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ECONOMIC & MARKET UPDATE: FEBRUARY 7, 2011 "THE ECONOMIC RECOVERY PUSHES AHEAD DESPITE THE STRANGE LABOR REPORT"

Economic Data - Previous Week					
Date	Series	Actual	Survey	Prior	
1/31	Personal Spending	0.7%	0.5%	0.3%	Auto sales, gas prices inflate spending report
2/1	Construction Spending	-2.5%	0.1%	-0.2%	Broad weakness weighs on construction spending
2/1	ISM Mfg	60.8	58.0	58.5	ISM hits 7 yr high; expansion across components
2/3	ISM Non-Mfg	59.4	57.0	57.1	Orders, labor components bolster services index
2/3	Factory Orders	0.2%	-0.4%	1.3%	Healthy report despite negative aircraft data
2/4	Nonfarm Payrolls	36K	140K	121K	Weather conditions may be to blame for weakness
2/4	Unemployment Rate	9.0%	9.5%	9.4%	Sharp drop in labor force improves headline rate
Economic Data - Upcoming Week					
Date	Series	Actual	Consensus	Previous	
2/7	Consumer Credit	--	\$2.4B	\$1.3B	Robust auto sales should buoy credit outstanding
2/10	Wholesale Inventories	--	0.8%	-0.2%	Retail strength should predicate inventory growth
2/11	Trade Balance	--	-\$40.5B	-\$38.3B	Analysts expect widening of trade gap for Dec
2/11	UMich Confidence	--	75.0	74.2	Optimism to remain high as expectations improve

Source: Bloomberg

A JANUARY/SUPER BOWL WIN-WIN FOR THE EQUITY MARKETS?

It was a strongly positive week for equity markets, as investors determined that the situation in Egypt would not result in a long-term headwind to global economic growth. A number of positive trends in the domestic economy were a main reason investors increased their collective optimism. The Dow Jones Industrial Average gained 2.3% and the S&P 500 Index tacked on 2.7%.

For the duration of January, the S&P 500 Index was up by almost 2.4%. The age old adage, "as goes January, so goes the rest of the year" is one that should bring happiness to investors. Based on research popularized by Yale Hirsch in 1972, when the markets rise in January, they tend to do so throughout the rest of the year, and vice versa, when they fall in January, they tend to continue that trend throughout the rest of the year. Dating back to 1937, the "January effect" is successful 90% of the time. However, we would be remiss if we did not point out that it was

horrendously wrong in each of the past two years.

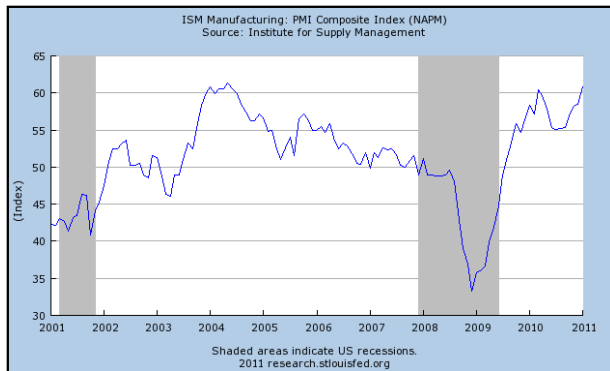
Last night's Super Bowl offers another piece of positive news. George Kester, professor of finance at Washington and Lee University, found that if the Super Bowl winner was an original member of the National Football League (a fact that both Pittsburgh and Green Bay can lay claim to), stock markets rose 77% of the time over the remainder of the year.

There is of course no causal effect between football and the markets, but nonetheless, last week's economic news suggests the economic recovery is fully intact and gaining steam. Yes, even that strange labor report.

