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Daily Market Notes

Market Update :

DJIA:	**10775**
S&P 500:	**1114**
Nasdaq:	**2371**
10YR T-Note:	**1.82%**
EUR/USD:	**1.32**
VIX:	**43.98**
Gold:	**1661**
Crude Oil:	**77.92**

Prices Current as of 1:10PM

Source: CNBC

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Confirming my long-held theory that the market rarely does the same thing very late in the session two days in a row, the major averages collapsed into Friday's close after making a very strong upside rally on Thursday after having collapsed into the close in Wednesday. And what a collapse it was on the last trading day of the month and of the quarter as well, and this was no surprise because it is also my contention that the two worst days of the month for stocks are the third Friday, which is the options expiration whose function is to cause as many buyers of calls as possible to end up with worthless merchandise, and the last day of the month, in order to induce investors to sell at low levels after seeing their awful monthly statements.

After that terrific late upside recovery on Thursday (a premature New Year's gift to those who celebrated it), things gapped down lower right off of the opening on Friday, with the Dow down by 158 points right out of the starting gate. From those lows, it was able to fight its way back and actually had the nerve to show a loss of "only" 18 points at 11:45am, from which level it started to drift lower once again, with a loss of 75 at 2pm. Then for whatever reason, not that anything had changed fundamentally, things really accelerated to the downside in the last part of the session, resulting in a Dow loss of 240 points at the close. And following the recent pattern, the Nasdaq did worse as a result of declines in its high-priced technology leaders which had done so well for most of the year, as investors seemed to want to lock in profits on the few winners that they have had this year. It ended with a large loss of 65 points and it was no surprise that on a day like this the breadth numbers were awful, with a negative 1 to 4 ratio. And naturally the VIX decided to rub it in, as it rose by a much larger than it should have 4.12 points to 42.96, which starts to get it closer to its historical resistance level of 48, and which hopefully means that we are starting to approach another oversold condition once again.

And to no one's surprise, the financials put in another horrible performance after trying to do better earlier in the day, and they were joined in the downside misery by the industrial, energy and resource stocks on the slowing cyclical nature of these types of shares.

And to no one's surprise either, stocks followed the Euro to a great extent, as when the Dow was down by "only" 75 points at 2pm, the Euro was 1.345, and by 4pm when stocks tumbled to their worst levels of the day, the Euro fell as well, down to 1.339. And ditto for crude oil, which was around $81 at 2pm, before it also fell apart to trade at $78.80, down a large $3.30 on the day when stocks collapsed as well. So who is leading who here – do stocks look at these outside markets and decide that when these items go lower then stocks should decline as well, or do these other items look at stocks and say – if equities are declining, then that must mean that worldwide economies are slowing down and we should go lower as well?

Not helping either was the announcement that former Dow component and the former photography bellwether might be declaring bankruptcy, but this stock is another sad case of not being able to adapt to changes taking place in its industry, and Wall Street is littered with the carcasses over the years of many stocks that were the victims of changing technologies and consumer tastes.

And naturally as equities declined, another market that trades in a symbiotic relationship to stocks, namely bonds which go in the opposite direction but whose yields do follow stocks either to the upside or downside, saw yields make a sharp decline, with the curve narrowing back in, with the 30-year at 2.91% down .15, the 10-year lower by .09 at 1.91%, and the two-year lower by .01. These yields are now lower than where they were at the time of the Operation Twist announcement from the Fed after having gone above those levels a few days ago.

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So the market ended the third-quarter with its worst performance since the fourth-quarter of 2008 and its fifth straight monthly decline, with losses for the S&P at 14%. Let us hope that the fourth-quarter shows a better performance that this awful one that just ended.

And if the third-quarter was a poor one for stocks, today's start of the fourth-quarter has yet to show much improvement, although the Dow did manage to stick its head above water on two occasions before being rewarded for its troubles with selling that brought it back into the negative column, and even when things were on their highs, the participation was not that great as the Nasdaq is lagging once again and breadth numbers are poor.

