

Daily Market Notes**Market Update:****DJIA:** 10412**S&P 500:** 1110**Nasdaq:** 2246**10YR T-Note:** 3.78%**EUR/USD:** 1.358**Gold** 1122**Crude Oil:** 79.69Prices Current as of
1:46 PMSource: *Bloomberg*

In a remarkable third day of the week yesterday, the major averages were able to put together their third straight up day for the first time since January 7, 8 and 11. It was also the best three-day performance since early November, as more economic reports that showed that the economy continues to recover sparked bullish upside market action once again. This will now be the second week in a row of market gains after four consecutive downside weeks during which time the S&P made a -9.2% correction from the January 19th high to the February 5th low.

Economic reports that showed better performances from the January L.E.I. and the February Philadelphia Fed Survey continued a string of better indicators that we have seen all week and put aside for the time being the concerns over the economic basket cases of Europe, which had spooked markets prior to this recent recovery. Strong earnings from a Dow technology component and a large Internet consumer issue also helped the upside sentiment as well.

So with the Dow showing a gain of +293 points in three days and investors feeling better, the Fed pulled the trigger at 4:30pm yesterday afternoon with the announcement that it had raised the discount rate to .75 from .50. This is the rate at which commercial banks lend to each other. They also insisted that this first rate move since December 2008 would not raise borrowing costs for consumers or companies. They said that the decision to raise this rate was a response to improved financial market conditions that now require less of a helping hand from them.

They tried to calm the situation by saying that "Like the closure of a number of extraordinary credit programs earlier this month, these changes are intended as a further normalization of the Fed's lending facilities. These modifications are not expected to lead to tighter financial conditions for households and businesses and do not signal any change in the outlook for the economy or for monetary policy." But financial markets had to view the announcement as a sign that eventually there will be some tightening of policy.

Let us also remember that before the financial panic that began in 2007 to 2008, the

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discount rate was usually a full percentage point above the federal funds rate that controls overnight lending between banks. And the Fed closed four emergency lending facilities this month and is preparing to reverse the more than \$1 trillion in excess bank reserves they have pumped into the banking system. So this discount rate increase will now encourage banks to borrow in private markets rather than from the Fed.

So naturally we saw a knee-jerk panic reaction in most financial markets in the aftermath of the Fed's late afternoon announcement, with the Dow futures declining as much as -98 points and the S&P and Nasdaq futures down by the same relative amounts. And the panic selling hit the Euro as well, with traders running into the supposed "safe-haven" of the dollar, and oil, gold, copper and other commodities followed dutifully to the downside. Then as the night wore on, these stock index futures steadily clawed their way back, as did the Euro and the aforementioned commodities as well. This illustrated that the initial panic to the Fed's statement was easing.

In fact, by the time the stock market was about to open, these various futures were only indicating nominal declines. And this is what we got, with the Dow reaching its low point around 10am with a loss of -53. Sentiment was helped to some extent by the January C.P.I. report, which rose only nominally in the headline number and actually declined in the core rate which excludes food and energy, for the first time since 1982. This decline was led by price decreases in new autos, clothing, housing and airfares. This benign reading is also a reason for the Fed to do nothing with the fed funds rate for a long time, late in the year at the earliest. This should take away some of the anxiety caused by the discount rate increase announcement. But what was disturbing about the announcement was that it came on the eve of an options expiration session, and the various closeout strategies that were going to be employed could have been thrown temporarily out of whack. Now I know that it is not the Fed's job to be a market timer, but these policy change announcements traditionally come in the morning, and it would have been cleaner, so to speak, if this statement were released this coming Monday morning.

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I guess they should nominate Tiger Woods for Fed Chairman or even for President, because unlike the two holders of these positions whose recent pronouncements on various matters relating to the economy invariably cause the market to decline, when Tiger took the podium at 11am the Dow was lower by -12 points, already starting to claw its way back from the early lows. It then proceeded to gain as much as +43 points as this is being written. And most of the market experts will say that the comeback was the result of the lower than expected C.P.I. number, but if that were the case, then why did the market make its low two hours AFTER this number was released and then decided to go positive around 11:15am?

And as stocks have improved, so has the Euro, as now investors are deciding to run out of the "safe haven" of the dollar all of a sudden, and commodities are also doing a bit better after their initial knee-jerk panic reaction lower as well, and these commodities like crude oil, copper and gold have been rising along with stocks this week even as the dollar did strengthen further. In fact, it is the industrial and commodity stocks that are leading the way higher.

Since today is options expiration, the market does tend to decline, and the Dow has given back half its gains as this is being written. If it does not decline today, there could be increasing vulnerabilities for next week if the VIX were to fall into the teens once again.

For the fourth quarter, the S&P companies are expected to show a profit gain of +80%, according to the consensus of analysts who follow these companies. But without the financials, which are expected to report gains of +120% just by themselves, according to analysts who follow financial firms 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. According to the analysts, for 2010, earnings are projected to increase by +29%, followed by earnings increases of +22% in 2011, as reported by Bloomberg Financial.

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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 now have gotten two consecutive quarters of positive growth, with the third-quarter at +2.2% and the first estimate of G.D.P. growth for the fourth-quarter at +5.7%, according to the Commerce Department.

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Disclosures

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