

Daily Market Notes

Market Update:

DJIA: 12231

S&P 500: 1321

Nasdaq: 2794

VIX: 16.16

10YR T-Note: 3.66%

EUR/USD: 1.373

Gold 1364

Crude Oil: 86.71

Prices Current as of
1:35 PM

Source: Bloomberg

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Once again, the foolish buying of puts on the stocks that represent major equity indexes such as the SPY the first two days of the week backfired badly on the proponents of this strategy once again yesterday, as stocks rose and the Dow ended with just about the same gain that it made on Monday, namely an advance of 71 points versus the 69 that it gained the day before. So for the first two days of this week, it has advanced by 140 points while the VIX is just about unchanged.

In other words, the VIX closed at 15.93 on Friday, then made an astounding advance even while the market rallied on Monday, and even yesterday when the Dow was on its low by being down a measly 11 points, the VIX jumped up to 16.60. Then when the market drove relentlessly and steadily higher again yesterday, the VIX finally gave it up and declined by about what it should have, namely by .47 to close at 15.81. This meant that with the Dow advancing by 140 points the first two days of the week, the VIX declined by only .12, much less than it should have. This imbalance in the traditional Dow/VIX ratio of 100/1 is what has allowed the market to move higher, despite the fact that it extremely overbought. As one example of how overbought it is, and this is only one of many examples, bullish sentiment as measured by the American Association of Individual Investors has been above its historic average for 22 consecutive weeks, the second longest such streak in history.

Breadth numbers were also strong at a positive ratio of 19/11, which once again showed that the broader market was also participating in the gains of the larger averages. And this was the Dow's seventh straight advance, something it had not achieved since last July, when it was coming off the beating that it had taken in the May and June so-called European sovereign debt crisis situation, which basically was just an opportunity to buy at low levels before the market underwent this historic advance starting at the end of August.

Since there were no economic reports of any consequence and just the usual run of the mill earnings reports, market observers pointed to further merger

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and acquisition activity creating further positive sentiment, and yesterday it involved the shares of a rehabilitation center company. The S&P Retail Index hit its highest level since July 2007 due to sales for the week that ended February 2nd showing a gain for the first time after a few consecutive weeks of declines, obviously partly weather-related. For some reason, the homebuilder stocks also did well, at least for one day. In addition, the National Federation of Independent Businesses optimism index for January rose to the highest level in three years, and this might be significant because these small companies create 65% of all jobs.

The Dow was led by gains in the fast-food restaurant chain on good earnings, despite the stock still being a bit lower for the year, and by another new all-time high in the highest priced technology component. Because of concerns that China had raised interest rates for the third time in the past several months in an attempt to cool off inflation which is rising in that country, the price of crude oil and copper declined, the latter coming off of record high levels.

So after the Dow and the S&P both rose to their highest levels since June 2008, before the financial crisis devastated investors worldwide, things are taking a bit of a breather today, although the market is certainly not giving too much on the downside. The Dow is somewhat in its own world today because of the upside distortions caused by a few members rising nicely as a result of good earnings reports – the theme park and media company, and the soft drink maker. The former is adding 19 points just on its own and the latter is adding five points. In addition, a strong gain in the large diversified manufacturing company is adding eight points on a raised profit forecast. After a mixed to lower start, the Dow did manage a gain of 21 points at around 10:45 while all of the other major measures of the market stayed in negative territory. And breadth numbers are awful at almost 2 to 1 to the downside, although there are that same group of large Nasdaq stocks that are in their own upside worlds all at or close to new highs. Retailers continue to do well on the heels of a new all-

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time high in an apparel, accessories, fragrances and home furnishings maker as a result of earnings.

Energy stocks are particularly weak today as crude oil has cooled off with gasoline supplies at 20-year highs and think of that the next time that you pay the current very high prices at the pump. But this is what Chairman Bernanke wants, namely higher prices without regard to the consequences by his QE2 program whose intention was to inflate all asset classes. Of course, this is one of the reasons why bond yields have risen to 10 month highs and inflation is rearing its head in other countries, such as the U.K. which reported that foods prices reached their highest level in 19 months in January. And this is the main reason why China has raised interest rates again, in order to reign in the price rises that are now prevalent in that country. This is why the emerging stock markets have taken a beating this year, namely the threat of higher interest rates.

And the Chairman repeated his long-held mantras today in testimony before a Congressional committee when he said that "Labor markets remain sluggish and I continue to believe that inflation will remain subdued." The bond market certainly does not believe him, which is the reason for its recent sharp declines and rises in yield levels.

The worst performers today are once again the energy stocks, which would seem to be in need of a breather considering that they have been the best performers since the rally began in late August. And the VIX has proven that it does not appear to be in the mood to decline below its 15.35 support level, as it is rising from yesterday's close of 15.81 to around 16.30, still pretty lame and a reminder to the bearish crowd that the bullish upward move is still the dominant force until proven otherwise.

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

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.

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 \$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

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