October 14, 2011

Dear Investors:

Last week, I discussed the fact that the markets had risen to the upper boundaries of a declining trend channel. This week, the markets broke through their upper resistance level. This means that we may be in the midst of the bear market rally that I have been suggesting would follow the last major wave down. However, it is important to see where the next leg down bottoms. If the markets trade down to their October 3rd Fibonacci phi mate turning point level and then bounce higher, there is an increased probability that the markets are in the midst of the bear market rally that should retrace about 50%-60% of the amount lost from the April high to the October low. On the other hand, if the markets break below their October 3rd lows, then we still have further downside to the decline from the April highs. There is another Fibonacci phi mate date approaching on, or about, November 11th. It will be interesting to see if that signals a market high or a low.

The markets rallied this week for no apparent, or valid, reason other than the fact that technical levels created market demand. The Dow Jones Industrial Average jumped 541.37 points, or 4.9%, to close at 11,644.49, and is now up 0.6% for the year. The S&P 500 gained 69.12 points, or 5.9%, this week to close at 1,224.58, and is down 2.6% year-to-date. The NASDAQ Composite added 188.50 points, or 7.6%, this week to close at 2,667.85, and is up 0.6% this year.

The week started with news that France and Germany may agree to recapitalize troubled European banks. This news sent global and U.S. markets over their resistance levels and unleashed the buying frenzy. Recapitalizing the banks does not solve the European troubles. In fact, Standard and Poor’s downgraded Spain’s sovereign debt this week, but it did not matter because either investors or computer trading were working off the buy signal of breaking through the upper resistance level.

As the markets rallied, the pundits quickly dismissed the possibility of a double dip recession that had dominated Wall Street for the last two months. Does a technical market rally really signal that we have avoided a double dip recession? However, economists are raising their expectations for third quarter GDP based on the market rally and a better than expected September Retail Sales estimate. On Friday, the Commerce Department announced that September retail sales were up 1.1%, which was much better than the 0.6% that economists were expecting and a significant improvement over the August Retail Sales report that showed a zero increase in consumer spending. Maybe September was much better than expected because economists did not realize that most of the east coast was shut down for a week or more due to Hurricane Irene. In fact, home foreclosures are increasing again and home sales are sluggish. Seasonally-adjusted first-time unemployment claims dropped by 1,000 to 404,000 only because last week’s claims were revised higher. More importantly, the non-seasonally adjusted or actual claims jumped up by 66,442. I do not believe that you can dismiss a double dip recession based on this data. In fact, I think it provides more support for a second recession.

This week investors also overlooked the fact that our national debt is $14.8 trillion. For fiscal year ended September 30, 2011, the federal government spent $1.3 trillion more than it took in from tax revenues. It was the third straight year where spending exceeded revenues by more than a trillion dollars. It was the second largest fiscal year deficit since 2009 and slightly more than last fiscal year’s $1.29 trillion loss. In simple terms, the government borrowed 36 cents of every dollar spent. The problem is that the interest on the national debt is taking away from other critical government spending such as healthcare and social security. I encourage you to look at this website and draw your own conclusions about our politicians and government spending, <http://home.adelphi.edu/sbloch/deficits.html>

The Occupy Wall Street protestors have some valid arguments but they are aimed in the wrong direction. It is not Wall Street squeezing 99% of the population; it is the Federal Reserve and the policies of this Administration. The Federal Reserve has created hyper-inflation making it more expensive for the average American to buy goods and services. Excepting celebrities and professional athletes, who make up the majority of the 1% of people who are angering the protestors, everyone is paying more. Unfortunately, economics can be very difficult for the average person to understand. Blame is being placed on Wall Street when it should be the Federal Reserve and the out of control spending of the government because these two factors have weakened the middle class.

The current difficult market is making it critical that you diversify among asset classes and even investments such as mutual funds, annuities and alternative vehicles, such as structured certificates of deposit. As always, I welcome your comments and feedback regarding my letters. I want to thank you again for your referrals and confidence. A referral is the greatest validation of our service and commitment.

If you have any questions, please do not hesitate to call.  Our mission is to be your trusted financial professionals dedicated to delivering a high level of service to enhance your lifestyle and provide peace of mind.

﻿﻿Best Regards,

**Vincent Pallitto, CPA, CFP®**

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