AF CAPITAL MANAGEMENT
Registered Investment Advisor

The Investors' Newsletter

November 6, 2011
Volume 1 Issue 6

Inside This Issue

"When investors put Europe's woes aside and focus on the actual earnings for US companies the picture is much brighter."

Perspectives

The Dow Jones Industrial Average fell more than 275 points on the last day of the month, but still managed a monthly gain of 9.5% in October -- the third biggest on a percentage basis in its 115-year history. The S&P 500 finished October with its best monthly gain in almost 20 years with a monthly gain of almost 11%, claiming its first monthly gain since April.

Bears find it increasingly difficult to drum up fear based on an economy that is supposed to be crumbling, but isn't showing major cracks yet. At the same time, bulls have a hard time making the case for a market that deserves a price/earnings multiple equal to its historic average. Economic indicators are not showing a recovery that is running on all cylinders yet, but it is still growing and that alone keeps the bulls at the reigns most days lately. The bears still invest out of fear of what could (and probably will) eventually happen in Europe. Greece continues to toy with traders' investment models and emotions nearly every day with as much drama as any far fetched movie could deliver. Bears bring out their worst case scenarios for Italy on any day that Greece doesn't take the headlines.

Hopes, fears and rumors will continue to rule the headlines until Greece defaults or its final debt haircut is put into place and acted upon.

When Greece's debt holders "voluntarily" agreed to take 50% of the value of their loans the markets rebounded sharply off a five percent decline in just two days. While this isn't the end of the story, it shows reality is starting to reach Europe. As noted in this space as far back as June, Greece faces defaulting on its debt unless it goes through a major restructuring. The question remains if 50% is enough to save Greece. Most economists think 70% is a more realistic target. Without a large enough debt restructuring, Greece remains at risk for leaving the euro and returning to the drachma where it can devalue its way out of future defaults.

When investors put Europe's woes aside and focus on the actual earnings for US companies the picture is much brighter. Recent earnings announcements have been decidedly positive with a few outlying companies that are not seeing such a rosy future. The fear coming into earnings season in October was that companies' revenue and earnings power would be dampened by losses in Europe and the continued employment slump in the US. Instead Europeans continue to buy US goods and services for now. On this side of the world, the 83.8% who are still working full time jobs seem to be spending without much concern. Fears of massive layoffs have subsided to a great degree for most companies. In turn, workers have paid down personal debt from the 2008 peaks and are beginning to open their wallets again giving the economy a small boost.

Companies have been slow to rebuild inventories during this slow spending pick-up. This has left retailers and wholesalers in a position where restocking and increasing buying will be required in the very near term to keep their shelves stocked. This bodes well for the coming months' business cycle and is one of the reasons the markets rebounded so strongly in October.

Summary of Indexes

Courtesy of Morningstar.com

Name	As of Date	YTD	1-Year	3-Year	5-Year
Stock Indexes					
DJ Industrial Average TR	11/4/2011	5.72	7.55	10.75	2.75
NASDAQ Composite PR	11/4/2011	1.25	4.22	14.7	2.88
Russell 2000 TR	11/4/2011	-3.74	3.08	12.56	1.2
S&P 500	11/4/2011	1.33	4.73	10.04	0.44
S&P MidCap 400	11/4/2011	0.25	6.53	17.49	4.51
Bond Indexes					
Core Bond	11/3/2011	7.17	5.25	8.62	6.81
Intermediate Core Bond	11/3/2011	6.28	4.38	8.02	6.92
Long-Term Core Bond	11/3/2011	15.78	11.97	15.7	9.34
Short-Term Core Bond	11/3/2011	2.26	1.55	4.29	4.58

