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Mike Schwager, Chief Market Strategist

Weekly Viewpoint



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Macro Drivers in Place for Additional Upside

WEEK IN REVIEW

11/9/09 – 11/13/09

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Performance for Week Ending 11/13/09

The Dow Jones Industrial Average (Dow) rose 2.5%, the Standard & Poor's 500 Index (S&P 500) added 2.3% and the Nasdaq Composite Index (Nasdaq) tacked on 2.6%. Sector breadth was positive as all 10 of the S&P sector groups finished higher. The Materials (+4.2%) sector was the best performing while Energy (+0.24%) was the laggard. The Canadian market, as measured by the S&P/TSX Composite Index, gained 1.4%.

Index*	Closing Price 11/13/09	Percentage Change for Week Ending 11/13/09	Year-to-Date Percentage Change Through 11/13/09
Dow	10270.47	+2.46% ▲	+17.02% ▲
S&P 500	1093.48	+2.26% ▲	+21.06% ▲
Nasdaq	2167.88	+2.62% ▲	+37.47% ▲
S&P/TSX Composite	11407.68	+1.40% ▲	+26.93% ▲

*See Last Page for Index Definitions.

Market Observations: 11/9/09 – 11/13/09

The major market indices finished higher for a second consecutive week reflecting the pending turn in corporate profitability and building confidence in the durability of the economic recovery.

Investors shrugged off a report late in the week from the University of Michigan that showed consumer confidence declined to 66.0 versus the expected rise to 71.0. The decline appeared to be a reflection of the grim outlook for job and income prospects and the uptick in gasoline prices. Offsetting the weak report was a pullback in the dollar and upbeat quarterly earnings reports from retailers JC Penney and Dow-component Walt Disney. The solid results from Disney and JC Penney were viewed as a favorable sign for the upcoming holiday shopping season. While overall holiday sales are expected to be lackluster, optimism seems to be rising that pent-up demand from consumers may leave room for an upside surprise.

Crude Reality. Oil prices retreated for the second time in three weeks and are now at the lowest level in almost a month. Last week, the Department of Energy reported that crude inventories surged by 1.76 million barrels, well ahead of the 1 million barrel build expected by analysts. Meanwhile, gasoline inventories jumped by 2.6 million barrels versus the 350K-barrel decline expected by analysts. On a year-to-date basis, U.S. crude inventories have grown by more than 18 million barrels which seems to go against the 71% gain in crude prices.

Upside Remains but Pace of Gains Likely to Slow. Despite the fact that the S&P 500 has gained almost 62% since the March lows, 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%, 28% and 26% in Q4, Q1 and Q2, 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, Technology, Industrials, and Consumer Discretionary) over Defensive sectors. In addition, on an asset class level, there are beginning signs of a rotation back into large-cap stocks from the small-cap 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.

Strong Dollar Policy? Last week Treasury Secretary Timothy Geithner, speaking in Singapore, reiterated the U.S. government’s commitment to a strong dollar. Mr. Geithner said, “It’s very important to the United States that we have a strong dollar.” However, Mr. Geithner’s statement, generally conflicts with rhetoric coming from Federal Reserve Board (the “Fed”) officials. Fed officials have maintained a consistent message over the past couple weeks that interest rate hikes are not likely for quite some time. Interest rates are either the cost of money or the return of money. A low interest rate environment will likely continue to foster the “carry trade” where investors sell dollars and reinvest the proceeds into higher yielding currencies. Downward pressure in the dollar will likely remain the prominent trend as long as interest rates remain at extremely low levels.

Europe Exits from Recession. Following the United State’s lead, the eurozone economy returned to growth mode, although the rate of growth fell short of economist expectations. The European Union reported that economic growth in the 16 nation block, expanded at a 0.4% rate after contracting for five consecutive quarters. Economists were expecting the economy to grow by 0.5%. Nonetheless the return to positive growth was a welcome event.

Gains in Baltic Dry Index Confirming the Global Recovery? Since early March the Baltic Dry Index (BDI) has gained over 81%. The BDI is looked at as a proxy for the health of the global economy as the index measures worldwide shipping rates on cargo ships. The sharp rise in shipping rates is likely signaling a pickup in global demand and highlighting the rebound in the global economic environment.

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.

The University of Michigan Consumer Sentiment Index is a consumer confidence index published monthly by the University of Michigan. The Index is developed from 500 telephone interviews, which include 50 core questions, conducted each month of a United States sample which excludes Alaska and Hawaii. The Index of Consumer Sentiment (ICS) is developed from these interviews. Especially valued for its quick turnaround, the University of Michigan Confidence survey is considered one of the foremost indicators of U.S. consumer sentiment.

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 Baltic Dry Index (BDI) is a shipping and trade index created by the London-based Baltic Exchange that measures changes in the cost to transport raw materials such as metals, grains and fossil fuels by sea. The Baltic Exchange directly contacts shipping brokers to assess price levels for a given route, product to transport and time to delivery (speed).

The Baltic Dry Index is a composite of three sub-indexes that measure different sizes of dry bulk carriers (merchant ships) - Capesize, Supramax and Panamax. Multiple geographic routes are evaluated for each index to give depth to the index's composite measurement.

The eurozone economy is comprised of 16 European Union member states that have adopted the euro currency as their legal tender.

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Claymore Investments, Inc.
200 University Avenue, 13th Floor
Toronto, Ontario M5H 3C6
866-417-4640
www.claymoreinvestments.ca