

Daily Market Notes**Market Update:****DJIA:** 9779**S&P 500:** 1066**Nasdaq:** 2127**10YR T-Note:** 3.44%**EUR/USD:** 1.471**Gold** 1017**Crude Oil:** 71.71Prices Current as of
1:21 PM

Source: Bloomberg

Similar to Monday, the market hesitated early yesterday, bouncing between small gains and small losses before deciding it wanted to advance once again, as all of the major averages made new highs for the year. These gains came despite the fact that the first two companies that reported earnings for the third quarter – the largest electronics retailer and a large supermarket chain – both came up short of expectations and sold off. But stronger economic reports on NYState Manufacturing and retail sales prompted investors to buy on the theme of economic recovery that continues to manifest itself. Never mind that the August retail sales numbers were distorted upward because of a huge gain in gasoline prices (not that more gasoline was bought, it was the same amount being bought at higher prices which distorts the number upward because the total dollar outlay is higher. We have also seen this number getting distorted on the downside as well when gasoline prices decline even though the same number of gallons is sold). To be fair, there were some increases in other areas of consumer spending as well, which were a truer reflection of a recovery.

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As a result of these reports, the entire industrial sector did very well, with four Dow industrial components accounting for almost 50 points of its entire 56 point gain.

And the VIX closed at 23.42, which is still about 1.00 point away from its support level at 22.48. So this means that the Dow theoretically has 100 points to go on the upside.

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And the bullish party is continuing today, as the Dow is trying to accomplish its new upside objective in a rather fast manner. The initial impetus for this strength was that the August Industrial Production number came in slightly better than expected, with a gain of +0.8% against the consensus of +0.6%, and the July number was revised slightly higher as well. Capacity Utilization was also revised slightly higher for July and the August number came in a little better than expected also.

This got things out to a nominally higher start, but the market did not dip into negative territory as it had done the first two days of the week. From this point on, with the dollar making new lows against the Euro at 1.47 and gold blasting to \$1,016, this was

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all that the equity bulls needed to see, as the old "risk appetite" dynamic reared its head again and the old "risk aversion" dynamic went out the window.

And once again the irony is that the economic recovery theme is completely overwhelming the fact that every company that has reported third-quarter earnings so far has been disappointing - today both a large computer software products company and an agricultural equipment manufacturer are down on their reports. Now it is true that this is just the start of the reporting period, and we hear from the important enterprise software management company tonight, but the weakness of the dollar and the strength in commodity prices ultimately cannot be good longer term for stocks, especially if the earnings season continues the way that it has started. Not that this is any sort of tip off as to how its numbers are going to come out later, but despite a very strong day in the Nasdaq, the shares of this software company are trading down ahead of its report.

The financial stocks, which took the day off yesterday, continue to rocket ahead to the upside, and the large technology issues are once again leading the charge higher on the Nasdaq. And even the VIX is cooperating, down only -.24 to 23.17 versus a gain of +73 for the Dow as this is being written, so this gives the Dow theoretical room to rally another 70 points from here.

Perhaps this latest acceleration to the upside was prompted by yesterday's comments from Chairman Bernanke, who said that "the recession is likely over, but the pace of growth in 2010 will be moderate." Of course, these sentiments have been expressed very often lately by many market observers.

Earnings continue tonight with: ORCL; Thursday: FDX, PALM and PIR. So there could be an impact from what these early reporters have to say.

The economic reports the rest of the week are: tomorrow: August housing starts and building permits, September Philadelphia Fed Index; Friday: September quarterly options expiration. So there is certainly enough on the table to provide reasons for the market to move one way or the other.

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There has been a lot of controversy recently over the shares of UNG, which is the ETF for natural gas prices, and is not a leveraged one. After declining below \$9 two weeks ago as natural gas prices hit a seven-year low of \$2.50, the stock rallied as high as \$11.60. This gain has corresponded to an increase in the price of natural gas itself to as high as \$3.68 today, so it appears as if a bottom could finally be in for this item after a very long move down. We would urge people to look at UNG on pullbacks and one can sell what appear to be high priced covered calls against the purchase.

During the second quarter, stocks in the S&P 500 reported profit declines of -29%. 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. Projections for the third quarter are for some modest growth in the +1 to 2% range. 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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