May 5, 2011

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Daily Market Notes

Market Update:

DJIA:	12674
S&P 500:	1344
Nasdaq:	2832
10YR T-Note:	3.19%
EUR/USD:	1.457
Gold	1480
Crude Oil:	102.43

Prices Current as of 1:00PM

Source: Bloomberg

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In a scenario that is following a traditional seasonal pattern, and last year was certainly a classic example of this, the month of May is living up to its reputation of being a difficult one for stocks, as after the terrific rally in April and the good news to start off the week – the Osama Bin Laden killing, which touched off worldwide euphoria and stock index futures gaining as a result, trying to continue the gains for the major averages in seven out of the past eight months, and they were only very nominally lower in the one month (November) that they did not advance; S&P earnings were beating the forecasts in almost three-quarters of the 359 companies that had reported; profits were up by around 20%, more than the 12% projected gain at the start of the reporting period; merger and acquisition activity now reached $843 billion, a 23% gain from last year; bullish sentiment was high as various market experts were falling all over each other to raise their price projections for market indexes; Fed Chairman Bernanke had promised to keep interest rates at record low levels for "an extended period"; thanks to the Q.E.2 program, commodity prices were spiraling to ever higher and higher prices on the bizarre reasoning that these higher commodity prices were good for stocks because they supposedly showed economic growth instead of being an impediment to economic growth because of the punishment that consumers have to undergo when paying for food and energy products; the dollar was getting devalued because of the low interest rate policy here as opposed to the inflation perceptions in other parts of the world that has caused central banks from South America to Asia to Europe to start raising rates, but not here because everything is just great with the economy; and the VIX had declined to lows not seen since June 2007 because investors saw very little reason for anxiety ahead.

And for the fourth day this week, we are seeing a classic example of the market topping out on the abundance of good news, which is now turning out to be not so good. And this has been consistent with why the month of May historically has been the second worst one for stocks going back to 1929.

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Yesterday investors got all bent out of shape on the A.D.P. estimate for Friday's jobs report, which they said would be 179,000 versus the official estimate for 198,000 and this was after they raised last month's projection to 207,000 from 201,000. Let us also remember that they consistently underestimated the number of private payroll jobs that were actually created for months on end before showing a better degree of accuracy lately, so this looked like a case of investors looking for a "reason" to want to sell a market that had clearly gotten ahead of itself. In addition, the April ISM Non-Manufacturing Survey rose at the slowest pace in eight months, and this also added to the pressure.

As a result, the Dow declined yesterday to a loss of 134 points at its worst level around 12;50PM, from which it was able to claw its way back to show a loss of only 60 points at 3pm, before going into another little slide into the close, and ended with a loss of 84 points. Breadth numbers, which were really awful at the market lows with an almost 1 to 4 advance/decline line, improved somewhat as the day wore on and ended with a closing ratio of slightly worse than 1 to 2.

The stocks that showed some life were the old-time Dow technology components which have underperformed for years now, in addition to some consumer defensive issues. And once again the booby prize went to those industrial, resource, energy and one technology stock that until this week were the stars.

And if one wants to look for some good news, at least the most important commodity markets such as crude oil, gold and silver continued to sell off from unjustified levels as well, but this continues the pattern since the start of Q.E.2 late last August of all these markets moving together instead of the historical tendency of them to move opposite to each other. But this is what the Fed wanted when they mistakenly thought that the biggest enemy to the economy was deflation and by weakening the dollar, they wanted all asset prices to increase and they certainly got their wish these past eight months.

The only item that continued to rise almost without interruption was the Euro, which yesterday reached the highest level against the dollar in 17 months, and the dollar was also weakened by the perception of further interest rate increases from China as well. Even the Portuguese bailout by the E.U for $113 billion did not stop the Euro's advance, although supposedly some Portuguese bond yields did decline because of this.

And as the old expression goes, "when it rains, it pours", as today stocks are lower for the fourth day in a row on a surprise 43,000 increase in weekly jobless claims to 474,000 versus an estimate for a decline to 410,000. But what has really greased the downside skids for stocks, and this is really pathetic, is that commodity prices continue to get blasted to the downside, with crude oil really crumbling, down as much as $8 to $101 a barrel at the lows, and is this supposed to be bad for consumers? This is the pathetic mentality that the Fed's Q.E.2 program has put us into. And heaven forbid, gold and silver prices are also continuing to come off of their unsupportable levels in the stratosphere as well.

But the crowning jewel to the downside, so to speak, is that the dollar is finally strengthening, heaven forbid, as the Euro is getting blasted to the downside, its largest one-day decline since last November, as the E.C.B. said today at its meeting that they are going to watch inflation risks "very closely", which was interpreted by currency experts to mean that they may wait after the June meeting to raise interest rates. So here you have a case of an overvalued currency finally getting its just reward after an almost uninterrupted rise, despite the fact that three of its members (Greece, Ireland and Portugal) are basically economic basket cases.

At its worst level, the Dow was lower by 124 points, and breadth numbers were not that terrible, with an almost 1 to 2 downside ratio. It has since improved to a loss of 47 points as this is being written and the Nasdaq is actually up by 10 points, as gains in technology stocks led by a good report from an

entertainment software company is helping, and some of those high-fliers are doing well. The VIX is also up less than the Dow is down for the second day, higher by only .86 to 17.94 when the Dow was on its low. And naturally as crude oil prices declined by as much as $8 to $101, the energy stocks have been taking the biggest beating, as well as those resource, material and industrial stocks as well.

The earnings calendar finishes this week with Nasdaq high-flyer PCLN tonight.

Economic reports will be highlighted by Friday's April non-farm payroll number, which is supposed to show an increase of 185,000 versus 216,000 in March, and the expectations for this report have been lowered after the A.D.P. numbers, so with the stock market going into this report on a down move, perhaps the bar has been set lower for things to hopefully advance after the report. It appears as if the market could stand a number as low as 150,000 but anything below that would not be viewed too well.

The S&P trades at 13.5 times forward earnings, and 15.5 times current earnings, as 2010 earnings are going to be $85 for the S&P and $99 for 2011, according to the analysts who follow these companies. The average P/E multiple for the S&P going back to 1954 has been 16.2.

For all of 2010, earnings increased by +30%, which was the most since 1995. For 2011 the analysts are forecasting increases of +12% for the first-quarter of 2011 and +16% for the entire year, as reported by Bloomberg Financial and this would be the largest two-year advance since the period ended in 1995. This means that S&P earnings for 2010 were $85 and projected to be $97 in 2011. This would equate to around a 14% 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 six consecutive quarters of positive growth, starting with the third-quarter of 2009 and continuing with every quarter in 2010 according to the Commerce Department. For all of 2010, G.D.P. rose at a 2.9% 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 3.1% 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.