November 25, 2011

Dear Investors:

Three weeks ago following the best October for the markets in almost 40 years, it seemed unthinkable that the markets would give back those impressive gains. However, the markets suffered a steep two day decline that began on the last day of October. In my November 4th market letter, I discussed the technical damage caused by the sharp sell-off and suggested the possible downside scenarios. Last week, I suggested that since the markets broke through critical support levels, it increased the probability that the Dow Jones Industrial Average could fall to 11,000 to 11,200 and the S&P 500 Index could drop to 1,150 to 1,160. After this holiday-shortened trading week, the markets are precisely at the next critical support levels.

The Dow Jones Industrial Average suffered its worst Thanksgiving week percentage loss since 1932 as it plunged 564.22 points, or 4.8%, for the week to close at 11,231.94 and is now down 3.0% for the year. The S&P 500 dropped 56.98 points, or 4.7%, this week to close at 1,158.67, and is down 7.8% year-to-date. The NASDAQ Composite lost 130.92 points, or 5.1%, this week to close at 2,441.58, and is now down 8.0% this year.

Since the S&P 500 has declined in eight of the last nine trading days and the short term stochastics are over-sold, it appears that this support level should hold and the markets should begin a 5% to 10% rally into the New Year. This rally wave would be the third of an a-up (10/3-10/27), b-down (10/27-present), c-up (this week to year-end) of the second major leg up portion that began on October 3rd. The first major wave down began with the April 29th highs and ended with the October 3rd lows. Once this second major leg up is complete, it is probable that the third major leg down will begin and this could bring the markets substantially lower in 2012. The alternative theory is that the markets have a brief recovery from this over-sold position and continue to fall below their October 3rd lows. If the latter scenario should occur, then it would mean that the second major leg up only lasted four weeks into the October 27th highs and we are in the midst of the third major leg down.

The panic on Wall Street this week was caused by the lack of progress by the “Super Committee” to create a plan with acceptable budget cuts and also the increasing uncertainty in Europe. As Greece, Italy, Spain, Portugal and other countries battle with temporary austerity measures, Germany is beginning to pay the price. For the first time, Germany was unable to sell all of its bonds at auction. This means that Germany is now printing money. It is only a matter of time before the European crisis blows up.

The big news this week was that the Commerce Department revised its estimate for third quarter Gross Domestic Product to show that the economy is expanding at a rate of 2% which is slower than was originally expected. Last month, it was the Commerce Department’s estimate that the third quarter GDP was about 2.5% and that sent the markets to their October 27th highs. It is remarkable how the Commerce Department could have a 20% margin of error, especially when you consider that the second quarter GDP was 1.3%. There was not any news during July, August and September that was 100% better than the second quarter which makes you wonder how they come up with these numbers. Their inaccurate estimate and October’s rally had most “experts” raising their expectations for a strong year-end recovery. Instead of following misleading government reports, the “experts” should look at their friends, family and colleagues to measure what is really going on.

Today is Black Friday. The media and retailers have hyped this to be the most anticipated shopping season in years as most stores opened late Thanksgiving evening and remained open all night. I am not sure how increased shopping hours in the middle of the night causes consumers to spend more overall for the season. It may be more convenient for some and appealing to others, but I do not believe that it is going to cause people to buy more than they planned to buy during the holiday season. By the time the retailers report earnings, it is unlikely that profits will increase due to increased payroll costs and sale priced items with lower profit margins. I am sure that the hype will continue throughout the week about how strong sales were this weekend, but the more important concern is if they will remain strong over the next four weeks.

The key to a solid financial plan is to stay your course and not to be fooled or persuaded by unjustified rallies. I encourage you to make an appointment to review your financial plan and explore year-end tax planning opportunities. 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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973-301-2360

973-301-2370 Fax

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