Turning to the economy, manufacturing showed that it continues to be a bright spot for the economy after the Institute for Supply Management (ISM) Purchasing Managers Index (PMI) shot to 60.8% for January. That

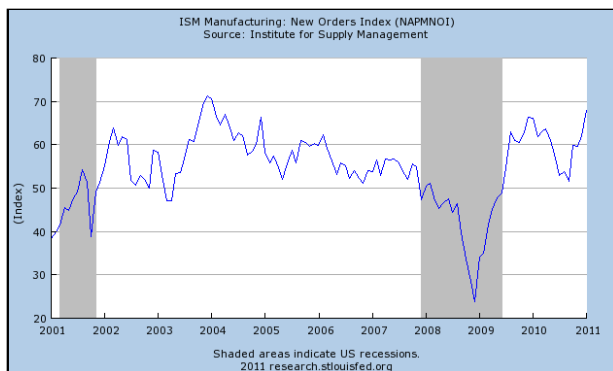
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placed the index well above the 50% threshold considered to be indicative of expansion in the manufacturing sector, and marked the highest reading of that index since May 2004.



Source: Federal Reserve Bank of St. Louis

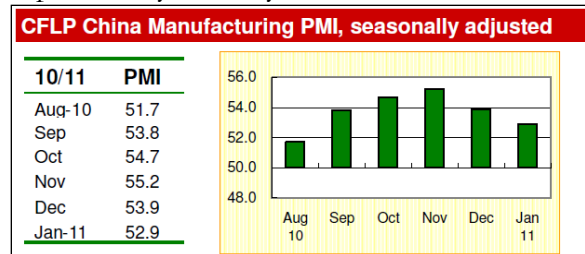
New orders represent the source of the strength in recent months. Currently at 67.8%, new orders are steadily trending higher and offer reason to believe that manufacturing will continue along its current course in the months ahead.



Source: Federal Reserve Bank of St. Louis

Chinese manufacturing was not as fortunate in January, with the headline PMI falling 1.0% to 52.9%. Tighter monetary policy, combined with the Chinese New Year created

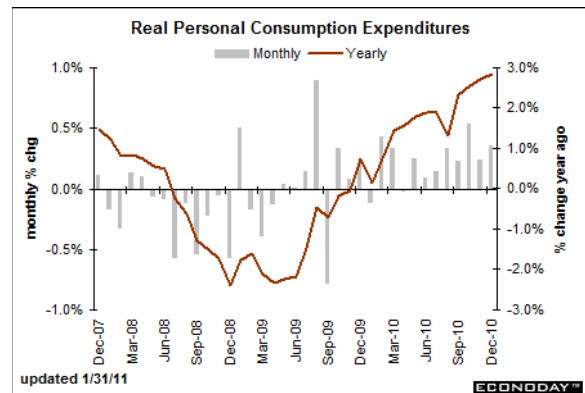
headwinds for the manufacturing sector, but the index does remain well within expansionary territory.



Source: LI & Fung

We received further confirmation that consumers were a driving factor behind fourth quarter economic growth in the US.

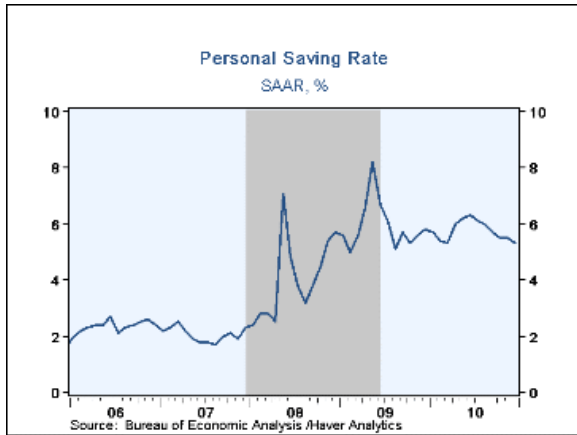
Personal consumption expenditures (PCE) rose 0.7% in December to bring the yearly gain to 4.1%. Personal income posted healthy gains over the course of the past year as well, rising 3.8%.



