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Morning Markets Briefing

Market Commentary: October 1st, 2010

A snapshot of the markets through the lens of ConvergEx.

Stocks closed the final day of 3rd quarter in negative territory (S&P 500: –31 bps, Dow: –44 bps, Nasdaq: –33 bps), but the S&P 500 and Dow posted their best September in 71 years. In the day's economic news, 2nd quarter GDP was revised up to 1.7% annualized growth from the previous estimate of 1.6%, due to a moderate rise in the inventories component. The GDP price index was unrevised at +1.9% annual growth. Initial jobless claims fell 16K last week to 453K, coming in just shy of expectations of 459K. The 4-week moving average declined for a 5th straight week, dropping to 458K, which is more than 30K lower than 1 month ago. Finally, the Chicago PMI came in well above market estimates, rising to 60.4 in September from 56.7 the prior month. New orders and production were the strong points.

@#$% My Boss Makes Me Do – A Trip to the Center of the Gold "Bubble"

Summary: We recently did some firsthand investigation into the likelihood of a gold/silver bubble by heading straight to a source of the would-be bubble – the precious metals mecca that is New York City's 47th Street Diamond District. Surprisingly, absent from our findings was any sort of bubble-like human behavior. Yes, the booming asset prices are there, but just as critical to any bubble is the bad behavior that launches it into the stratosphere. Think subprime jumbo mortgages sold to part time hairdressers or 10x oversubscribed IPOs for profitless dot com companies. We tried every way possible to get salespeople to lure us into unwise, non-economic precious metals investments, but with no luck. Yes, we know this is "anecdote" rather than "data." But the utter absence of heavy-duty hustling and cajoling in what precious metal bears call a bubble leads to a common-sense conclusion: this is no bubble. Not yet, anyway.

(Note from Nick: Nearby our office in New York is 47th Street – the toughest, most aggressive retail/wholesale marketplace for jewelry, gemstones, and precious metals in the world. A logical place to find proof of a retail-driven gold bubble, but too daunting for me. I hate pushy salespeople. So I sent Beth. This is her report from the front lines of the precious metals market.)

A typical day at the office entails about 10 hours at my desk staring at computer screens backed by a blank white wall. I have my own window view of sorts – about a 1" x 2" opening that gives a 48th floor perspective of lower Manhattan, and if I lean over a bit I can even see New Jersey. Nonetheless, it does occasionally feel like I sit in one of those sensory deprivation tanks, just one that is equipped with a keyboard and screens.

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Wednesday, however, was quite a different story. I spent my afternoon trapped in a non-air-conditioned Midtown pawn shop with a Swiss tourist who wasn't permitted to leave after politely declining the owner's offering price for a used Rolex. Yes, not only do they buzz you in the door (for security purposes), they must buzz you out as well. Apparently the shop girls are instructed not to let customers leave if they haven't purchased anything. That way the owner has more time to cajole, haggle and even harass.

Eventually the girl allowed the tourist to leave, at which point she was berated by the owner while I stood awkwardly in silence.

Ahh, the things I do in the name of research… And why isn't Nick here? This was his idea originally…

However, there was a purpose behind this field trip to the only pawn shop in Midtown. With all the commotion surrounding gold and silver these days and speculation we may be in the midst of a precious metals bubble, it made sense to do a little firsthand investigation.

Every bubble has a "home" – Wall Street for the dot com bubble, literally "homes" in Arizona and Florida for the housing bubble, and so on. Naturally, one home for any potential gold/silver bubble must be jewelry and coin dealers, long known as a bastion of high-pressure sales and don't-let-a-prospect-leave-empty-handed intensity. Hence the point in visiting New York City's (in)famous 47th Street Diamond District: to scope out the source of the bubble in retail demand for precious metals. Yes, we know that central banks and ETF buyers are also sources of gold demand. But when one of the global hubs for the jewelry trade is about 500 yards from your desk, there's just no excuse for not taking the pulse of one key part of the market – small buyers purchasing physical gold and silver – with some site visits.