After Friday's end of quarter late in the day collapse, things started today to the downside, as overseas concerns overshadowed what were two better than expected reports here in the U.S. There was an entire litany of bad news from overseas, as the Chinese Purchasing Managers' report for September came in at the lowest reading ever for that month even though it did rise nominally to 53 from its all-time low of 50.6 in August. Then the misery shifted to Europe, as a Eurozone new orders report contracted to its lowest level in two years, and manufacturing reports in both Spain and France also declined to their worst levels in two years as well. Then what would a day be without further drama from Greece, as their budget is now projected to miss its deficit target, which supposedly puts that country closer to default.

Never mind that two reports here came in better than expected, with August construction spending showing a slight gain when a loss was forecast, due to the largest state and local government spending on projects in two years. In addition, the September ISM Manufacturing Survey increased slightly as well and still showed a reading that indicates expansion, although not by much.

As a result, after an initial decline to the lows of a Dow loss of 96 points right before the 10am release of these two reports, the Dow made a very fast upside reversal to show a gain of as much as 66 points at its best level around 10:15am.

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Unfortunately as mentioned above, this was met by immediate selling which drove the Dow to 96 point lows once again at 11am, before another upside attempt got it to be ahead by 27 points at 12noon, and this lower high level failed quickly as well, and the reason for the failure was that the gains were not broad-based and were primarily the function of some strength in just a few of its components for whatever reasons. And as this is being written, things are heading lower once again, and have now broken below the earlier lows, with the Dow showing losses of as much as 109 points.

Breadth numbers are awful at a negative 1 to 3 ratio, which of course is not allowing the major averages to make much upside headway, and the VIX is sort of taking it easy today, rising by less than it should be relative to the Dow's decline, and it would be better if it rallied by more than it should in order to create an oversold condition from which stocks might finally be able to improve.

And markets have to suffer through the ignominy of four more E.U. members having to vote on whether to expand the size of the bailout fund, and here they are - in addition to the Netherlands, votes on this issue will take place in such economic powerhouses as Estonia, Malta and Slovakia, would you believe it, and this lineup sort of summarizes what is wrong with that entire E.U. situation, as world financial markets are held hostage to what these pipsqueaks have to say.

This week is light on economic reports, with the exception of the big one on Friday, namely the September non-farms payroll number, and we will discuss this more as the week moves on. Tomorrow sees August factory orders, Wednesday gives us the A.D.P. estimate for Friday's number, in addition to the September ISM Non-Manufacturing Survey. Thursday has weekly jobless claims and September chain-store sales ahead of the jobs report on Friday.

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Third-quarter earnings continue to drift in, with this week seeing the likes of YUM, MAR, MON and RT before the floodgates open next week and the two weeks after, and if one thing is going to perhaps save the market from further declines, it is going to be how the profit picture shapes up for the quarter just ended.

Isn't it enough that around $10 trillion was wiped off of equity values worldwide in the quarter just ended, which one would like to think makes stocks look cheap at current levels, especially given the level of all-time record low interest rates. The argument for stocks being good values here is further enhanced by the fact that despite all of the turmoil on fears of slower economic growth or worse, analysts have actually raised their profit forecasts for the S&P companies for 2011 to a record $99.34 from $98.73 in late April when stocks were on their highs, according to Bloomberg. This is somewhat of a strange occurrence, because the rap against stocks lately has been that earnings estimates are too high. So we will have to see who is right on this one.

The S&P trades at under 12 times 2011 earnings, which could bring a measure of support to stocks. Earnings were $85 in 2010 and are still projected to be $96 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 the first half of 2011, earnings gained +18% as reported by Bloomberg Financial and the 16% overall 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. For 2012, earnings are now projected to be $104 for the S&P.

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After four consecutive quarters of negative G.D.P. growth, we now have eight consecutive quarters of positive growth, starting with the third-quarter of 2009, every quarter in 2010 and the first quarter and second quarters of this year, although these numbers are weaker than earlier estimates, according to the Commerce Department. For all of 2010, G.D.P. rose at a 3% rate, which was the highest since 2006 after a worse than originally estimated decline of 3.5% in 2009 and an overall decline of 0.3% in 2008. For 2011, the prediction is now for G.D.P. growth of 1.5% and it is 2% in 2012, although estimates for 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.