March 7, 2011

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Daily Market Notes

Market Update:

DJIA:	**12100**
S&P 500:	**1310**
Nasdaq:	**2736**
10YR T-Note:	**3.48%**
EUR/USD:	**1.397**
VIX:	**2105**
Gold:	**1436**
Crude Oil:	**105.31**

Prices Current as of 12:38 PM

Source: Bloomberg

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Instead of looking at Friday's lower market as a down day, one should perhaps look at it in the context of Thursday's bizarre upside moonshot, the largest market advance in three months. In other words, combining the 191 point Dow gain from Thursday with the closing Dow loss of 88 on Friday means that the market basically rallied 103 Dow points in reaction to what was a very good jobs report. The reason it would be better to combine the two days is that Thursday's rally did not seem to have any basis of rationality in the sense that it is very unusual to see the market make this type of upside explosion ahead of a monthly jobs report. Usually it sort of treads water as investors do not want to make major commitments ahead of news that sometimes moves the market one way or the other in a large manner on many occasions.

In any event, the report on Friday was a very good one, with total gains of 192,000 jobs, which was the best gain in nine months, the unemployment rate at 8.9% was the lowest since April 2009 and December and January were revised upward to show an additional 55,000 jobs were created. In addition, January factory orders rose to their highest level since September 2006 on a strong jump in commercial aircraft orders. So as the old expression goes – "What was there not to like?"

After very fleeting early nominal gains by the major averages, things deteriorated steadily to the downside, and at its worst level the Dow fell to a loss of 179 points at 3:30pm. Then just when things looked like they were going to end with awful losses, the major averages made a tremendous very late push to the upside, with the Dow able to cut that 179 point loss in half to end with a closing decline of 88, and the Nasdaq was able to cut its worst level of being down 30 points to a closing decline of 14. This relationship actually meant that the Nasdaq/Dow ratio was decent even on a down day and perhaps this had something to do with that very late comeback as well. Breadth numbers ended poorly at a negative 10/19 ratio, but this was better than the almost negative 1 to 3 ratio that existed when the major averages were on their lows.

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The financial stocks led the way lower on a downgrade of a widely held bank after the stock had already declined by 9% since its rally to over 5 in mid-January. As stocks declined, the bond market, which has been showing large moves on a day to day basis, and usually in the opposite direction of the day before, made a large rally which lowered the yield on the 10-year Treasury note to 3.48%, on a flight to safety perhaps because of the deteriorating situation in Libya and the potentially negative effects of a slowdown in consumer spending as gasoline and home heating oil prices make historic jumps in such a short period of time.

And speaking of crude oil, it rallied by a very large $2.51 to $104.42 a barrel and this was obviously a reason why stocks came under selling pressure as well, in addition to adjusting downward in reaction to Thursday's bizarre upside moonshot as mentioned above. The VIX gained .46 to 19.06, less than it should have relative to the Dow's decline, and it now feels comfortable in the recent 18-23 range.

And once again, those weekly options with the largest open interest went out worthless as they usually do, with the 4.50 puts on the widely held bank ending with no value despite the downgrade, as the stock finished slightly above that level. There were 375,000 puts on the stock that represents 1/10th of the S&P itself that expired worthless as well, in addition to both calls and puts in the large mobile telecom and computer stock mainly going out with no value as the stock closed exactly at 360 to inflict the most punishment to buyers on both sides.

Today started out higher based on a fleeting positive reaction to further merger and acquisition activity and a statement from a Fed official who said that additional asset purchases after the expiration of the $600 billion Q.E.2 program that expires in June should not be ruled out. After a fast gain of as much as 74 points, the Dow has now turned lower, and we are seeing a classic case of a weak Nasdaq/Dow ratio wreaking its negative havoc on the overall

market. Even at the Dow highs, the Nasdaq was lagging with only a 10 point advance at the time, much less than it should have. And once the Nasdaq turned lower, the entire market gave way, as when the Dow was still at its highs at 10am, the Nasdaq went negative and we all know who wins that battle.

Ironically, the reason being put forward is that crude oil prices are continuing to move higher, but earlier in the day crude oil was up as much as $2 a barrel to as high as $106.95 and the various stock index futures were actually unchanged to a bit higher. So now crude oil has come off of its best levels with a gain of "only" $1.04 to $105.46 and yet equities are in a downward spiral, with both the Dow and the Nasdaq lower by around 40 points, which is obviously a very poor ratio.

If the Nasdaq is doing so poorly, then it must be that technology stocks are weak, and that is certainly the case today, with the high-priced leaders cooling off a bit and when this happens the weaker ones such as the three Dow tech stocks that are also in the Nasdaq do not have a chance. And this is certainly the case today. Breadth numbers are also turning progressively worse as the day has moved on, with a negative ratio of more than 1 to 2 to the downside.

Since this week is light on both earnings and economic reports, it would appear the obsession with energy prices is going to drive trading in stocks, and it now appears as if the highs reached more than two weeks ago on February 18th are going to be upside stoppers and the market will now trade in a more volatile manner between recent support under 12,000 on the Dow and under 1,300 on the S&P to those highs reached two weeks ago. This range now appears to be a valid one until the first-quarter earnings reports are released in April, which might move things either above this range or below it.

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The S&P trades at 13.5 times forward earnings, and 15.8 times current earnings, and this gets it to the highest level in the past year, if one assumes that this year's earnings are going to come in at $83 for the S&P and $95 for 2011. The average P/E multiple for the S&P going back to 1954 has been 16.2. This current level of the S&P could be used as the "excuse" for any market selloff that we see, if in fact we see one the rest of this month.

According to the sector analysts who follow these companies individually, for all of 2010, earnings are projected to increase by +29%, which would be the most since 1995, followed by earnings increases of +15% in 2011, as reported by Bloomberg Financial, and this would be the largest two-year advance since the period ended in 1995. First quarter profits rose by +52%. Second-quarter profits rose by +49%, the third-quarter rose by +28%. The fourth-quarter is supposed to gain by +37%. If these numbers do come to fruition, then S&P earnings should be around $83 for 2010 and $96 for the S&P in 2011. This would equate to around a 15% 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 five consecutive quarters of positive growth, starting with the third-quarter of 2009 and continuing with every quarter in 2010 according to the Commerce Department. Economists now predict that G.D.P. expanded 2.8% in the fourth quarter. For 2010, G.D.P. rose at a 2.8% 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 3.5% 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: {PROVIDE SOURCES}. 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.