Source: Econoday

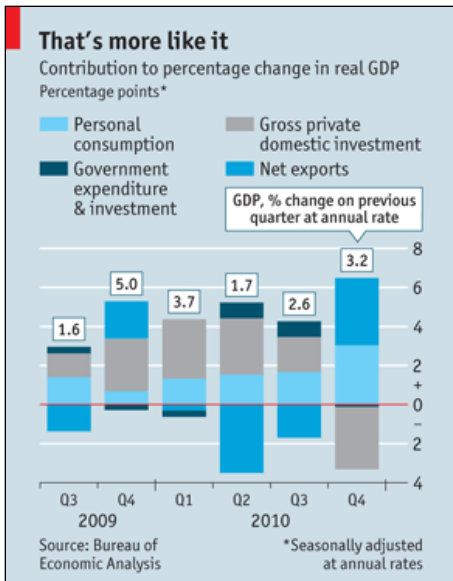
With incomes not quite keeping up with the rate of spending, consumers once again dipped into savings to buoy their purchases over the quarter. Personal savings as a percent of disposable income reached a near-term peak of 6.3% in June, but fell to 5.3% in December.

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Source: Haver Analytics

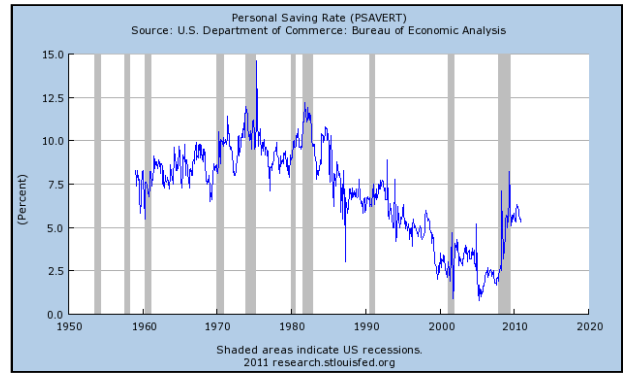
Consumers play an outsized role in economic growth in this country, so it is a positive development that they are willing to play a leading role in the economy once again. As we saw with 4th quarter GDP figures released the week prior to last, consumers were one of the primary drivers behind overall growth.



Source: The Economist

There are reasons to be cautious, however. A personal savings rate at 5.3% is a dramatic improvement from the 0.8% level experienced in 2005, but it remains a far cry from the savings rates seen prior to the past two

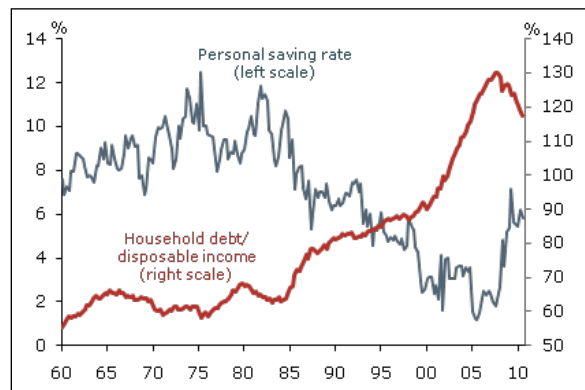
decades. With savings already at low levels, consumers will be unable to propel spending through savings.



Source: Federal Reserve Bank of St. Louis

The other alternative would be the resurgence of credit, specifically credit cards and home equity lines of credit. This is highly unlikely, though, considering tighter bank lending standards and consumer apathy towards those products.

Recent analysis from the Federal Reserve Bank of San Francisco demonstrated the negative relationship between the personal savings rate and household debt. Not surprisingly, as interest rates fell over the twenty years between the mid-1980s and the mid-2000's, the savings rate correspondingly fell and investors embraced higher levels of debt. Those two trends reversed sharply at the start of the recession.



Source: Federal Reserve Bank of San Francisco

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Since the end of the recession, the savings rate is showing signs of declining, as we discussed earlier, but this time around, debt is unlikely

to play an offsetting role. Thus, sustainable wage growth will be necessary for consumers to continue leading the charge in this recovery.

LABOR MARKETS ON THE MEND, MORE OR LESS

Encouraging. Confusing. Disappointing. Mixed Bag. These were all terms used to describe the labor report for January. Ultimately, it may turn out that none of those terms are relevant and investors would be better served in pretending this report was a figment of our imaginations.

Granted there was plenty of data to decipher in the most recent report, but a number of strange factors at work in January cause this report to lose most of its importance. Economists were quick to blame everything from winter weather to annual benchmark revisions, but the overall picture for the labor market is one of tenuous improvement. Ultimately, there were a few positives, a few negatives and a whole lot of who knows.

