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Daily Market Notes

Market Update:

DJIA:	**9305**
S&P 500:	**997**
Nasdaq:	**1968**
10YR T-Note:	**3.34%**
EUR/USD:	**1.425**
Gold:	**975**
Crude Oil:	**67.68**

Prices Current as of 12:11 PM

Source: Bloomberg

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Let us review what has occurred in the markets since the last time this newsletter was written on Friday, August 21st:

On that day, stocks made a huge gain, mainly because of the positive reaction to the July existing hone sales report, which rose by a very strong +7.2%, and this was the largest increase since August 2007, and was the fifth straight month of increases. It was also the fourth straight gain for the major averages, on their way to a string of eight straight up sessions, which unfortunately ended this past Friday.

The fact that the VIX only declined nominally on August 21st when the Dow rose by +156 points was the prime factor that allowed the market to rise for the first three days last week, as it stayed further away from the support level of 23, by closing around 25 on that day. For those first three days of last week, the market was able to extend its advances, with the Dow reaching a new intraday high for the rally, at 9620 on Tuesday, August 25th. These three days saw further encouragement from economic reports, such as the August Consumer Confidence Index, which gained for the first time since May. In addition, the National Home Price Index showed an increase for the first time in three years. Finally, for better or worse, the President announced that he is nominating Fed Chairman Bernanke to a second term.

Unfortunately on the day that the Dow made its high, Tuesday, August 25th, at 9620, the VIX declined to 23.68, very close to the support level of 23 that has stopped further advances these past several weeks. For the next two days, the major averages were able to extend their advances a bit, as strong reports on July durable goods and new home sales kept the bulls in charge. Then on Thursday, August 27th, the second revision of the 2Q G.D.P. showed that the decline was unchanged at -1%, when a slightly worse decline was expected. This was the fourth straight decline for the U.S. economy, which now appears to be the final one, as most forecasters are projecting growth for the 3Q and beyond.

After a close of 9580 on Thursday, August 27th, the market was greeted with ostensibly good news on the morning of Friday, August 28th, as technology companies DELL and INTC came out with good news, the former with profits and revenue that exceeded forecasts and the latter with an increased third-quarter revenue forecast. In addition, there was more friendly data as home prices edged up for a second straight month and registered their first quarterly gain since 2006. July new home sales rose by a strong +9.6% and July durable goods orders increased by +4.9%, and both of these figures were much better than the consensus. In addition, the August Chicago Purchasing Managers Survey rose to its highest level since last September, reaching a level of 50, which is the dividing line between contraction and expansion. This “good news” prompted what turned out to be the last gasp of the bulls for the time being, as the Dow unfortunately could not hold an early gain of +50 points to a now new recovery high at 9630, and slid as the day wore on, losing -86 intraday points to close down on the day, at -36 to 9544.

At the same time that the Dow made its intraday high on the 28th, the S&P also attained its best level for the recovery of 1038, which represented a very strong advance of +56% from the March intraday low of 666. So this 1039 level finally proved to be the stopper, as the major averages continued their downward move the first two days this week as well.

Despite this very late weakness in August, the major averages were still able to complete their sixth straight month of gains, and this was the longest stretch of gains since January 2007, but it appeared that by the end of the month the market was not reacting as strongly to ostensibly good news as it had been earlier. There was also the technical situation where an astounding 93% of S&P stocks were trading above their 50-day moving average, certainly a sign of an overbought condition.

And so the market entered the dreaded month of September yesterday, and historically this month is the worst of all for equities over time. But just as the calendar changed from August to September, it seemed as if the market was about to reverse this historically negative time of the year. The Dow raced out to an early gain of +61 points due the August ISM National Purchasing Managers Survey showing an expansion for the first time in 19 months and its best two-month gain since 1983. In addition, July pending home sales rose by +3.2% for a record sixth consecutive gain.

Then all of a sudden the bottom dropped out, as the market underwent a vicious decline starting around mid-morning, to as low as a Dow loss of -204, which meant that it basically declined from its best level of the day by -265 points. It ended slightly off of these worst levels with a closing loss of -185, its steepest one day decline since mid-August. In addition, the VIX, which had been hovering in the 24 - 26 range for several weeks, shot up to its highest level since July 9th, to 29.15. This was the old fear factor coming back into stocks after several weeks of fairly small moves and somewhat of a complacent attitude that things are going to continue to get better in terms of the economic recovery and ultimately, stock prices.

The decline was led by a huge downside turnaround in the financial issues, both large and small. In fact, the S&P Financial Index declined by -5.3%. This was led by large percentage declines in the shares of AIG, which had run up by +745% from very low post- split adjusted levels. The declines were the result of some vague rumors that banks will report more losses. Then of course there is always the reason put forward that there is concern that the global rally in equities this year has outpaced the prospect of an economic recovery. There is some justification to this line of reasoning because the price to earnings ratio of the S&P 500 has reached 19, which is the highest ratio since June 2004.

Things started out lower today, with the Dow losing as much as -48 points as a result of the ADP prediction for this Friday's jobs report for a loss of -298,000 jobs. Apparently this was worse than the consensus for a loss of -228,000. But let us also remember that their predictions generally have been way off, primarily to the negative side. So why these people have any credibility is always beyond me. In addition, the July factory orders report came in with a gain that was less than the projected one. On the other hand, productivity for the second quarter did rise at the fastest pace in six years primarily because of lower labor costs.

Since that lower opening, the major averages have managed to claw their way back to small gains, even as breadth numbers remain slightly negative. Financials remain under somewhat of pressure, but the Dow is being supported by gains in its energy components.

The next big event will be the 2pm release of the F.O.M.C. minutes for the August 12th meeting. As always, this could push stocks one way or the other depending on what they say about the potential for economic recovery.

Of course, the major report of the week will take place on Friday morning, as the August jobs report will be released, and current projections are for a decline of -228,000 as mentioned above and a slight increase in the unemployment rate back up to 9.5% after the small decline down to 9.4% last month. We will discuss this in more detail tomorrow.

Now that the second quarter reporting period is over, stocks in the S&P 500 have 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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