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Bittles' Market Notes

Please refer to Appendix – Important Disclosures and Analyst Certification.

Oil, Dollar and T-Bond Yields Decline Supporting Stocks

The popular averages have declined for four consecutive weeks, but the losses have been miniscule, measuring just over 2.0% for the period. The weakening economy and the expiration of the Fed's QE2 program in June have raised investor anxiety. This has been offset by falling energy prices and a sharp drop in bond yields, which is the reason the decline has been exceptionally shallow. The equity markets have also been supported by the increased likelihood that the Federal Reserve will remain friendly into the fourth quarter of 2012. The weak economic statistics caused the dollar to weaken substantially late last week. This is important and favorable for stocks because exports are a record 13.5% of GDP and extremely important to the large multination's top and bottom lines. Over the very near term, we anticipate stocks to rally off and on into mid-summer. Longer term, the risks remain elevated both at home and globally. Federal, state and local austerity programs kick in during the second half of 2011 and the world economy faces deteriorating growth prospects with increased inflation pressures and rising interest rates. New buying should be concentrated in those sectors exhibiting the strongest relative strength, which include health care, telecom, consumer staples, industrials and energy.

The very near-term outlook for the equity markets has improved. Following four straight down weeks, the stock market appears oversold. Investor psychology has shifted decidedly away from the excessive optimism found in early May. There is an inverse relationship between investor sentiment and liquidity. The recent move from optimism to pessimism argues that cash positions are building that could support a short-term rally. The options exchanges report a sharp increase in the demand for put options the past two weeks. This is an indication that too many traders are looking down. The latest survey from the American Association of Individual Investors (AAII) shows more bears than bulls (41% to 26%). The most recent report from Investors Intelligence, which tracks the recommendations of Wall Street letter writers, shows the bullish camp falling for the third week in a row to 43.0% from 54.9% earlier in the month. The bearish camp among the advisory services was nearly unchanged at 19.4%. The American Association of Active Investment Managers (NAAIM) reports a sharp drop in equity exposure to 60% from 72% the previous week (74% is considered bearish and below 50% bullish). The weight of the sentiment indicators using longer-term gauges is neutral. But short term, the potential for a rally has improved with psychology having moved away from the extreme optimism found at the February peak.

The latest economic reports portray an economy that is losing upside momentum. First-quarter real GDP remained at 1.8%, below the consensus of 2.2%. Real final sales and personal consumption expenditures were revised down and existing home sales missed on the downside in April. Reports from regional Federal Reserve districts including Kansas City, Richmond, Philadelphia and New York had the same message that shipments, orders and backlogs were slipping. The slowdown in economic activity has not been lost on the bond market. The yield on the benchmark 10-year Treasury note fell to 3.07% last week, down from 3.74% three months ago. The rally in bonds is likely the result of falling commodity prices with oil and gasoline prices falling by 10% or more. Long-term bond yields are most sensitive to inflation expectations and the level of fed funds. As inflation slows for essential products and given the Fed is likely to remain on hold into next year's election, bond yields are anticipated to remain low and stable over the next several quarters. The focus of attention this week will be on the ISM Manufacturing Index and the May Employment Report. The data is expected to confirm that the economy slowed in recent months. We do not expect these reports to be market movers given that a business slowdown has been well advertised.

Sector Strategies

No. 1 Health Care = Increasing RS – Marketweight/buy. Groups expected to outperform: Health Care Equipment & Services, Health Care-Managed and Health Care Facilities

No. 2 Telecom Services = Strong gain in RS – Marketweight/buy. Group expected to outperform: Wireless

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No. 3 Industrials = Improved RS – Marketweight/buy. Groups expected to outperform: Railroads, Construction & Farm Equipment, Aerospace & Defense, Industrial Machinery, Railroads, Air Freights & Couriers and Electrical Components

No. 4 Consumer Staples = Favorable RS – Marketweight/buy. Groups expected to outperform: Packaged Foods & Meats, Personal Products, Soft Drinks and Food distributors

No. 5 Energy = Improved RS – Marketweight/buy. Groups expected to outperform: Oil & Gas Storage & Transportation, Oil & Gas Equipment & Services, Coal & Consumable fuels and Oil and Gas Refining and Marketing

No. 6 Consumer Discretionary = Sharp drop in RS – Marketweight/hold. Groups expected to outperform: Auto Parts & Equipment, Leisure, Broadcasting & Cable and Manufacturing Home Furnishing