What I was looking for, in two words, was bad behavior. Yes, everyone thinks they can spot a bubble just by looking at a price chart. But there is a lot more to a bubble than price action. There are all the greedy, unscrupulous, sordid actions that humans engage in when greed takes over. Stupid negative amortization mortgages sold to senior citizens. Initial public offerings of online retailers whose only real asset was a well-known sock-puppet spokesperson. A jumbo loan issued to a part-time hairdresser with no working knowledge of English or basic math.

So it came as quite a surprise that my trip to 47th Street was, in this sense, uneventful.

Before I tell you the details of my visits, however, a little background on this slice of jewelry heaven/hell: An estimate popular with the press places the value of a single day's trade on the block at a cool $400 million, and other reports say as much as 90% of diamonds in the U.S. first stop on this 150 meter stretch of real estate. And as home to more than 2,600 independent businesses (most of them simply one-man-operations who have set up booths within the various jewelry exchanges), it is in theory a jewelry hustler's dream.

As someone who can't even stand being approached by a Bloomingdale's salesgirl, believe me when I say there was a complete absence of sketchy con-man types, high-pressure salesmen, and any other shady characters trying to rip me off. I've spent 3 years of my career working in close enough proximity to this block that I've aimlessly ventured down it on my way to 5th Avenue more than a few times. As often as I've been unwillingly harassed by unabashedly intense salesmen, I was shocked at the low pressure atmosphere that awaited me when *I* willingly approached *them*.

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The idea once inside was to get a feel for what average, non-financial people in the precious metals trade think about the direction these assets are headed. I simply told them I had $500 that I wanted to invest in a precious metals portfolio of sorts and that I would like their opinion on what I should purchase, whether it be gold or silver, coins or jewelry. And then I let them talk.

The six vendors I spoke with fell into one of two camps – those who love gold and those who champion silver. Though they didn't agree on which specific precious metal should highlight my $500 portfolio (one even suggested platinum), they all quite emphatically discouraged me from purchasing jewelry as an investment. I unintentionally approached two vendors who only dealt in jewelry (no coins, etc.), and even they reluctantly told me they couldn't recommend jewelry as an investment. The reasoning behind this revolves around the labor and design costs associated with "wearable" precious metals.

Though everyone was in agreement that coins are the way to go, surprisingly gold coins were not the overwhelming favorites. Half of the dealers suggested that with my $500 I purchase one ¼ ounce gold coin (cost = approximately $350) and use the remaining $150 to buy seven 1-ounce silver coins at about $21 each. One vendor with supposedly 20+ year of experience reasoned that gold will always gain in value. While it may not go up as rapidly as we've become accustomed to lately, his belief was that it will never experience another significant, lasting drop in value.

On the other side of the spectrum, three of the six retailers recommended without hesitation that I invest all of my $500 in silver coins. That would equate to about 23 silver coins at roughly $21 each. Reasoning varied from the simple (although not necessarily inaccurate) to the complex. For example, one retailer hypothesized that since silver is the poor man's gold, and there are more poor people than rich people, obviously silver is a better investment. He asked what I did for a living, so I replied for the sake of simplicity that I worked for a bank. His response? "And they don't tell you that there? You have to come to me?"

A more complex argument for silver over gold involved the ratio of the price of gold to the price of silver. Currently it stands at 60:1 while in previous peak times it has been closer to 20:1. Currently, silver is proportionately undervalued in comparison to gold, by this logic, and hence it theoretically has more room to grow. The price of gold is also rapidly approaching the price of platinum, and some of my contacts questioned how high it can actually go from here. *I've attached a chart showing the gold/silver price relationship over time so you can reach your own conclusions on this point.*

The main takeaway here is that there was no bubble-like bad behavior. I expected something out of the high-pressure school of sales. Men dangling gold chains with "Beth" in fake diamonds and telling me it was a better investment than a prosaic gold coin. Or perhaps a creative soul pushing some crappy ¼ carat uncut diamond as a "superior" choice to precious metals. But none of this happened, despite my repeated attempts and encouragements to all who would listen. As a final note, keep in mind that recent or current issue gold coins have some of the thinnest margins in the business. Maybe you buy some as a dealer and the price of the metal rises, but generally the bid/ask spread is no better than 10-15%.

