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Daily Market Notes

Market Update:

DJIA:	11876
S&P 500:	1285
Nasdaq:	2701
VIX:	18.35
10YR T-Note:	3.38%
EUR/USD:	1.370
Gold	1335
Crude Oil:	91.86

Prices Current as of 1:15 PM

Source: Bloomberg

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Friday's session was sort of like a replay of a bad movie which we have all seen before. In other words, we have had a market that had been "sleepwalking higher", as one market observer noted, with the Dow having advanced for eight weeks in a row, the number of stocks trading above their 200-day moving average at the highest level since last April, 75% of the 183 S&P companies reporting so far for the fourth quarter beating their numbers, market touts and cheerleaders gleefully raising their price targets for the major averages, and most importantly a VIX that had gotten dangerously close to its support level.

So the Dow made a nominally higher start, up by 23 points after the first estimate for fourth-quarter G.D.P. showed a gain of 3.2%, with consumer spending at its highest level since the first-quarter of 2006 and exports at their highest level since 1980. In addition, final sales excluding inventories rose by 7.1%, which was the highest level since the second-quarter of 1984. For the entire year, G.D.P. rose by 2.9%, the highest since 2005. In addition, the final January U. of Michigan Consumer Sentiment Survey declined by less than expected from December's number.

But as the Dow made that brief foray into positive territory, our old friend the VIX declined as low as 15.92, which gets it close to the 15.30-40 support area, and this appears as if it is definitely going to hold on the downside for the foreseeable future. And let us remember that it is always easier to identify downside support levels than it is to pick upside resistance levels, because when the stock market goes into a panic mode like it did on Friday, the VIX can get pushed to higher than reasonable levels, as investors think that "buying downside protection" is the way to go when there is the perception that the market is going to take a severe dive.

So after that brief foray higher, which turned negative around 10am, things steadily cascaded downward, with the selling intensity reaching panic type of levels, as breadth numbers deteriorated to a horrible negative 1 to 5 ratio and

the S&P and the Nasdaq underwent their largest one-day declines since August 11th and the Dow declined by the most in two months. By falling 166 points, the Dow ended its eight-week winning streak and the S&P and Nasdaq ended lower for the second week in a row. As stocks cratered, the so-called "flight to safety" trades were put back on, as gold prices rallied after having been in a severe correction lately, the dollar gained against the Euro, breaking its recent period of weakness, the bond market underwent a huge rally and worst of all, crude oil prices, which had also been in a recent downtrend, decided to make a very large gain of almost $4 a barrel.

So what happened? The anti-government street demonstrations, which had been going on all week, apparently caught the attention of investors who used this turmoil as an excuse to sell the market off. The reasons offered were the usual nebulous ones, such as "fear that the rioting could spread to other countries", as this activity was responsible for bringing down the Tunisian government recently; "concern" that the Suez Canal, which ships around one-third of world oil supplies, could be closed down; and the usual blah, blah about crises of various sorts.

And our old friend the VIX went crazy on the upside, rallying by a huge amount, 3.89 points to 20.04, which was its largest percentage gain since May 20th, right at the depths of the European debt crisis. It was also the highest level since December 1st, and once again proves that resistance levels on the upside are more difficult to quantify than support on the downside, as the high 18 area had served to halt stock market setbacks since December 6th.

There was some negative earnings news from important companies that also contributed to the weakness, as the largest Online retailer, one of the high-flying Nasdaq darlings of late, sold off big-time, as did the maker of flash data storage products, which contributed to the weakness in the Nasdaq. In addition, a large U.S. automaker, another strong performer in the past year, came up with a poor report as well. Finally, the largest software company,

which in its own restrained manner had also been doing better lately, released its report right before the closing bell late Thursday in what had to be a strange situation on its own. It initially rose after the results beat expectations, as it usual sycophantic chorus of analyst support clapped their hands once again and raised price targets to as high as 37, but it then sold off sharply on Friday because the revenues from Windows came in well below expectations. It appeared as if this a brutal attempt to make sure that the huge number of buyers of calls from the 28-30 levels got a sad comeuppance for their troubles, as the stock finished below 28. As I always say, let the buyer of these out of the money calls before earnings beware.

So with all of the dire predictions for a continuation of the selloff today, the market has so far confounded its bearish advocates by putting in a steady performance to work off some of the oversold conditions created by the panic selloff from Friday. But some of the developments in the outside markets could be troublesome, as crude oil prices are rallying again, to over $91 a barrel on supposed fears of shutdowns of Suez Canal oil shipments. This is leading to gains in the energy sector stocks, led by the largest energy company after its strong report this morning. In addition, the financial stocks are doing better after shaky performances lately. The largest semiconductor company did it again for the second time in a year, namely lower their forecasts after raising them during their regular earnings conference call a couple of weeks ago, at which time the market rewarded their great report with a selloff in the stock, and the same thing has repeated itself and no wonder why people are skeptical about this company. This time it is a design flaw in a recently released chip that is the cause of the lowered forecasts.

The Dow got as high as a gain of 65 points at its best level and the VIX is declining from the extremely high level over 20 that it reached during Friday's Egypt-induced panic selloff. It is down by .73 to 19.31, so it now appears as if the 20 level will become resistance to further market selloffs. Breadth numbers are doing very well relative to the advances in the major averages, with a

positive 3 to 1 upside ratio, which once again is proving that setbacks in the market are going to be used as buying opportunities. It also appears that the 12,000 Dow level and the 1,300 S&P areas will continue to be resistance and could also mean that the market could be in a trading range as we enter the historically treacherous month of February, the second worst for stock performance after September.

The Euro is rising once again against the dollar after a very brief flight to quality knee-jerk reaction back into the dollar caused by the Egypt situation on Friday. Apparently the worry here is that the E.C.B. will raise interest rates soon in response to the fastest gains in inflation in two-years there.

Earnings reports continue this week, with over 100 S&P companies reporting, and we hear from the next Dow component tomorrow, with PFE reporting its results. We also get the January payroll report on Friday, with preliminary estimates for a gain of around 140,,000 jobs and we will discuss this in greater detail later in the week.

The S&P trades at 13.5 times forward earnings, and 15.2 times current earnings, if one assumes that this year's earnings are going to come in at $82 for the S&P and $92 for 2011. The average P/E multiple for the S&P going back to 1954 has been 16.2.

According to the sector analysts who follow these companies individually, for all of 2010, earnings are projected to increase by +33%, which would be the most since 1988, followed by earnings increases of +14% in 2011, as reported by Bloomberg Financial, and this would be the largest two-year advance since the period ended in 1995. First quarter profits rose by +52%. Second-quarter profits rose by +49%, the third-quarter rose by +28%. The fourth-quarter is supposed to gain by +24%. If these numbers do come to fruition, then S&P

earnings should be around $83 for 2010 and between $93 to $95 for the S&P in 2011. This would equate to around a 14% gain this year. The highest ever earnings for the S&P in one year took place in 2006, at $88.

After four consecutive quarters of negative G.D.P. growth, we now have five consecutive quarters of positive growth, starting with the third-quarter of 2009 and continuing with every quarter in 2010 according to the Commerce Department. Economists now predict that G.D.P. expanded 3.2% in the fourth quarter, and for 2011, the prediction is G.D.P. growth of 3% and it is 3.2% in 2012.

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