

**ECONOMIC & MARKET UPDATE: OCTOBER 31, 2011**  
**"JUST WHEN YOU THOUGHT EUROPE WAS RESCUED, NEW SKELETONS EMERGE"**  
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### Economic Data - Previous Week

Date	Series	Actual	Forecast	Prior	
10/25	S&P/CS 20 City MoM	-0.05%	0.10%	-0.15%	Home prices stable in Aug, revised down for July
10/25	Consumer Confidence	39.8	46.3	46.4	Confidence in current, future conditions down sharply
10/26	Durable Goods	-0.8%	-1.0%	-0.1%	Strong report as new orders up 1.7% ex-transportation
10/26	New Home Sales	313K	300K	296K	Sales up as home prices decline 3.1% during month
10/27	GDP - Q3 Adv Est.	2.5%	2.5%	1.3%	Consumption and business investment boost Q3 GDP
10/28	Personal Spending	0.6%	0.6%	0.2%	Spending higher, but partially due to price gains
10/28	UMich Confidence	60.9	58.0	57.5	Expectations up but sentiment still near record lows

### Economic Data - Upcoming Week

Date	Series	Actual	Forecast	Prior	
11/1	Construction Spending	--	0.3%	1.4%	September uptick in starts may boost spending
11/1	ISM Mfg Index	--	52.0	51.6	Improvement in regional surveys points to uptick
11/3	ISM Non-Mfg Index	--	53.6	53.0	New orders point to upward momentum in services
11/3	Factory Orders	--	-0.2%	-0.2%	Durable goods orders indicates mild contraction
11/4	Nonfarm Payrolls	--	95K	103K	Modest job growth anticipated in October
11/4	Unemployment Rate	--	9.1%	9.1%	Labor force growth will likely offset job gains

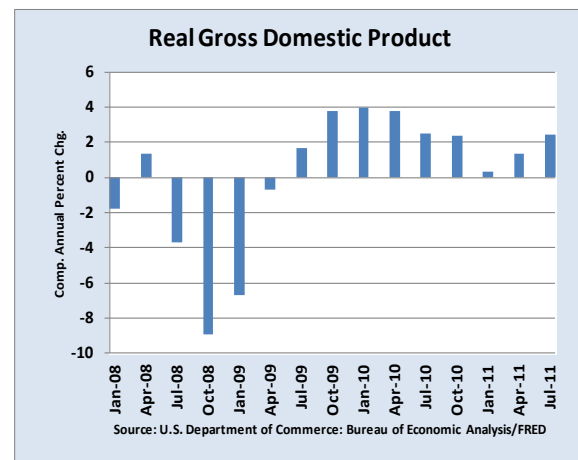
Source: Bloomberg

## MARKETS CHEER AN IMPROVED ECONOMY

Positive developments in Europe and improving economic data in the US led to continued gains in equity markets. The S&P 500 Index gained 3.8% and the Dow Jones Industrial Average rose 3.6%.

Throughout the week, data on GDP growth, personal income and spending, and new home sales provided relief for investors concerned about slowing growth. In addition, corporate earnings reports continue to support the notion that fundamentals remain healthy.

The closely watched GDP report showed the economy expanding 2.5% in the third quarter – a significant improvement over the 1.3% growth rate in the second quarter. Underlying the report was stronger growth in consumption and business investment. Spending in the durable goods and services component was particularly strong.



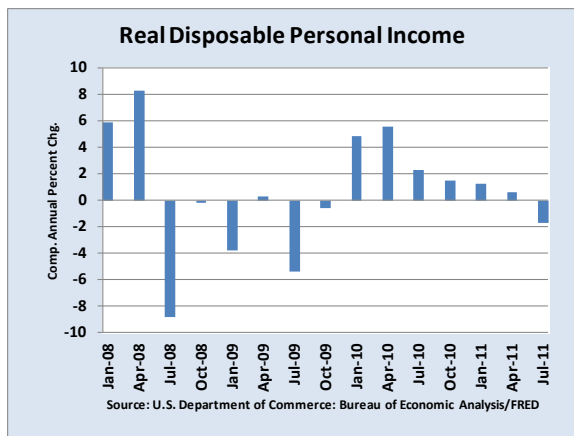
Source: Federal Reserve Bank of St. Louis

The most encouraging news in the third quarter GDP report was a 2.4% expansion in personal consumption expenditures, up from 0.7% in the second quarter. Spending surprisingly rebounded during a third quarter

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in which macroeconomic headlines dominated the news. Spending was healthy across durables and services.

