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Daily Market Notes

Market Update:

DJIA:	**10932**
S&P 500:	**1134**
Nasdaq:	**2364**
10YR T-Note:	**2.10%**
EUR/USD:	**1.438**
VIX:	**41.53**
Gold	**1888**
Crude Oil:	**83.58**

Prices Current as of 1:12PM

Source: Bloomberg

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After Thursday's downside disaster, stocks on Friday actually had the nerve to stick their heads into positive territory for a while before the unrelenting fear of worldwide economic growth and investor dissatisfaction with the ineptness of policy makers both here and in Europe took hold once again, resulting in a steady selloff as the day progressed, with the major averages finishing on their lows.

The Dow started out with a loss of 100 points right off of the opening, and then actually battled its way back to show a gain of 95 points at 10:30am, based on a statement from a top European monetary official that the E.U. may draft legislation on joint issuance of Euro bonds and present it along with a report on the feasibility of these common bonds. Then the German Chancellor threw a wet blanket on that idea when she said "we do not want that" and that a "collectivization" of the region's debt would leave Euro members worse off. And once the market heard this, it was back down once again, and it is really pathetic that our stocks are held in thrall to these European politicians who have obviously mishandled their own issues for the past year or so.

As a result, the Dow went into the negative column by 11am, and then spent the rest of the session in a classic down-staircase pattern, where each high gets lower and each low gets lower and then this is topped off by a summer Friday late downside acceleration to the lows.

This late acceleration was probably accentuated by the August options expiration series, which resulted in call strikes with large open interest that were comfortably in the money for most of the week and even for the first part of the day to basically vaporize, as let us remember that it is the function of an options expiration to cause as many buyers of calls to lose their money. For instance, the following calls with large participation vaporized in value by day's end, and these are only a few of the more prominent examples of this process – BAC 7, XOM 70, CAT 80, AAPL 360 and GOOG 500 and so on and so on.

The Dow ended with a closing loss of 173 points, which meant that it did a 268

point intraday downside reversal. The Nasdaq actually tried to hang in there, as it was still positive at 1:30pm when the Dow was down by around 40 points or so, but it could not hold up to the tremendous selling that took place as the day wore on and ended with another loss, this time of 38 points, which gave it the booby prize of being the worst performer last week with a loss of 6.6%, while the Dow and S&P gave up 4% and 4.7% respectively. This gave the market the ignominious distinction of having declined for four straight weeks, which was the largest decline in this period of time since the dark days of late 2008/early 2009.

And the so-called "safe havens" kept getting safer, as the Japanese yen and the Swiss franc both rose to record highs against the dollar, based on investors' assumptions that the current account surplus of both these countries makes them less reliant on foreign capital, unlike the U.S. for instance. And talk about supposed "safety", the yield curve here continued to flatten a bit as the 30-year bond declined in yield to 3.40% while the 10 and two-year maturities remained unchanged at 2.07% and .19% respectively. In fact, the former fell to its lowest yield since December 2008 on the slowing economy scenario.

Breadth numbers were poor at a negative 1 to 3 ratio and the VIX rose by only .38, much less than it should have relative to the Dow's decline of 173 points, as perhaps this was a sign that scared investors were not willing to pay much more for so-called "protection."

There are all kinds of measures to show that the stock market is undervalued at current levels, but the fact that the S&P is 10% below its 50-day moving average for the first time since the March 2009 bottom is one of them, and this is only the second time since the 1950's that overall yields on the S&P are above the yield on 10-year notes. Hopefully, these conditions, along with other measures of very reasonable valuations, will bring buyers into the market at current levels.

That hope was realized early today, as the market decided that it wanted to go higher based on the belief that the Federal Reserve will take steps to stimulate the U.S. economy when its Chairman makes a speech on Friday, which is the same venue that he announced the infamous QE2 program a year ago, which did cause the market to rise over the next six months by almost 30%, but whose gains unfortunately disappeared in the recent meltdown. The only thing that this program did, in my opinion, was raise the prices of certain commodities by its deliberate goal of weakening the dollar and now the word "inflation" is creeping back into the conversation for the first time in a long time, and this is the last thing that we need.

The exuberance was so extensive after the downside punishment of the past four weeks that the Dow actually had the nerve to start out the day with a very strong advance of as much as 203 points right off of the opening bell. But unfortunately this did not last as sellers immediately jumped on it and as a result, the Dow fell as low as only a 9 point gain by 11:50am, which meant that once again, similar to Friday, it dampened the hopes of the bullish contingent for some sort of recovery from the recent misery. But if "hope springs eternal", it was able to pick itself up, dust itself off and start all over again, as it has moved back to a 118 point advance as this is being written.

And the cause of the sharp selloff was none other than, surprise, surprise, the large financial stocks, which have been the downside misery leaders for months now, and for those old enough to remember the old limbo song – "How low can you go?"

Breadth numbers are okay at 17/12 currently and the VIX is down by just about what it should be relative to the Dow's advance. The one economic release today was a slightly less negative reading than expected for the Chicago Fed July National Activity Index, which might have contributed to the very exuberant opening.

It goes without saying that the market needs to preserve most of the current gains and not do what it did on Friday, and if there is some hope for today, Friday's late decline seemed to be a function of the August options expiration mechanics as described above.

This week's earnings calendar is not worth listing, as none of the stocks on it are considered market movers and investors are more concerned with the macro issues at present in any event. Economic reports see July new home sales and the August Richmond Fed Manufacturing Index tomorrow, July durable goods orders on Wednesday, weekly jobless claims on Thursday, and then the big events on Friday, namely the next revision of second-quarter G.D.P, which is projected to decline to 1.1% from its current reading of 1.3% and then the Fed speech. The best thing that they can do would be to say they are going to continue to purchase 30-year bonds and keep the size of the fed balance sheet the same as it currently is. But let us also remember that it was last year's Jackson Hole, Wyoming speech that launched the famous (or infamous) QE2 program, which has been a failure because it did almost nothing for the economy and all it did was raise commodity prices through the weakening of the dollar, which has partly helped to put us in the mess that we are currently in.

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 now 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 2011, first-quarter earnings gained +19% and are projected to gain +17% for the second quarter 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.

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.