

Bittles' Market Notes

Please refer to Appendix – Important Disclosures and Analyst Certification.

Fed Ready to Assist Economy

The deteriorating economy continued to weigh on the equity markets last week. Yet in the face of a string of negative business data, the popular averages gave little ground. Friday's strong rally included gainers outpacing losers by more than 10 to 1 and although the trend remains negative the stock market has some positive momentum leading into the new week. The technical picture is further enhanced by the fact stocks are oversold and pessimism is widespread. The stronger technical position increases the potential for a short-term improvement toward resistance near 1100 on the S&P 500. Despite the less-than-favorable outlook for the economy, anticipation of a more aggressive Fed and the potential for a change in direction in fiscal policy next year is expected to prevent stocks from suffering a significant breakdown in the historically weak September and October period. Looking further out, we expect stocks to remain in a trading range in the third quarter followed by a year-end rally beginning in front of the November elections.

A steady flow of negative economic news caused pessimism to rise among a greater number of investors last week. With a large crowd looking down, contrary opinion argues that stocks could work higher despite the economic uncertainty. The most recent survey from the American Association of Individual Investors (AAII) shows a sharp drop in bulls to 21% from 30% last week and the outright bears jumping to 49% from 42%. With the AAII data showing more than 2x as many bears as bulls, this valuable indicator is considered bullish. The CBOE 10-day put/call ratio fell to 95% from 100% last week but remains on a buy signal (75% is considered bearish and 95% bullish). The CBOE 3-day equity put/call ratio slipped to 67% last week from 72% the previous week and remains on a buy signal (52% is considered bearish and 67% bullish). The most recent report from Investors Intelligence, which tracks the opinion of Wall Street letter writers, shows a drop in bulls to 33.3% from 36.7% the previous week and with the bears among the advisory services steady at 31.2% versus 31.1% the previous week.

Second-quarter GDP was revised down to 1.6% from 2.4% last week, which is expected to result in markdowns of third-quarter expectations to 1.5% from 2.5%. Corporate profits remained firm in the second quarter due principally from lower labor costs, but margins are expected to weaken in the second half of the year. New and existing home sales plunged to new lows in July, raising the risk that home prices could come under pressure later this year and early 2011. Although housing affordability has improved significantly, the frozen labor market is sidelining new buyers and preventing lenders from taking a more aggressive posture toward lending. The focus this week will be on the ISM reports and the employment situation for August. Both the ISM Manufacturing and Non-Manufacturing data are expected to be down slightly, suggesting growth is slowing appreciably. Friday's employment numbers are expected to show a loss of 80,000 jobs in August with the unemployment rate rising to 9.6% from 9.5%. The jobs report this month could be very important in determining the Fed's next move, which is expected to be toward quantitative easing should the economy continue to falter. This should keep the yield on the benchmark 10-year Treasury note anchored in the vicinity of 2.50% to 2.75%.

Sector Strategies

- No. 1 Telecom Services** = High yields driving RS – Marketweight/buy. Group expected to outperform: Wireless
- No. 2 Utilities** = RS favorable – Marketweight/buy. Groups expected to outperform: Gas Utilities, Electric Producers
- No. 3 Consumer Discretionary** = Consumer spending suspect – Marketweight/hold. Groups expected to outperform: Auto Parts & Equipment, Leisure and Broadcasting & Cable
- No. 4 Consumer Staples** = Defensive – Marketweight/buy. Groups expected to outperform: Packaged Foods & Meats, Personal Products, Soft Drinks and Food distributors
- No. 5 Materials** = Improving RS – Marketweight/hold- Groups expected to outperform: Diversified Metals & Mining, Diversified Chemicals and Producers, Gold
- No. 6 Industrials** = Capital spending a positive – Marketweight/buy. Groups expected to outperform: Railroads, Construction & Farm Equipment, Aerospace & Defense and Industrial Machinery

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No. 7 Health Care = Weak RS – Marketweight/hold. Groups expected to outperform: Health Care Equipment & Services, Health Care-Managed and Health Care Facilities

No. 8 Information Technology = Falling RS – Overweight/hold. Groups expected to outperform: IT Consulting & Services, Electronic Equipment & Instruments, Office Electronics and Application Software

No. 9 Financials = Plunge in RS – Underweight/hold. Groups expected to outperform: Insurance – Multi-Line, Consumer Finance and Real Estate Services

