

Daily Market Notes

Market Update:**DJIA:** 9929**S&P 500:** 1062**Nasdaq:** 2094**10YR T-Note:** 3.49%**EUR/USD:** 1.484**Gold** 1046**Crude Oil:** 79.86

On September 2nd, the VIX got as high as 29.56 intraday after a very late August-early September decline of -4.3% in the S&P. On October 2nd, the VIX reached an intraday high of 29.56 after a very late September-early October decline of -4.3% in the S&P. After both of these declines, the market then proceeded to make new highs for this recovery off of the March lows.

Yesterday, after a decline of -5.3% in another very late in the month sell off, this time of -5.3% in the S&P, the VIX closed at 27.91. For the third time, after these declines, bearishness among so-called market "experts" rose dramatically, especially now that the S&P apparently closed below its 50-day moving average for the first time since the sharp mid-June to mid-July correction, and during that period, the decline was the steepest one since the rally began, totaling -8.9%.

Prices Current as of
2:30 PM

Source: Bloomberg

These most recent declines have come about even as third quarter earnings results have beaten the analyst's estimates in 82% of the 250 S&P companies that have reported so far. If this pace continues, it would be a record for this statistic. And yet the average stock has declined by -0.7% after their numbers have been released. So what's up?

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The answer is that the historic rally that the market has undergone in the past eight months has obviously discounted the better earnings that have been reported and the economic recovery that is underway, even though these earnings are still down by -18% compared to a year ago. In fact, through yesterday, the Nasdaq, which has been the best performing of the major averages this year, had its worst week since May 15th. And we had pointed out that four Dow stocks that reported better than expected numbers are all lower now than where they were before their numbers were released. This type of market action is in sharp comparison to the first and second quarter reactions, when stocks consistently rallied after better numbers, albeit from obviously lower price levels.

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A poor September new home sales report and what now appears to be the self-serving estimate of today's G.D.P. report by an influential house whose

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pronouncements are treated like the second coming of the Gospel were responsible for yesterday's sharp sell off, which constantly accelerated as the day wore on, with investors panicked into selling in anticipation of the fact that since they were told by this organization that third-quarter G.D.P. was going to come in at only +2.5% against a consensus of +3.2%. If that was the number that was going to be reported, then the "correct" thing to do was to hit the sell button. As a result, breadth numbers were the worst we have seen in a long time, at 9 to 1 on the negative side, and the major averages ended lower for the sixth day out of seven.

Leading the way down once again were the financials, which have recently fallen out of favor by various analyst downgrades and yesterday they had to labor under the additional burden of the news that GMAC was in talks with the Treasury Department about the possibility of having to receive a third bailout. As previously mentioned, the Nasdaq really took it on the chin as the large technology leaders who have done so well recently after their reports and made new yearly and in once case, all time highs, got sold off.

So after all the trepidation that these recent events have caused, were suddenly done away with this morning by continuing jobless claims that fell to their lowest in seven months, and most importantly by the G.D.P. estimate which came in above consensus. The first reading was a gain of +3.5%, which was certainly much better than the 2.5% number put out by the all-knowing organization yesterday.

So with some good news for a change, the market is reacting nicely to the upside, and one would like to see a closing Dow gain of at least +100 points to get some of the bearish attitudes that had developed during the recent decline out of the way. It is also alright that the VIX is down by twice as much as the Dow is up, as it was up twice as much as the Dow was down yesterday. At current relationships, the VIX is projecting a potential Dow gain to 10,400.

Leading the way today is the large consumer products Dow component on good earnings, and the beaten down Dow financials are finally moderately joining the

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upside party for a change. The large technology stocks, which had gotten sold off sharply during the first three days this week, are once again pushing to the upside. As has been typical of the large energy stocks after their reports, The Dow component that is the largest American integrated oil company is down after its results and that is restraining the upside to some extent.

And sure as the stock market is higher, so is the Euro on a decrease in “risk aversion” after several days of an increase in it, and gold and oil prices are dutifully following to the upside as well – why not, as investors think that these higher prices are wonderful for stocks, and we have discussed this issue many times recently.

The month finishes off tomorrow with more earnings as listed below, and there is another Dow component reporting – CVX. The economic data is listed as well.

The earnings parade finishes this week with – ACI, CVX, CVH, DUK, WY.

Economic reports include: 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 -18%. During the second quarter, profits declines for stocks in the S&P 500 were -29%. This is after a first quarter decline of -33%. According to the analysts surveyed, 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, according to the analysts surveyed, earnings are projected to increase by +26%, followed by

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earnings increases of +22% in 2011.

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. According to Bloomberg Financial, 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. The initial projection for the third quarter is for growth of +3.5%. 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.