

Daily Market Notes

Market Update: Special comment: We have now sent out two reports on the VIX. The first one explains its influence on how stocks behave and the second one is a graphic history of the relationship between the performance of the S&P and the VIX for the past 15 years, with explanations. I hope that these reports will help explain the importance of this indicator in understanding and predicting overall market direction. This is the last day that this special comment will appear, as by now everyone should have seen it.

DJIA: 12174
S&P 500: 1321
Nasdaq: 2794
VIX: 16.08
10YR T-Note: 3.67%

EUR/USD: 1.356
Gold 1349
Crude Oil: 87.81

Prices Current as of
 1:16 PM

Source: Bloomberg

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New definition of Egypt – a Middle Eastern country with a population of 80 million whose internal political turmoil has absolutely nothing to do with our stock market, or worldwide stock markets either. The Dow rose every day last week despite constant images in the media of camels charging into Tahrir Square, violent clashes between anti-government supporters and pro-government supporters and all kinds of hand-wringing from experts about the potential negative effect of higher oil prices because of the potential closing of the Suez Canal. Never mind that only 4.5% of oil is shipped through this waterway and the adjacent Sumed pipeline, in addition to 14% of liquefied natural gas traffic. But natural gas prices have been in their own bear market for the last two years.

If one wants to talk about a potential danger to oil supplies, let it be noted that 45% of world oil supplies get shipped through the Straits of Hormuz, which is near the largest Middle Eastern producers, namely Saudi Arabia, Iran and the U.A. E. But as we pointed out last week, the type of demonstrations that we have seen recently in Egypt, Tunisia and Yemen cannot really take place in these largest oil producing countries, because they are the most repressive dictatorships in the region, as witnessed by the Iranian pro-democracy demonstrations that were ruthlessly suppressed two years ago.

What made Friday's stock market advance really astounding was that it came despite an awful January jobs report, which showed the lowest job creation in

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four months, with a gain of only 36,000 jobs, well below the official estimate for a gain of 140,000 jobs and significantly below the ADP nonsensical projection of 187,000, which was only 137,000 above the private number of jobs created. The overall total was lowered by a loss of 14,000 government jobs. On the more positive side, there was an upward revision of 40,000 jobs in November and December and manufacturing jobs increased by the largest since April 1998. The unemployment rate made its second straight monthly decline, down to 9%, which is the lowest since April 2009. The size of the labor force was unchanged, but 886,000 people did not work because of the horrible weather that large parts of the country were subjected to in January. So in a sense this was an extremely difficult report to figure out because of all the various crosscurrents, but let us remember that the number of jobs created and the unemployment rate are based on two different surveys – businesses and households. This is why there can be these discrepancies on a month to month basis.

Fed Chairman Bernanke said that the U.S. needs to see faster job growth for a sufficient time before the central bank can be assured that the economic recovery has taken hold. “With output growth likely to be moderate for a while and with employers reportedly still reluctant to add to their payrolls, it will be several years before the unemployment rate can return to a more normal level.”

The stock market ultimately behaved as if this was a wonderful report, as a 36 point Dow loss by 11am was quickly erased, but what gave the bulls hope was that the Nasdaq/Dow ratio was strong, as the Nasdaq went positive first, at 11:30am while the Dow was still negative. The latter finally joined the upside party at 1:15PM and things improved into the close, with the Dow ending higher by 30 points as the result of a very late upside spurt, which is exactly what it did on Thursday as well. Breadth numbers actually finished slightly negative despite the fact that the three major averages all finished higher.

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Bond yields continued to rise, as this market ignored the negative jobs report and instead concentrated on potentially higher inflation because of rising commodity prices and an expanding economy outside of the labor market. The ten-year Treasury note yield rose by the largest weekly amount since last June and more importantly, the two-year note, which is most closely tied to expectations of what the Fed is going to do about the federal funds rate, made its largest weekly yield increase since June 2009.

And to prove once and for all that the goings on in Egypt have absolutely nothing to do with our stock market, the S&P put in its best weekly performance in nine weeks. At the same time, the VIX declined down to 15.93 with a loss of .76, falling by more than it should have relative to the Dow's advance.

Finally, despite the generally upward trend of the market, there were some very large options positions that expired worthless, and what else is new here? For instance, the huge number of buyers of calls on a large casino operator ahead of its earnings report Thursday evening ended up with nothing to show for their efforts, as the stock got blasted to the downside. And the bank that usually does this once again hung out its large number of 5 call buyers out to dry as usual, and the stock that represents 1/10th of the S&P had bearish put buyers accumulating 560,000 of them, which also went out worthless on the close.

The VIX close at 15.93 should have meant that a further advance today would create a showdown at the 15.35 support level and probably limit any further gains in the Dow to another 60 points or so. So what we are getting today is a very strong advance of as much as 96 Dow points at the best level and the VIX doing absolutely nothing!! This is astounding because when the Dow started out with a gain of 17 points right off the opening bell and basically never looked back until it got to that high, the VIX actually rose by as much as .31 points to 16.24, which is really difficult to believe unless one thought that the

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“smart money” knew that this early start would reverse itself to the downside. So instead of that bearish scenario playing itself out, the market kept grinding steadily higher and the VIX has stayed just about unchanged despite this 96 point Dow advance. This is astounding, and the only explanation is that this proves the validity of the 15.35 support area which does not want to be broken at the present time, and the fact that the VIX is remaining unchanged despite the advance means that the Dow still has another 60 points to go on the upside until that support level on the VIX is finally reached.

And the reasons for the advance seem to be that the uptrend is just feeding on itself, as there were further good earnings reports and some not so good ones, but now the estimates for fourth-quarter earnings growth have been raised to 37%. In addition, India’s economic growth projections were raised to the highest in three years and Indonesia’s were raised to the highest in six years. There were also two mergers involving the shares of a medical instrument company and an offshore oil driller, which is also helping sentiment as well.

And the bond market continues to get clocked to the downside, with the yields at these higher levels continuing to reflect the prospects of stronger growth and higher potential inflation as the economy expands, and investors in bond funds are probably jumping out of them and chasing stocks as they move higher.

Crude oil prices are down again, correcting that absurd rally on Egyptian concerns, and gasoline inventories are at an 18-year high, and think of how consumers are being cheated when they have to pay current prices at the pump.

Perhaps it is the Super Bowl indicator that has everyone excited on the upside once again, as in prior years when the Green Bay Packers won, the market advanced by 18% and in the 44 prior Super Bowl years, in 35 of them the

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market advanced when a team from the original N.F.L. won the game. So is history about to repeat itself once again this year as well?

Earnings reports the next two weeks will virtually bring the earnings season to a close, and we do hear from the following Dow companies - Tuesday: DIS; Wednesday: CSCO, KO; Thursday: KFT, among some other important companies as well.

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.

According to the sector analysts who follow these companies individually, for all of 2010, earnings are projected to increase by +30%, 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 \$95 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% and it is 3.2% 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.