

# Rochester Financial Services

Fee-Only® Financial Management Services

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Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Earnings Yield (S&P)	Crude Oil	Gold
12,019	1,244	2,627	735	2.03%	8.12%	\$101.00	\$1,750

Principal



## Investment Strategy Report

### Stock Market Fortunes Still Tied to the Fate of Europe

For a while this past month, I thought that I would have to eat my words. The theme of my letter last month was that despite the specter of economic collapse that threatened Europe, chances were that world leaders would find some solution to prevent that catastrophe from occurring. That was the gist of what investor Leon Cooperman and fund manager Ron Baron had said on CNBC in early November. I wrote that on Nov. 6th. The market continued higher for two more days but then collapsed 390 points on Nov. 9th. It stabilized for the next week but then dropped 860 points from Nov. 15th through the 25th, in the process, giving us the worst Thanksgiving week since the Great Depression. Again it was fears from Europe and in particular Italy that caused the declines. I was beginning to wonder whether this time it was different, that the problems facing the economies of Europe were bigger than we realized and therefore dire consequences were unavoidable. Then just as everyone began wondering whether we would ever see an up day in the market again, word came out this week that our Federal Reserve along with the world's central banks had come up with a plan to help Europe. In response to this, the Dow rose 490 points on Wednesday, closing out the month on an up note and wiping out most of the month's losses. So following an abysmal Thanksgiving week, the markets rallied this week with the biggest point gain since March 2009. The roller coaster ride continues.

Don't think for a minute that I'm sounding the all clear signal for the markets. In fact just yesterday, billionaire financier George Soros was quoted as saying that "The world financial system is on the brink of collapse, with developed markets running full speed ahead toward disintegration". Porter Stansberry (stansberryresearch.com) commented on this week's plan to bailout Europe, saying that it's not going to work. His point was that despite the Fed's plan to provide fresh capital to banks to increase lending, banks will continue to be reluctant to lend as they demonstrated during the subprime crisis. He also wrote on Nov. 18th that most of Europe's banks are insolvent and that there remains the threat that we can see a run on Europe's banks. The bottom line that I see developing here is that 1) solving the European problem will cost more than anyone wants to believe and 2) while countries will hate to bite the bullet and pay these enormous sums, they eventually will come to realize that there is no alternative. And for the first time since this crisis began, I have seen more analysts becoming more comfortable with the realization that a breakup of the Euro region is now a likelier occurrence. So we might be able to get from "here" to "there" eventually, but no one knows how much pain will be endured in the process.

The unfortunate part of all of this is that our economy is doing surprisingly well. Today's unemployment report showed a drop in the unemployment rate from 9% to 8.6%. While this number is somewhat misleading because the number of those who have stopped looking for a job has increased, there definitely is an improvement in the employment picture. Companies in the S&P 500 are projected to have operating earnings of \$100 per share next year, giving the index a P/E ratio of 12.4, much below its historic average and an indication that stocks are cheap. The index of Leading Economic Indicators continues to improve, having increased 6.6% over the past year. Industrial production is up and motor vehicles sales continue to do well. Even the home building industry, while still mired in a severe slump due to the large number of foreclosed houses still on the market, is showing signs of improvement. Putting it all together, we will see the tug-of-war continue into 2012, with the slow global economic recovery having to struggle with the overwhelming problems in Europe - optimism mixed in with a good deal of market volatility.

**HAVE A HAPPY AND HEALTHY NEW YEAR** - Another year has come and gone. I hope that this letter finds you and your loved ones in good health and I'd like to wish everyone a **Happy Holiday Season.** *Jeff Feldman*

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