

Daily Market Notes

Market Update : Friday's session was influenced by both the drama over the second Greek bailout and the monthly February options expiration. And the Dow did just about what it has been doing on most up days this year, namely make an early high, then sell off somewhat toward the middle of the day before finally ending with a rush going into the close that does not quite match the early high.

DJIA: 12966
S&P 500: 1366
Nasdaq: 2956

10YR T-Note: 2.07%
 EUR/USD: 1.32
 VIX: 17.92
 Gold: 1756
 Crude Oil: 104.88

Prices Current as of
 1:10 PM
 Source: CNBC

The initial Dow gain right out of the opening gate was a 50 point advance, which then became only a 12 point gain on the low at 11am, which then turned into the best level of the day with a 63 point push before ending 45 point higher. And we have to give the Dow credit because for one of the rare times in its relationship with the Nasdaq, it was able to ignore weakness in the latter and power ahead on its own as the Nasdaq was around 12 point negative for most of the session before ending with a closing 8 point decline. Breadth numbers were decent at a positive 17/12 ratio and the yield on the 10-year Note rose to 2% on the perception of the ongoing economic recovery here in the U.S. and the push into riskier assets like equities, which has been the major theme so far in 2012.

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Despite all of the drama relative to Greece, the Euro was sort of calm, as it stayed in a narrow range and ended at 1.3140, higher by a bit for the day. More drama took place relative to the VIX, which made those investors who are obsessed with it on the upside look foolish once again, as it made a much larger decline than it should have relative to the Dow's advance, falling by a large 1.44 to 17.78. And despite the large gain in the VIX on Tuesday, when the Dow fell by 97, its only losing session of the week, the VIX actually declined by twice as much as it should have for the five trading days, with a loss of 3.01 relative to the weekly Dow advance of 148 points. This is why those cries of woe, which are constantly magnified by the financial media for reasons that I cannot figure out when the VIX goes up by this much and that much, it is once again headed close to its near-term support at 17.50.

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On the other hand, what was not so good was the relentless climb of crude oil prices, and they reached close to \$104 a barrel, and the reasons for this increase will be discussed in today's Bi-Weekly Commodity Report, which will be released later today. It is somewhat spooky in the similarity to last year, when the market was rising in the early part of the year at the same time that crude oil was also going up, and one of the reasons for the awful decline from early May to the October lows was that those higher energy prices resulted in consumers pulling in their wallets because of the absurdly higher prices for gasoline at the pump and for heating oil costs as well. And this year these high energy prices will take on a political component, as it appears as if they are destined to keep rising if the stock market continues to advance along with the Euro, and this could become an election year issue as the summer approaches with the height of the driving season and the November vote getting closer and closer. But for the bizarre reason that we have discussed so many times in the past, when these risk assets like stocks and the Euro rise, then it is supposedly good that energy prices rise as well, because this shows "worldwide economic growth."

So now the major averages have risen for six out of the first seven weeks of the new year, and the S&P is already ahead by 8.2%, which is about what it tends to gain for an entire year.

Earnings are now becoming somewhat irrelevant for the overall market, but still have an effect on individual companies, and with 418 of the S&P firms having reported, 64% of them have exceeded their estimates, which is still slightly below the recent average of 70% over the past few years.

It was mentioned above that aside from Greece, Friday's session was influenced by the fact that it was the monthly February expiration series, and we pointed out how major option stocks were maneuvered so that the largest number of call and put buyers ended up with worthless merchandise at the close.

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The most glaring example of this was to no one's surprise, the shares of BAC, which were pinned close to the 8 strike price so that 164,000 call buyers and 153,000 put buyers lost virtually all of their money. And how about AAPL, which got call buyers all juiced up earlier last week when the stock got as high as 526, from which level it cooled off and this left 116,00 holders of the 505 and above strike price with nothing to show for their efforts. Of course the list goes on and on, but in keeping with tradition, we pointed out the SPY, which always attracts the largest number of positions because this is what the so-called "experts" use to "hedge" their positions. Of course, in the overwhelming majority of cases, they would be better off doing nothing, as Friday's totals read – 4.9 million puts and 485,000 calls going out with no value, as opposed to 56,000 puts and 1.4 million calls having some value, which means that 78% of total calls and puts expired worthless, and this was just about in line with the historical averages. And you can be sure that the action in those individual stocks and in averages such as the SPY had nothing to do with Greece. And as fate would have it, all three of the issues that were just mentioned are nicely higher today, which of course raises the old dilemma for those who bought calls that expired on Friday – "Oh darn, if there was only one more session to trade these things, I would have made so much money!", and don't you think that the market makers know this and let us remember that their job is to keep the buyers' money, and what else is new!

