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Daily Market Notes

Market Update:

DJIA:	**12316**
S&P 500:	**1339**
Nasdaq:	**2832**
VIX:	**16.68**
10YR T-Note:	**3.57%**
EUR/USD:	**1.359**
Gold	**1384**
Crude Oil:	**86.36**

Prices Current as of 1:39 PM

Source: Bloomberg

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After a one-day slight setback on Tuesday, the market resumed its upside ways yesterday on the back of more merger and acquisition news, some good earnings reports, a better housing number and a more optimistic note on G.D.P. growth from the Fed. And the most bullish part of the upward move is the fact that the VIX also rose even as the major averages finished near their best levels of the day.

The Dow started out higher due to the supportive influence of the first three items and reached its best level of the day at 11am with a gain of 77 points. It then made a very fast decline to an advance of only 8 points on its low at 12:10pm. This rapid decline was due to a report that two Iranian warships were moving through the Suez Canal in what Israel called a "provocation." Iran said that these ships were being sent to Syria in order to help combat those pesky Somali pirates, although this explanation does stretch the geography a bit if one looks at a map of this region. At that point, the dollar weakened badly against the Euro and the reason for this dollar weakness, as opposed to the traditional running into the dollar when there are these supposed international crises, is that, as one market expert put it, "what is bad for Israel is bad for the United States as well", and if this isn't the most bizarre reasoning to explain market movements, then I do not know what is. Other currency experts attributed the Euro's rise to a well-received bond auction in Spain, and why not.

The Dow was led by gains in its energy, industrial and material components on the stronger Euro and also on a reversal of Tuesday's declines in those groups. There was also the supportive influence of merger and acquisition activity involving the shares of a discount retailer and a global biotechnology company. Earnings reports have been mainly favorable as of the almost 400 S&P stocks that have reported fourth-quarter earnings so far, 72% of them have beaten the estimates. Finally, the release of the F.O.M.C. minutes from their last meeting said that the committee believed that "economic data showed a stronger tone", and they raised their G.D.P. projections as a result,

to a gain of 3.5% this year and 3.9% in 2012.

By far the most bizarre aspect to the session was that as the major averages ended near their best levels of the day, the VIX also ended higher. Let us go over this in more detail, as when the Dow hit its morning high, the VIX declined as it should to 15.84, a loss of .53. As the Dow fell to that gain of only 8 points, the VIX rose back up to around 16.60, which was a gain of .23 points. But as the Dow kept rising in the afternoon, the VIX continued to creep higher and ended with a closing gain of .35 to 16.72, which was its best level of the day. And if the buyers of VIX calls and sellers of SPY puts think that they are doing the right thing in situation like this, let them be advised that this is the most bullish scenario, namely when the major stock averages advance at the same time that the VIX advances as well, because this then pushes the VIX further away from its support level of 15.35 and then gives stocks more room to advance in order to get the VIX back down to that support level once again.

And as a note to those bearish investors who pushed the VIX higher despite yesterday's closing advance to new highs in stocks for almost the two-year bull market, let it be noted that so far the largest downside correction that this latest phase of the bull market has seen since late August has been the 3.7% decline in the S&P from 1225 to 1180 from November 5th to November 30th. It then came roaring out of the gate to start the month of December and has basically not looked back.

So after yesterday's strong close, things started out lower today based on weekly jobless claims that were higher than expected and a slight increase in the January C.P.I. core rate to a gain of 0.2%, which was the largest increase since October 2009. As a result, the Dow declined to a loss of 35 points at its worst level in the first 30 minutes of trading. From these levels things started a comeback, as the January L.E.I. report advanced for the seventh straight month and the February Philadelphia Fed Survey rose by much more than expected.

So from those early losses, the Dow has risen to a gain of around 14 points at its best level and the other major averages are up a bit as well. And breadth numbers really turned around, to show a positive ratio of 18/11 at the present time. And with the Dow currently ahead by 10 points or so, the VIX has the nerve to rise once again, showing an advance of .10 to 16.82 as this is being written. So if the major averages do end higher today and the VIX advances once again, this will be the second day in a row that this has taken place, and as was mentioned above, this is ultimately friendly for stocks to keep on gaining.

And how about the bond market, which has risen to a two-week high and yields on the 10-year Note have fallen to 3.56% on those higher than expected jobless claims and also on the “rising” Middle East tensions, although the dollar is declining once again, so why the move into Treasuries at the same time that the dollar is weakening appears a bit strange. Otherwise, another noteworthy aspect today is the decline in the shares of the large mobile telecom and computer company on further speculation about the health of its C.E.O. If it was not for the decline in the shares of this stock, the Nasdaq would be up by much more than it is, and the fact that the Nasdaq is advancing while its leading member is lower is another tribute to the internal strength of the overall market, and let buyers of VIX calls take note.

Economic reports for the week are finished, so now the next focus of attention will be tomorrow’s February options expiration session, and once again the option positions with the largest open interest appear as if they will expire worthless. This would include the champ of them all, otherwise known as the 5 calls on a large bank. There are 625,000 of them. And if the market closes tomorrow at around the same levels it is now, there are more than 5 million puts on the stock that represents 1/10th the size of the S&P that will be worth nothing as well. Combined with the over 1 million VIX calls that expired worthless yesterday, these bearish strategies have been a complete failure so far as stocks keep grinding higher these past five and a half months.

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The S&P trades at 13.5 times forward earnings, and 15.9 times current earnings, and this gets it to the highest level in the past year, if one assumes that this year's earnings are going to come in at $83 for the S&P and $95 for 2011. The average P/E multiple for the S&P going back to 1954 has been 16.2. This current level of the S&P could be used as the "excuse" for any market selloff that we see, if in fact we see one the rest of this month.

According to the sector analysts who follow these companies individually, for all of 2010, earnings are projected to increase by +29%, which would be the most since 1995, followed by earnings increases of +15% 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 +37%. If these numbers do come to fruition, then S&P earnings should be around $83 for 2010 and $96 for the S&P in 2011. This would equate to around a 15% 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 3.5% and it is 3.9% in 2012.

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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: {Bloomberg Financial, Reuters, Associated Press}. 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.