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Weekly Market Commentary by Emmett Wright

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Let's see. Devastation and radiation in Japan. Chaos in the Middle East and Libya. The rising price of oil. Portugal on the brink. The federal government heading for a shutdown. And what did it all add up to? Another up week for the stock market as the Dow hit a 2011 high on Friday and, gaining 6.4% over the first three months of 2011, turned in its best first quarter since 1998.

	Key Market Data		
	Week ending…		
	4/1/11	3/25/11	Change
Dow Jones Industrial Average Index	12,376.72	12,220.59	+1.28%
S&P 500 Index	1,332.41	1,313,80	+1.42%
NASDAQ Composite Index	2,789.60	2,743.06	+1.70%
10-Year Treasury Note Rate	3.448%	3.445%	+0.003 pct. pts.
NYMEX Crude Future (Barrel)	$107.94	$105.40	+2.41%
Euro/U.S. Dollar	$1.4223	$1.4074	+$0.0149

The week's top story – and the spur for the market's strong finish last week – was unquestionably Friday morning's news that 216,000 new jobs were created in March (including 230,000 private sector jobs, offset by losses at the local government level). Better still, the overall jobless rate dropped yet again, this time from 8.9% to 8.8%, the fourth straight decline. It was also the twelfth month in a row of private sector job expansion, and so far this year the private sector has added an average of 188,000 jobs a month. Though there are still reasons to be concerned – the plight of the long-term jobless, for instance, and the fact that wages have not kept up with inflation, however modest it may be these days – it was hard to be disappointed about this news. As *The Wall Street Journal* noted, "The American job market is starting to show some muscle."

President Obama went a step further, linking the good news about jobs to the ongoing budget battle while issuing a not-so-subtle warning to the GOP: "If these budget negotiations break down, we could end up having to shut down the government just at a time when the economy is recovering," he said, adding, "It would be the height of irresponsibility to halt our economic momentum because of the same old Washington politics."

Regarding the budget, the Democrats have now come much further than once expected to meet the GOP halfway, leaving some Dems in the Senate unhappy, but the question remains whether or not House leader John Boehner (R - Ohio) can tame the 87 Republican freshmen who are clamoring for still more.

The House has now twice passed a bill calling for $61 billion in cuts for the rest of this fiscal year, which ends on Sept. 30 – it was voted on again last week for extra effect. Meanwhile, the Democrats, with Vice President Joe Biden as the point man, have offered to split the difference and accept $33 billion in cuts (including the $10 billion already cut in the two stopgap spending bills).

The other sticky issue is the insistence of the House Republicans on attaching riders to the bill that would torpedo spending for programs they dislike, including the healthcare bill, National Public Radio, and Planned Parenthood, while the Democrats in the Senate are insisting on a bill without any ideologically driven riders.

"There are a lot of problems with the idea of shutting the government down," Mr. Boehner conceded late last week. "It is not the goal. The goal is to cut spending." However, Representative Mike Pence (R – Ind.), who has become one of the most visible of the House's spokesmen for larger cuts, retorted, "I say shut it down. It's time to pick a fight." On the flip side, Senate Majority Leader Harry Reed (D - Nev.), observed, "The biggest gap in this negotiation isn't between Republicans and Democrats – it's between Republicans and Republicans." *The Wall Street Journal* advocated the deal, noting, "The fact that Congress is cutting any spending from the $3.6 trillion budget is a big cultural shift in Washington," and *The Economist* was even blunter, saying of the freshmen: "Time to stop play-acting and spit out the tea."

It's also worth remembering that the current budget battle, as acrimonious as it is, is only the undercard to the main event of the budget for the fiscal year that begins on Oct. 1 when the deficit, entitlements and the looming elections of 2012 will all come into play.

