

Daily Market Notes**Market Update:****DJIA: 10408****S&P 500: 1119****Nasdaq: 2270****10YR T-Note: 3.60%****EUR/USD: 1.411****Gold 1100****Crude Oil: 76.46**Prices Current as of
1:56 PM

Source: Bloomberg

What happened to all of the supposed bullishness that was generated by Tuesday's rally resulting from the Republicans winning the special election in Massachusetts?

This was the explanation that was put forward to explain the sharp gains on the first trading day of this week, a pattern seen for 18 out of the past 20 first days of the week. All of that bullishness went out the window yesterday as the Dow declined by triple digits for the second session out of the past three sessions. But it was able to trim an intraday loss of more than -200 points into a closing decline of -122.

The culprit yesterday was the country that seems to hold the world's financial fate in it hands, namely China, which said that it was going to curb bank lending for the rest of this month in order to cool off its economy, which grew at a +10.7% rate in the fourth quarter, the fastest rate since 2007. Of course since China is a surrogate for world economic growth in the new era in which we live, once they sneeze, the entire world catches a cold.

In addition, another Dow stock that reported its earnings declined, namely the large computer maker and information technology provider, but that was no surprise given the fact that it had run up strongly into its report and there was huge buying in the out of the money calls, the usual pattern when important companies are about to report their results. And naturally these buyers lost a large percentage of their money. In fact, of the first six Dow stocks to report, five of them have declined after their numbers and it was only a very small gain by a large Dow bank stock yesterday after its results that got one member of the Dow into the plus column, at least for one day, after earnings.

Donald M. Selkin

Chief Market Strategist

(212) 417-8017

dselkin@nationalsecurities.com**Jason Wotman**

Research Analyst

(212) 417-8264

jwotman@nationalsecurities.com

And what about our beloved VIX, which declined to as low as 16.86 on January 11th, when all of the VIX observers thought that this was a sign that future market moves were going to get quiet with volatility reaching the lowest level since May 2008, a few months before the financial roof caved in. The more traditional way to look at the VIX has finally re-asserted itself once again, namely that the lower the VIX goes, the greater the probability that the market will decline, because a lower VIX usually indicates an overbought situation. In fact, after yesterday's third triple-digit move in a

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row for the Dow (down Friday, up Tuesday, and down yesterday), the VIX started to move higher once again.

And today, after a sort of benign start to the proceedings, things fell off the cliff around 10:20am. The Dow had been up a bit at the opening with a gain of +9 points, but the Nasdaq had done much better, starting out with a gain of +17 after good results from various smaller technology companies, and also on a recovery in the shares of the largest web based search engine stock ahead of its number tonight. Even though all of the ones who reported are still higher, this one has turned down ahead of its report, which is probably the best thing that can happen, as it lowers the bar for success as opposed to all of the other stocks who rally into their reports and then sell off even though the numbers they come out with are decent.

What turned the market around very sharply to the downside was a complete rout in the shares of large financial stocks, which have come under heavy selling pressure because of the President's proposal to limit the size and trading activities of these large financial institutions as a way to reduce risk-taking and hopefully to prevent another financial crisis. The proposals would be part of an overhaul of regulations and would specifically prevent banks from having proprietary trading operations or investing in hedge funds and private equity funds. This could particularly affect the stocks that run the largest proprietary trading desks. The plan is subject to approval by Congress, where his other financial reform proposals have run into resistance from some members.

So now the VIX induced lull is certainly gone from the market, as this will be the fourth day in row that the Dow will have had a triple digit change, and unfortunately three out of the four have been to the downside. This has had the effect of putting the VIX back above the old 20 support level, which looked like a thing of the past since it broke decisively below that level with the strong stock gains to start off the New Year. So we can say with a strong certainty that the 16.86 level will now become the new support level on the downside, and if the VIX were to get that low anytime soon, which now appears unlikely, then the stock market will certainly become oversold at

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that point.

Today's economic numbers certainly have taken a back seat to the financial proposals, as weekly jobless claims did come in higher than expectations, but this reflected the backlog of applications from the holiday period late last month and early this month. The January Philadelphia Fed Index report did show expansion for the fifth month in a row, and the December L.E.I. report showed a gain of +1.1%, which was the largest in three months. Obviously these are taking a back seat to the President's proposals and its effect on the large banks.

And once again, the dollar is little stronger against the Euro, but weaker against the Yen, and this is having the effect of knocking crude oil prices, gold and the industrial commodities like copper lower once again, and the stocks that are related to them such as mining, resource and energy issues are getting sold off very sharply. So with this combination of these stocks and the banks all lower, things certainly look bleak at least for today.

And if one wants to add in another source of woe, that basket case in Europe, namely Greece, is still a concern because of its largest E.U. member budget deficit, although their finance minister did say that they will not need a rescue package, although this has been met with skepticism in their financial markets.

For the fourth quarter, the S&P companies are expected to show a profit gain of +67%, but without the financials, which are expected to report gains of +120% just by themselves because of the easy comparisons to the disastrous fourth-quarter of 2008, the balance of the companies will show profit declines of -2.5%, according to the analyst's estimates. So there is going to be real distortion here, and it therefore will become more important to look at the earnings of each company on an individual basis.

This week finishes up with more financial stocks reporting, with tonight: ED, EFII, ELX, GOOG, JJSF and financials AXP, COF, Friday: HOG, JCI, KMB, MCD, SLB,

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STM and financials GE, BBT and STI.

After declining for the first three quarters of 2009, which culminated an unprecedented nine straight quarters of profit declines, earnings for the fourth-quarter are expected to show a large increase of +62%, with the bulk of those gains in the financial segment, with comparisons to the disastrous 4Q of 2008 allowing for good upside. Without the financial contribution, which is supposed to be gains of +120% according to the analysts, S&P earnings would actually decline by -2.8%. According to the analysts, for 2010, earnings are projected to increase by +28%, followed by earnings increases of +22% in 2011.

After four consecutive quarters of negative G.D.P. growth which started in the third-quarter of 2008 and extended through the first two quarters of 2009, we finally got a positive growth period in the third-quarter, at a final gain of +2.2%.

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Disclosures

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