

Weekly Commentary May 4, 2009

The Markets

Set the bar low and then step over it. That idea helps explain why the S&P 500 index has jumped 30% since its March 9 low, according to *Barron's Magazine*.

By early March, investors were quite pessimistic about the outlook for corporate earnings and the economy. In effect, the bar was quite low in terms of near-term expectations. Over the following few weeks, earnings and economic reports came in weak, but they were “less bad” than expected. Relieved investors took this “less bad” as a sign that perhaps the worst is over so they started dipping their toes back in the investing waters and stocks rose.

Here are a few of the recent “less bad” numbers that investors warmed up to:

- The purchasing managers’ index contracted again in April, but showed a significant improvement over March’s number, according to the Institute for Supply Management.
- The consumer sentiment index – although still at a depressed level – rose in April compared to March, according to MarketWatch.
- Initial claims for unemployment insurance for the week ending April 25 were 631,000 – a horrible number – but it was an improvement from 645,000 the previous week, according to the Department of Labor.
- The S&P/Case-Shiller Home Price Index for February, which was released last week, showed a slowing in the rate of decline in residential home prices.
- First quarter GDP plummeted a worse than expected 6.1%, but the consumer spending portion of GDP rose a pleasantly surprising 2.2%, according to *The Wall Street Journal*.
- Companies such as Caterpillar, Coca-Cola Enterprises, Wells Fargo & Co, Ford, American Express, and Marriott posted earnings that were historically low, but still above expectations, according to Bloomberg.

When the stock market can rally on news that is bad, but “less bad” than expected, that may suggest underlying strength. Only time will tell if this move is sustained or if it will falter and lead to a retest of the early March lows.

Data as of 5/1/09	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	1.3%	-2.9%	-37.9%	-12.4%	-4.7%	-4.2%
DJ Global ex US (Foreign Stocks)	1.8	1.2	-44.0	-13.5	0.0	-0.5
10-year Treasury Note (Yield Only)	3.2	N/A	3.8	5.1	4.5	5.4
Gold (per ounce)	-2.5	1.7	3.7	10.2	17.7	12.0
DJ/AIG Commodity Index	2.8	-2.7	-44.0	-13.8	-5.4	3.1
DJ Equity All REIT TR Index	-5.4	-14.2	-51.3	-17.6	-1.5	N/A

Notes: S&P 500, DJ Global ex US, Gold, DJ/AIG Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.

Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not available.

CYCLICAL OR SECULAR? Whether the current economic storm is a traditional cyclical adjustment within a long-term uptrend or a secular turning point into a “new normal” may help explain the course of the economy and the financial markets in the decades to come.

One could argue that since the end of World War II, the global economy has been on an upward march with only periodic interruptions by rather shallow localized recessions. The baby boom after the war coupled with business innovation, the growth of emerging countries, and the expansion of credit, helped usher in a six-decade long improvement in our standard of living. In recent years, this growth was turbo-charged by an expansion of credit that helped consumers finance a lifestyle that was not sustainable out of normal cash flow.

What we’ve witnessed over the past 18 months is an unwinding of the recent credit binge to a more sustainable level of consumption. The big question is whether this unwinding is just a temporary adjustment before we jump right back on the credit bandwagon or whether we are adjusting to a new lower level of consumption and a higher level of savings.

A recent Gallup poll found that nearly one-third of Americans have reduced their spending lately and intend to make this lower spending level their “new normal” in the years ahead. Twenty-seven percent said they are saving more and intend to make saving more their “new normal.” If consumers follow through with what they told the pollsters, we may be witnessing the early stages of a secular change in American’s spending and savings patterns.

Trends can only be identified after you’ve been in one for a while. While we definitely have seen consumers pull back and savings start to rise, it’s too soon to say if this trend will continue and become a long-term secular change or reverse course after the recession ends and just be another cyclical speed bump along a decades-long growth curve.

Trends like this have important implications for the financial markets. If this is a secular change, then it’s possible the financial markets will stay in a wide trading range for many years. If it’s a traditional cyclical recession, then growth should return and the markets may resume their gallop toward new record highs.

Since no one can predict the future, we continue to look at the facts as they appear and make portfolio adjustments accordingly. Regardless of the secular or cyclical outcome, we continue to do our best on your behalf.

Weekly Focus – Think About It

“Opportunities to find deeper powers within ourselves come when life seems most challenging.”
--Joseph Campbell

Best regards,

Jim

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* The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks.

* The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.

* Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.

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