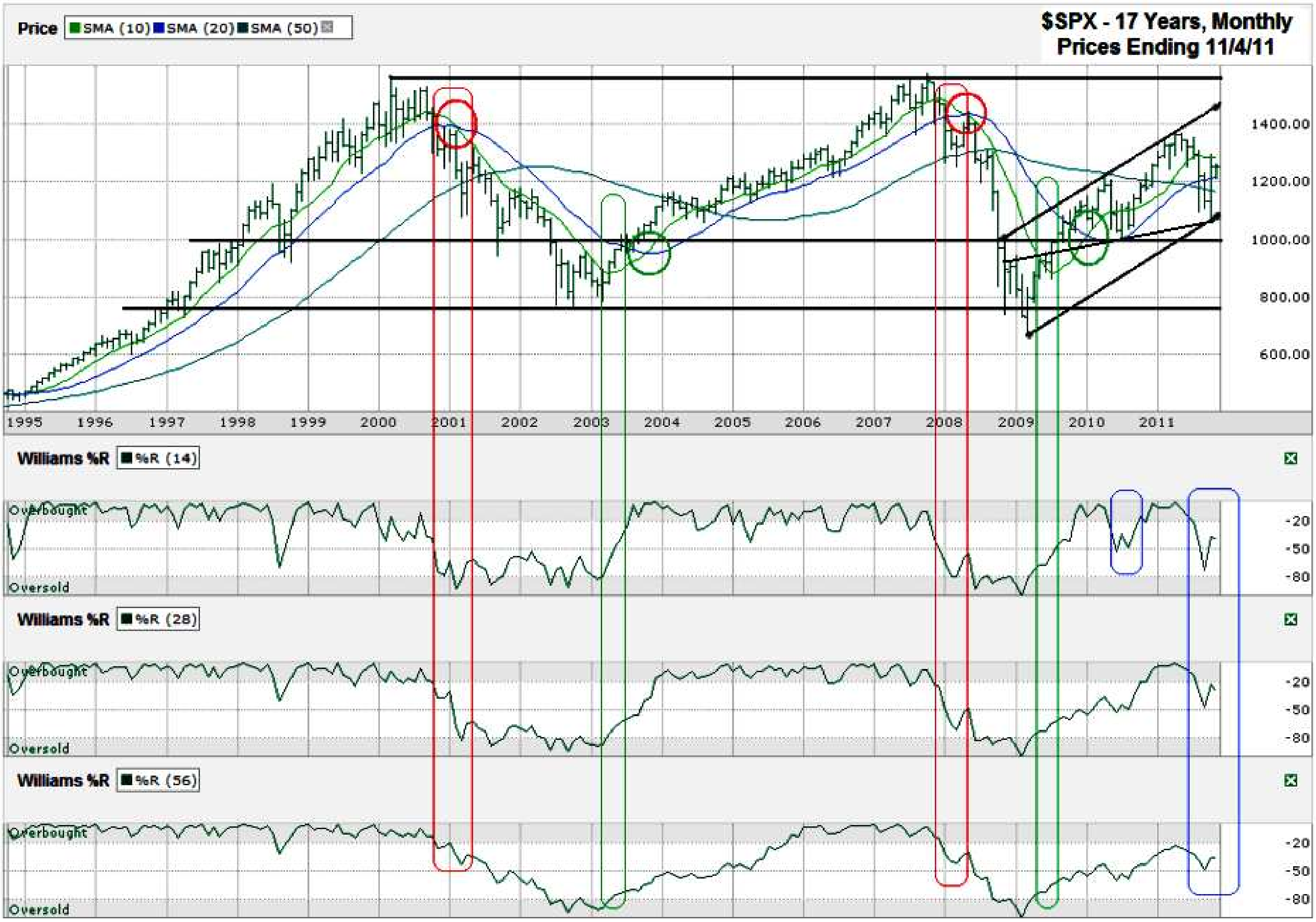
Market Movers

- October's rally started with positive earnings announcements and economic reports that often favored the bulls. The fears of another US recession began to fade with each report that was not as dire as predicted. Out of the 371 companies in the S&P 500 Index that have reported third quarter earnings 71% surpassed estimates.
- News hit the headlines that China might become a bigger investor in Eurozone debt than previously thought. The idea of a Chinese "backstop" to stem further losses helped lift the market again.
- Creditors of Greece's debt agreed to a voluntary 50% loss of principle in an effort to save the country from defaulting. This gave the markets another lift.
- The Federal Reserve kept its target interest rate at 0.00% to 0.25%. The continued easy money stance from the Fed kept investors from pushing their sell buttons briefly.
- The new European Central Bank (ECB) President is Mario Draghi. He replaced Jean-Claude Trichet and immediately announced the decision to become more accommodative by cutting its primary lending rate by 25 basis points to 1.25%. This move was seen as long overdue to many who see the euro-zone moving back towards recession. This also gave the markets another lift.
- In between each of these positive pieces of news, rumors leaked out of Greece that their austerity measures might not go through and even if they did could be too little too late to save the country from defaulting.
- Greece's Prime Minister Papandreou is scheduled to step down from power, but the change in government does not insure Greece will keep its euro membership. This should continue to be the major market mover in the weeks ahead.
- The dollar's daily fluctuations helped push the market in both directions as its inverse relationship with stocks continued.

