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Weekly Viewpoint



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Cautious Tone Leaves Market Mixed, but Trend Remains Our Friend

WEEK IN REVIEW

11/16/09 – 11/20/09

The major market indices finished the week mixed, reflecting uneven economic data and growing skepticism surrounding the sustainability of the economic recovery.

Note: The next edition of the Weekly Viewpoint will be published on 12/7.

Performance for Week Ending 11/20/09

The Dow Jones Industrial Average (Dow) rose 0.5%, the Standard & Poor's 500 Index (S&P 500) lost 0.2% and the Nasdaq Composite Index (Nasdaq) shed 1%. Sector breadth was mixed as four sectors closed higher while six closed lower. The Health Care sector (+1.9%) was the best performing while Technology (-1.3%) was the worst. The Canadian market, as measured by the S&P/TSX Composite Index, gained 1.5%.

Index*	Closing Price 11/20/09	Percentage Change for Week Ending 11/20/09	Year-to-Date Percentage Change Through 11/20/09
Dow	10318.16	+0.46% ▲	+17.57% ▲
S&P 500	1091.38	-0.19% ▼	+20.83% ▲
Nasdaq	2146.04	-1.01% ▼	+36.08% ▲
S&P/TSX Composite	11579.33	+1.50% ▲	+28.84% ▲

*See Last Page for Index Definitions.

Market Observations: 11/16/09 – 11/20/09

The mixed performance last week likely reflected the growing skepticism surrounding the rebound in the economy. This mindset is being fostered by uneven economic data and concerns over the health of the consumer. While the current recovery is feeble and likely to be well shy of trend line growth for the next several quarters, the recovery, in my opinion, remains intact. As mentioned in this publication during the past few months, the road to recovery is rarely a straight line and often contains pot holes along the way. The market's ability to shrug off these "speed bumps" and demonstrate considerable resiliency likely means the market's overall trend remains to the upside.

The day after the upcoming Thanksgiving holiday, dubbed "Black Friday," will be very closely watched this year to see if and how wide consumers open their wallets. While expectations are generally low, as we have seen over the course of the year, consumers will spend money

if they feel a deal is at hand. (For example, the Cash for Clunkers program generated an estimated \$10 billion in auto sales in August.) A solid “Black Friday” followed by a strong “Cyber Monday” will likely be a “tell” about the progress towards a consumer-driven recovery. Good news from retailers will likely spur a renewed buying binge in the equity markets and set a favorable tone for the remainder of the year. Year-over-year comparisons should be relatively easy as last year at this time we were in the middle of a financial hurricane. Consumers not knowing the outcome generally refrained from spending; in 2008 holiday sales fell for the first time since records began in 1993. The recovery in the equity markets and the stabilization of the housing markets should bode well in reversing the “negative wealth effect” in place over the past year and could set the stage for increased consumer confidence to spend.

Treasury yields finished the week near 12-month lows. The retreat in yields underscores the growing uncertainty in the marketplace. In addition, lower yields, in light of the stock market’s strong performance raises the question of whether a disconnect is developing in the market place between what is priced in the market and what is coming to fruition in the economy. While the economic data of late has been on the softer side, the trend, in my opinion, is more important at this stage of the game. In terms of trend, almost all economic barometers are decidedly better off today than they were several months ago. In addition, the downward pressure on bond yields may also be related to seasonal factors and the stagnate demand for bank loans. On the first issue, as the end of the year approaches, investors have a tendency to book profits and reallocate the proceeds to “safe-haven” investments in an effort to preserve the gains. The strength in the 2-year Treasury note may be a sign of monetization of profits by large institutional investors who tend to use the 2-year as a “place holder” because of its highly liquid nature. On the second point, with banks generally reluctant to lend and with few consumers beating the doors down for loans, commercial banks may be allocating their excess reserves into the Treasury market in an effort to keep those funds “productive.”

Last week’s choppy performance looks more like a simple digestion of recent gains and not the start of a bigger correction. Despite the fact that the S&P 500 has gained over 60% since the March lows and is up better than 20% year-to-date, I continue to believe that additional upside is likely over the intermediate term. While I believe the “easy money” in the market has been made and the pace of gains will likely slow, the combination of low interest rates, a turn in the corporate earnings cycle and the building economic recovery, likely means the bull market rally has further room to run. In addition, bull market rallies rarely end at the early stages of a recovery in corporate profits. After nine consecutive quarters of negative earnings growth, S&P 500 earnings are forecast to grow 71%, 29% and 26% in Q4, Q1 and Q2 of 2010, respectively.

