

Daily Market Notes

Market Update:

DJIA: 12142
 S&P 500: 1319
 Nasdaq: 2778
 VIX: 22.10
 10YR T-Note: 3.43%

The latest phase of the bull market that began in late August had seen its worst correction of 3.7% during the November 5th to November 30th time period. After this little hiccup, things exploded to the upside once again starting in December and continued their merry way higher until last Friday, February 18th with nary a worry, save for the large selloff on January 28th when the Egyptian crisis started heating up. Then over the Presidential holiday weekend, the Libyan situation got out of control, with the resultant anxieties about shortfalls in oil production, which we have discussed in detail in these notes all week.

EUR/USD: 1.375
 Gold 1409
 Crude Oil: 97.89

So after two large downside jolts on Tuesday and Wednesday, with the resultant side effects such as a huge rise in the VIX, with investors falling all over each other for the first time since the summer to “buy protection” at inflated prices, the market appeared ready for its third straight triple-digit Dow loss once again yesterday. At 2:30pm, the Dow was lower by 120 points and the VIX rose to its intraday high of 22.71, a gain of .58 points. Ironically, prior to that, the VIX was giving the Dow some slack, actually staying lower even as the Dow was down by as much as 85 points, which meant that perhaps things were going to stabilize at those lows. But in what might be a classic bear-trap, the averages fell to their lows at that time, causing the VIX to spike higher and also causing the S&P to fall below the 1300 support level to as low as 1294, and this 1300 level had held on Wednesday. So when this decline to new lows for the correction manifested itself, those investors who trade on technical signals got all excited that the uptrend line that had been in effect since the late August lows, including the November correction as mentioned above, had been “broken”, and hysterical new buying of inflated downside puts began once again. Adding muscle to the supposed bearish argument at these lows was that not only had the S&P broken a nice round number, but the Dow also fell below another nice round number, namely 12,000. It got as low as 11,983.

Prices Current as of
 1:39 PM

Source: Bloomberg

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But just as fast as these major averages fell to these intraday lows, they made dramatic upside turnarounds from these levels and the Dow was able to turn that 120 point loss into a closing decline of only 37 while the S&P ended only

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around 1 point lower. The Nasdaq, on the other hand, ended with a closing gain of 15 points and let us also remember that unlike the prior two days when the market got clocked to the downside, the Nasdaq/Dow ratio was very strong all day yesterday. This was a major factor in helping the turnaround as well. Other factors that led one to believe that the day might end better than the prior two had was that the Dow had actually shown an early gain and the VIX was not rising hysterically as it had during the first two sessions of the week. And breadth numbers, which were at a negative 11/18 downside ratio on the market low, also turned around to the upside as the major averages came back, to end at a positive reading of 16/14.

And how about the fact that at yesterday's low, the S&P had declined from its high of last Friday of 1344 to yesterday's low of 1294, which comes out to a correction of 3.7%, which exactly matches the one that took place during those three weeks in November as mentioned above. It is obvious that the reason that this correction stung a little more was that the same 3.7% downside move took place over three days instead of three weeks.

The background reason why perhaps stocks made that dramatic upside reversal was that crude oil prices, which had hit the ridiculous level of \$103.40 in the Wednesday overnight session, made a dramatic decline to as low as "only" \$96.50 as cooler heads prevailed and the International Energy Agency said that they were prepared to make up for any shortfall caused by Libyan-induced shortages.

Leading the Dow to the downside yesterday despite better results in other areas of the market was another awful performance from the largest computer maker after its earnings report, ongoing weakness in the financials for whatever reasons are put forward to explain why this group is sort of stuck in the mud, weakness in a large consumer products company on rising raw material costs, and a selloff in the largest energy stock finally after this one was rocking to the upside due to the higher oil prices.

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And despite weekly jobless claims that fell below 400,000 for the third time in four weeks and the lowest four-week moving average of these claims to the lowest level since July 2008, the bond market underwent another strong rally, sending yields to their lowest level since the beginning of the month, at 3.44%. This could have been the result of a decline in spending on non-defense capital goods orders and a very weak new home sales report and evidence that housing prices have not stabilized and are continuing to decline to nine-year lows.

After yesterday's dramatic late rally off of the worst levels, stocks started out higher today, helped by a better than expected final February U. of Michigan Consumer Sentiment Survey to its best level in three years. On the other hand, the second revision of fourth-quarter G.D.P. declined from an original estimate of 3.2% to 2.8%. This was primarily due to lower state and local government spending and a decrease in the original estimate of consumer spending. The latter was lowered from 4.4% to 4.1%, but this number was still the highest since the first-quarter of 2006. In addition, the Personal Consumption Index rose from 0.8% in the third-quarter to 1.8%, which shows that we are seeing the incipient inflationary effects of the higher commodity prices that have been with us lately. For all of 2010, G.D.P. rose at 2.8%, which was the most in five years after a 2.6% decline in 2009.

The Nasdaq is leading the way to the upside, courtesy of good earnings reports from various members. The technology group is also getting help from a strong report from a leading cloud computing non-Nasdaq stock as well. And even those poor performing financials are having a little up-day as well after having been lower for almost a week. The Dow is being helped by a strong gain in the airplane manufacturer as well. After an initial gain of as much as 71 points at 10:45am, the Dow slipped to being up by only 25 points at 12 noon, before taking off from this level to show a gain of 82 points at its best level. The VIX is declining by much more than it should be relative to the Dow's advance, down by 2.36 to 18.96, which is also a sign that things are calming

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down as well.

It is incumbent for things to go the distance today to show that yesterday's support levels are valid and that the current decline might stop at the 3.7% level. The problem now is that the market is sort of being held hostage to outside events.

The S&P trades at 13.5 times forward earnings, and 15.7 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.

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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 2.8% in the fourth quarter. For 2010, G.D.P. rose at a 2.8% rate, which was the highest since 2006 after a decline of 2.6% in 2009. For 2011, the prediction is G.D.P. growth of 3.5% and it is 3.9% in 2012.

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Disclosures

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