Earlier in the week, the Commerce Department said that consumer spending improved a solid 0.7% in February, the eighth consecutive month of increases, and that after adjusting for inflation, especially gas, it was up 0.3%. Personal income rose 0.3% and the savings rate fell to 5.8%. The core price index for personal consumption expenditures (PCE), which excludes the volatile food and energy categories, increased 0.9% year to year in February and 0.8% from January. The overall index climbed 1.6% from a year ago.

Despite concerns about the price of gas and production stoppages in Japan, car sales jumped 17% in March from a year earlier. Among the automakers that sold more than 100,000 vehicles, Chrysler led the way with a 31.4% increase, its fastest pace in three years, followed by Nissan (a record 26.9%), Honda (23.5%), Ford (19.1%) and GM (9.9%). Toyota was down 5.7%. Total sales were 1,246,623 vehicles compared to 1,066,205 in March 2010.

The Institute for Supply Management (ISM) said its index for March dipped slightly from 61.4 to 61.2, still well above the 50 figure that indicates growth.

There's still no agreement on the final cost of the federal bailout during the Great Recession, with the number having gone from a loss of $100 billion to a $100 billion profit. But last Wednesday the Treasury Department said it expects the final tally to be a profit of $23.6 billion (though not everyone – read the Republicans – buys it). Representative Patrick McHenry (R - N.C.), dismissed the new math, saying, "In the beginning, they weren't touting payback – they touted effectiveness. Now they are touting payback but ignoring the moral hazard this program has created." Treasury Secretary Timothy Geithner naturally felt otherwise: "There is no historical precedent for a financial rescue this effective. We are performing better than all expectations and ahead of the other countries caught up in the crisis."

Mr. Geithner was also at an economic forum in China last week and took the opportunity to talk about China's currency yet again, urging China to adopt a more flexible monetary policy and warning that not doing so would make inflation worse and hurt global growth. He described it as "the most important problem to solve in the international monetary system today."

One other story, long dormant, began to resurface last week: the Fed and the possibility of it raising the benchmark rate, which has been at 0% to 0.25% since

December 2008. There are now murmurs that the Fed will raise its rate before the year ends if inflation keeps rising. Last week, Narayana Kocherlakota, the president of the Minneapolis Federal Reserve Bank, said a "big upward movement" was expected in inflation and it's therefore "certainly possible" that the Fed will raise its benchmark rate this year. But on Friday, William Dudley, president of the Federal Reserve Bank of New York, sounded one of the week's few warnings notes, saying events in Japan and the Middle East could yet take a turn for the worse and the recovery was therefore "still tenuous."

There has been little to cheer about when it comes to housing, but last week the National Association of Realtors announced that its index for pending home sales rose 2.1% to 90.8 in February from January, though sales were down 8.2% from February 2010. But the next day it was reported that the Standard & Poor's Case-Shiller Home Price Index for 20 metro areas fell 1% from December to January, the sixth straight drop. From its 2006 peak until now, the index is off 31.8%. Eleven of the cities hit a new low and only two, San Diego and Washington, were up year to year. The Commerce Department also reported that construction spending in February fell 1.4% from January, though weather may have been the issue.

In other news about housing, the Home Assistance Modification Program designed by Obama and introduced last year to use $1 billion to help out-of-work homeowners pay their mortgages has been a dud. The GOP wants to kill it (the House did so on Tuesday), and the Democrats want to modify it. It was supposed to be up and running by the end of 2010 but has so far not paid out a penny.

And on Wednesday, the nation's top mortgage servicers met in Washington with attorney generals from five states to address the foreclosure issue and rules for homeowners in default, but both sides said the process will be long and arduous. An estimated two million households are in foreclosure and another two million are in severe default.

In Europe, there was still more grim news about the two countries that have already been bailed out, Greece and Ireland, as well as the one widely seen to be next in line for a lifeline, Portugal.

