

Rochester Financial Services

Fee-Only® Financial Management Services

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Principal

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Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Earnings Yield (S&P)	Crude Oil	Gold
10,024	1,071	2,222	641	3.26%	7.12	\$71.90	\$1,227



Investment Strategy Report

Stocks Suffer Worst Correction Since March '09 Bottom

Stocks got hit hard last month, wiping out all the gains for 2010 and then some. Since my report last month, the major US averages are down about 11%, making this the worst correction since the current bull market began in March 2009. We have had three other pullbacks in the past 14 months. But those were not as severe, experiencing losses of from 8 to 10% for each. Another factor making it worse this time is that the majority of this correction has thus far taken place within the confines of one calendar month. The previous correction occurred in June to July 2009, October to November 2009, and January to February 2010. So when the monthly results came in via my monthly reports for those corrections, the bad news was spread over two months. And each time, the markets rebounded and continued their move higher.

As things stand now, we have revisited the lows of this past February, when the S&P 500 closed at 1056 on February 8th. During the past week we have tested that low, dropping to 1040 intraday on May 25th before reversing and finishing the day higher. Back in February, that marked the end of the correction and stocks moved ahead another 15% before peaking. We now stand less than 2% above those support levels and are again faced with the question of whether support will hold, making this another correction within a bull market, or whether the market continues to deteriorate into something more severe.

With such a bad month for the stock market, you might think that it was the result of poor economic data, but that wasn't the case. On May 7th, the Non-Farm Payroll Report came out, indicating that a larger than expected 290,000 jobs were created in April. And the report for May, which will be released this Friday, has preliminary estimates of over 500,000 new jobs created. While many of these new jobs will be government census jobs, a good number are projected to be private industry positions. So the jobs picture, which has been so bleak for so long is finally beginning to improve.

Reports this past week showed that the US economy is growing at 3% while the global economy is being projected to grow this year at 5%, mostly due to the growth in emerging markets. These reports came amidst a very favorable first quarter earnings season for US companies. Reports out today were also favorable. Construction spending was up 2.7% in April, the biggest increase in 10 years, and the Institute of Supply Management index came in at 59.7, well above estimates.

Our economy is coming out of a severe recession and is showing strong growth. Most economists do not predict that we will see a double dip recession. So why are stocks behaving badly? In short, it's most likely the fear of the European contagion. The problems facing Greece and the rest of the European PIIGS, Portugal, Ireland, Iceland, and Spain, seem eerily similar to the domino-like fall of the banks back in 2008. At times, it seems like the European Union is dealing with the problem, with the EU announcing on May 10th that it would support the PIIGS to the tune of \$1 Trillion (750 billion euros). However, concerns about the solidarity behind this effort are leaving many in doubt about the ultimate conclusion of events. Today, Louis Navellier wrote that "The Sovereign Debt Crisis is Dying Down". He pointed out that 1) Portugal was able to sell \$1.27 billion in new government debt, 2) China announced that it was not reducing its holdings of euro-zone bonds, and 3) the Spanish Parliament was able to approve a controversial \$18 billion austerity package.

If what Navellier is saying about Europe is true, then there are some great bargains to be had in the stock market. This correction has knocked down prices to the point where investors who have missed out because they weren't fully participating in the stock market's surge last year, are now thinking that they have a second chance. What's stopping them? Fear, the fear that this decline is only the beginning of a more substantial decline and that last year's gains will evaporate. And the level of fear in the market is rising. I would love to be able to tell you that we can ignore Europe, and while we're at it, ignore the high levels of foreclosures still going on around the country, and the economic effects of the Gulf Oil spill, etc. But I can't. These are real threats. I have thus far reduced our exposure to foreign funds and have maintained our holdings in bond funds to try and weather the storm. However, if the support levels for the market fail to hold, I will probably begin to reduce our stock exposure. As always, please don't hesitate to call me to discuss your investments. *Jeff Feldman*

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