

**Daily Market Notes****Market Update:****DJIA:** 9206**S&P 500:** 988**Nasdaq:** 1951**10YR T-Note:** 3.50%**EUR/USD:** 1.414**Gold:** 940**Crude Oil:** 68.44

Unfortunately, as we pointed out yesterday, the fact that the major equity averages closed lower last week and the VIX also closed lower was the worst possible combination for stocks. When the VIX goes lower, stocks theoretically become more overbought, and this was the situation that stock faced yesterday.

A -6% decline in the Chinese stock market, its largest loss since November, which has now resulted in a cumulative decline of -16% after it had rallied as much as +90% this year got everyone bent out of shape, as did the fact that the Japanese economy expanded by "only" +3.7% versus expectations of +3.9%. Naturally Europe followed like lemmings on the downside, and the stage was set for a very nasty day here in the U.S.

Prices Current as of  
12:22 PM

Source: Bloomberg

And awful it was, with 28 of the 30 Dow components lower and breadth numbers overall were negative by -8 to 1. The worst hit groups were the financials, which have been the biggest winners in the rally, and also the materials stocks got sold off sharply as commodity prices went way down on the stronger dollar and weaker Euro. Also not helping was a poor report from a major home improvement retailer, which got the entire retail sector down as well. The only areas to show any sort of resilience was the healthcare stocks, on reports that the public option provision might be dropped from the Obama health care reform plan.

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And the VIX got its upside revenge on those who pushed it lower last week, with a large increase of +3.62 points versus a Dow decline of -186 points, which was exactly twice as much as it should have gone up. If stocks had to decline, then this is the best possible scenario, because if the stock market is going to decline sharply, then let the VIX go up more than it should, because then equities become more oversold and are susceptible to an upside recovery, the exact opposite scenario of what the market was setting us up for yesterday. In conjunction with the large rise in the VIX, there was huge buying of out of the money puts on the SPX index, which go out this Friday morning, and this buying did seem excessive and hopefully these buyers will be proven wrong at the end of the week.

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So far we are seeing a classic "Turnaround Tuesday" today, which is the tendency of the stock market to rally on the second day of the week after getting sold off the prior Friday and even more on the following Monday, like we saw the past few days. These early gains are coming despite a lower than expected July housing starts report, and a very low July P.P.I. report, which once again was terribly distorted by the sharp drop in energy prices from the middle of June to the middle of July. It is ironic that for the full month of July, energy prices were just about unchanged, but the energy component of the inflation numbers are calculated from the middle of the prior month to the middle of the survey month, and this certainly did distort the numbers in July. This means that the August P.P.I. and C.P.I. reports will come in higher than consensus, which will cause market "experts" to wring their hands over "budding inflation", just like they are pontificating about lower inflation after this month's reports were released.

Helping to steady things were some decent reports from a Dow retail component and a major discount retailer, so this is helping to bring some stability as well. And the financial stocks, which got whacked around to the downside yesterday, are digging in their heels once again, and this is helping to bring overall stability to the averages. Finally, there were some upgrades to three major technology stocks, which is giving the Nasdaq a good bid and is resulting in a favorable Nasdaq/Dow ratio, unlike yesterday when it was the weakest of the major averages.

The trick today is to go the distance so that investor confidence will again be restored after yesterday's debacle. In addition, what could make for some interesting dynamics as the day wears on is the fact that the VIX options for August expire on the close today and settle on the opening tomorrow, so there will probably be some manipulating around that situation as well, and it should be noted that the VIX is declining more than the Dow is rising, almost on a two to one basis similar to yesterday when it changed on a two to one basis in the opposite way as today.

The second-quarter reporting period comes to an end this week, and traditionally it is the retailers that always report late, so the lineup this week is as follows: tonight –

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Dow technology component HPQ; Wednesday – NTAP, BJ, PETM, DE; Thursday: GPS, ARO, RST, DKS, SHLD, FL, INTU, HNZ.

There will also be some important economic reports, and the lineup is as follows: Thursday: July L.E.I., August Philadelphia Fed Survey; Friday: July existing home sales and the August options expiration series.

Now that the second quarter reporting period is winding down, stocks in the S&P 500 are expected to report profit declines of -30%. This is after a first quarter decline of -33%. The projection is for a -20% decline in the third quarter, before a rousing gain of +62% 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.

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 and could continue through the third quarter of 2009, although most forecasters are now predicting positive growth for the third quarter. This would be the first time ever that the U.S. economy has contracted for five consecutive quarters, if that were in fact to take place. In fact, 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.*