To me, this experience was somewhat like walking into a mortgage broker in Florida in 2006, asking for a $750,000 loan with no income verification, and being laughed out of the office. Which is what should have happened, but obviously rarely did. I am not trying to portray every jewelry and precious metals dealer as the paragon of virtue; that's obviously not true. If you keep up on this space, you know the criticisms of organizations like Goldline International.

But perhaps what my visits highlighted most clearly is that the precious metals business, at least at high volume locations like 47th Street, does not feel the urgency to "make hay while the sun shines." Maybe my non-hustling salespeople have confidence that underlying demand is robust (so why push?) Perhaps the family/small business nature of their enterprise gives them a longer term perspective on the precious metals cycle.

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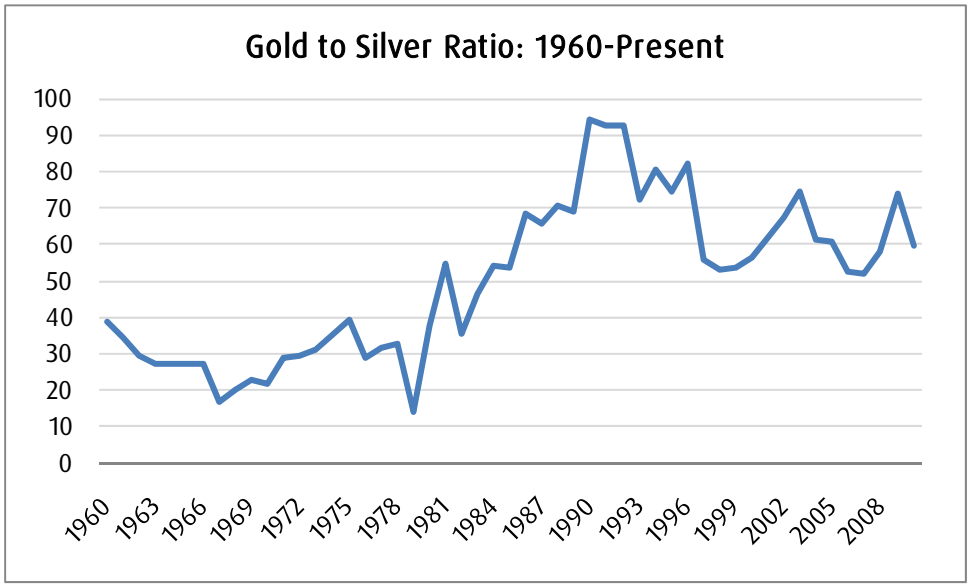
Bubbles are clearly punctuated – and driven to their final demise – by bad behavior on the part of market participants. My short, but colorful, excursion to the heart of the physical precious metals market revealed no such excess. Is that enough proof to eliminate the possibility of a gold bubble? Of course not. But I think it is enough to characterize recent calls for the demise of the gold/silver rally as very much premature.



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U.S. EQUITIES

Shares of AIG spiked 4.3% on news it will repay taxpayers in full after working out a deal with the U.S. government. The insurer will also sell 2 Japanese life insurance units to PRU (-4.2%). Meanwhile, earlier in the day CAR advanced 1.0% as it revealed plans to include a $20 million break-up fee in its offer for DTG (+0.0%), and later DTG shareholders rejected HTZ's (-8.8%) $1.5 billion bid. In other news, BP (+2.9%) incoming chief executive Bob Dudley said he wanted to restore the company's dividend payments next year, while CAT (-1.6%) announced it will raise product prices in 2011 by as much as 2%.

