

## Daily Market Notes

<b>Market Update:</b>		Maybe it was Moody's downgrade of Cyprus' government debt by two notches bringing it closer to junk levels that did it, or perhaps in a larger sense it was the "Four D's" at work - Debt, Downgrades, Deadlock and Durable goods – but yesterday's market action, particularly the late selling, had the look of a panic climax on the downside. This was evident as the VIX spiked to its highest level since June 16 <sup>th</sup> , rising to 23.30 before ending with a very large gain of 2.75 to 22.98.
<b>DJIA:</b>	12332	
<b>S&amp;P 500:</b>	1311	
<b>Nasdaq:</b>	2791	
<b>10YR T-Note:</b>	2.95%	
<b>VIX:</b>	22.04	The way that one can detect a selling panic climax is when the financial and mainstream media run stories about "panics" on Wall Street and investors rush to buy short-term Treasury Bills due in one-week at NO interest, in effect lending the government money and getting nothing in return, as this is the ultimate example of the so-called "flight to quality". In addition, ironically, just when we are in the midst of a crisis in Washington, D.C. that has all kinds of potentially ominous implications for the United States, the dollar made a huge rally yesterday on the "flight to quality" syndrome as well, in other words into an asset that has basically lost 75% of its value in the last 10 years.
<b>EUR/USD:</b>	1.432	
<b>Gold</b>	1613	
<b>Crude Oil:</b>	97.23	
Prices Current as of 1:37 PM		
Source: CNBC		

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I had pointed out in yesterday's notes that a very poor Nasdaq/Dow ratio was "going to make the upside more difficult today (i.e. yesterday) than it had been on Monday and Tuesday." And this certainly turned out to be the case, as the Nasdaq had its worst day since February 22<sup>nd</sup> with a large loss of 75 points and the S&P had its poorest showing since June 1<sup>st</sup>. The Dow fell by 198 points, and if one notices the pattern of the past four sessions, the losses were 43, 88, and 91, which led up to the 198 point debacle yesterday. This is another reason perhaps why the accumulative effect was to create somewhat of a selling climax as well. And if one really needed evidence that investors had hit the panic button, take a look at the advance/decline line, which ended at a very rare and absolutely awful negative 1 to 10 ratio.

There were all kinds of negative inputs, as for instance the fact that the industrial and resource components of the Dow contributed 87 points of

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losses just by themselves was attributable to a poor earnings report from a designer and manufacturer of electrical equipment, and how many times is this stock ever mentioned as a market mover? The same thing went for the Nasdaq, whose awful showing was attributed to a poor report from a networking products maker, which supposedly took the wind out of the sails of the main technology high-fliers such as the large mobile telecom and computer company and the largest Internet search firm, which were due for some sort of cooling off no matter what.

One of the “D’s” mentioned above was a weak June durable goods report, which “unexpectedly” declined and also fell in the capital goods orders transportation component. And not helping either was the Fed Beige Book survey which said that the economy grew at a slower pace in more parts of the country since the start of June as shoppers restrained spending and factory production eased.

The strong dollar knocked the prices of most commodities lower for a change, and how terrible is it when crude oil prices decline, but in the sick positive symbiotic relationship that has developed between crude oil prices and stocks, when energy prices decline, this is construed as negative for stocks when it should have the opposite effect. And in the biggest tragedy of all, gold, which has taken on an upside life of its own, actually had the nerve to decline by around \$1 an ounce after initially rallying to a new all-time record high price at \$1,628 an ounce.

And of course lurking in the background to yesterday’s market action was the overhang of the debt and budget issues, as both Republicans and Democrats worked on a compromise even as they publicly pressed ahead with rival debt plans that have little chance of winning broad congressional approval. In the meantime, the U.S. Treasury warned that it could not guarantee that the government could keep paying all of its bills if Congress failed to raise its

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borrowing limit by August 2<sup>nd</sup>. Even if a deal is reached to raise the \$14.3 trillion debt ceiling, a budget plan that does not address large cuts in the deficit may result in a downgrade of the currently high U.S. credit rating, and this could have negative financial implications worldwide.

