

July 27, 2009

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Daily Market Notes

Market Update:

DJIA: 9079

S&P 500: 978

Nasdaq: 1958

10YR T-Note: 3.72%

EUR/USD: 1.421

Gold: 953

Crude Oil: 68.15

Prices Current as of
11:53 PM

Source: Bloomberg

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The market ended another strong week to the upside on Friday with further gains, and once again the market was able to end with a late upward push after vacillating between small gains and losses for most of the session. This shows that the path of least resistance is still higher for the time being. In fact, with Friday's gains, which were led by the Dow, its two-week rise was its best run in that time period since March 2000, a gain of 11.6%.

The advances the past two weeks have been primarily a function of the better earnings picture for the second quarter, and of the approximately 200 S&P companies that have reported so far, 77% of them have beaten the estimates, This compares to the long-term average of 61% and is the highest percentage since records of this sort have been kept since 1994. So far, second-quarter earnings have declined -31% from the same period a year ago.

Despite the fact that the major averages were nominally higher on Friday, breadth numbers were quite positive at 19/11, which means that more stocks are participating in the advance, and this is further evidenced by the fact that 85% of stocks are above their 50-day moving average. This is a sign that a correction could occur any time soon, and the fact that the VIX closed at a low 23.09 also shows that the market is very overbought as well. One can also argue that the better earnings numbers have been a function of cost cutting rather than revenue growth, which has actually declined around -3% so far for those companies that have reported.

The Nasdaq finally broke its 12 straight days of gains, the longest since 1992, courtesy of poor earnings from some important technology companies. Remember how the house that is now considered the premier one in terms of the profits that they have been able to generate recently upgraded the largest applications software developer at 24 after it had rallied 60% from a low of 16. Another large house raised its year-end target on the S&P from 760 to 930, which means that they had been bearish all during the rally of the past four months and got forced to follow the market higher, missing out on the overwhelming majority of the up move. These types of

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reactive analysis is a classic example of waiting for the market to make a move rather than anticipating the move, and could be another sign that a correction could be around the corner.

Another sign that things could perhaps start to cool off is that mutual fund inflows the past week reached \$1.5 billion, which is the highest since February 2008, and is another sign that people who had been skeptical of the rally in its early stages are finally jumping in after the S&P has already advanced by 46% from its March low.

As we have been pointing out, behind the huge up move in stocks, the best rally off of a bear market low since 1975, there are potential danger signs in that the price of oil is moving higher, longer-term interest rates are also moving up, and the dollar keeps declining. These are potential inflationary factors which could potentially undermine any sort of sustained economic recovery hopes.

Today's market action could be a sign that perhaps we have reached a near-term top after all of the euphoria and raised analysts targets. After a spike higher as a result of the June new home sales numbers, which at an 11% gain was the most in eight years and a Dow gain of +30 points, things have gone into reverse as this is being written, with the Dow now showing a decline of -20 points.

The decline is being attributed to disappointing results from a health care benefits company, a fiber optical cable manufacturer and a Dow integrated telecommunications company. But these results were known before the opening, and it seems like a classic bull trap that the market went from a steady type of opening to the +30 point gain to its current loss of -20 points. Today's highs on the a major indexes will now be the resistance that the market has to overcome in order to move higher.

And continuing to work its potentially negative effects is the fact that the yield on the 10-year Note continues to rise, and this could be a function of the fact that there will be a record \$115 billion in note auctions this week. It is typical of the bond market to

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sell off ahead of major auctions in order to cheapen the prices and induce buyers to pick up this government paper at higher yields. But this is a potential negative for stocks as interest rates in fact do move higher. The Euro keeps rising, and this could ultimately hurt as well, as could the continued rise in the price of oil.

The economic reports this week will be on the more heavy side than last week and the lineup is as follows: Tuesday - May CaseShiller home price index, July Consumer Confidence Index, Richmond Fed Manufacturing Index; Wednesday - June durable goods orders, Fed Beige Book; Friday – first look at 2Q G.D.P., Chicago and Milwaukee Purchasing Managers Survey.

The earnings lineup this week is as follows: tonight: AMGN, BWLD; Tuesday: DB, ODP, PNRA; Wednesday: AET, MT, COP, MCO, TWX, ESRX, WLP, HES; Thursday: CL, EK, K, MA, MET, MOT, SNE, DIS, TRV, DOW, XOM, ADP, BDK; Friday: CVX, PSEG. This means that there are three Dow companies reporting.

Now that the second quarter reporting period is upon us, stocks in the S&P 500 are expected to report profit declines of -25%. 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.

The best that can be said about these dire forecasts is that the bar has been set so low that any time a company says things were not as bad as expected, this leaves the potential for a rally in those stocks, such as we saw already last week. Let us also remember that during the first quarter reporting period, even though the first quarter earnings were lower, two-thirds of the companies that reported did beat the lowered expectations.

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Overhanging the market are the negatives of seven 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 quarter of 2009. If as expected, earnings come in lower for both the second and third quarter of 2009, this will be the first time ever that there have been nine consecutive quarterly profit declines.

We now have three consecutive quarters of negative G.D.P. growth which started in the third-quarter of 2008, and has now extended through the first-quarter of 2009 and could continue through the third quarter of 2009, although some 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.

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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: Bloomberg Financial, Reuters Financial. 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.