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Daily Market Notes

Market Update :

DJIA:	**11954**
S&P 500:	**1229**
Nasdaq:	**2596**
10YR T-Note:	**2.00%**
EUR/USD:	**1.32**
VIX:	**27.64**
Gold:	**1664**
Crude Oil:	**97.75**

Prices Current as of 12:30 PM

Source: CNBC

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Which market is the correct one? The one that saw the Dow decline by 198 points on Thursday or the one that saw it rally by 186 points on Friday?

After a shellacking on Thursday on the usual worries that things are not going well in Europe, the market gave that part of the world the benefit of the doubt on Friday, as the Dow reached its high of the day at 3pm with a gain of 215 points before easing off a bit to end ahead by 186 points as mentioned above. The Nasdaq finally did better for a change and closed up by 50 points, and the positive Nasdaq/Dow ratio ensured that things would go the distance, which they did as breadth numbers were at a strong 5 to 1 positive ratio. And naturally the Euro rallied as well, with a gain of .0040 to 1.338.

What was a little disturbing was the fact that the VIX declined by much more than it should have relative to the Dow's advance, with a large loss of 4.21 to 26.38 and most unsophisticated pundits hailed this as a bullish development, when it is exactly the opposite of bullish because one does not want to see a decline of this amount, which equates to a Dow gain in the 400 point neighborhood, rather than the 200 point neighborhood that it found itself in on Friday. Remember that the lower the VIX goes, the less theoretical room there is on the upside for stocks.

Bond yields rose as stocks rallied in another one of these "risk-on" days that can come after a "risk-off" day as we saw on the final two days of last week, but stayed within ranges that they have been in for weeks now. A potentially disturbing factor is that we are seeing a greater than normal number of large companies issuing fourth-quarter profit warnings, and on Friday we had a Dow component, the large chemical company, in addition to two semiconductor companies, say that things are not going to be as positive as they had originally thought. If this trend continues, it could be a problem for the traditional year-end rally and it would only bring joy to the bearish contingent that says our market is not going anywhere on the upside.

At least we did not get one of those last 45 minute collapses, but once again the market did close below the level that it attained during that time frame, although not as dramatically as on other days last week.

And what was behind the bullishness, which left the major averages ahead by about 1% for the week, the second up-week in a row after that disastrous Thanksgiving week performance?

Naturally one has to look overseas, but the market did get a boost from the mid-December U. of Michigan Consumer Sentiment Survey, which rose to its highest level in six months. The first bit of positive news was a report that China's central bank will create a new vehicle to manage investment funds of $300 billion, and hopefully some of that money will be headed toward Europe.

But dominating the discussion was the final day of the E.U. summit meeting, which ended with an agreement to draft a new treaty for deeper economic integration that will include tougher budget discipline, with automatic sanctions for deficits. In other words, this is a treaty that will take many months to finalize and it then will still need approval from the various countries that will take part in it. The kicker is that any of those countries could eventually reject the final plan. So in a sense this plan is conditional with no enforcement rules announced and in addition there were no new policies aimed at improving economic growth.

Also, the E.C.B. still has not given any indication that it will buy government bonds of the individual countries that have been the biggest causes of headaches, but they did say that they would offer European banks unlimited loans for up to three years, while broadening the collateral that banks could use to back their borrowings. This would certainly help the liquidity situation for Europe's large banks, which have recently had difficulties obtaining funding in the interbank market because of their exposure to questionable sovereign credits.

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After the euphoria that was created by the results of the E.U. summit meeting last Friday, markets once again have put the "risk-off" trade back on, as the Euro, stocks and commodities are getting blasted to the downside while the U.S. bond market rallies, sending yields here lower. So what happened to start the week off on a negative note?

And to no one's surprise, when things are lower, the first place to look is news out of Europe, and sure enough, Moody's Investors Service said that it will review ratings for European nations. Their announcement said that while a European agreement to limit budget deficits represents "progress", the burden is on governments themselves rather than the E.C.B. to resolve the crisis with financial backing.

And then in what is a continuation of the disturbing pattern mentioned above, another large company, the second one in the Dow, the largest semiconductor company, which actually had the nerve to put in a nice gain this year, lowered its forecast for fourth-quarter revenue by saying that supply shortages for hard drives are causing computer producers to reduce orders for other components. These shortages are the result of the worst flooding in Thailand in 70 years, would you believe it?

And then there is always the question of how the yields in Italy and Spain are doing, and apparently they are rising somewhat today, with the Italian 10-year note having the nerve to get as high as that troubling 7% level before E.C.B. intervention pushed it as low as 6.6% before it ended at 6.8%. Spanish 10-year yields got up to 6%, and these higher yields in those two problematic countries is another factor that the bearish crowd is fast to jump on as another reason to sell.

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The Dow opened lower and has continued to retreat in one of those down staircase patterns where each successive intraday high gets lower as does each successive intraday low, which is never a good sign for any potential recovery. As this is being written, the Dow is just off of its worst level of the session with a 225 point loss and the breadth numbers are awful at a negative 1 to 5 ratio. And to no one's surprise, the Dow has basically been a clone of the Euro, and as the latter hits its lowest level since October, under 1.320, the Dow also sheepishly fell to its worst level of the day as well. And what is also not so good is that with this more than 200 point Dow decline, the VIX is only higher by 1.29, which basically means that with Friday's and today's trading producing a net very nominal Dow loss, the VIX is lower by 3 full points, and unless it is indicating a latent bullishness among traders, this is not the best scenario for creating an oversold condition off of which stocks can once again resume their recent rally.

With earnings virtually non-existent as we come to the end of the year, except for those disappointing warnings that we have seen in recent days, economic reports might or might not influence things here, and the lineup for the rest of the week is as follows – Tuesday: November retail sales, F.O.M.C. statement accompanying their interest rate decision; Wednesday: import price index; Thursday: November P.P.I., December N.Y.State Empire Manufacturing Index, weekly jobless claims, November industrial production and capacity utilization, December Philadelphia Fed Index; Friday: November C.P.I.

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, although this probability is getting less after the horrible start to November threw things off, but there has obviously been a strong improvement starting last week and moving forward.

The S&P trades at 11 times projected 2012 earnings of $108, which could bring a measure of support to stocks. Earnings were $85 in 2010 and are projected to be $99 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 three-quarters of 2011, earnings gained +17% 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. Fourth-quarter earnings are projected to rise by 10% and revenues are now projected to rise by 7%. 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 $108 for the S&P.

After four consecutive quarters of negative G.D.P. growth, we now have nine consecutive quarters of positive growth, starting with the third-quarter of 2009, every quarter in 2010 and the first three 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 1.6% and it is 2.6% 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.