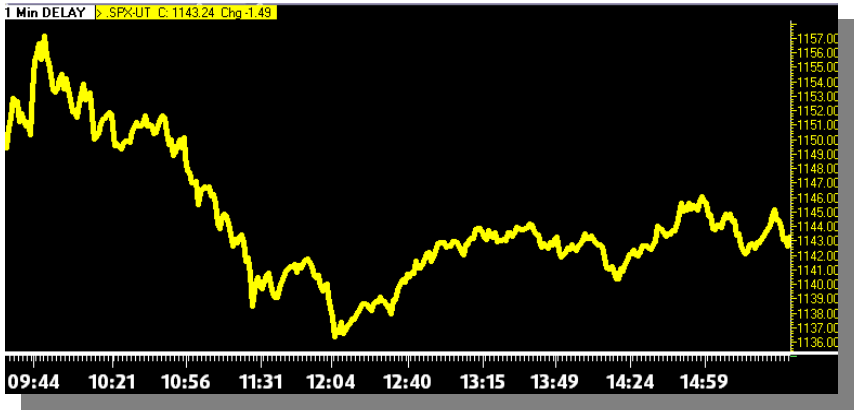
Important Earnings Today (with Estimates) From…

None

Important Conferences/Corporate Meetings Today:

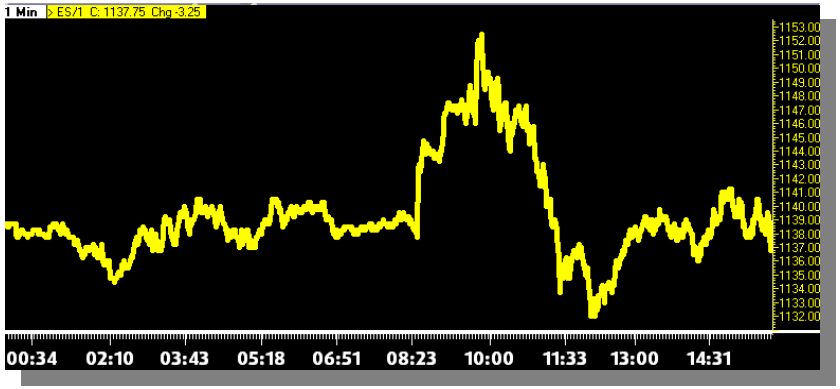
None

Prior Day SPX (High – 1157.16; Low – 1136.08; Close – 1141.20):

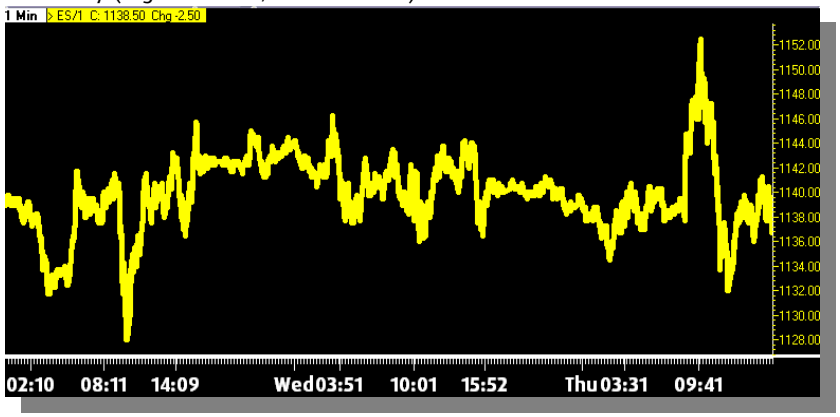


S&P Futures

One Day (High –1153.50; Low – 1131.25):



Three Day (High – 1153.50; Low – 1127.25):



