

## Daily Market Notes

**Market Update:** The market put in a miserable performance on Friday to end its sixth straight week with losses, which was its worst performance over this period of time since last August, a decline of 7%. It was also the longest number of weeks lower since 2002. In addition, the Nasdaq and Russell 2000 Indexes now had the dubious "honor" of actually being lower for the year (albeit not by much), while the Dow and S&P are still showing nominal advances. This decline of around 7% from its late April high has not been so far as painful as last year's May and June losses, which totaled 16% before it was over.

**DJIA:** 11990  
**S&P 500:** 1275  
**Nasdaq:** 2648  
**10YR T-Note:** 2.99%  
**VIX:** 19.05

**EUR/USD:** 1.441  
**Gold:** 1515  
**Crude Oil:** 97.26

The reasons for this particular day of losses was sort of more of the same, namely the perception that worldwide economic growth is slowing, the uncertainty surrounding the end of the QE2 program on June 30<sup>th</sup>, and the potential for further turmoil in the Euro region relative to its weaker members. There were reports of slower growth in China and India, in addition to the U.K., but this had to do with the fact that there was an official holiday so that everyone could either attend or watch the royal wedding, so this nation-wide celebration did have its downside consequences.

Prices Current as of  
3:07 PM

Source: CNBC

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What we saw was also typical of a summer Friday, as namely when things start out lower, it is very difficult for them to come back, as the Dow really never had a chance, and it fell as low as a loss of 187 points at its worst level at 2pm. Then a report came out that was construed as friendly to the large banks of all things, as originally they were under pressure because of increased capital requirements, and then all of a sudden at 2pm there was a belief that international regulators are considering toning down their proposed capital rules for these banks to only between a 2-2 ½% surcharge instead of the 3% that was originally proposed. And by some miracle, these stocks actually had the nerve to rally from the new lows for the year that they had so ignominiously fell to at that time.

This sudden revitalization, at least for one day in a beaten-down group had an overall positive effect on the entire market, as the Dow was able to cut its loss

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to “only” 110 points by 3pm, before doing what a down day on a summer Friday usually does, namely continue to go lower into the close. As a result, the Dow ended with a 172 point loss. Breadth numbers were awful at a negative 1 to 4 ratio and the only stocks that were able to show to some advantage were those poorly performing bank issues as mentioned above.

One problem for making future progress was that despite that Dow loss of 172 points, the VIX rose by only 1.09, to 18.86. So for another week it was not able to rise as much as the Dow declined, which means that it is not creating enough of an oversold condition to allow stocks to rise on a more consistent basis. To further illustrate this, the Dow declined by 200 points last week while the VIX rose by only .91, or less than half of what it should have. In fact, if one goes back to the closing market high on April 29th, the Dow was 12,810. On Friday it closed at 11,952, a loss of 858 points. But at the same time the VIX rose by only 4.11 points, from 14.75 to 18.56, or less than half of what it should have risen. And this is the reason why the market has not been able to make a consistent advance to break this losing cycle, because we do not have the oversold conditions that a higher VIX would have created. In other words, with a Dow decline of those 858 points, the VIX should have risen by around 8.5 points instead of the 4.11 that it actually has gone up by.

And isn't it ironic that the market declines sharply on a day when crude oil prices also go lower, in fact down by \$3 to around \$99, and I have been saying this for the longest time that if energy prices are lower than where there were when the market was also on its high, then one would like to believe that this could be beneficial to consumer spending but in the sick symbiotic relationship that QE2 brought forth, when higher crude oil prices were a sign of supposed economic recovery and therefore supposedly beneficial to stocks, then this was ultimately a situation that could not last. Let us all remember that historically, higher commodity prices were detrimental to stocks because of their inflationary implications and why anyone thought it would be different this time has completely missed the picture.

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After the steady downdraft that stocks have been in these past six weeks, things tried to start out better today, with the Dow rising by 59 points at its best level at 10:30am. But we saw a classic case of the Nasdaq not being able to keep up the pace, rising by less than it should have relative to the Dow's advance. And we all know what happens when this dynamic is in place. As a result, the Dow declined to a fast loss of 34 points just after 1pm, but has since recovered while the other indexes are lagging.

There were reports that China's money growth fell to a 30-month low and that Japanese machinery orders fell. In addition, Portuguese bond yields rose to their highest level since the introduction of the Euro in 1999. Finally, Standard & Poor's cut the credit rating on Greek long-term sovereign debt to the CCC level. And in perhaps the largest "negative" for stocks, crude oil prices had the nerve to decline once again, as low as minus another \$3 to \$96. This has been a recent support level going back several weeks now, so it will be interesting to see if this area holds.

From those lows after 1pm, things have reversed for the time being to the upside, as for the first time in a long time the VIX rose by much more than it should have relative to the Dow's decline, up by a large 1.16 to 20.02 against that Dow loss of 34 points. This perhaps might have created somewhat of an oversold condition, which we have not seen so far. And participating in the comeback are the financial stocks once again, and it would be extremely helpful if they can at least make a more respectable showing going forward, which could be a big help to a potential recovery in stock prices.

Since earnings are no longer a factor as the second-quarter reporting period will not be with us for another three weeks, economic reports might have some influence and there are quite a few of them this week. The lineup is as follows: Tuesday – May P.P.I. May retail sales, April business inventories and annual revision of that number; Wednesday – May C.P.I., June NYState Empire Manufacturing Survey, May Industrial Production and Capacity Utilization;

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Thursday – May housing starts and building permits, June Philadelphia Fed Manufacturing Index; Friday – June mid-month U. of Michigan Consumer Sentiment Survey, May L.E.I. and the monthly June options expiration series.

The S&P trades at 12.1 times forward earnings, which could bring a measure of support to stocks. Earnings were \$85 in 2010 and are projected to be \$105 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. Since 2006, the average P/E multiple has been 14.7

For all of 2010, earnings increased by +30%, which was the most since 1995. For 2011, first-quarter earnings gained +15% and are projected to gain +20% for the entire year, as reported by Bloomberg Financial and this would be the largest two-year advance since the period ended in 1995. These projections would equate to around a 14% earnings 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 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.*