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Daily Market Notes

Market Update :

DJIA:	**11734**
S&P 500:	**1227**
Nasdaq:	**2619**
10YR T-Note:	**2.15%**
EUR/USD:	**1.38**
VIX:	**32.11**
Gold:	**1724**
Crude Oil:	**91.12**

Prices Current as of 1:25PM

Source: CNBC

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After Monday's upside gains put the market into an overbought position, with the VIX declining to under 30, things got blasted to the downside big-time yesterday, the result of weaker earnings reports from major companies, disappointing economic reports here, and the sudden cancellation of the E.U. meeting that was supposedly going to finally come up with a solution by the E.U. in terms of talking to the banks on bondholder losses as part of a second Greek rescue package.

After decisively breaking through that 1225-1230 S&P resistance level on Monday, that index fell back right into that level yesterday and closed at 1229. If the market is going to build on its recent gains, then this former resistance level should now become support. After an early decline of 173 points, the Dow tried to make a comeback and reached its best level of the session with a loss of "only" 53 points at 10:45am before sliding back lower once again, and was down by around 100 points at 3pm, when one of those sickening late collapses pushed it as much as 231 points to the downside before ending with a closing loss of 207. And the Nasdaq did worse than the Dow all day, partly influenced by a large earnings-related loss in the online movie rental company and large declines in the high-priced technology leaders that had done so well lately. It fell by 61 points. And in a complete reversal of Monday, breadth numbers were 1 to 5 on the negative side while the VIX rose by more than it should have, advancing by 2.96 to 32.22. In a sense, this close was the complete opposite of what took place during Friday's late upside explosion during the October options expiration session, and is there any fundamental basis for these kinds of very late moves to be taking place, or have investors been beaten into the expectation of this type of market action, so the mantra is – just get used to it.

Naturally, as stocks declined the bond market rallied, pushing yields for the longer maturities lower by more than those for the shorter term, which is typical of what happens on a down day in stocks on the slower economic scenario.

And take a look, but we now have a bull market in none other than crude oil, whose price declined as low as $75 when stocks also hit their low for the year intraday on October 4th and then made this 16.6% rally from those lows until Monday's highs in the S&P. But crude oil has been going up even on some days when stocks decline, like yesterday.

And the reason being offered for this rally to a 12-week high is that stockpiles at the main U.S. storage hub, the one in Cushing, Oklahoma, are declining and this will be dealt with in more detail in the latest issue of the Bi-Weekly Commodity Comments. As has been mentioned all along, unfortunately this is what has come along with higher equities prices, and this is not the best scenario that one would like to see.

After yesterday's awful session, things started out sharply higher today, with the Dow advancing by as much as 161 points right off the opening bell, due to a combination of ostensibly friendly factors such as Germany's lower house of parliament approving plans to boost the European bailout fund, the September durable goods orders report which was the highest in six months if transportation equipment orders are excluded, a better than expected September new home sales report at lower sales prices, and a good earnings reaction to the Dow airplane manufacturer component.

But from those early highs things have deteriorated, as that 161 point Dow gain became a loss of 12 points at the 11am low. And the first thing that began the deterioration was classic, as the Nasdaq started giving ground after being 28 points higher at its best level, and even that was less than it should have been relative to the Dow's 161 point advance. Unfortunately it went negative at 10:10am while the Dow was still ahead by 100 points, and we all know who wins that battle. The Nasdaq got as low as a loss of 40 points, which dragged the Dow to that aforementioned low as well. And once again, it was another negative reaction to the earnings of a high-priced technology leader that did the Nasdaq in, and this time the booby prize went to the largest online retailer, which came out with a disappointing report last night. This is the same pattern that we have seen with other high-priced technology stocks as well.

In addition to the weak Nasdaq/Dow ratio, when one is at a loss to explain violent market movements, the answer of last resort is always the Euro, which was as high as 1.3975 at the same time that our market was opening and the Dow hit its best level, then proceeded to plunge to as low as 1.380 at exactly the same time that the Dow hit its low as well, and as stocks are recovering from those lows, so is the Euro. So the question is once again – who is leading who, and it appears as if the Euro sets the tone for what happens here.

And what was the reason for the decline in the Euro in the first place from those highs? Apparently, there was a report that E.U. governments will signal a readiness to back banks with guarantees to avert a credit freeze, but will not give an overall figure for recapitalizing banks. The E.U. will pledge to inject fresh capital into weak banks if necessary, but will first allow up to nine months to see if the banks can raise the money through private means. This promise of guarantees underscores the determination to head off a funding crunch that could threaten the region's economy, but failure to sign off on an overall recapitalization figure may undermine efforts to win back market confidence. Adding to the confusion was a statement that said there was "broad agreement" on bolstering the capital ratio of banks to 9% after taking into account the market worth of their sovereign debt holdings, but the statement gave no overall figure for re-capitalizing E.U. banks.

As this is being written, the market is very mixed, with the Dow able to regain positive territory with a 46 point advance, as the airplane manufacturer alone is accounting for 25 points of those gains, while the Nasdaq remains under pressure with a decline of 13 due to the largest online retailer company losses, which is having a negative effect on other high-priced technology issues as well. Breadth numbers are decent, with an almost 2 to 1 upside ratio. The VIX is lower by just about what it should be relative to the Dow's advance, with a current loss of around .40 points.

Believe it or not, the Dow has now risen by 1,000 points this month, and the only other time that this has taken place was in April 1999. This is also the largest gain for the S&P since December 1991, so what we have seen this month is certainly historic in terms of the upside, but let us also remember that these gains have come after the terrible beating that the market took in August and September.

This week will once again be dominated by earnings, and the lineup is as follows: Thursday: MET, GILD, BMY, DOW, MO, OXY, COL, BIDU and Dow component XOM; Friday: Dow components CVX and MRK.

Once again, technical types are keeping their eyes on that 1230 S&P level, which had represented the high end of the recent trading range, and which has now been reached on the upside, with Monday's 1254 close. This former 1230 resistance level should now act as support if things start to come down once again. 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 130 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).

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 $99.38 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 18% overall projected gain for 2011 would be the largest two-year advance since the period ended in 1995. Third-quarter earnings are projected to now rise by 16%. 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

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.