NATIONAL
SECURITIES
Established 1947, Member FINRA/SIPC

# Daily Market Notes

**Market Update:**

| | |
|---|---|
| **DJIA:** | **12555** |
| **S&P 500:** | **1326** |
| **Nasdaq:** | **2812** |
| **10YR T-Note:** | **2.89%** |
| **VIX:** | **18.60** |
| **EUR/USD:** | **1.414** |
| **Gold** | **1585** |
| **Crude Oil:** | **98.48** |

Prices Current as of 1:58 PM

*Source: CNBC*

**Donald M. Selkin**
Chief Market Strategist
(212) 417-8017
dselkin@nationalsecurities.com

**Let us go over what has transpired since the last issue of these notes was written on Friday, July 1st.**

**After declining from the yearly highs reached in late April, which were also three-year highs, the market then proceeded to undergo a correction from those highs at 1370 for the S&P to as low as 1258 intraday on June 16th, which amounted to an 8% decline. This decline was the result of fears that: 1) the Japanese earthquake supply disruptions would interfere with global economic growth and could possibly affect earnings here as well; 2) higher oil prices could affect consumer spending; 3) the European sovereign debt crisis could spread from Greece to the other weak members of the E.U.; 4) the approach of the August 2nd debt ceiling deadline could have all sorts of negative effects if in fact some sort of agreement to break the impasse that currently exists between the White House and the Republican Congressional leadership was not approved.**

**But from those mid-June lows, the markets once again started to rebound, and after declining for seven out of eight weeks, things made a dramatic upside turnaround the week leading up to the Independence Day holiday here in the U.S., namely from June 27th to July 1st. In fact, the increases that week were so dramatic that I had referred to them in the same way that the old-time civil servants used to say that you just went to work and came home with more money on that day that you started to work, the old "another day, another dollar" syndrome. These gains were of a historic nature in that the 5.6% rally in the major averages was the best week in two years. These gains were a function of the Greek parliament approving the famous "austerity" plan despite the major financial news programs obsessively showing the riots by young people who were "afraid" that the retirement age would be raised to levels that are more consistent with other western countries, heaven forbid, and that even worse, the people of that country would have to pay their income taxes, and let us remember that Greece is the most corrupt country in the E.U. in this regard, even more so than Italy if that is possible. In addition, there was**

an agreement by the German banks to permit rollovers of Greek debt. Also helping was the perception that the drag from Japan's disaster will eventually fade and oil prices coming down would have a beneficial effect on consumer spending.

Just to illustrate how astounding these gains were, in the course of a week, the percentage of stocks trading above their 50-day moving averages rose from an oversold level of only 16% to 60%, which in a sense started to create a bit of an overbought situation in the course of that week alone. The Dow's gains were of a really astounding variety, as on five consecutive days the advances were as follows – 108, 145, 73, 153, topped off by Friday's 168 point gain, which was motivated by the June ISM Manufacturing Survey which rose for the first time in four months after all of the experts whose job it is to predict these things were looking for a decline. Adding to the bullish fever was that both the Dow Transports and the S&P Mid-Cap Index both hit all-time record highs and the S&P gain of 71 points was its largest since March 2009.

As if these gains were not enough to satisfy the bulls, last week's holiday-shortened four days started with further but smaller advances as the first three days of the week saw the Dow put in a 12 point loss followed by gains of 56 and 93 points going into last Friday's all-important jobs report. These gains were motivated in part by good same-store sales results. In fact, the Dow was higher for good parts of Tuesday until Moody's decided to downgrade the debt of Portugal to junk status, and traders here made that knee-jerk selling reaction to cause the nominally lower close. However, the Nasdaq did end higher by 9 points. These gains came despite a weaker than expected June ISM Non-Manufacturing Survey which showed slightly less expansion than had been projected. On Thursday, the market put in its best showing of the week as mentioned above as that horrible predictor of the jobs report, otherwise known as ADP, came out with a strong estimate of 157,000 private payroll positions being added. This number was twice as much as what had been expected. Also helping the rally was the decision by the E.C.B. to suspend minimum credit

rating requirements for Portugal's debt despite Moody's recent downgrade of that nation's bonds to junk status.

As wonderful as these gains during the time-frame described above were, they set up a classic no-win situation for Friday's jobs report. And this no-win situation arose because of the following – the fact that ADP's numbers have historically been way off the mark, and this time it was bizarre because they were ultimately much too high after usually being much too low. The second reason why things probably had to decline on Friday was that the VIX had fallen as low as 15.30 from its high of 24.65 reached at the market correction low on June 16th. This was only 1 full point away from its ultimate downside support level of 14.30, which does not appear that it will be broken for the foreseeable future.

And as Jay Leno is fond of saying – "You can knock me over with a feather", as Friday's jobs report was basically a disaster, when instead of the 157,000 private jobs that were supposed to be created as per the experts at ADP, the number was only a third of that figure at 57,000. This was offset by losses of 39,000 government jobs which meant that the final figure was an anemic gain of only 18,000. And what made this number more surprising was the fact that the experts all rushed to raise their estimates in light of what ADP had said, which just goes to show that these experts really know nothing when it comes to predicting these figures and history will show this. In addition, the unemployment rate rose to 9.2% and the May numbers were revised downward from 54,000 to a final number of only 25,000. The final insult in this horrible report was that both the average workweek and average hourly earnings declined as well.

As a result, the market got hammered, with the Dow declining by as much as 152 points at its worst level, but managed to end with a closing loss of "only" 62 points, which had to be something of a victory considering how awful this report really was, and as a result, the major averages still ended the week with

gains, although nowhere near as dramatic as the week before.