And talking about that country in the Peloponnesus, they did move close to winning a new rescue package worth \$130 billion Euros as apparently Germany, the paymaster of Europe, was optimistic that a deal could be struck despite misgivings over whether Athens would stick to its commitments. The Greek Prime Minister was trying to persuade Germany and others to back the bailout measures needed to stave off bankruptcy.

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Of course there are still questions over whether Greece has done enough to ease the crisis and bring its debt load lower from 160% of G.D.P. down to the still daunting target of 120% by the 2020 deadline agreed to with partners and lenders last year. The latest estimates are that Greek debt will still be around 129% of G.D.P. in 2020, which is higher even than the 125% that most Euro-zone countries would probably accept.

Then there is the question of whether to allow Greek bonds held in Euro-zone banks' investment portfolios to be subject to the same write-downs which private investors are about to take, namely on the order of 70%. These banks hold around \$20 billion Euros of Greek bonds in their portfolios and if they do take losses on those bonds, it would provide an immediate lump sum to Athens and so help it approach the debt reduction goal.

And sure enough, over the weekend the E.U. finance ministers agreed to that \$130 billion Euro rescue for Greece in order to avert an imminent chaotic default after forcing Athens to submit to unpopular cuts and private bondholders to take bigger losses. The complex deal does buy time to stabilize the E.U. but at the same time it leaves doubts about Greece's ability to recover and avoid default in the longer term. The deal will cut Greek debt to 120.5% of G.D.P. by 2020, which was a fraction above the original target. This will secure the rescue in time for that major bond repayment next month. Greece will be placed under permanent surveillance by an increased E.U. presence and it will have to deposit funds to service its debt in a special account to guarantee repayments.

By agreeing that the E.C.B. would distribute its profits from bond buying and private bondholders would take more losses, Greece's debt was reduced to a point that should secure funding from the I.M.F. In sympathy with these Greek developments, both Spanish and Italian bond yields declined as well, and remember late last year, the rise in those yields caused investors here to get bent out of shape on many occasions.

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Of course, this means that Greece will struggle for years without economic growth, and these measures are very unpopular with the electorate ahead of the April elections. Then there is the question of whether they can pay off even a reduced debt burden, which means that the deal may only delay a deeper default by a few months and an eventual exit from the E.U. later this year.

Our market, after being closed yesterday, has reacted mostly positively to the news, with the big question being whether the Dow can close above the round 13,000 level, which would be a 50 point advance and this level has already turned it back a few times so far. Breadth numbers are nicely positive at an 18/11 ratio but the VIX is having a tough time with this advance, as it is still nominally positive even though the Dow is ahead by 42 points as this is being written.

Naturally the Euro is well ahead from Friday's close, all the way up to almost 1.3300, which has proven to be a big resistance level, and what is not so good is that crude oil prices are now up to \$105 a barrel, the highest in nine months and how is that supposed to be good, as mentioned above.

Earnings season is winding down, and traditional retailers report late and the lineup for this week is: tonight – DELL; Wednesday: DLTR, TJX, LTD and Dow component HPQ; Thursday: GPS, KSS, SHLD, TGT; Friday: JCP.

Economic data is on the light side with: Wednesday – January existing home sales; Thursday – weekly jobless claims; Friday – January new home sales and the final February U. of Michigan Consumer Sentiment Survey.

The S&P trades at 13 times projected 2012 earnings of \$102, which has been a major supporter of stocks lately. Earnings were \$85 in 2010 and are projected to be \$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. Since 2006, the average P/E multiple has been 14.7

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For all of 2010, earnings increased by +38%, which was the most since 1995. For the first three-quarters of 2011, earnings gained +17% 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. Fourth-quarter earnings are projected to rise by 5%. The highest ever earnings for the S&P in one year so far took place in 2006, at \$88. For 2012, earnings are projected to be \$102 for the S&P and for 2013 the estimate is for \$107.

After four consecutive quarters of negative G.D.P. growth, we now have 10 consecutive quarters of positive growth, starting with the third-quarter of 2009, every quarter in 2010 and every quarter in 2011 as well. For 2011, G.D.P. rose at a 1.7% rate, and it is projected to grow by 2.2% 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.