No. 7 Materials = Falling RS – Marketweight/hold. Groups expected to outperform: Diversified Metals & Mining, Diversified Chemicals, Gold Producers and Containers & Packaging

No. 8 Utilities = Uptick in RS – Marketweight/buy. Groups expected to outperform: Gas Utilities, Electric Producers

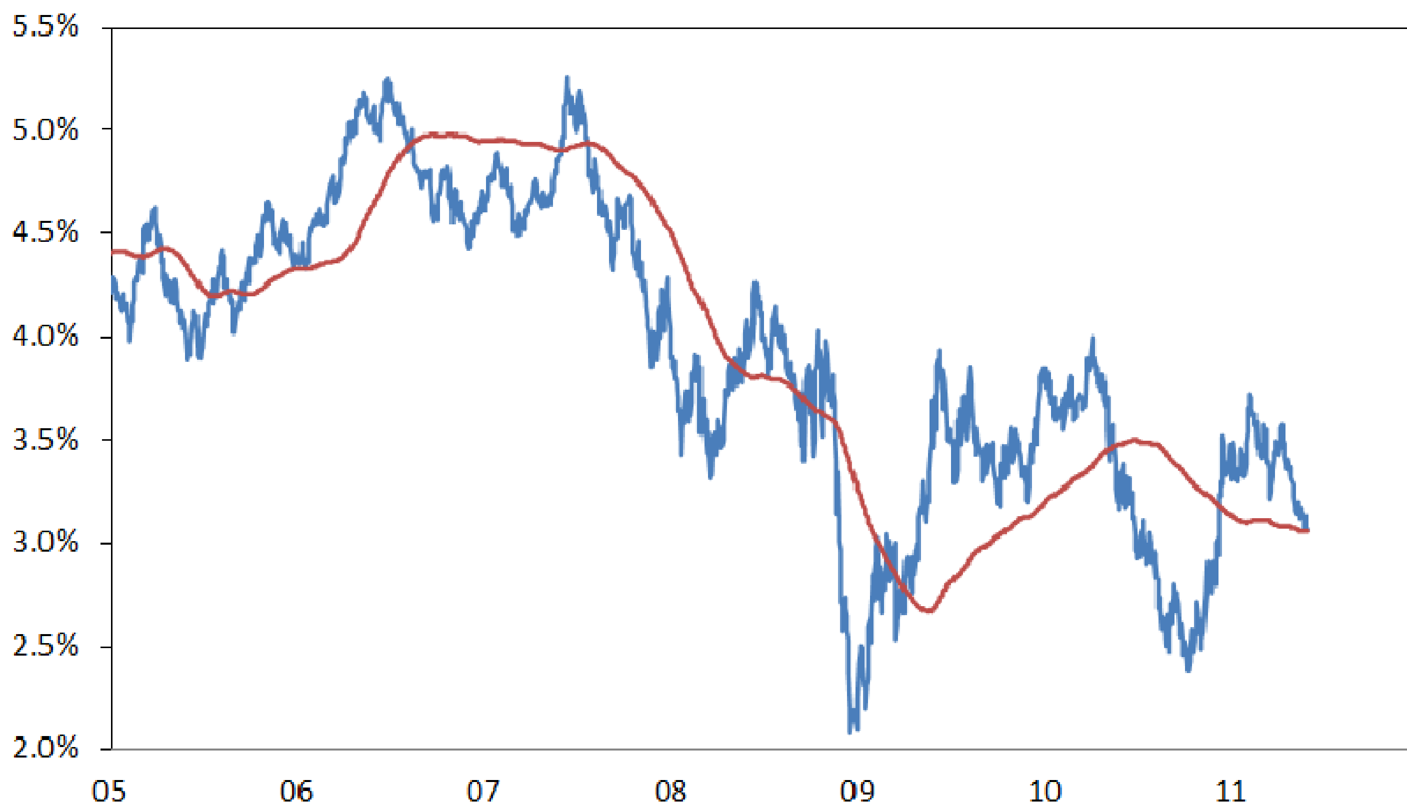
No. 9 Information Technology = Weak RS – Marketweight/hold. Groups expected to outperform: Software & Services, IT Consulting & Services, Electronic Equipment & Instruments, Office Electronics and Application Software

No. 10 Financials = Weakest RS – Marketweight/hold.

Market Overview

Stocks

Short-Term	Trading range with risk to 1300 and reward to 1365 on the S&P 500
Intermediate-Term	Trading range with risk to 1250 and reward to 1390 the S&P 500
Long-Term	Major support at 1100 on the S&P 500 – Reward to 1400 on the S&P 500



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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