

Daily Market Notes**Market Update :**

DJIA: 11415

S&P 500: 1205

Nasdaq: 2616

10YR T-Note: 2.13%

EUR/USD: 1.37

VIX: 32.97

Gold: 1636

Crude Oil: 87.00

Prices Current as of
11:40PM

Source: CNBC

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After the rousing rally of the past two weeks, including last week's best upside move since July 2009 which brought the S&P right into a resistance area that had stopped further upside in both late August and mid-September, things failed once again at those same levels yesterday. And it took the same dynamic that has basically been controlling the market lately, namely the fate of the Euro, to do stocks in, just as the rallying Euro the past two weeks was cited as the major upside motivator for equities as well.

So what happened yesterday to cause the Euro and stocks to do an about-face after such nice gains? Initially the optimism over this recent strong performance carried over Sunday night as the S&P futures rose by as much as 11.5 points, but then something had to pour cold water over the budding rally, and those Euro losses were attributed to comments from the German Finance Minister to the effect that "dreams" of an imminent resolution to the European financial crisis are not likely to be fulfilled at the upcoming October 23rd summit. And certainly the omens for this upcoming meeting in Brussels are mixed. It is true that governments there appear to have reached some sort of consensus on a plan that involves a bigger haircut for Greek creditors, bank recapitalization and leveraging the European Stability Facility bailout fund. But these plans must still clear multiple hurdles before they can begin to be implemented, and unfortunately the E.U. track record on taking decisive action is far from encouraging. It is true that the G20 finance ministers and central bankers said at the Paris meeting that ended on Sunday that they expected E.U. leaders to "decisively address the current challenges through a comprehensive plan" at this Sunday's summit, as France and Germany are supposedly making good progress on a plan to resolve the E.U. debt crisis and recapitalize the region's banks. But yesterday's German comments sort of threw a wet blanket over that to some extent.

As a result, things opened lower and steadily deteriorated as the session moved on,

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with the Dow reaching a 250 point decline by 2:50pm, at which point it tried to snap back to show a loss of 195 at 3:30pm before ending with a closing decline of 246 points. The Nasdaq did slightly worse by declining 53 points and breadth numbers were 1 to 4 to the negative side. The VIX really exploded to the upside, with a large advance of 5.15 to 33.39, about twice as much as it should have gained relative to the Dow's decline. This put it back in that low 30's to low 40's range that it has been in for a while now as the S&P has stayed in the low 1100's to low 1200's overall range for the past three months.

Naturally as the Euro got sold off sharply, which was the major reason behind the stock selloff, those markets that march to the same tune also came down after last week's strong gains, such as metals and energy. And naturally as stocks sold off, the bond market underwent a huge rally, pushing yields lower but also within recent ranges as well.

These losses came despite what might have traditionally helped the market as there were two mergers in the natural gas area, but never mind, as the Euro goes, so goes all other markets.

Earnings season for the third-quarter is underway, and for what it is worth so far, of the 45 companies in the S&P that have reported, 62% of them have beaten the numbers, which is a little less than what we have been used to lately, although it is early in the season.

After yesterday's downside debacle, things started out lower once again, as a decline in the shares of its highest-priced technology component is accounting for minus 73 Dow points just on its own when the stock is down by around 10 points, so there is a lot of distortion in today's numbers. And talk about a weak start to the earnings season, the largest U.S. bank by customer deposits has the honor of being the only Dow stock that is higher after its report, as following the aluminum company and the second largest bank selling off after their numbers last week, so far this week,

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in addition to the technology company decline, both the largest soft-drink company and the medical care product manufacturer are nominally lower after their reports. This is not the best way for the season to get started.

Naturally, there are other factors at work, and as usual our market is naturally following the trials and tribulations of the Euro, which is lower once again, this time apparently because Moody's Investors Service said that France's top credit rating is under pressure, which supposedly adds to the concern that the E.U. will continue to struggle to find a solution to the region's debt crisis. In addition, the Euro declined on a report that German investor confidence fell to its lowest level in almost three years. And heaven forbid, China's economy grew by "only" 9.1% in the third-quarter from a year earlier, which was the slowest pace since 2009. Part of this supposed slowdown was that industrial production increased by "only" 13.8% in September as compared to the consensus for a 13.5% advance.

And just to illustrate how sick this relationship has become, when the Dow hit its low of the session so far with a loss of 100 points at 10am, this is the same time that the Euro also fell to its low as well. Both have since recovered, and as this is being written, the Dow actually had the nerve to rise by as much as 35 points at its best level, and this is quite an accomplishment as one must take into account the distortion that the technology company is creating today. Breadth numbers are swinging all over the place, but as of now they are nicely to the positive side. Currently, the VIX is nominally lower by just about what it should be relative to the Dow's small gain, but these numbers for both the Dow and the VIX are certain to change as the day moves along.

The September P.P.I. report came in at the highest level in five months, with a gain in the headline number of 0.8% while the core rate excluding food and energy advanced by a nominal 0.2%. The outsize gains in the overall number were a function of gasoline prices rising sharply last month due to some seasonal accounting adjustments,

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in addition to the price of light trucks also rising by more than predicted. Rather than viewing this number as any sort of sign that inflation is with us once again, the bond market is doing nothing, as some investors are still running into the supposed safe-haven of these instruments which have handed those who bought them at the record low yields last month some losses in the process.

It would be helpful if the market can dig in its heels and not close lower by 65 points or so in the Dow, which would sort of be a victory considering the fact that the technology company is accounting for so much distortion. Tonight we hear from the large mobile telecom and computer maker, whose numbers are certain to influence the proceedings tomorrow, and let us see if another large technology stock that comes out with its numbers after achieving all-time record high prices just ahead of that report can escape what happened to the Dow technology component, even though it beat its earnings estimate.

Once again, technical types are keeping their eyes on that 1220 S&P level, which starts to represent the high end of the current trading range, from which there was a failure on August 31st at 1230, a mid-September comedown from 1220 and another failure from the same level at last Wednesday's high. So this is the level at which the battle will be engaged, and it is interesting to hear those market touts who did not buy at the lows say that they are now waiting for the opportunity to come back into the market at the "lower end" of the recent range, which is at least 100 S&P points lower than where we are now, and a decline of that magnitude might not be forthcoming based on seasonal and historical patterns (see below).

This week sees the really heavy start of the third-quarter reporting period and the lineup is as follows – tonight: AAPL, CSX, INTC, JNPR, YHOO; Wednesday: ABT, AXP, BLK, EBAY, FCX, MS, OMC, PNC, RVBD, TRV, USB, UTX, XLNX; Thursday: ABT, CMG, LLY, MO, NUE, LUV, MSFT, SNDK, UPC, T, TRV; Friday: CAKE, GE, HON, MCD, QLGC and VZ.

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This means that there are 12 Dow companies reporting, in addition to several other important ones.

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. There is another statistic that says when the S&P declines by 14% or more during the third –quarter, as what occurred this year, it has an 89% chance of advancing during the fourth-quarter. Let's see if history repeats itself this year.

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, 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.

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Third-quarter earnings are projected to now rise by 14%. 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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