

Daily Market Notes**Market Update:****DJIA:** 9834**S&P 500:** 1073**Nasdaq:** 2149**10YR T-Note:** 3.48%**EUR/USD:** 1.479**Gold** 1016**Crude Oil:** 71.60Prices Current as of
12:40 PM

Source: Bloomberg

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Stocks took a look at the Euro, oil and gold yesterday and decided that if these items were lower, then stocks have to go lower as well, as "risk aversion" returned for a day after having basically disappeared for the past several months as all of these aforementioned items have been on upside tears. It is difficult to believe that stocks basically look to these outside situations to decide which way they want to go, but all one has to do is put charts of stocks, the Euro, oil and gold next to each other and the similarity in their price behavior is uncanningly similar. Without belaboring the point any further, equities really cannot go consistently higher if these other items rise, because these items are inflationary, which is a situation that cannot support equities on the upside. If one takes this reasoning a step further, then it can also be argued that the rise in the stock market lately has little to do with traditional financial metrics. Despite the Dow and the S&P ending slightly lower yesterday, the Nasdaq actually ended nominally higher due to strength in the large search engine company which has been on an upside tear lately, and also by strength in the large biotechs.

Perhaps the most potentially friendly dynamic is that the VIX hit a low of 22.48 on September 11th, at which time the Dow was 9605. From that time until yesterday's close, the VIX actually rose to 24.06, and if one looked only at the VIX the conclusion would be that stocks declined during that time. But during this time, the Dow closed at 9779. So this is the most bullish possible combination, namely a higher VIX and higher stocks, because with the VIX currently at 23.41, it gives stocks room to move higher to get the VIX back to its old support level of 22.48, which means that theoretically the Dow can rally around 100 more points, which could get it to over 9,900.

It was pointed out that the S&P is now 20% above its 200-day moving average and this overbought condition has taken place in 1932, 1938, 1975, 1985 and 1986. On every occasion in the past, this overbought situation led to pullbacks of 12% on average three months later before an eventual recovery led to average gains of 13% one year later.

And after a little strength in the dollar and slight declines in oil and gold for the past

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two days, the old disappearance of risk aversion is back with a vengeance today, as the dollar has collapsed once again to a new low against the Euro. This has led to large increases in the price of both oil and gold, and this is all that stocks needed to see to get their upside legs back once again. Overseas markets got going to the upside as the Asian Development Bank raised its economic growth forecast for the region, predicting that Asia, excluding Japan, will grow by 3.9% in 2009.

The main gainers today are the financials, which were a little on the weak side recently, and which got upgraded by sector analysts at a few of the large brokerages. In addition, some technology stocks are up on the raising of price targets in some of the large members of this group. These financial and technology gains are contributing to strength in the major averages.

Also helping today is that we finally got some good earnings reports, from companies as diverse as a cruise liner, a seller of used cars and light trucks, a supplier of global economic and financial data, and a manufacturer of railroad freight cars. This finally breaks the negative scorecard, which was 0 for 11 coming into today. Obviously there is a long way to go in this area.

As was previously alluded to, the dollar is getting clobbered ahead of the F.O.M.C. interest rate decision tomorrow, at which it is almost universally predicted that rates will be left unchanged. The only drama will be in the Fed's statement which could say that "tight" bank credit is slowing down growth, and this is the result of the Fed ordering banks to raise more capital and toughen their lending standards, something that all of us have probably personally witnessed this past year. This restricted bank credit could mean that the economic recovery in the U.S. will be slower than the Fed anticipates, which is the main reason that rates will be kept close to zero for a long time and this could be one of the reasons why the dollar has been under so much pressure as investors gravitate toward the higher yielding currencies. Ironically, this syndrome has been responsible for the stock market moving higher.

Another item to keep our eyes on will be the statement as to whether or not the Fed

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will decide to extend the end date of the \$1.45 trillion program to buy mortgage backed securities, and this program is now set to expire at the end of the year. There is also the question of whether or not they will slowly reduce the size of the purchases.

This week's earnings scorecard continues with more third-quarter earnings reports trickling in, and there will be an important one on Thursday, with RIMM coming out with its numbers: Wednesday: BBBY, GIS, RHT; Thursday: COMS, FINL, RIMM, RAD; Friday: KBH.

The main economic event this week will be another F.O.M.C. meeting at which interest rates will be held at current record low levels. There will also be a number of economic reports, the most important of which will be the various housing statistics – Wednesday: Fed interest rate decision and statement; Thursday: August existing home sales; Friday: August durable goods orders, U. of Michigan final September Consumer Sentiment Survey and August new home sales.

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.

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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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