Before dissecting the data, it is important to point out that there are two surveys used to gather data on labor from a month to month basis. The first is the establishment survey, which canvases about 140k public and private agencies to determine the monthly payroll figure. The unemployment rate is derived from the household survey, a monthly poll of 60k households across the country.

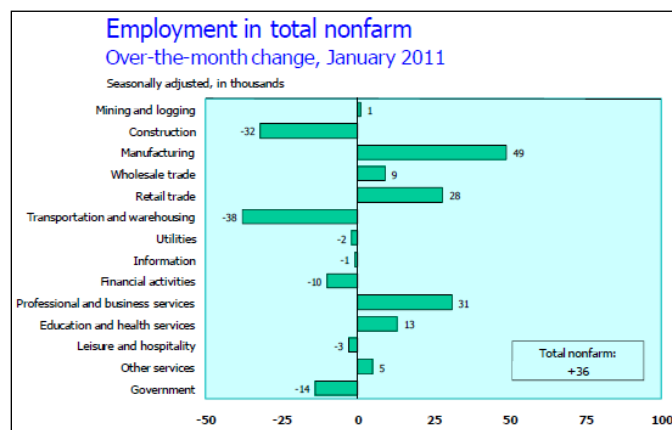
It is not uncommon for each of these reports to provide conflicting accounts from time to time.

By now everyone is likely aware that nonfarm payrolls added a disappointing 36k jobs in January, while the unemployment rate unexpectedly fell from 9.4% to 9.0%.

A decline in the unemployment rate was the result of several factors. First, the number of

unemployed individuals fell by roughly 600k in January, but the incorporation of recent Census Department data on population led to a perceived decline in the working age population.

There were several positive trends to glean from the underlying data. Earlier we discussed the ongoing strength in the manufacturing sector. The January employment report confirmed that notion after showing that manufacturing experienced the largest employment gain of any sector, with the addition of 49k jobs.

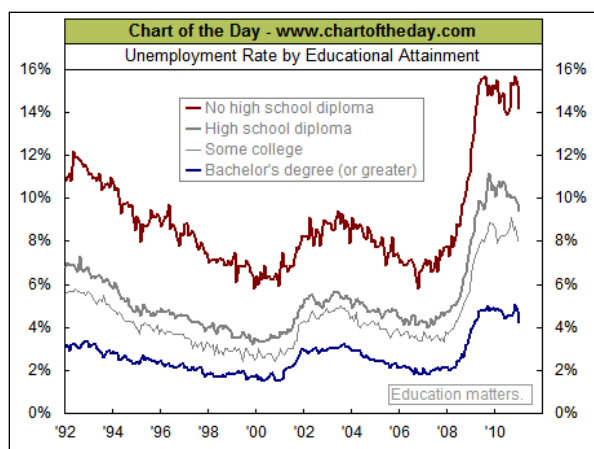


Source: Bureau of Labor Statistics

What is also apparent is that areas such as transportation and construction, which are heavily influenced by weather conditions, felt the biggest job losses in the month. This is another indication that weather likely had a larger influence in dragging down the jobs report than is accurately being reflected.

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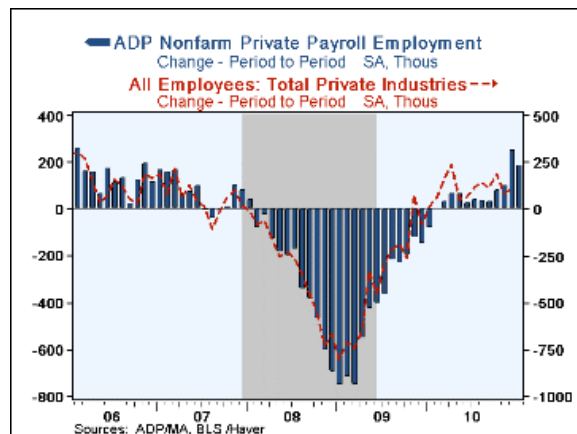
One trend that remained obvious since the start of the recession is how important of a role education plays in finding and keeping a job. For individuals over the age of 25, the unemployment rate for people with at least a Bachelor's degree is 4.2%, less than half the 9.4% rate for people with a high school diploma. Among people with less than a high school diploma, the unemployment rate skyrockets to 14.2%.



