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Daily Market Notes

Market Update :

DJIA:	**12083**
S&P 500:	**1241**
Nasdaq:	**2615**
10YR T-Note:	**2.04%**
EUR/USD:	**1.30**
VIX:	**24.69**
Gold:	**1661**
Crude Oil:	**99.87**

Prices Current as of 12:30 PM

Source: CNBC

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After two straight weeks of gains, the market decided yesterday that the path of least resistance was lower, as the Dow did not have a chance on a classic "risk-off" day by opening sharply lower and reaching its worst level of the session at 12noon with a loss of 244 points. From those lows, it sort of chopped around slightly above its worst levels before going into somewhat of an upside acceleration at the infamous time of 3:15pm (when strange things happen either to the upside or downside), and ended with a closing loss of 162.

Breadth numbers were horrible at a negative 1 to 4 ratio and in the strangest development of all, which can become a problem for the market going forward, is that the VIX actually ended LOWER on a day when the Dow declined by triple-digits. In fact, even when the Dow was on that 244 point low, the VIX was only higher by 1.35, or just about half of what it should have been. And when the market decided to improve from those worst levels, the VIX went negative. The reason that this is not good is because if stocks are going to go lower, then let the VIX go higher to create more of an oversold situation from which stocks can then rally. Remember that the lower the VIX goes, the less potential upside that remains for stocks, because it cannot go below 10.

As an example of this recent disturbing trend, if one takes Friday and yesterday, the Dow had a net gain of 24 points but at the same time the VIX declined by an astounding 4.92 points, which would imply a Dow advance of close to 500 points! Of course, this begs the question as to why this is happening in the first place, and the only answer that I can come up with is that since we are going to have a monthly options expiration on Friday, investors who supposedly bought "downside protection", namely puts at strike prices that are not going to be reached by the end of the week, they are liquidating them to try to salvage anything before they expire worthless at Friday's close. To further prove my contention that this weakness in the VIX is not good for stocks, take a look at the last time that the VIX was at the level it closed at yesterday and one sees that it was intraday on December 2nd, at which time the S&P was 1260 as opposed to yesterday's close of 1237.

Naturally, yesterday's stock market action was strictly a function of ….. you guessed it…..the almighty Euro, whose movements on a daily and intraday basis seem to control everything that goes on in the world of investing, as for instance when the Dow hit its intraday low, the Euro was down to 1.3163, a large loss of .0223, before also gaining from this worst level to end at 1.3190, down .0196, and what else is new? This weakness in the Euro was supposedly a result of the fact that the cost of insuring against a default on E.U. government debt rose to an almost record high.

What accounted for yesterday's miserable performance in the first place was a report that 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 a recently disturbing pattern, another large company, the second one in the Dow, namely 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 was the perpetual question of how yields in Italy and Spain are doing, and apparently they are rose somewhat, 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 was another factor that the bearish crowd is fast to jump on as another reason to sell.

The market got driven to the lows as mentioned above, from which it made that late partial comeback, by a report that Fitch is jumping into the downgrade act, by saying that a comprehensive solution in Europe has not yet been offered and therefore predicted a "significant economic downturn" in the region, thank you very much.

After yesterday's downside debacle, things tried to make a nice improvement on the opening, as a report that German business confidence rose for the first time in 10 months and a "successful" (whatever that is supposed to mean) Spanish debt auction got the Dow to gain as much as 126 points at its best 10:15am level. But just when things looked they were going to make an attempt to make back yesterday's losses, that ultimate market torpedo, otherwise known as the Euro, decided to go into a free-fall, collapsing to its lowest level since mid-January, with a downside plunge from 1.3233 when the Dow was on its high to as low as 1.3057, a large loss of .0131 on the day.

This was too much for our stock market to take, as the Dow gave back practically all of its early gains to be ahead by only 15 points at its worst level, which is somewhat of a compliment, and has since recovered to a gain of 60 points as this is being written. And the reason being cited for the sharp Euro drop was a comment from German Chancellor Merkel that the $500 billion euro cap on the planned permanent bailout fund will stay in place, rather than being expanded as some had hoped for. This statement is another example of the discord that still exists as to ways to fix the problems there, rather than the optimism that their statements about common purpose had led the market to believe on Friday. And as the Euro came off of those worst levels, the Dow also improved from its worst levels as well.

But the advance is not what I call a "good one" because half of the Dow's gain is a function of its two energy components on a report that Iran will hold drills to close the important Strait of Hormuz shipping channel and as a result, crude oil is now back over $100 a barrel,

and how is this supposed to be good for the American consumer?

And we are having a VIX problem once again today, as when the Dow was at its best level, the VIX was down by 2.40 points, twice as much as it should have been, and the last time it was at the level it reached on those lows, the S&P was around 1300 in late July as opposed to the 1250 or so level it reached on today's highs, obviously not a good sign for longer-term improvement unless this strange trend can go back to something more normal.

Also continuing a recent disturbing pattern, another major company has come up short on the earnings front, and this time it was the largest consumer electronics retailer.

And if this news isn't cause for concern, how about the Fed statement today at 2:15pm, and when is the last time that the market rallied on what they had to say?

With earnings starting to come in for companies whose fiscal fourth-quarter ended on November 30th, economic reports might or might not influence things here, and the lineup for the rest of the week is as follows – later today: 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. We do hear from ADBE, FDX and PIR on Thursday.

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.