Both Greece and Portugal had their sovereign debt rates downgraded yet again, Portugal to the brink of junk (Greece was already at junk level). In Portugal, where the prime minister recently resigned over parliament's failure to adopt a new round of spending cuts, the government said that the budget deficit last year was higher than expected, 8.6% of GDP compared to the goal of 7.3%, though it claimed it would still try to meet the target of 4.6% for 2011. Portugal will not hold new elections until June 5 and has to raise €9 billion to pay for redemptions in April and June. There was one bright moment on Friday when Portugal had a successful bond sale, selling €1.65 billion euros – more than originally announced – at 5.79%, an indication that it was indeed trying to avoid a bailout. Even so, talk of restructuring began to bubble up again, with *The Economist* urging the International Monetary Fund to force the issue "by refusing to lend more without a deal on debt" to push "Europe's pusillanimous politicians into doing the right thing."

In Ireland, a new series of stress tests revealed that four of the nation's leading banks would need as much as €24 billion euros to cover bad real estate loans, perhaps leading to the nationalization of the banking system. That would bring the bill for the banks alone to about €70 billion – and counting. Meanwhile the new Irish government is still arguing that the terms of the first bailout are unfair and should be revised.

The prognosis for the beleaguered nations looked even worse when euro zone inflation jumped to 2.6% last week, above the European Central Bank's target for March and the highest level since October 2008. To combat inflation, the ECB is expected to raise its benchmark rate at its next meeting this Thursday from 1% to 1.25%.

A look ahead

This will be a relatively quiet week with only a handful of key releases, notably the ISM's nonmanufacturing index, wholesale inventories and chain store sales. The Fed will also release the minutes of its March 15 meeting which may provide further insight into the board's take on raising the benchmark rate. The lead story will be the battle of the budget as the two parties see who will blink first and decide if either of them wants to risk being blamed for a government shutdown.

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All index references and performance calculations are based on information provided through Bloomberg. Bloomberg is a provider of real-time and archived financial and market data, pricing, trading, analytics, and news.

The Dow Jones Industrial Average Index® is a price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Standard and Poor's 500 Index® (S&P 500®) is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Standard & Poor's offers sector indices on the S&P 500 based upon the Global Industry Classification Standard (GICS®). This standard is jointly maintained by Standard & Poor's and MSCI. Each stock is classified into one of 10 sectors, 24 industry groups, 67 industries and 147 sub-industries according to their largest source of revenue. Standard & Poor's and MSCI jointly determine all classifications. The 10 sectors are Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Telecommunication Services and Utilities.

The NASDAQ Composite Index® Stocks traded on the NASDAQ stock market are usually the smaller, more volatile corporations and include many start-up companies.

NASDAQ - National Association of Security Dealers Automated Quotations. The NASDAQ is a computer-operated system owned by the NASD that provides dealers with price quotations for over the counter stocks.

Bear market calculations and interpretations are derived from data supplied by Ned Davis Research, Inc.

The ISM Index, released monthly by the Institute for Supply Management, tracks the amount of manufacturing activity that occurred in the previous month.

The National Association of Realtors (NAR) is a real estate trade association involved in all aspects of the residential and commercial real estate industries. NAR also functions as a self-regulatory organization for real estate brokerage.

The S&P/Case-Shiller Home Price Indices are designed to be a reliable and consistent benchmark of housing prices in the United States. Their purpose is to measure the average change in home prices in a particular geographic market. They are calculated monthly and cover 20 major metropolitan areas (Metropolitan Statistical Areas or MSAs), which are also aggregated to form two composites – one comprising 10 of the metro areas, the other comprising all 20.

The gross domestic product (GDP) is the amount of goods and services produced in a year, in a country.

The International Monetary Fund (IMF) is the intergovernmental organization that oversees the global financial system by following the macroeconomic policies of its member countries, in particular those with an impact on exchange rate and the balance of payments.

The European Central Bank (ECB) is the institution of the European Union (EU) which administers the monetary policy of the 17 EU Eurozone member states. The current President of the ECB is Jean-Claude Trichet, former president of the Banque de France.