0.1% to 8.1%. The U6 jobless rate, which includes discouraged jobseekers and those forced to work part-time, was flat at 14.5%. Many investors view the U6 rate as the true level of unemployment.
- Much of the cause for the improvement in the unemployment rate came from a drop in the labor-force participation rate which fell to 63.6% from 63.8%. The unemployment rate improves by reducing the count of total workers or increasing those who are employed. However, the reduction in the participation rate is viewed as more negative because it shows workers have started giving up their searches.
- The average work week was unchanged at 34.5 hours, while average hourly earnings rose 1 cent to \$23.38.
- A bright spot in this month's employment data came from the revisions of prior months readings. The increase in employment in March was revised up to 154,000 from an initial reading of 120,000. The gain in February was revised up to 259,000 from 240,000.

## Index Chart & Analysis



This S&P 500 (\$SPX) chart shows the past three months of daily prices after the index finished the week at 1,369.10 on Friday, May 4, 2012. The technical indicators are not giving as clear of a picture as they often do in foreshadowing what is to come in the near term. This tends to happen when an index or stock is in a consolidation phase and is range bound. Indicators, such as the moving averages and Williams %R can give false readings or roll over before the next trigger comes into play.

The 10 day moving average (dma) moved above the 20 dma early in this past week. This crossover is bullish and typically indicates more positive days are ahead for the bulls. However, within a couple of days, the 20 dma moved below the 50 dma. This is often indicative of the end of a rally and can lead to weeks lower for stocks.

*Please see Index Chart & Analysis on page 5*

*Continued from Index Chart & Analysis from page 4*

The direction for stocks lacks certainty without these three moving averages in agreement. Williams %R showed a fall below the overbought range in the 14 day indicator by Thursday. This is another bearish signal, but the 28 and 56 day periods had not made it back to the overbought range before stocks rolled over again. This means any dip should be short lived. Large bear markets rarely start without extreme optimism seen within longer time periods.

The lack of clarity from the moving averages and Williams %R leaves the trend lines to tell traders the story. The area of resistance to watch comes from the trend line of lower highs and the horizontal line that is close to multiple intraday highs. Both of these are above 1,410 and give the SPX plenty of room to move higher from Friday's closing level. The downside is closer to being tested sooner. The large cap index closed within a few points of the trend line of higher lows. Friday's intraday low is very close to multiple points of support and resistance over the past three months and could mark another turning point. If Friday's low doesn't remain as near term support, the next area to watch is close to 1,350, about 20 points or less than 1.4% below Friday's close. Another 1.5% lower will shake out more of the nervous traders and will bring the S&P 500 to a point where value investors can start picking up stocks that have been dragged down with the masses. This will stop the exodus from stocks and move the index back towards the middle of its trading range where it could stay for another month or longer before breaking to the upside unless a new catalyst surfaces to warrant more selling.

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