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Daily Market Notes

Market Update:

DJIA:	12214
S&P 500:	1317
Nasdaq:	2764
VIX:	21.00
10YR T-Note:	3.47%
EUR/USD:	1.366
Gold	1402
Crude Oil:	94.79

Prices Current as of 1:54 PM

Source: Bloomberg

Donald M. Selkin
Chief Market Strategist
(212) 417-8017
dselkin@nationalsecurities.com

Friday was another example of why stocks have continued their relentless upside move this year, in fact the largest recovery off of a major bear market low since the Great Depression of the 1930's. As the Dow rose to its first intraday high of being up by 54 points at 1pm, the VIX was lower by what it should have been, namely down .54 to 16.05. At 2:20pm, the Dow took a bit of a dip to show a gain of only 32 points, at which time both the S&P and Nasdaq went nominally lower. For some strange reason, the VIX went from being lower as it should have, to rise into positive territory, perhaps once again anticipating the long-awaited correction that had not arrived at the end of last week.

So here you had that same situation that has prevailed quite often the past few weeks, namely a higher Dow and a higher VIX. And sure enough, just when both the Dow and the VIX were positive at the same time, the major averages all got a late second wind, to end at their best levels of the day, with the Dow finishing with a 73 point gain. When the VIX saw this late upside spurt by all of the major averages, it decided to meekly pull in its tail and close nominally lower, down .16 to 16.43, much less than it should have relative to the Dow's advance. In fact, for the week we saw the Dow rise 118 points at the same time that the VIX rose as well, up .74 to 16.43. And up until last week, this is why the market has kept on grinding higher, despite all of the skeptical reasons why it should set back – low volume, which in fact saw the two lightest volume days of the year on Monday and Thursday, which were both higher days; concerns about potential inflation, as evidenced by a higher core rate for the January P.P.I., China raising reserve requirements ten days after raising interest rates to deal with higher inflation, the Euro rallying on anticipation of higher interest rates there after the German P.P.I. rose by the most in two years, silver prices reaching their highest in 30 years; concerns about what is going on in the Middle East, as now that Egypt is out of the picture, investors have started to worry about Iranian warships in the Suez Canal and anti-government demonstrations in Bahrain, Libya and Yemen.

On the positive side, earnings continue to provide underlying support, with 72% of the 400 S&P companies to have reported so far having beaten their estimates. For instance, a Dow machinery and construction component raised its sales estimates today and this stock alone accounted for almost 20 points of the Dow advance.

The Dow did much better than the broader market as the result of strong gains five of its components, which accounted for 51 points of the 73 point gain. This was illustrated by breadth numbers which were only 17/13 to the positive side and the S&P and Nasdaq lagged due to another large selloff in the second largest component in the former and the largest component of the latter namely the large mobile telecom and computer company on antitrust concerns over its new subscription service, slower sales of the Verizon iPhone and worries about the health of its C.E.O.

The bond market started out lower due to the rising inflation concerns, but late in the day it rallied back to unchanged on the flight to safety concerns about all of the Middle Eastern upheavals.

Could the recent pattern be changing? And that recent pattern has been for the market to open lower and then grind higher as the session wears on. And today, the opening was more extreme than we have seen in other lower starts, primarily because our market was closed yesterday when the Libyan turmoil took a deadly turn for the worst, and stocks here had to catch up to the declines in other world markets that traded yesterday. So after a lower start with the Dow down by 120 points early, things started to claw their way back, and by 10:15am this opening loss had been cut to a decline of "only" 37 points, courtesy of a February Consumer Confidence Survey that rose to a three-year high on optimism that the economy and consumer incomes will get better. But instead of steadying at the higher levels in anticipation of even more gains in the afternoon, as has been the recent pattern, things made an abrupt turn to the downside again, with the Dow falling to a new session low of

down 165 as this is being written.

Breadth numbers are awful with a negative downside ratio of 1 to 7 and the VIX is finally showing some upside movement, rising much more than it should all the way up to 20.90, a gain of 4.47, which is almost three times as much as it should have relative to the Dow's decline. Let us also remember that the same thing took place early in the Egypt crisis on Friday, January 28th before the market turned around the next week and more than made up for the losses on its way to the new highs this past Friday. Of course the fact that the major averages continued their advances for another two weeks after that has left them more vulnerable to a downside correction.

Other markets are also showing large moves, particularly U.S. Treasuries which are undergoing a very strong rally on the old "flight to safety" syndrome, with yields on the 10-year Note falling to 3.47%, the lowest since February 2nd. This sharp decline in stocks and large rally in bonds is probably wreaking havoc on those Johnny-come-lately investors who moved money out of bonds and into stocks recently at the higher levels for stocks and lower levels for bonds on the assumption that stocks would continue their rally and bonds would continue to decline on the prospects for an improving economy which is now showing signs of expansion as well.

The main item over the weekend was the huge rise in crude oil prices, currently at $94.58, which is up from Friday's close at $86.20 but thankfully off of the high of $98.48, would you believe it? This is the result of the fact that Libya is a major producer, with 2% of world production at around 1.5 million barrels a day. These higher prices could obviously have a major negative impact on consumer spending and sentiment down the line as well, and this is the primary reason for the decline in stocks.

Gold and silver are also skyrocketing upward on the perceived threat of higher inflation and on the "safe haven" aspect as well, but other commodities such

as copper and the grains in particular are getting slammed to the downside due to Chinese banks recalculating capital levels on higher risk weightings on loans to local governments, and also on the perceived notion of Middle East turmoil interrupting normal world trade patterns.

The S&P trades at 13.5 times forward earnings, and 15.8 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.

Donald M. Selkin

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.