

Daily Market Notes

Market Update:**DJIA:** 9897**S&P 500:** 1071**Nasdaq:** 2147**10YR T-Note:** 3.54%**EUR/USD:** 1.489**Gold** 1042**Crude Oil:** 78.70Prices Current as of
1:04 PM

Source: Bloomberg

After Thursday's strong rally, which appeared to be a counter-reaction to the strange late Wednesday sell off, the market was presented with several positive items on Friday, both in terms of economic numbers and company earnings. So instead of reacting well to these inputs, things proceeded to start nominally higher with the Dow up +18 points to start out. After this brief move higher, stocks did an abrupt about-face as the session wore on and ended with a closing loss of -109 points, and under the magic 10,000 level once again, at 9972. Since crossing this level for the first time on October 14th, there have been three closes below this level after moving back above it.

One would have hoped that good results from two large technology companies, a large specialty retailer and a major oil refiner would have carried stocks higher, as well as a good September existing home sales report, the best since July 2007. But once again, it appears as when the VIX gets closer to the huge 20 support area it acts as a stopping point on the downside and therefore a resistance level to stocks on the upside. In fact, during the brief morning upward spurt, which did not last very long, the VIX got as low as 20.34, and this more than anything else appeared to be what stopped stocks from continuing to move higher.

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Today, following what had been a very consistent pattern, the market started out with another one of its recent strong Monday showings. In fact, six out of the past seven Mondays in September and October had been higher, an astounding record during what are historically the two most difficult months of the year. In fact, two of those gains were in excess of 100 points and one was close, at +96 points.

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After being as high as +100 points with a very good Nasdaq/Dow ratio, things all of a sudden went into a nosedive just after 11am, with the Dow declining from this early gain to a loss of as much as -123 points on its worst level.

Let us try to explain the reasons offered for the early advance and then for the sudden turnaround to the downside. Unfortunately the supposed "explanation" as to why stocks came out of the starting gate in a strong manner was that the weaker

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dollar, which hit a new low against the Euro at 1.5063, is supposedly good for equities. And crude oil, which had been as much as +\$1.08 higher at 81.58 a barrel, was also good for stocks because it shows “global economic growth.”

And if stocks can only go when the dollar weakens and crude oil advances, then this market is going to get itself into trouble. We have been talking about the folly of these kinds of explanations for weeks now, and if these types of gains in stocks earlier today were a function of these inflationary items going up, then we do not buy into this, and when crude oil and the Euro decline, which one would think would be friendly for stocks, and stocks follow lamely to the downside, then the major equity averages are not going to get very far on the upside because these higher outside markets are the cause for stocks to become overvalued, NOT the fact that these outside markets decline and this is interpreted as negative for stocks. If stocks do end lower today, it is because they cannot deal with the effects of higher oil prices and a higher Euro, NOT because these two items have declined!

In fact, of the companies that have reported earnings so far for the third quarter, more than 80% of them have beaten the estimates, compared to what was then the record pace of 72% for the second quarter.

What was a potential trouble spot today was that even when the major averages were on their early highs, the large financial stocks were not doing well, so as things in general have moved down, these losses in bank stocks are being exacerbated. And even the technology stocks, which were doing extremely well in the early going, are selling off from new highs in some cases, with a notable exception being the shares of the two large technology companies which did so well on Friday, and both of them are still basking in the glow of their strong reports late last week.

What is supposedly hurting the banks stocks is that there is also the expectation that one of the large banks that specializes in asset management and other financial and risk-management products and services, will repay the TARP, which could be dilutive, and there were also further analyst downgrades, this time of regional banks.

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As a result of this decline, the VIX is shooting up from its depressed levels of last week when it got close to 20, and which as we said above, this number now be huge support on the downside and which will mean that equities definitely will have trouble advancing if the VIX were to decline to this level again.

The earnings parade continues this week with the following lineup – tomorrow: APOL, BIDU, BWLD, CBI, DV, FISV, HMC, JCI, LCAV, PNRA, PCX, PLT, RFMD, X, VLO, WYNN; Wednesday: AKAM, ARBA, CBT, COP, ESRX, FSLR, GP, GSK, HIST, HES, INSP, JAH, NWL, RYL, TER, WLP; Thursday: AET, AGN, ABX, CL, COCO, DB, EK, ETH, EXPE, K, MET, MHK, MOT, MYL, NBL, ODP, Dow component PG, STRA; Friday: ACI, Dow component CVX, CVH, DUK, WY.

Economic reports include: tomorrow: Case Shiller August home price index, October Consumer Confidence; Wednesday: September durable goods orders, September new home sales; Thursday: first estimate of 3Q G.D.P.; Friday: last trading day of the month, September personal income and spending, October Chicago Purchasing Managers Index, U. of Michigan final October Consumer Sentiment Survey.

It should also be pointed out 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.

So far in the third quarter, profits are down -19%. During the second quarter, profits declines for stocks in the S&P 500 were -29%. This is after a first quarter decline of -33%. The expectation is for 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. For 2010, earnings are projected to increase by +26%, followed by earnings increases of +22% in 2011.

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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

Don Selkin is the Chief Market Strategist at National Securities Corporation, member FINRA/SIPC, (NSC) and provides the Fair Value analysis for CNBC each morning. The commentary provided in this Market Letter is intended to provide our customers with timely market analysis and should not be considered a research report. This Market Letter may contain, and is limited to: Discussions of broad based indices; Commentaries on economic, political or market conditions; Technical analyses concerning the demand and supply for a sector, index or industry based in trading volume and price; Statistical summaries of multiple companies' financial data, including listings of current ratings; and, Recommendations regarding increasing or decreasing holdings in particular industries or securities. This Market Letter does not make a financial or investment recommendation or otherwise promotes a product or service of the firm. This Market Letter contains only news, facts, and commentary on information previously reported from a news source believed to be accurate and reliable by the author. These news sources include the following: {PROVIDE SOURCES}. It is possible that at any given point in time, the author, NSC, or one or more of its employees or registered individuals associated with NSC, may hold a position, either long, or short, as well as options, bonds, or other instruments in the companies noted in this report. This Market Letter is intended strictly for current National Securities Corporation customers only.