Source: Chart of the Day

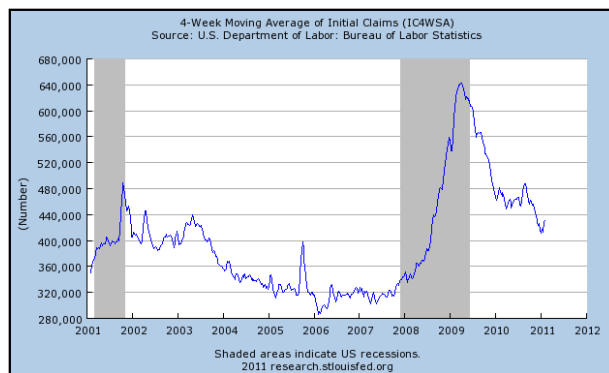
Outside of the establishment and household surveys, there were two other labor market reports that proved confusion reigns supreme.

First, Automatic Data Processing (ADP), a payroll processing company that releases a monthly report on national employment, said that private sector employment increased by 187k in January. ADP's report suggested fairly robust growth in private sector employment, a suggestion that was not confirmed by the Bureau of Labor Statistics.



Source: Haver Analytics

On the flip side, initial claims for unemployment insurance remain at an elevated level. The current 4-week moving average of initial claims stands at more than 430k. After the previous recession, sustainable employment growth was not evident until initial claims fell below 400k.



Source: Federal Reserve Bank of St. Louis

With labor markets sending overly mixed signals at the moment, investors might prefer to simply wait until next month for a more palatable release. Month by month data can be volatile at times, shrouding improvement in the overall trend. Yes, the labor markets are improving, but not nearly quick enough to replace the more than 7.7mln jobs lost since the peak in January 2008.

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THE WEEK AHEAD

The economic calendar in the US will be relatively quiet this week, with only a handful of reports being released. Consumer credit on Monday is expected to show a gain, although the revolving credit component, which includes credit cards, is likely to continue its decline.

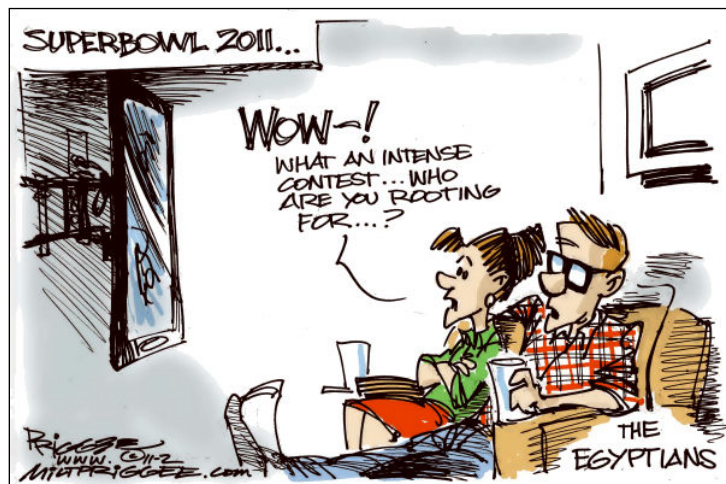
Federal Reserve Chairman Ben Bernanke will appear before the House Budget Committee to discuss “The Economy, Jobs and the Budget.” His comments will be closely watched by the markets, but it is anticipated that he will focus on keeping policy accommodative in order stimulate job growth.

Several Treasury auctions are set to occur this week, including \$32 bln of 3-yr notes (Tuesday), \$24bln of 10-yr notes (Wednesday) and \$16bln of 30-yr bonds (Thursday).

Earnings will remain in the spotlight this week. Companies set to report include Hasbro, Loews, Sara Lee, Toyota, UBS, Disney, Cisco, Coca-Cola, Credit Suisse, Diageo, Kraft, PepsiCo, Rio Tinto, Thomson Reuters, Alcatel-Lucent and Total.

The Bank of England convenes its regularly scheduled monetary policy meeting on Thursday. There is no change expected to overnight interest rates despite rising inflation pressure in England.

LIGHTER SIDE



Source: Milt Priggee



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