

Daily Market Notes**Market Update:****DJIA:** 10458**S&P 500:** 1105**Nasdaq:** 2188**10YR T-Note:** 3.54%**EUR/USD:** 1.461**Gold** 1115**Crude Oil:** 69.95Prices Current as of
1:16 PM

Source: Bloomberg

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The market put in a very steady performance yesterday, as a narrowing of the October trade deficit due to better exports from the U.S., and weekly jobless claims that fell to a one-year low got the bullish juices going again. The better level of exports, which were the highest since November 2008, were obviously a function of the weaker dollar but hopefully were a sign of improved demand from other countries which would lend credence to the idea of worldwide economic recovery.

And it was nice to see the equities markets advance despite another decline in the price of crude oil to around \$70 a barrel. We have maintained for the longest time that upward moves in crude oil this year to over \$80 were strictly a function of the weak dollar by the thinking that investing in commodities because of the weak dollar is a good hedge. Of course, what those investors who bought crude oil at these higher prices forgot was that the fundamentals of the crude oil market did not justify prices at those levels, and the argument that high crude oil prices are good for stocks because they supposedly show "worldwide economic recovery" when the U.S. is still by far the largest consumer of energy is really a ridiculous one. As we have repeatedly said, lower energy prices are beneficial to consumers as they act like a de facto tax cut. So it was nice to see stocks advance despite crude oil prices falling for the seventh straight day.

It was also nice to see equities hold onto their gains despite a weak 30-year bond auction, which continued to push yields on the longer-dated maturities to higher levels. This could also be a function of the thinking that the stronger economic reports we have seen lately will cause the Fed to push up the date for the first interest rate increase to earlier in 2010 than the consensus thinking had been. We still believe that weak labor markets and the absence of any inflationary pressures will allow the Fed to maintain rates at these record low levels for most of 2010. This is especially true now that the dollar has strengthened somewhat as a result of these stronger economic reports and this will keep inflationary pressures subdued because of the stronger dollar's negative effect on commodity prices.

And sure enough, today we saw two more economic reports that point to continued

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improvement, the first one being the November retail sales report which rose by +1.3%, the largest increase since August. But the report was a bit deceptive in the sense that the bulk of the gains came from higher gasoline prices, and as we have said so many times in the past, the energy component of this report is calculated from the middle of October to the middle of November, not from the first of the month to the last day of November. Oil prices rose from a low level in mid-October to mid-November, which is why the gasoline component of the retail sales number showed a large gain, but this will become a negative factor in the December retail sales report, as it will show a large decline that will subtract from the overall number and could be interpreted as a sign that holiday shopping was lagging.

In addition, the mid-December U. of Michigan Consumer Sentiment Survey showed a larger than expected increase, to the highest level since September, and this was also construed as positive for stocks.

But then came the old "good news is bad news" syndrome once again, as these signs of better economic times were interpreted by the bond market that rate increases are coming sooner rather than later, and sure enough the yield on the 30-year Treasury bond rose to its highest level since August at over 4.5%.

And as a result, the dollar continued on its recent path of strength, as the Euro declined to its lowest level since early October, resulting in the eighth straight day of declines for crude oil to a price below \$70, which is where it should have been all along, and this is the longest stretch of price declines in six years. I guess if the frustrated bulls want to force the price back up, we will soon hear stories that Israel is planning to attack Iran's nuclear facilities, and how many times did we hear that one last year when oil prices were manipulated to their all-time record high of \$147 a barrel. And as the dollar strengthened, gold is selling off after being as high as \$1,142 earlier this morning, and it did get to as low as \$1,110, and the gold super bulls are also starting to get a little religion as well as the oil bulls. This dollar strength, if it does continue on the anticipation of higher rates, will continue to diminish commodity values. And let us also not think that central banks are so smart

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that when they take a particular action in the gold market that this is an indication of higher prices, as India's sales have recently been used as an argument for higher prices because they must "know" something. Let us remember that the Bank of England, under the direction of Gordon Brown, now the Prime Minister but then the Chancellor of the Exchequer (similar to Treasury Secretary in the U.S.), sold most of England's gold supply in 1999 right at the historically low price of \$255 an ounce, so what do these central bankers know about gold? Therefore, this recent central bank buying becomes a difficult argument to make for sustaining further price rises.

What is interesting today is that the Nasdaq/Dow ratio is poor, even when the market was on its best levels of the morning, with the Dow ahead by +64 while the Nasdaq could muster a gain of only +6 points at the time,. Early in the session the ratio was better but the large technology leaders that have done so well this year are selling off, and the stronger dollar is being used as the excuse for that dynamic, but other multinational stocks such as the large consumer oriented ones, are doing well, so that argument certainly does not hold either. It is perhaps a bit of profit taking in the group that has done so well this year and perhaps some sector rotation into other areas that have done poorly lately, like some financials. What is also helping the Dow to do better than the Nasdaq is that the large aerospace and defense equipment manufacturer, a Dow component is doing well on a raised profit forecast while the technology stocks could be hurting a bit due to a weakened forecast from a large manufacturer of analog and mixed-signal integrated circuits.

As the third quarter earnings season is over, profits are down -14%, as 80% of the S&P companies did manage to beat the estimates, which is a record. 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, 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. According to the analysts, for 2010, earnings are projected to increase by +26%,

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followed by earnings increases of +22% in 2011.

We have now seen nine 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 three quarters of 2009. Earnings have never been down for nine consecutive quarters.

We have had 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. Projections for the third quarter are currently for growth in the +2.8% range. According to Bloomberg Financial, 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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