No. 10 Energy = Losing RS – Marketweight/hold. Groups expected to outperform: Oil & Gas Storage & Transportation, Oil & Gas Equipment & Services and Coal & Consumable

Market Overview

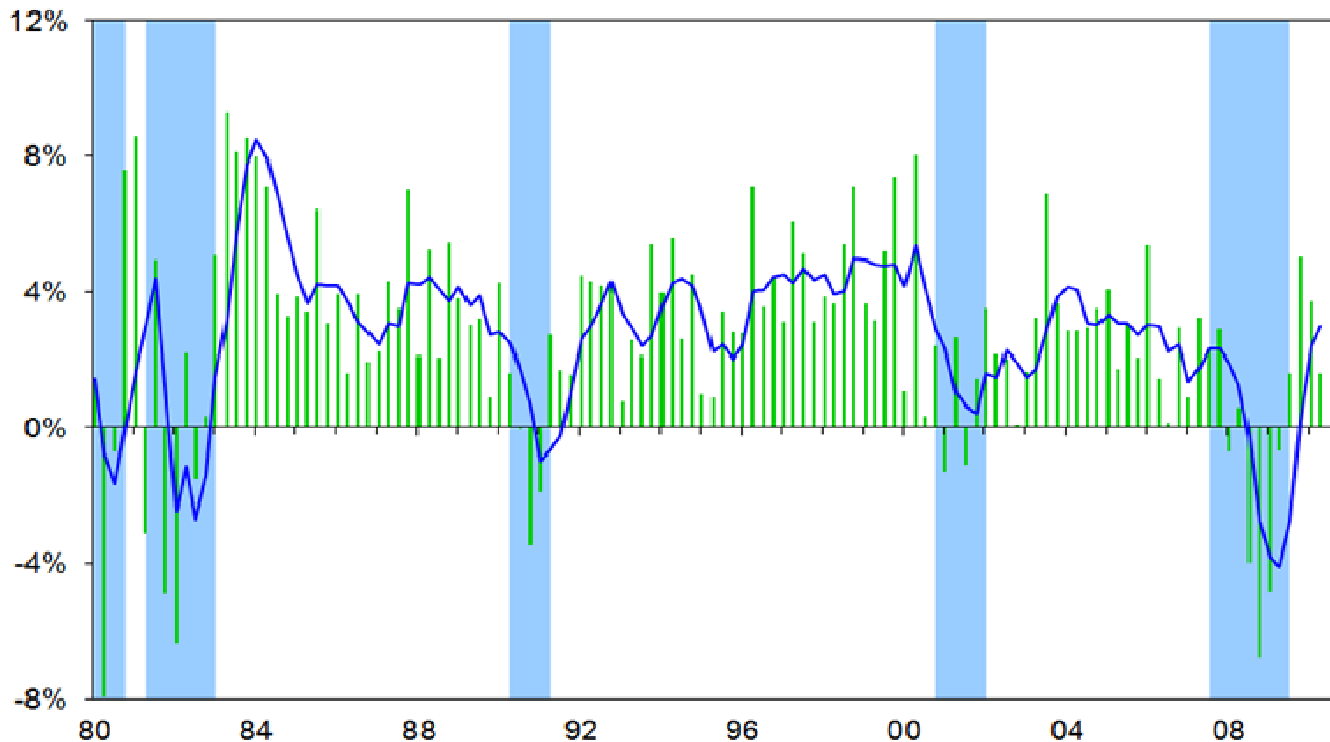
Stocks

Short-Term	Trading range with risk to 1025 and reward to 1100 on the S&P 500
Intermediate-Term	Trading range with risk to 1000 and reward to 1150 on the S&P 500
Long-Term	Major support at 950 on the S&P 500 – Reward to 1250 on the S&P 500
Strongest Sectors	Telecom, Consumer Staples and Utilities
Leadership	Mid-Cap Income and Growth

Economy

Fed Action	Fed expected to hold interest rates low into second half of 2011
Treasury Yields	10-year Treasury yield next six months 2.50% to 3.25%

Real GDP Growth



Source: BEA

Recession

Quarterly Growth

Yearly Growth

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Appendix – Important Disclosures and Analyst Certification

Disclaimers

This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.

ADDITIONAL INFORMATION ON COMPANIES MENTIONED HEREIN IS AVAILABLE UPON REQUEST

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