With that said, selectivity will also become more important going forward as the rising tide may not raise all ships as it has over the past several months. The recent return of the Institute for Supply Management (ISM) Manufacturing Index back into expansionary mode historically has favored “pro-economy” sectors (Materials, Energy, Tech, Industrials, Discretionary) over Defensive sectors. In addition, on an asset class level, we continue to see a rotation back

into large-cap stocks from the small-caps space. Not only does relative valuation favor large-cap stocks, but large caps also tend to have a higher portion of revenues generated in the overseas markets and are likely to benefit from the positive “currency translation” effect associated with the weakness in the U.S. dollar (i.e. approximately half of the revenues from the S&P 500 are generated in overseas markets vs. approximately 30% for the small-cap S&P 600).

Housing – Double Dip? The recent round of economic data on the housing sector is raising concerns of another downturn in the real estate market. Last week, the Mortgage Bankers Association reported one in seven U.S. home loans was in some state of foreclosure at the end of September, while new mortgage applications fell to a 12-year low despite very low financing costs. Meanwhile housing starts and building permits were well below economists’ expectations. Admittedly, the outlook is concerning, but some of the recent weakness may be explained by the uncertainty throughout the month of October over the extension of the first time homebuyers tax credit. On November 6, the Obama administration announced the program would be extended through the end of April 2010 and expanded to include higher wage earners and existing homeowners. While we can’t be sure whether the extension of this stimulus initiative will cause housing statistics to rebound in the forthcoming months, the program, coupled with increasing affordability, at worst should provide further stabilization and limited downside risk, in my opinion.

Gold. Gold continues to power higher and from a purely technical point of view appears ripe for a period of consolidation. The love affair with gold has generally become a crowded trade and might be compared to what happens when everyone stands on one side of a boat. With that said, the macro environment will likely lead to higher prices over the foreseeable future, but only after traders blow some froth off the yellow metal, in my opinion.

Market Viewpoint

Maintain Positive Intermediate Term Outlook. While my bias is for the market to continue on an upward trajectory over the intermediate term, the markets have also discounted a lot of good news and may need to go through a period of consolidation to filter out any excesses. I view pullbacks and periods of consolidation as healthy components of bull market advances as they typically set the stage for the next leg up in the market.

With that said, I think March 9 represents the low in the current market cycle. Also, because of the high levels of cash on the sidelines and what appears to be a growing level of risk taking, a “buy-the-dip” mentality should provide a downside buffer, in my opinion. In other words, any pullback in the market will likely be short and shallow.

Potential Risks/Wildcards: My expectation that stock prices will trend higher over the next 6-12 months assumes an economic recovery continues to progress, a stable to moderately declining price environment (no extended periods of deflation and/or hyperinflation), and the eventual recovery of earnings growth. A delay of any of these events could ultimately prolong the market’s recovery period.

Definitions

The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally defined as the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Standard and Poor's 500 Index is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Nasdaq Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

The S&P/TSX Composite Index is a capitalization-weighted index designed to measure market activity of stocks listed on the Toronto Stock Exchange (TSX). The index was developed with a base level of 1000 as of 1975.

Institute for Supply Management (ISM) Manufacturing Index is a monthly composite index that is based on surveys of 300 purchasing managers throughout the United States in 20 industries in the manufacturing area. The index is released on the first business day of the month and covers the previous month's data, which makes it particularly timely. If the index is above 50, it indicates that the economy is expanding. Values below 50 indicate a contraction.

The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 370,000 people in virtually every community in the country. The mission of the Washington, D.C.- based association includes, but is not limited to, investing in communities across the nation by ensuring the continued strength of the nation's residential and commercial real estate markets; expanding homeownership and extending access to affordable housing to all Americans and supporting financial literacy efforts.

Indices do not include any expenses, fees, or sales charges, which would lower performance. Indices are unmanaged and should not be considered an investment. It is not possible to invest directly in an index.

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