Just when investors thought that the worst was behind them, the market got hit over the weekend with new concerns about the European debt crisis once again, and this time, after weeks of uncertainly about the Greek bailout situation, Italy became the latest problem child, as investors now took aim at other countries with the toxic combination of high debt, slow growth and political dysfunction, all of which Italy has in spades. Fears of political paralysis could make it more difficult for this country to embrace the austerity demanded by investors to reduce one of the highest debt levels in the world, at 119% of G.D.P., which ranks second in Europe as the worst after Greece at 143%. The Italian stock market got hammered with a decline of 4%, although one would never have noticed this as my wife and I were in Venice on Monday and things looked like they were as booming as they always are in that city, which is perhaps not the best way to judge the overall state of the Italian economy. As a result of another country being dragged into the misery of the Eurozone sovereign debt crisis, the Dow ended with a loss of 151 points and for the first time in a while the VIX rose by much more than it should have, gaining a large 2.44 points.

So now we had the classic makings for a "Turnaround Tuesday" situation yesterday, which usually results when the market sells off on a Friday, then follows that up with a worse decline on Monday, and then starts out lower but finally ends higher. And sure enough, after a hesitant day for most of the session, the Dow started to move up at 2pm, and actually showed a gain of as much as 64 points at its best level around 2:15pm. This move higher was in reaction to the release of the minutes of the June Fed meeting which indicated the possibility of more stimulus. But this positive market move was completely down away with when shortly after this move to the highs, Moody's decided to go on its downgrade path once again, and this time the unlucky receipt of its wrath was none other than Ireland, another one of those weak E.C.B. members. Its credit rating was lowered to junk status, which meant that here we have

**another European country that will probably need additional rounds of official financing.**

**As a result of another late announcement, the Dow turned that 64 point gain into a final closing loss of 59 points, and not helping was a poor Nasdaq/Dow ratio, as the former ended with a decline of 20 points and even early in the session, as my wife and I were boarding the plane in Paris for the flight back to New York, the Dow had started out up 1 but the Nasdaq was down by 6, which meant that the ratio was starting out the day poorly and I said to my wife that things will probably end lower because of that, and she does understand what I am talking about. In fact, when the Dow reached that 64 point high, the Nasdaq could only manage a gain of 5 points, which is a very poor ratio and not conducive to further advances. The reason for the weakness in the latter was that a chip-maker came out with a profit warning which put pressure on that segment and prevented the Nasdaq from getting going, so to speak. And the breathlessly awaited results for the first Dow company to report, namely that pathetic aluminum maker, were a big nothing as the stock made small moves on either side of unchanged, so we will have to wait for more important companies to report later this week, and we will certainly be getting a few of them as I will mention below. And to add insult to injury, the VIX for the second day in a row gained by more than it should have, with a 1.48 point advance, or almost three times as much as it should have relative to the Dow's decline, as the nervous nellies once again came out of hibernation, and this pushed it to around 20, which has been a bit of an intermediate resistance level lately. This indicated that things were probably a bit oversold after the three straight days of declines.**

**And riding to the rescue today was none other than Fed Chairman Bernanke, who said in his Congressional testimony that "The possibility remains that the recent economic weakness may prove more persistent than expected and that deflationary risks might re-emerge, implying a need for additional policy support." This is all that an already higher market needed to make today a**

**"Turnaround Wednesday" instead of the usual Tuesday rally after the type of declines that were mentioned above. Things were higher in any event, as the various stock index futures were showing good gains ahead of the opening and the Dow was higher by around 50 points when the Chairman's testimony started at 10am. From these levels the Dow shot to a gain at its best level of 164 and is currently not too far from this high. Breadth numbers are outstanding at a 5 to 1 upside ratio, and even those pathetic financials are up nominally, will miracles never cease.**

**The reason that the market had been higher earlier was that China reported second-quarter G.D.P. growth of 9.5% as opposed to the experts' prediction of a 9.4% gain, but this was the slowest since the third-quarter of 2009 and shows that their raising of interest rates is finally cooling things off a bit, which was the intended effect of this policy.**

**And some of those high-priced technology stocks, which have managed to hold onto most of their gains despite the recent market declines, continue to roar ahead, with new all-time highs in the online movie rental company, almost new highs in the large mobile telecom and computer company after a sluggish four months and strong gains in the Chinese internet stocks after a sharp two-day selloff.**

**The only problem with these gains is that they come as a result of dollar weakness and resultant gains in commodities, and once again, how is this ultimately supposed to be good for the consumer? This is the scenario we saw in the early part of the year, which then led to the declines during May and most of June as mentioned above. But this degrading of the dollar is the natural effect of the record low interest rates that we have in the U.S. and the yield on the 10-year Treasury Note has once again fallen to its lows of the year at under 2.90%. But Bernanke's obsession with deflation is still a bit puzzling.**

**After the non-event from AA, there are some important companies that will**

finish the earnings week, and they are: tonight – MAR, YUM; Thursday – JPM and GOOG; Friday – C. Next week will see an avalanche of reports as well the week after and we will list them on Friday. There are also some economic reports as well, and they include: tomorrow – June P.P.I., June retail sales, weekly jobless claims; Friday – June C.P.I., July N.Y. State Empire Manufacturing Survey, June Industrial Production and Capacity Utilization and the mid-July U. of Michigan Consumer Sentiment Survey. So these are reports that can move things one way or the other.

And to repeat what was said recently, the market has now 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 +30%, which was the most since 1995. For 2011, first-quarter earnings gained +15% and are projected to gain +20% for the entire year, as reported by Bloomberg Financial and this would be the

**largest two-year advance since the period ended in 1995. These projections would equate to around a 14% earnings 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 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 2.8% and it is 3.3% in 2012.**

**Donald M. Selkin**

## 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.*