

Daily Market Notes

Market Update :

DJIA: 11084
S&P 500: 1155
Nasdaq: 2478

10YR T-Note: 2.06%

EUR/USD: 1.34
VIX: 37.50

Gold: 1635
Crude Oil: 81.94

Prices Current as of
1:30PM

Source: CNBC

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For the third day in a row yesterday, the market was able to overcome lower than fair value stock index futures at the start of trading and follow the same pattern it had exhibited the prior two days as well, namely close sharply higher after a lower start.

And sure enough, yesterday saw the Dow fall to its low right out of the gate with an 80 point decline at its worst level of the day. This was the result of some unnecessary comments from outgoing E.C.B. President Trichet, who must have read the memoirs of his U.S. counterpart Ben Bernanke, and could not help himself from spouting a very negative comment about the state of the world economy by saying that there are “intensified downside risks” to the economic outlook, thank you very much. He also said that interest rates will be kept unchanged after having foolishly been raised three times this year, and perhaps this has contributed to the awful mess that Europe finds itself in at the present time.

And once again, as we have seen every day this week, the economic reports released here have come in a little better than expected, further pushing the U.S. economy out of the danger of falling into a recession, although economic growth is not going to be that robust either. Yesterday saw weekly jobless claims decline by less than projected, rising to 405,000 from 395,000 the week before, which was the lowest in six months. In addition, September chain store sales rose by more than forecast, with a gain of 5.5% and this was the highest level since May.

From those early European-inspired lows, things once again began the same pattern that they had exhibited during the prior two days, helped by a strong Nasdaq/Dow ratio once again, as even when the Dow made a slight negative dip around mid-day after having been higher, the Nasdaq remained in positive territory, which was the main factor that resulted in a very dramatic upside close, with a huge late final push to the highs at a closing Dow gain of 183 points.

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The Nasdaq ended 46 points higher and breadth numbers were a very strong 5 to 1 to the upside. The VIX declined by just about what it should have relative to the Dow's advance, with a loss of 1.54 to 36.27. This is quite a significant decline from its panic move higher to 46.88 at the market's intraday bottom on Tuesday.

And would you believe it that the best performing stocks were the.....financials, which rallied on a report that the French government is working on a contingency plan to take stakes in the country's largest lenders, and is that a good thing? It sounds similar to what happened here after the financial crisis three years ago. Also helping those stocks was the potential issuance of new covered bonds, which are backed by public sector loans and mortgages, and whose \$2.5 trillion outstanding is the basis of European real estate lending.

And naturally when the bond market saw stocks rallying, it had no choice than to go lower for the third day in a row, as the yields on longer maturities pushed higher once again, as if the stock market goes up, then that is a sure sign that economic activity is supposedly getting stronger and bond yields have to reflect this with higher rates. This is another example of how outside markets make this knee-jerk reaction to whatever stocks do, or is it the other way around, and we also saw the same dynamic playing itself out in the copper market, which underwent its largest one-day rally since early 2010 and crude oil, which also made a huge rally on lower inventory supplies and it also looked over its shoulder at stronger stocks as well. And to finish the picture, the Euro also rallied, and since our stock market is just a follower of what the Euro does, its rally certainly added to the upside picture as well.

After this terrific three-day recovery, which has advanced the S&P by 8.4% since Tuesday's plunge to the 1075 bear-market territory, investors breathlessly awaited this morning's September jobs report. And after another day of slightly lower stock index futures before the opening,

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the report was a pleasant surprise relative to expectations, as the overall number of jobs created was 103,000 but from this one has to add back in 34,000 government jobs that were lost, which gets the private payrolls number up to 137,000. Of course those 45,000 striking VZ workers that were deducted from the August report had to be added in to this number as well. What was also positive was that 99,000 additional jobs were added to the July and August figures and the average hourly earnings and workweek components rose also. The unemployment rate stayed at 9.1%

After a higher start, with the Dow gaining as much as 108 points at its best level at 10:20am, things have steadily deteriorated. And if any readers of these notes do not know the reason for this deterioration, then they have not been paying attention. And for those who still do not know the answer after this clue, it is one of the oldest indicators of all, which we constantly refer to, and that is the Nasdaq/Dow ratio, which as we have pointed out all week, was responsible for the market's ability to go the distance the prior three days. But today this dynamic was badly lacking, as the Nasdaq went negative early, and even when the Dow was on its best level as just mentioned, all the Nasdaq could do was muster a gain of 5 points, which is a terrible ratio relative to the Dow advance of 108.

