

**Daily Market Notes****Market Update:****DJIA:** 9248**S&P 500:** 995**Nasdaq:** 1968**10YR T-Note:** 3.72%**EUR/USD:** 1.416**Gold:** 949**Crude Oil:** 79.29Prices Current as of  
12:40 PM*Source: Bloomberg***Donald M. Selkin**Chief Market  
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After four straight weeks of gains, topped off by Friday's better than expected jobs report, things finally took a breather yesterday, as the price/earnings ratio for the S&P reached 18.6, the highest since December 2004. This is above the historical average around 17, and therefore one could argue that stocks are a bit overvalued based on earnings through the second quarter. Those earnings showed a decline of -30% from last year from the 450 S&P companies to have reported. These companies have beaten the analyst's estimates by an average of 10%, which is also the highest in five years.

But similar to the price action of the past few weeks, stocks did manage to finish above their worst intraday levels, as the Dow was able to cut a loss of as much as -80 points to a close of only -32 points. This is consistent with the fact that the Dow has not undergone a loss of triple digits since July 7th.

For the second day in a row today, stocks are lower, and it is once again a continuation of the corrective process after the S&P has undergone its best rally since the 1930's rising almost 53% from its March intraday low of 666 to last Friday's intraday high of 1018. Stocks took another intraday leg down after it was reported that wholesale inventories declined by more than expected for a record 10th consecutive month, but sales did rise by +0.4% for a second straight month, the first back to back increases in a year. This higher than expected inventory decline could lead to a downward revision in 2Q G.D.P., which is the reason why this number is being interpreted negatively. Since it shows that production is currently lower than demand, it means that potential increases in production could lead to sustained economic recovery next year, which could ultimately be friendly for stocks.

On an even more potentially positive note, second quarter non-farm productivity rose at the fastest pace in almost six years, and labor costs fell by -5.8%, which was the most in eight years. This was obviously the result of cost cutting through corporate downsizing, and this lack of wage pressures will certainly keep a lid on inflation, which has to be an ultimate positive for equities.

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Hurting the market today were some downgrades in the banking sector, and this group has been the big upside leader the past several months. Both the large money center banks and the regional banks in particular are leading the way down. In addition, there were some analyst downgrades of individual stocks, and the strangest one here is that a wireless communications stock was \$3 even before the downgrade. It had cut its dividend a year and a half ago, so who cares about this one and why is a downgrade of this type of stock being interpreted so negatively after it has basically collapsed in price?

There is also some anxiety over the Fed statement that will be released tomorrow afternoon. It is a given that they will hold the federal funds rate at its current level of between zero to ¼%. The main question is what they will say about the prospects of the economy going forward and how this might affect their interest rate policy for the remainder of this year going into next year.

The main dynamic today will be to see if the Dow can close with a loss of less than -100 points, since losses of worse than -100 points have not taken place since July 7th when stocks were in that four week corrective period from mid-June to mid-July, before the latest upward leg took place.

Since the earnings this week are on the light side, with some retailers winding down the clock, such as WMT, JCP and M later in the week and AMAT tonight, the focus will be on economic news, and there is plenty of that. Wednesday will be particularly important because we will get the FOMC interest rate decision, which will keep the federal funds rate at its current low level but which might give some clues as to what the thinking is as to whether an eventual rate increase will be in store, as the bond market is trying to force the Fed to finally raise rates in response to an economy that appears to be on the mend. There will also be the June trade balance which is an old number, as it has already been factored into the 2Q G.D.P. estimate. Thursday sees an important one in the July retail sales report and the week ends with Friday's July C.P.I. report, July Industrial Production and Capacity Utilization and the preliminary August U. of Michigan Consumer Sentiment Survey.

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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.*