

Daily Market Notes**Market Update:****DJIA:** 9555**S&P 500:** 1034**Nasdaq:** 2062**10YR T-Note:** 3.51%**EUR/USD:** 1.456**Gold:** 995**Crude Oil:** 72.14Prices Current as of
1:05 PM

Source: Bloomberg

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The market advanced for the third day in a row yesterday, and this time the motivation for the upside was something we have seen many times this year—namely that when the dollar weakens and commodity prices rise as a result, this is somehow bullish for stocks because it shows that investors are becoming more “risk averse” and are willing to sell the supposed safe haven of the U.S. dollar and move into more risky assets like equities. And the dollar’s weakness sort of feeds on itself, as commodities like gold, crude oil, copper and others rally not on their own fundamentals but simply because they are priced in dollars, so that a weaker dollar makes these items cheaper in foreign currency terms.

There was another reason for the decline in the dollar to the lowest level in almost a year against the currencies of six major U.S. trading partners, and that is because currency traders are now funding their buying of higher yielding currencies by borrowing dollars to invest in other markets. This is the result of still record low borrowing costs for the London interbank offered rate, or Libor, which means loans in dollar terms.

So after the long Labor Day weekend, stocks in the U.S. opened higher and stayed higher all day, obviously led by industrial, metal and resource type stocks. The Dow did lag on a relative basis versus the other major indexes because of weakness in the major food and beverage company on a takeover bid, and some sluggishness in financial issues.

Otherwise, the most positive dynamic to emerge from yesterday’s session was that despite the market being up all day, the VIX also opened higher and closed higher, which is the most bullish scenario possible because the further away the VIX moves from its support level at 23, then the higher that the stock market can go. And we have been pointing out time and again that this is the most misunderstood situation by financial commentators who salivate over the fact that traders are “buying downside protection” which in their way of thinking means that the stock market is about to decline. Since the major

averages are close to their highs for the recovery that has been underway for
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the past six months, this strategy of buying downside

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protection has been a failure.

And sure enough, that dynamic yesterday of the major averages and the VIX both being higher has resulted in a higher opening this morning. If stocks can go the distance today, this would be the fourth straight day of gains, and if the market closes where it is now, then the dreaded month of September would show gains so far.

There is no specific reason for the advance other than just continued momentum after recent gains the prior three days. There were some upgrades here and there, and once again the financials are lagging a bit and the stars today are some technology stocks which are rising on upgrades. The major computer and mobile communication device company is trading water ahead of its media event later today. There has been a historical tendency for the shares to decline after these types of presentations.

As a result of the gains in certain technology stocks, the Nasdaq/Dow ratio is strong, and this should lend support as the day progresses. And once again the dollar continues to fall apart against the other major currencies so commodities like oil and gold are rising again, with the latter having the continued drama at the \$1,000 level. But copper, which has been the best performing commodity of all this year, having more than doubled, is taking a well-deserved breather. Not all commodities have benefited from the dollar's weakness, and corn and wheat have been trending much lower as a result of potentially record size crops. This is a situation that could keep inflation under control relative to the food cost component.

The next event that could or could not have an effect on trading is the 2pm release of the Fed Beige Book of economic conditions. Otherwise, the VIX is finally doing what it is supposed to do, namely decline on an up day for stocks, and once again this proves the nonsense that some financial commentators put forward when the VIX rises on an up day in the market.

Earnings season for the second quarter is over, so the only input from profit reports is

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that there is always the potential for negative pre-announcements as the month of September moves on and the actual reporting starts to take place in early October.

Economic reports are also light this week, with: later today: the Fed Beige Book of current economic conditions; Thursday: July trade balance; Friday: U. of Michigan Consumer Sentiment Survey for mid-September. None of these reports look like potential market movers.

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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