September 7, 2012

Dear Investors:

The markets spiked higher this week and this may have resulted from the buy signal generated by the Volatility Index (VIX) and the sideways pattern that unfolded last month. The S&P 500 Index jumped 31.34 points, or 2.2%, to finish the week at 1,437.92, and is up 14.3% year-to-date. This is the highest level for the broad market index since January 3, 2008. The Dow Jones Industrial Average gained 215.80 points, or 1.6%, this week to close at 13,306.60, and is up 8.9% this year. The NASDAQ Composite finished the week at 3,136.42 after adding 69.46 points, or 2.3%, and is up 20.4% for the year. The Russell 2000 was the biggest gainer of the week as it jumped 3.7%, or 30.18 points, this week to close at 842.27, and is up 13.7% in 2012.

Although the technical market indicators have indicated short-term bullish trends, they are still suggesting that a major sell-off is on the horizon. As I have been saying since March, since the S&P 500 first crossed 1,400, the downside risk of this market is far greater than the upside potential. In late April and May, it looked as though the economy was improving and the markets might not be receiving any more artificial stimulus from the Federal Reserve and the S&P 500 dropped 10% from its 2012 high. That sell-off reversed course on June 4th after a dismal May Jobs Report led investors to believe that the Federal Reserve would continue its quantitative easing to further artificially prop up the economy and stock market. Over the last three months, the economy has become progressively worse, the probability of the Federal Reserve intervening has increased, and the markets have gone up. This is not sound fundamental investing by any means, and very dangerous to the average investor.

In our opinion, the Federal Reserve is about to announce its latest round of Quantitative Easing. This will be QE3 because QE1 and QE2 failed to stimulate the economy and create job growth. The Federal Reserve has two primary objectives. They are to increase employment and to maintain price stability. The Fed Chairman believes that by printing money and pumping it into the system Americans will feel wealthy and spend money to stimulate the economy and job growth. However, this has not happened the first time or the second time so there is no reason to believe that it will work a third time. In basic terms, the Fed prints money and buys U.S. debt from Wall Street. Wall Street investment firms turn around and put the money into the stock market creating demand. When demand is created, prices rise. This is exactly what has happened with each round of quantitative easing.

On Friday, the Bureau of Labor Statistics released a worse-than-expected August Jobs Report that stated that only 96,000 jobs were created last month. The June and July reports were revised down by another 41,000 jobs. The unemployment rate dropped from 8.3% to 8.1% only because over 368,000 Americans stopped looking for work. The Jobs Report is very deceiving and it is important to understand how the government survey is compiled. Since it is impossible for the BLS to immediately know how many jobs were created by new businesses, they use a model-based estimate in each monthly report to account for employment resulting from new business births. A summary of how the Current Employment Statistics Birth/Death (CESBD) model improves the payroll survey estimates is on the [BLS website](http://r20.rs6.net/tn.jsp?e=001qPrFTrlieigTkpgILt81awTD-sa0if7YyNgIoJ2uvagtATZzay6y_IkMuoV0Q3muZi8FbzRaLMvmergTDp-Q6YIVAN-xhjkUShZFYXgyYZ0KGoqDsr6Qpu4MrqkhZzZ9Vm0CQ7jRogxtHrbJ69tNsg==). This number is not based on any hard data. The August Jobs Report included 87,000 CESBD estimated jobs from newly created businesses, which means that there were only 9,000 jobs created. If you exclude the CESBD estimates over the last three months, then only 19,000 jobs were added to the economy since the market began its rally on June 4th. When you actually read the reports rather than the headlines, it is easy to understand why the economy is stalling.

Are you better off now than you were four years ago? Unlike politicians, numbers do not lie. We have the lowest labor market participation rate in 31 years, the unemployment rate is 30% higher, inflation on everyday items is higher and gas prices have doubled. The pundits and media will spin this every way possible but if you look at the real data the answer is no.

 As you can see, the markets are disconnected from fundamentals. At this point, I would not be surprised if the markets move slightly higher when QE3 is announced but that should be short lived as markets have moved higher in anticipation and this may be priced into the market at the current levels.   Since the Fed action appears to be priced into the market, you may see a market correction begin shortly after its announcement. If the Fed does not implement QE3 at their next meeting, then it is highly likely that the markets will suffer a steep decline. It will be interesting to see how this unfolds with the next Fibonacci phi mate, turning point, date scheduled for October 3rd.

We are sponsoring "Protect Your Retirement Nest Egg" dinner seminar at Nero's in Livingston on September 20th. If you, a family member, or colleague are interested in attending, please call our office to register as soon as possible as seating is limited. I welcome your comments and enjoy reading your feedback regarding my market analysis letters. I am sure that you know someone that needs to focus on their financial plan. A referral is the greatest validation of our service and commitment. If you have any questions or would like make an appointment to review your financial plan and take a proactive approach to your financial goals, please call my office for an appointment.

Best Regards,

**Vincent Pallitto, CPA, CFP®**

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*You cannot invest directly in a market index, market indices are for benchmark purposes.  The information in this market commentary is obtained from various news sources, Stockcharts.com and* [*technicalindicatorindex.com*](http://r20.rs6.net/tn.jsp?llr=5cqn8gdab&et=1106853148619&s=0&e=001IItwJYjbGUGAZoe_wgsIZpB-JXjRkDDWqOGUFmIcZP2fFuPoIxhNMFIS6pAtPRPDVnZlBys4bIxMVXlI4DEhRCU7ddKPYvMpZt2E0FdU1o1bYF2Uy2d3wWFJUKikKb4G&id=preview)*.  Fibonacci Phi Date (also known as Fibonacci Time Extensions) is a technical indicator used to seek to identify the timing of significant price movement in the market, and is based on the Fibonacci Number Sequence. The opinions voiced in this material do not necessarily reflect the views of LPL Financial and are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you consult your financial advisor prior to investing.  There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk. The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful. All performance referenced is historical and is no guarantee of future results. VIX relates to the implied volatility of the S&P 500 Index.*