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Daily Market Notes

Market Update:

DJIA:	**10454**
S&P 500:	**1109**
Nasdaq:	**2192**
10YR T-Note:	**3.37%**
EUR/USD:	**1.509**
Gold	**1218**
Crude Oil:	**76.80**

Prices Current as of 1:31 PM

Source: Bloomberg

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After Tuesday's strong upside surge to start the month of December, things chopped around yesterday, albeit with an upward bias. The financial stocks continued to be a drag on the Dow, which finished with a closing loss of -19 points. The reason for their weakness yesterday was a report from a banking analyst that financial reform on derivatives legislation could adversely affect the profit picture at the bank that is the largest derivatives dealer and a Dow component. This caused the rest of the financial components of the Dow to close lower as well.

Despite the Dow being lower, the Nasdaq managed to forge ahead once again, and the large online retailers hit new highs for the year to lead the upside charge. The fact that the Nasdaq/Dow ratio was strong all day was able to contain the losses on the Dow, as we had pointed out in yesterday's notes.

In addition, breadth numbers were actually strong at almost 2 to 1 to the upside, and the Russell 2000 Index of smaller stocks did well, so this was a contrary move to what we had been seeing lately, where the large blue-chip types of stocks were doing better than the smaller ones, which had previously been up more than their larger counterparts. The fact that the Nasdaq was up while the Dow was lower also showed that a broader number of stocks was participating in the advance. To illustrate that yesterday was more of an up day, of the Dow's loss of -19 points, only four components of that index accounted for -21 points just by themselves. So sometimes the Dow, which is made up of only 30 stocks, does not reflect what is going on in the broader market, and yesterday was certainly one of those days.

Helping to move things off of their intraday worst levels was the Fed Beige Book release at 2pm, which said that the economy improved "modestly, with some improvement in overall conditions." This offset concerns that the S&P now carries a price/earnings multiple of 22:1, which is the highest since 2002.

What was not so good about yesterday's market action was the fact that the VIX declined by -.80 on a day when the Dow also declined. This is the worst possible combination possible, as if the S&P and the Dow are going to close unchanged to lower, as they did, then let the VIX go up to move it away from the 20 support level which indicates an overbought equity market. This is what happened last Wednesday, the day before Thanksgiving and this closeness to the 20 VX level allowed the steep decline on Friday to take place. With a close at 21.12 yesterday, the VIX starts to get too close for comfort to the 20 level.

So the stage was set for today's early rally, with the Dow advancing by as much as +55 points courtesy of the financial stocks, One Dow financial component, which is the nation's largest lender, rose nicely on a report that it plans to pay back government bailout funds. Since they are the nation's largest lender, it was important news that they will repay the T.A.R.P. back using $26.2 billion of "excess liquidity" and $18.8 billion from the sale of securities. They plan to increase equity by $4 billion through asset sales and will issue $1.7 billion of restricted stock instead of year-end bonuses to some employees.

But after these highs were reached at around 9:50am, things started coming down as if someone "knew" that the November ISM Non-Manufacturing Survey, released at 10am, would show an unexpected contraction and drop to its lowest level in four months. This report is much more important the ISM Manufacturing Survey because the components of this report make up almost 90% of the economy. The poor report reflected weakness in consumer incomes and consumer spending amid a still fragile labor market.

But the negativity from this report was tempered to some extent by the fact that initial jobless claims fell to their lowest level in more than a year, the fewest since September 2008. In addition, third-quarter productivity rose at the fastest pace in six years, which means that companies are doing more with less, so to speak, not an encouraging sign for the labor market to improve as it has in the past. Also, November chain store sales came in weaker than expected. So the economic reports today certainly present a mixed picture and if the Dow does finish higher, commentators will emphasize the positive reports and events but if it finishes lower, they will point to the negative reports.

The day is shaping up now similar to yesterday, with the Dow down a bit after having declined by as much as -45 points on its low, and the Nasdaq up a bit, courtesy of the same leaders as yesterday the largest online retailers.

Most importantly, as the Dow hit its early high as mentioned above, the VIX fell to as low as 20.61, a little too close for comfort. It is now up more than the Dow is down, and this is good because it gives stocks room to go up if tomorrow's important jobs report is not negative.

As we mentioned the consensus is for a decline of -125K, which would be an improvement from October's -190K. Yesterday ADP estimate came out at -159K, which is good because this means that the market can tolerate a loss up to that level because that number is already out there. Of course, anything better than the official consensus would be bullish, especially if the unemployment rate does not get worse than the current 10.2%.

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%, 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.

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: {Bloomberg Financial, Reuters, Associated Press}. 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.