October 5, 2011

NATIONAL SECURITIES

Established 1947, Member FINRA/SIPC

Daily Market Notes

Market Update :

DJIA:	**10853**
S&P 500:	**1133**
Nasdaq:	**2444**
10YR T-Note:	**1.90%**
EUR/USD:	**1.33**
VIX:	**38.55**
Gold:	**1637**
Crude Oil:	**79.51**

Prices Current as of 3:10PM

Source: CNBC

Donald M. Selkin

Chief Market Strategist

(212) 417-8017

dselkin@nationalsecurities.com

In what had to be one of the great "Turnaround Tuesday's" of all time, not only did the market reverse to the upside from what was a potential downside disaster, but it was able to pull itself out of the ignominious distinction of falling into an "official" bear market in the process.

Let us go over this historic session in more detail. After two awful days where the Dow closed right at the low of the session, with losses of 240 and 258 points on Thursday and Friday, things were set up for another downside disaster, as the Dow was showing another loss of this magnitude, with a 251 point decline at 10am, just before the release of the 10am August factory orders report, which actually showed the highest capital goods orders component in three months. From this low of the day, the Dow managed to cut its loss to a decline of "only" 43 points by 12noon, from which it then went into another potential late in the day collapse, as it was lower by 220 points at 3:15pm, at which point the S&P officially fell into a bear market, having declined from its yearly high of 1370 to as low as 1075, much below the official 20% decline off of the high to 1096.

Just when all hope seemed lost, prayers to the Goddess of Lost Causes were heard once again, as the Dow made one of the most amazing turnarounds in such a short period of time in market history, changing that 220 point loss into a closing gain of 153 point by the close. This pulled the S&P out of the bear's den, as it closed at 1124, giving the bulls a reason to fight another day.

For those who follow these daily market notes, there are two items that are constantly pointed out and which one should have looked at to get a sense that things might have the potential to turn around for the better. The first is the old Nasdaq/Dow ratio, which had performing just awful in recent sessions, as large technology stocks were getting battered around even more than the stocks in the Dow.

But yesterday, while the Nasdaq was negative most of the day, its declines were less than those of the Dow, and it finally went positive at 3:30pm for good while the Dow was still lower by 100 points. And just as the Nasdaq leads on the downside, it can also lead on the upside as well, as when the Nasdaq was sticking its head above water, the Dow decided to join in the upside celebration as well.

Secondly, the VIX was acting as if the market wanted to go higher as well, as instead of rising by more than it should have relative to the Dow's declines on a panic selling day like yesterday. Even when the Dow was on its 10am low, the VIX was higher by only 1.43 to 46.88, less than it should have been. And the real clue to the fact that the market was going to turn around to the upside was that when the Dow made that secondary low of a 210 point loss at 3:15pm as mentioned above, the VIX was actually lower, with a decline of .75. Let us remember that the VIX usually goes down when the market rises, so this early "indication" from the VIX, combined with the strong Nasdaq/Dow ratio, meant that things were probably going to keep pushing to the upside.

After all was said and done, a horrible advance/decline ratio of as much as negative 1 to 5 turned into a closing positive ratio of 18/12, and the VIX really collapsed by much more than it should have relative to the Dow's closing gain, losing a large 4.63 points to 40.82 at the close.

Some of the gains were attributed to the Congressional testimony of Fed Chairman Bernanke, who said that the central bank can take further steps to sustain a recovery that is "close to faltering", so that got people excited that there might be some sort of QE2 program in the works. This caused the bond market to give up its early gains on the hopes of stronger economic activity.

And naturally when the Euro saw this, it decided to rally on the assumption that interest rates in the U.S. would now be even lower than they currently are. And crude oil and copper, which officially closed as stocks were cascading to that afternoon low, both turned higher in the aftermarket, continuing their symbiotic relationships with stocks, namely we all go in the same direction every day no matter what the fundamentals in each market for the particular day are.

So what caused this historic rally in those last 45 minutes, where the S&P gained an astounding 4.1%, which is almost half of the average gains that it achieves in a full year, going back 80 years or so? In addition to the real reasons as mentioned above, there was apparently a story that European officials are coming up with a "plan" to re-capitalize their banks – wonderful. Of course things had collapsed earlier in the day after European officials postponed a vital aid payment to Greece.

And similar to what happens on days when they introduce new products, the shares of the large mobile telecom stock got whacked big-time to the downside by 20 points in the afternoon when the market was headed to its lows, and when is the last time that this stock took the blame for a market decline? And when things turned around to the upside, it turned that 20 point loss into a closing decline of only 2 points, which certainly helped the major averages to recover.

If one wants to point out another example of an oversold market, how about the fact that only 7% of stocks in the S&P were trading above their 200-day moving averages going into yesterday's session.

So after that historic recovery, right after the close, the negative news kept coming, as Moody's downgraded the debt of Italy by three notches, which caused the various stock index futures to decline to below fair value, which set up a potentially lower opening today, similar to what had happened the day before.

And sure enough, this is exactly what took place, as the Dow started off today with a decline of as much as 70 points right off the opening bell. These early declines were tempered to some extent by the A.D.P. estimate for Friday's jobs report, as they put out a 91,000 private payroll job creation number, slightly above the estimate. Then at 10am, the September ISM Non-Manufacturing Survey came in slightly better than forecast as well, showing that the U.S. economy was not falling into a recession.

As a result, the Dow was able to chop to its highest level at 2:30pm with a gain of 100 points, from which things have eased off a bit as this is being written. The Nasdaq for the second day in row is doing much better with a 38 point gain relative to the Dow's current advance of 57 as this is being written. Breadth numbers are good at 19/11 and once again the larger technology stocks are atoning for their recent sins by advancing, but the financials could not take the one day or prosperity and are lower again, and so what else is new?

And for the second day a in row, the VIX is lower by much more than it should be, down an astounding 2.38 points to 38.44 relative to that Dow advance of 57 currently.

Unfortunately, if one thinks that there is going to be a "quiet" close, then that assumption might not be correct in the current market atmosphere, and what is also bothersome is that the market usually does not do the same thing very late for two days in a row, so let us hope for the best as the session nears its end.

And 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. Let's see if history repeats itself this year.

This week is light on economic reports, with the exception of the big one on Friday, namely the September non-farms payroll number, and we will discuss this more as the week moves on. Tomorrow sees weekly jobless claims and September chain-store sales ahead of the jobs report on Friday.

Third-quarter earnings continue to drift in, with this week seeing the likes of MAR and RT before the floodgates open next week and the two weeks after, and if one thing is going to perhaps save the market from further declines, it is going to be how the profit picture shapes up for the quarter just ended.

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. 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.

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.