Fundamentals & Indicators

- Retail sales increased by 1.1% in September, better than the anticipated 0.6% increase. The prior month's numbers were revised higher by 0.3% to add to the bullish sentiment.
- Overall producer prices popped higher by 0.8% in September and core producer prices increased by 0.2%.
- Overall consumer prices rose by 0.3% as had been expected while core prices rose by 0.1% which was lower than expectations. Lower core prices show inflation is still in check.
- Housing starts' pace improved to an annualized rate of 658,000 in September after August's numbers were revised lower to 572,000. The consensus call was for a rate of 595,000.
- The building permits report came in at 594,000, lower than the previous month and slightly below the 610,000 expected tally. This lower number helped to neutralize the bullish attitude created by the housing starts' beat.
- Existing home sales in September came in at an annualized rate of 4.91 million units, close to the outlook, but below the August rate of 5.06 million units.
- New home sales for September grew by 5.7% to an annualized rate of 313,000, beating estimates for a rate of 300,000.
- The index of pending home sales decreased by 4.6%. This was the biggest decline since April and well below the forecast a 0.4% gain.
- The Philadelphia Fed Survey came in with a much better report of 8.7 which beat expectations of another negative report. Just a month ago the same report pushed stocks much lower when -17.5 hit the tape and stunned traders. This was a key reversal the bulls needed.
- The August S&P/Case-Shiller 20-City Housing Price Index declined by 3.8% which was better than the 4.1% decline seen in July.
- Total durable goods orders fell by 0.8% in September. Early projections were for 1.0%. Excluding transportation items, durable goods beat estimates and increased by 1.7% for the month.
- The first reading on third quarter GDP showed growth of 2.5%. This is an increase from the second quarter's growth rate of 1.3% and beat the consensus of 2.3%. The positive news helped move the market to a multi-month high before news out of Europe dragged the market lower again.
- Personal income in September increased by 0.1% and personal spending rose by 0.6%. While income was anticipated to be closer to 0.3%, personal spending came in on target. The increase on spending shows a consumer who is still willing to spend and that is good for the economy's hopes of improving.
- The ISM Manufacturing Index for October dropped to 50.8 from 51.6 in September, below expectations.
- Construction spending during September improved by 0.2%, which is less than the 1.4% increase in August and below what the Street was looking for.
- The ISM Services Index for October came in at 52.9, below the expected rate of 53.9. This still shows an expanding economy, albeit at a slower pace than investors would like to see.
- Factory orders for September climbed by 0.3%, which beat earlier calls for a decline of 0.2%.
- Weekly initial jobless claims remained close to the 400,000 level that has been the sticking point for months. On the positive side, continuing claims dropped slightly to 3.683 million.
- The unemployment rate came down to 9.0% from 9.1% last month.
- Nonfarm payrolls were reported at 80,000, slightly below estimates. The biggest positive news within the announcement came from upward revisions to numbers for September and August totaling 102,000. However, this total is still below the 250,000 target many economists use as the level needed to get the economy truly growing again.
- The U6 unemployment rate which measures part-time and discouraged workers slid from 16.5% to 16.2%. This is a truer measure of unemployment and is bullish to see this improvement.

Index Chart & Analysis



This S&P 500 ($SPX) chart shows the past 17 years of monthly prices after the index finished the week higher at 1,253.23 on Friday, November 4, 2011. Charts are not only telling when viewed over short periods, but also over longer periods. Investors can use shorter charts to maximize gains and reduce losses week to week, but need to keep an eye on multi-year charts to smooth out intraday volatility and adjust risk accordingly.

In this chart, the 10 and 20 *month* moving averages (mma) tell the biggest story along with the Williams %R indicator. The red circles show each time the 10 mma crossed below the 20 mma and triggered a sell signal. The green circles show when the 10 mma moves back ahead of the 20 mma and triggers a buy signal. An investor who only paid attention to this single indicator would've saved a lot of money by withdrawing risk during the sell cycles.

However, using only one technical indicator can be dangerous. By adding in the Williams %R indicator a chart watcher would've had earlier signals to prepare for the bigger change in sentiment. The longer red loops show the area where Williams %R began to crack in the 14 month period and followed through all of

Please see Index Chart & Analysis on page 5

Continued from Index Chart & Analysis from page 4

the way to the 28 and 56 month periods. This has only happened twice in the past 17 years and both times were at the beginning of massive sell offs. The green loops show where it was safer to re-enter the market. The blue loops show where Williams %R has been less exact since the 2009 recovery. In 2010 only the 14 month indicator issued a sell signal. The 28 and 56 month signals had not reached overbought yet and their gyrations did not trigger any alarms. In 2011 the 14 and 28 month indicators issued sell signals, but the 56 month indicator never reached overbought and remained neutral. All three need to work in unison for a major market cycle to be in place. That is still not the case.

The trend lines work over longer periods also, just like they do on daily charts. The $SPX is still within its recent ascending trading channel, even when viewed with two different trend lines of higher lows. The index is also in the middle of its horizontal support and resistance lines which leaves nearly equal room for upside and downside movement.

When adding these indicators together, the probability leans to the bulls' side. The trend lines are somewhat neutral, but the edge goes to the ascending trend line. The moving averages still show a bullish cycle is under way, but teetering with the $SPX below the 10 mma. Watching support from the 20 mma and 50 mma could give early insight if another larger correction is starting. Williams %R gave the warning of a short correction, but without the 56 month indicator being included the chances of another major sell off are limited. This is not an easy market to watch daily, but the signs are there to remind patient investors to keep an eye on the long term before making short term decisions.

AF Capital Management, LLC
6935 Hunters Knoll NE
Sandy Springs, GA 30328

404-395-2752
alex@afcapitalmanagement.com

Twitter: @AlexRFoster
Facebook: AF Capital Management

Need help deciding when to buy and sell? Subscribe to AF Capital Management’s Market Timing Service.

If you are not on our distribution list yet, you can Join our Newsletter for free at any time.