Consumers were not necessarily in the best of positions though, as incomes declined during the quarter. Real disposable personal income fell an annualized 1.7%.

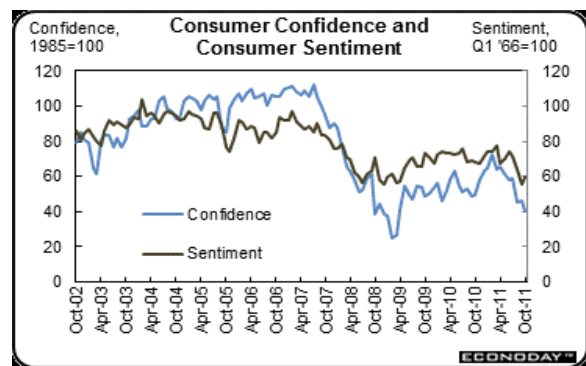


Source: Federal Reserve Bank of St. Louis

Those figures were largely confirmed by September's personal income and spending report. Personal income rose 0.1% in September, but more importantly, wages and salaries were up 0.3%. This was an improvement upon August's decline. The one sore spot was a decline in real disposable income for the third consecutive month.

Spending jumped 0.6% due to increases in spending on durable goods and services. However, higher spending came at the cost of savings. The personal savings rate fell to 3.6% in September, which is largely viewed as an unsustainable level. An easing of inflationary pressure in the last quarter of the year should stabilize the savings rate and provide a boost to incomes.

Consistent with recent months, consumer sentiment and confidence figures held at very low levels. The Conference Board's consumer confidence index shed another 6.6 points following a seven-point decline in the current conditions reading and a 6.4-point drop in the expectations reading. The Reuters/University of Michigan Consumer Sentiment Index actually increased in the final October reading, but, at 60.9, it sits near record lows.

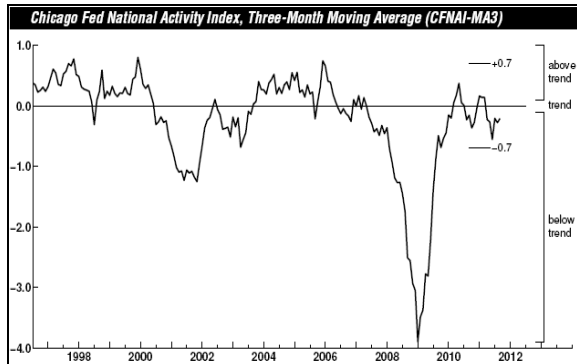


Source: Econoday

Hard data, such as personal spending, shows that consumers are refusing to clamp down despite headlines that have driven their confidence in the economy to near record lows. That is good news for the upcoming holiday season.

Confirming the broad economic improvement we saw in September, the Chicago Fed National Activity Index, an aggregation of 85 national economic indicators, also rose during the month. The index improved to -0.22 in September from -0.59 in August. In aggregate, 56 indicators improved during the month, while 27 deteriorated and two remained the same.

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Source: Federal Reserve Bank of Chicago

Three of the four major category groups contributed to the positive headline reading, with employment-related indicators being the strongest following improvement in nonfarm payrolls. Consumption and housing remained negative due to the overall weakness in housing markets.

## EUROPE'S TROUBLES ARE SOLVED THAT EASILY?

In a long awaited move, the European Union finally reached a credible plan to fix its debt crisis. At least, so it seemed for 24 hours. The EU's announcement that it would reduce Greece's debt load and expand the European Financial Stability Fund (EFSF) represented a significant move forward for the European continent, but the deal remains short on details, and long on hope.

From a high-level perspective, the EU announced Greek debt holders would agree to a 50% write-down, the EFSF would expand to roughly €1 trillion, European banks would increase their capital ratios to 9% by mid-2012, and nations such as Italy and Spain would accelerate structural reforms to stabilize their economies.

