

Daily Market Notes**Market Update:****DJIA:** 9304**S&P 500:** 998**Nasdaq:** 1969**10YR T-Note:** 3.49%**EUR/USD:** 1.425**Gold:** 945**Crude Oil:** 71.66Prices Current as of
1:22 PMSource: *Bloomberg*

Yesterday was a classic case of a "Turnaround Tuesday", which means the historic tendency of the stock market to rally on the second day of the week after having declined the previous Friday and by even more the following Monday. This is certainly the scenario that we saw these past few days, as the market's decline of Friday was doubled on the downside during Monday's very severe downdraft.

So things were primed for a comeback yesterday based on the aforementioned dynamic, and the better than expected earnings from two important retailers were put forward as the positive input of the day. A major Dow retail component and a large discount retailer both did well on their reports. These reports were mentioned as the fundamental factor that got stocks off and running, and the major averages never went into negative territory and finished close to their best levels of the day. In addition, three important technology stocks got price target upgrades, and did well as a result. This resulted in a strong Nasdaq/Dow ratio and this is something that usually portends a bullish day as well.

Donald M. SelkinChief Market
Strategist

(212) 417-8017

dselkin@nationalsecurities.com**Jason Wotman**Research Analyst
(212) 417-8264jwotman@nationalsecurities.com

And the VIX did an about face from Monday, when it rose by twice as much as it should have relative to the market decline. This was the result of complete panic buying of out of the money SPX puts that expire this Friday morning. As a result of this high level for the VIX, the stock market got itself into an oversold position which was also a factor allowing equities to recover nicely yesterday. And ironically, in a complete about-face from Monday, the VIX declined by twice as much as it should have relative to the stock market's advance. This could have put stocks in somewhat of an overbought position for today's opening.

It was reported today that 34% of fund managers are "overweight" equities in the month of August, and this is the highest percentage since October 2007, right at the top of the market. In July, only 7% of these managers were in a similar position, which means that as the market rose from mid-July to its highs in early August, it appears as if these managers, who were probably waiting for things to top out last month, were forced to "chase performance" in the sense that they felt that the upside train was leaving the station and they wanted to finally jump aboard, so to speak. It

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was also reported that sideline cash held by these managers declined to 3.5%, which was the lowest level since July 2007 and which means that there is not as much firepower around to fuel the purchase of stocks as there was earlier in the five-month bull run. This is perhaps the reason for the recent sharp sell offs we have seen in the past few days.

And sure enough, the stock index futures were indicating another day of gloom and doom, and once again the finger was pointed at China, which has now entered into a bear market because the Shanghai Index has declined -20% from its best levels. But this really has to be put into perspective, as at their best levels this market was up 90% for the year and is still up 53%, so what is wrong with that? There was also some concern that China's stocks were overvalued because the average price/earnings multiple in China was twice as high as it was for U.S. equities.

And after the little selling panic on the opening dissipated, with the Dow lower by as much as -85 points, things have recovered nicely, with the major averages showing good gains as this is being written. Leading the comeback are the shares of energy companies, on a recent strong rise in crude oil prices yesterday and today; healthcare stocks and consumer issues. It would be very positive if the market can end with these gains, as it would take away this "Panic sell if the Chinese stock market is down", which we have seen in recent years and certainly in recent days.

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 – NTAP, 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

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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

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