

Daily Market Notes**Market Update:****DJIA:** 9570**S&P 500:** 1038**Nasdaq:** 2073**10YR T-Note:** 3.22%**EUR/USD:** 1.454**Gold** 1003**Crude Oil:** 70.34

If one looked at the closing changes for the major indexes yesterday, one would have thought that it was a quiet day with nominal losses of -29 points for the Dow and -2 points for the Nasdaq. Were they ever wrong, as on the last trading day of the month and of the third quarter, the market took investors on a roller coaster ride in all directions before settling with these small losses.

In fact, the Dow traversed an incredible 480 points during the course of the session, starting with a gain of +22 points, then declining from that early higher start very rapidly to a loss of -133 points at 10am, then climbing its way back to a gain of +34 points by 2:45pm. From that promising rebound, it proceeded to fall quickly to a loss of -77 points at 3:15pm before clawing its back to show a closing loss of -29 points.

Prices Current as of
1:02 PM*Source: Bloomberg*

What accounted for this tremendous volatility was the release of economic reports which were contradictory, to say the least. The day started with the ADP estimates for tomorrow's jobs report, and true to their very poor track record for prognosticating the numbers, they came out with a decline of -254,000 which is much higher than the consensus for losses of -190,000. As difficult as it is to believe given their very poor record, the markets got a little rattled by this, but things got more optimistic when the final estimate for 2Q G.D.P. came in with a small loss of -.07% against the prior estimate for a decline of -1.2%. This resulted in the short-lived initial market bounce, which was then completely torpedoed to the downside when the Chicago Purchasing Managers Survey for September showed a decline to 46.1 when an increase to 52 was expected. The problem with this number is that instead of showing expansion over 50, it actually predicted a decline with the below 50 reading.

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From these lows right after the release of this report as described above, the averages went on their topsy-turvy machinations for the remainder of the day, with the final small lower close. This lower close on the last trading day of the month is consistent with historical precedent because as we have pointed out many times in the past, the two days of the month with the greatest propensity to be lower are the options expiration Friday and the last trading day. We have also explained the reasons why this phenomena takes place and they are 1) making as many out of the

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money calls as possible expire worthless; 2) making the end of month statements for the individual investor look worse than the overall trend of the market. And let it be noted that even in 2009, which has so far been a historic one in terms of the equity advances, on six of the nine last trading days of the months so far, the market has ended with losses!

Despite the declines of the past two days this week, this has been a historic year in terms of how well the market has done, but let us also remember that it has made its advances from levels that were last seen in 1996. For the month of September, the Dow rose by +2.3%, the S&P by +3.6% and the Nasdaq, which has been the leader so far, by +5.6%. This now means that for only the 16th time since 1928, or 81 years, the market has advanced for seven months in a row.

More optimistic statistics are that the S&P has undergone the best two consecutive quarters of gains since 1975 and has advanced by the most for seven straight months since 1938. The gains in the overall market were around +15% each for the past two quarters. This third-quarter gain was the best for the S&P since the fourth quarter of 1998. So far this year, financials have been the best performers, with gains of +25%, followed by industrials, up +21%, consumer discretionary, up +20%, and technology, ahead by +17%.

Now that all of the good news is in the past, where do we go from here? In other periods when the market advanced for seven months in a row, the gains continued for one or two months maximum, so perhaps we are getting closer to the end of this historic string of consecutive advances, which of course does not mean that things cannot continue to rise, but it appears that it will not be as predictable as what we have already seen.

Let us also remember that when the S&P has been 20% above its 200-day moving average, as it was only in 1932, 1938, 1975, 1985 and 1986, and as it was recently, the market underwent an average decline of -12% over the next three months before being higher by +13% a year later.

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The fourth quarter is starting out on a decidedly negative note, and this will now be the sixth day out of the past seven that stocks will be lower, which is an obvious sign that things are running out of upside steam after all of the wonderful advances described above. The best thing that can be said about this series of declines is that it puts the market into a weakened position ahead of the important jobs report tomorrow. In other words, the market will have less of an upside burden to want to advance, as the ADP number is already out there which means that the market can tolerate losses of up to -250,00 or so. Anything worse than that might not be negative, but only up to -300,000. Of course, if the number came in better than -190,000 stocks could have a very good day considering the extent of the losses that it has undergone recently.

So what happened today to set things off to the downside? The first ostensible explanation is that the weekly jobless claims number came in a bit higher than expected, even though the continuing claims number was better. The second reason, and this I find a little hard to take, is that the September ISM Manufacturing Survey came in at 52.6, down slightly from last month's 52.9, when an advance to 54 was expected. Does this slight miss, which still showed expansion in manufacturing for the second month in a row, warrant this type of vicious sell off?

This is why the market could be set up for a rebound if the jobs report tomorrow is not a complete disaster.

As usual, all of the outside markets are dutifully following stocks to the downside, as gold, crude oil, copper and the Euro are all lower, and this is understandable given the "risk aversion" dynamic that we have described so many times in the past. But all of these items were up yesterday despite stocks being down. Their gains yesterday seemed artificially induced and could have been the result of end of quarter portfolio adjustments where investors wanted to own these items going forward. At least for today, this was not a good bet.

The economic releases tomorrow will be obviously highlighted by Friday's

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September non-farm payroll report, in addition to August factory orders.

During the second quarter, stocks in the S&P 500 reported profit declines of -29%.

This is after a first quarter decline of -33%. The projection is for a -22% decline in the third quarter, before a rousing gain of +63% for the fourth quarter, when the comparisons to the fourth quarter of 2008 should be somewhat easy to overcome. The only problem with this projected gain is that the bulk of it is supposed to come from financials, because the comparisons to the disastrous 4Q of 2008 should allow for good upside.

We have now seen eight straight quarters of profit declines for companies in the S&P 500, starting with the last two quarters of 2007, all four quarters of 2008 and the first two quarters of 2009. Earnings have never been down for eight consecutive quarters. If earnings do come in lower for the third quarter of 2009, this will be the first time ever that there have been nine consecutive quarterly profit declines.

We now have four consecutive quarters of negative G.D.P. growth which started in the third-quarter of 2008, and has now extended through the first two quarters of 2009. Projections for the third quarter are for growth in the +2 to 3% range. This is the first time that there have been four straight quarters of negative growth since records have been kept since 1947.

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Disclosures

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