Such proclamations sounded wonderful on the surface, particularly last Thursday when they were first announced. However, the euphoria quickly abated as investors realized the details of the plan were nonexistent.

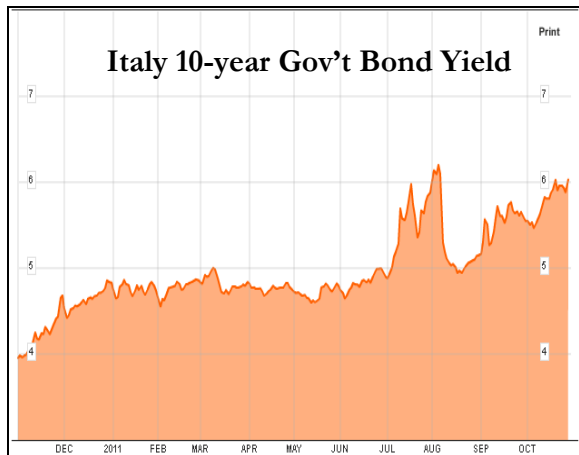
A haircut for Greek debt holders was inevitable and probably the easiest part of this plan. Recapitalizing banks during a stressful

period, on the other hand, is going to be extremely difficult.

Issues are already emerging with a Greek debt reduction. First, credit default swap (CDS) holders who thought they were protected in the event of a default are being told that this was a "voluntary" debt reduction. Thus, it is not considered a credit event and insurance will not be paid out. It is hard to find anything voluntary about this event.

Second, some of the largest holders of CDS contracts on Greece include European banks that were hedging loans to Greek companies. These are the same European banks that are now being told to recapitalize.

Moving past Greece, one of the primary reasons for an expansion of the EFSF was Italy, which is working to balance its budget and reduce a massive debt load. Unfortunately, markets do not believe the EU has done enough. By Friday morning, a poorly subscribed Italian debt auction sent Italian 10-year government yields racing back above the 6% mark.



Source: Bloomberg

Over the weekend, details emerged that the EU was turning to China as a major investor in the revamped EFSF. China has a huge stockpile of money under its mattress, but the Chinese are not quick to invest without concessions and guarantees. It seems, once again, that the EU jumped the gun, offering investors reason for optimism without having a concrete plan in place yet.

Investors were fatigued from a consistent barrage of frustrating news from Europe and they were quick to accept any agreement as a positive development. They may have been a little too quick to accept what is currently amounting to little more than a promise of solutions to come.

Despite these issues, the EU's latest plan did offer some elements of progress. A reduction of Greek debt was a foregone conclusion, and that headwind is finally being resolved. Unfortunately, a 120% debt-to-GDP level eight years from now may not be sufficient. In addition, it appears EU officials are finally willing to act in a coordinated manner, at least on the surface. That is something that has been severely lacking in the past few months.

While we remain constructive that this is an important move forward for the EU, it is important that investors remain cautious. Details are sparse and a tremendous amount of work remains to be done before it can truly be said that Europe is in a better place.

## THE WEEK AHEAD

Economic data in the US will receive plenty of attention this week. On Tuesday, the ISM Manufacturing Survey is released, with economists anticipating continued expansion in the manufacturing sector. Wednesday's ADP private payroll employment report will offer a taste of what is to come in Friday's nonfarm payroll employment report for October. Consensus expectations are for job growth of slightly less than 100,000 and an unemployment rate of 9.1%.

Earnings season continues in full swing this week, with key reports from Anadarko Petroleum, Credit Suisse, Nomura, Pfizer, Thomson Reuters, Kraft, Nissan, Sony, Time Warner, BNP Paribas, ING, KKR and Alcatel-Lucent.

Five major central banks will meet this week, with the most notable being the Federal Reserve on Wednesday. Economists do not expect a major shift in the Fed's outlook, but will look closely for any clues of additional quantitative easing measures. Other central banks meeting include Australia, Iceland, and the Czech Republic. For the first time, Mario Draghi will preside as President over the European Central Bank meeting on Thursday. Markets are looking for any indication of an interest rate cut or support measures for struggling nations.



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