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Daily Market Notes

Market Update :

DJIA:	**12042**
S&P 500:	**1234**
Nasdaq:	**2554**
10YR T-Note:	**1.96%**
EUR/USD:	**1.30**
VIX:	**22.56**
Gold:	**1614**
Crude Oil:	**98.50**

Prices Current as of 1:20 PM

Source: CNBC

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Special Comment – We recently sent out a very comprehensive report on high-yielding products and the reasons we feel that these are worthwhile investments in these trying times in the market. The areas covered include: international ETF's, mutual funds, domestic ETF's, municipal ETF's, U.S. blue-chip stocks, European blue-chip stocks and high-risk European stocks. It would seem that there should be something for people to get involved with among this extensive listing.

The market gave us a classic "Turnaround Tuesday" yesterday, as at least for one day it was able to ignore all of the negative dynamics that have prevented it from undergoing the traditional gains that it usually produces at this time of the year. At least for one glorious session, negative inputs such as the mess in Europe, the horrible performance of the VIX, the poor recent price action in the high-priced technology stocks and the late breakdown in prices in the last hour, were ignored, although unfortunately they still lurk beneath the surface, ready to play the role of Christmas Grinch at any moment once again.

The Dow began the day with an astounding advance of 230 points by 10am, when a too euphoric reaction to one economic report, namely November housing starts which rose to a one and a half-year high, got the upside juices salivating even further, as the Dow was able to gain as much as 350 points before ending with a 337 advance. The Nasdaq did even better for a change with an 80 point higher close. Breadth numbers were terrific at a 7 to 1 positive ratio and the VIX finally calmed down a bit on the downside with a loss of only 1.70, down to 23.22 which was half of what it should have declined but let us remember that it had been declining so much more lately, as I have been pointing out, that some sort of equalization was necessary.

And in the biggest miracle of all, those beaten-down financials, which have given investors coal for Christmas this year, actually had the nerve to gain a bit, as for instance even the most beaten-down one of all, the second largest U.S. bank, had the nerve to rise by 19 cents after having lost over 60% of its value this year alone, by far the worst performer in the Dow. The excuse for these stocks going higher for a rare change this year was that the Federal Reserve proposed new capital and liquidity rules for these large banks that would be put in effect in two stages and would not likely go any further than the standards for banks in other parts of the world. The first phase would require large U.S. banks to show that they can meet a Tier 1 common risk-based capital ratio of 5% during times of economic stress and the second phase would be based on the Fed's implementation of the Basel III international bank regulatory agreement. This brings up the Tier I capital ratio requirement to 7%, plus a 2.5% surcharge for the most complex firms. Let's see how long this ostensibly good news for financials lasts.

For a change, the news from Europe was interpreted as friendly, as none other than Spain, one of the bad boys of the region, managed to raise $5.6 billion Euros at an auction as their rate for three-month bills declined to 1.74% from 5.1% for this maturity last month. And then there was that report on German business confidence which rose slightly when a small decline was expected, and using this as a long-term factor for higher stocks is sort of pushing the envelope, so to speak, but hey, when the market wants to go higher, investors can go fishing for any reason, and let's see how long this German explanation lasts. As a result, the Euro was able to make a nice gain for a change, as it rallied almost a full cent to 1.31 from 1.30. And while the "risk on" trade was "on" at least for one day, the bond market here got sold off as the yields rose by around the same amount that they had declined on Monday for the 30 and 10-year maturities, back up to 2.93% and 1.93% respectively, and this is another market that just does a knee-jerk movement in the opposite direction of the Euro and the stock market on any given day, and what else is new in this regard.

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As we approach the end of the current year and the start of the new one, there is the old statistic about the well-known supposed "Santa Claus" rally and here it is – since 1969, the S&P has gained an average of 1.6% on the last five trading days of the old year and the first two of the new year, so let us see what happens this time.

Last evening started out with Asian markets making strong gains, but when this happens, this is strictly a "catch-up" function for what already happened here, either on the upside or downside, and means absolutely nothing for the next day in the U.S. In fact, S&P futures got as high as a 13 point gain, would you believe it, and this was after the awful results from the largest software company were already known yesterday evening. And of course the reason for the euphoria at these highs was that the almighty Euro had the nerve to jump up to 1.32, another full .001 point gain. And the reason for this advance around 6am was that the E.C.B. awarded $489 billion Euros in three-year loans to banks, which was apparently almost twice as much as the experts had predicted. This means that basically the E.C.B. is providing ultra-cheap money to these banks, which should allow them to buy sovereign debt, but at the same time it means that they are creating more money which could depress the price of the Euro, and of course we all know the negative implications of this type of market reaction.

As we moved closer to the opening here, those large gains in the various stock index futures started to dissipate as the Euro now reversed those large gains it had initially made to the E.C.B. actions. So now the "explanation" for the Euro decline was that these measures will not be enough to deal with the worsening sovereign-debt crisis, and so it goes, with the Euro deciding that it now wanted to give back those early strong gains and trade lower, which it did down to around 1.3050, and this was not what stocks here wanted to see after yesterday's powerful gains.

And not helping either was that Spanish two-year notes fell for the first time in nine days as apparently the banks that got these E.C.B. loans pulled a fast one and bought German paper instead of Italian and Spanish debt, those sneaky guys.

So naturally the path of least resistance has been lower, and despite a rise in November existing home sales of 4%, the overall number was revised lower by 14% since 2007, and this just shows that the nonsensical euphoric reaction to yesterday's housing starts report and upward reaction by homebuilding stocks was not going to last, however much it was put forward as an "explanation" for the terrific equity performance yesterday.

And then there was the awful report from the software company, which came up short on both the revenue and earnings side after four straight quarters of beating these numbers. This has had the disastrous effect of causing other large technology stocks to get blasted to the downside, and this terrible Nasdaq/Dow ratio is once again back with us after a one-day reprieve yesterday, and how is that supposed to help things do better today?

And once again the VIX is performing very poorly, as even when the Dow was on its 12:30pm low with a loss of 103 points, the VIX had the nerve to be lower by .40 and here we go again with that negative dynamic. As this is being written, the Dow has managed to cut its loss to around 65 points and the VIX is sinking even further, with a loss of .60 and this awful relationship is going to prevent the market from making consistent upside gains, as we have pointed out and despite the fact that in any negative environment there are always going to be these upside moonshots such as what we saw yesterday, which unfortunately do not tend to last too long.

A somewhat disturbing note as we keep moving into the fourth-quarter earnings season is that so far the number of negative pre-announcements has overwhelmed the number of positive ones by the large ratio of 97 to 26, a 3.7 negative relationship that is the largest in 10 years. However, this is subject to change as things keep going forward.

In this best time of the year for stocks, there is a sobering statistic that says since 1928 the S&P has rallied 80% of the time in the last two weeks of the year when it is already ahead for the year, but only 60% of the time when it is down for the year, as it currently is, so we should all hope that the nicest thing that can be said in this regard is that let us pray for the best.

Fourth-quarter earnings season continues to slowly build up and next week we will hear from the following important companies – tonight: BBBY and FINL. Economic reports might play a role this week as well, and the lineup is: Thursday: final estimate of 3Q G.D.P., weekly jobless claims, final U. of Michigan Consumer Sentiment Survey; Friday: November durable goods orders, November personal income and spending, November new home sales.

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, and the recent weakness is not going to help as we approach the finish line.

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.

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.