House Speaker Boehner is desperately trying to rally support for his deficit reduction plan amid a mutiny by the Tea Party Republican members and opposition from the Democrats as well. Apparently he told those very conservative members to drop their opposition to his plan and “get your ass” in line. His plan lost some steam when the non-partisan Congressional Budget Office found out that the plan would cut spending by \$350 billion less than the \$1.2 trillion promised over 10 years that he had claimed.

Also not helping yesterday was a comment from a White House spokesman who said that the government would be “running on fumes” if the deadline was not met.

Will today end up being a “Turnaround Thursday”, as after some hesitation because of the generally negative sentiment that the past four days of declines has produced, things turned around to the upside, helped by a decline in weekly jobless claims to their lowest level since April, a 10,000 lower number to 398,000. In addition, the June pending home sales report rose by 2.4% when the experts had predicted a decline. This positive reaction to a third-tier economic report was obviously a market looking for an excuse to work off its very oversold condition.

As a result, the Dow reached its best level of the day, with a gain of 82 points at 12noon, from which level it has currently surrendered around half of that advance. The Nasdaq is certainly holding its own weight with a gain of 29 points compared to the Dow’s advance of 45 as this is being written. Breadth numbers are decent at an 18/11 upside ratio and the VIX is trying to work off its oversold reading with a large decline of 1.05 to 21.93 at the present time.

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The highs of the day came when the same White House spokesman who made the “fumes” comment yesterday said that the “chances are great” for a compromise deal to be reached tonight when the House will vote on a bill to cut the deficit and raise the debt limit. This bill, if it does pass, is still opposed by all 51 Senate Democrats and will lead to negotiations among leaders on both sides in an attempt to avert a U.S. default.

Ironically, the market has declined around 3% since July 8<sup>th</sup>, which is the day that the second-quarter earnings season kicked off with AA’s report and despite the fact that around 80% of the S&P companies have beaten their estimates. Obviously the drama in Washington is overshadowing everything else.

Bond yields are declining a bit today on some increased optimism over the debt and budget situation and the dollar is mixed, as it dropped toward a postwar low against the Japanese yen and touched a record low against the Swiss franc. It did gain against the Euro as economic confidence there fell more than forecast, surprise, surprise and Greece’s credit ratings were cut even more, if that is possible, by another one of the ratings agencies.

It is imperative for the market to hold onto the gains for the remainder of the session, which would at least put a temporary stop to the extreme negativism that has developed recently, and then we wait for the vote and all of the political fighting that will accompany it.

The earnings parade finishes this week with: Friday: CVX, MRK, and NEM. This means that we will have heard from 6 Dow companies.

The economic calendar has some important reports, and finishes the week with: Friday: first estimate of second-quarter G.D.P., July Chicago Purchasing Managers’ Index, NAPM July Milwaukee Index and final July U. of Michigan Consumer Sentiment Survey.

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The market has taken on a resemblance to last year, when things reached their highs in late April, and then took a dive in May and June, which marked the lows for the year, and it was the same causes last year as well, with European sovereign-debt issues responsible for much of the comedown, although let us also remember that we started the decline this year from higher levels, which left the market more vulnerable to some sort of setback from the misplaced mind-set of higher commodity prices somehow being good for stocks. Let us hope that this year also sees the market low during this time period as well. And one sign for optimism in this regard is that the May and June declines this year were nowhere near as severe as they were last year and July was actually an up-month before another decline in August.

The S&P trades at 12.4 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 +38%, which was the most since 1995. For 2011, first-quarter earnings gained +19% and are projected to gain +9% for the second quarter as reported by Bloomberg Financial and the 14% projected gain for 2011 would be the largest two-year advance since the period ended in 1995. The highest ever earnings for the S&P in one year so far took place in 2006, at \$88.

After four consecutive quarters of negative G.D.P. growth, we now have seven consecutive quarters of positive growth, starting with the third-quarter of 2009, every quarter in 2010 and the first quarter of this year, 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 now for G.D.P. growth of 2.5% and it is 3% in 2012, although estimates for

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this number vary widely and are constantly changing.

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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.*