And as has been pointed out so many times in the past, we all know who wins this battle, as the weak Nasdaq forced the Dow into negative territory, with breadth numbers really deteriorating with a horrible 1 to 3 negative ratio.

It was sort of obvious that things were not going to get too far when even at the highs of the day, those universally loved financials from yesterday turned negative fast, and so did most of the technology issues as well. And without these two groups participating, things cannot get too far on the upside. Why these items were weak right off the opening was somewhat of a mystery, but once again, the large number of calls expiring today for the largest U.S. bank by customer deposits at 6

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and the low-priced wireless company at 3 might have something to do with it, as both of these looked like “slam-dunks” earlier this morning when both stocks were well above those prices. And ongoing weakness in the large mobile telecom and computing company after the passing of its charismatic C.E.O. has also hurt as well. The fact that this stock closed lower yesterday even though the overall market was very strong was somewhat telling, as what is it now supposed to do on a down day, and even on the market highs in the morning, it was lower. Large option positions are probably controlling its price movement today as well.

So what happened to make that nice Dow gain vaporize into a slight loss? Even before the Fitch downgrade of Spain and Italy’ credit ratings, there was a report that Germany and France were split ahead of talks on Sunday on how to strengthen these shaky European banks and prepare for further Greek aid. The U.S. has been pressuring their two leaders to come up with some sort of better solution than what has been proposed so far. The French want to be able to tap into the Eurozone’s \$440 billion rescue fund to recapitalize its own banks, which currently have the largest exposure to these weak countries’ debt. The Germans apparently insist that the fund should be used only as a last resort when no national funds are available. And then just when things were starting to deteriorate in any event, Fitch Ratings Service jumped into the downside goings-on by downgrading the debt of both Spain and Italy. And even before these lowered Fitch ratings, the financials were lower on a story that one of the Fed governors said that regulators have not yet put in place a system that would allow orderly failure of the largest financial firms without taxpayer rescues.

And to put the icing on the downside cake, when the outside markets saw this, they also decided that the path of least resistance is lower, continuing that sick symbiotic relationship between these markets that has existed for the past year. So now crude oil prices went negative after having been positive earlier and the Euro,

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which basically calls the tune for our stock market and other markets as well, went from being higher to being lower. And I actually saw a story from a large financial media reporting service that corn prices turned negative on the Spain downgrade – now give me a break here, although one can make the argument that since commodities are denominated in dollars, then Euro weakness and dollar strength can cause these types of items to decline.

So now all of the euphoria about this morning's jobs report has disappeared, but unfortunately one could sense that something like this was going to happen because of the dynamics that readers of these notes really should know by now.

Next week sees the start of the most important phase of the third-quarter earnings reporting period, and we will hear from Dow component AA on Tuesday, and talk about a weak lead-off batter; Wednesday sees ADTN and PEP; Thursday has Dow component JPM, in addition to GOOG; Friday has JNHT and MAT, among others.

For what it is worth, there is a statistic that says the S&P has gained on average 5% in the fourth-quarter after third-quarter losses of greater than 8% since 1924. Let's see if history repeats itself this year.

Third-quarter earnings will be the main market mover next week as the season gets into high gear with two Dow companies reporting, and we will list the lineup in tomorrow's market notes.

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,

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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 \$95 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. Third-quarter earnings are projected to now rise by 13%. The highest ever earnings for the S&P in one year so far took place in 2006, at \$88. For 2012, earnings are still projected to be \$104 for the S&P.

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

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