Source: Thomson ONE

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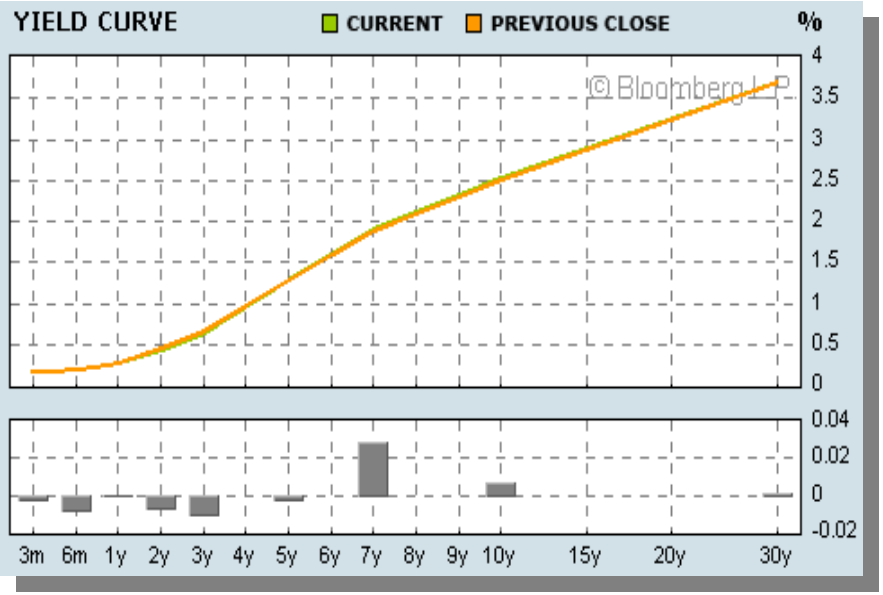
FIXED INCOME

Treasuries declined slightly Thursday as reports showed that 2nd quarter GDP grew at a higher pace than previously estimated, and initial jobless claims dropped more than forecast last week. The benchmark 10-year note yield inched up 1 basis point, while the spread between the 10-year and 2-year note yields widened to 209 bps from 203 bps on Tuesday, reflecting moderately less concern the US economic recovery is weakening. Friday there are numerous Fed speakers over the course of the day (see below).



Source: Bloomberg

U.S. Treasuries

	COUPON	MATURITY DATE	CURRENT PRICE/YIELD	PRICE/YIELD CHANGE
3-MONTH	0.000	12/30/2010	0.15 / .15	-0.002 / -.002
6-MONTH	0.000	03/31/2011	0.18 / .19	-0.004 / -.004
12-MONTH	0.000	09/22/2011	0.24 / .25	0 / -.000
2-YEAR	0.375	09/30/2012	99-28+ / .42	0-00+ / -.008
3-YEAR	0.750	09/15/2013	100-11 / .63	0-01 / -.011
5-YEAR	1.250	09/30/2015	99-28½ / 1.27	0-00+ / -.003
7-YEAR	1.875	09/30/2017	99-25½ / 1.91	-0-02+ / .012
10-YEAR	2.625	08/15/2020	100-31 / 2.51	-0-03 / .011
30-YEAR	3.875	08/15/2040	103-12½ / 3.69	-0-01½ / .003

Source: Bloomberg

Today's Important Economic Indicators/Events (with Consensus):

- Motor Vehicle Sales: 8.6M annualized
- Personal Income and Outlays (8:30am EST)
  - Personal Income: 0.3%
  - Consumer Spending: 0.4%
  - Core PCE Price Index: 0.1%
- University of Michigan Consumer Sentiment (9:55am EST): 67.0
- ISM Manufacturing Index (10:00am EST): 54.5
- Construction Spending (10:00am EST): -0.4%
- William Dudley Speaks at 8:30am EST
- Charles Evans Speaks at 11:30am EST
- Richard Fisher Speaks at 3:15pm EST
- Ben Bernanke, Tim Geithner, Sheila Bair, etc. participate in the first meeting of the Financial Stability Oversight Council in Washington, DC

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U.S. EQUITY OPTIONS

SPX – The underlying index turned in a more interesting performance than recently experienced, before ending little changed for the day. The market opened sharply higher on better than expected economic news, but quickly gave up these gains and then some to post a range of +1.1% to -0.7%, ending -0.3%. The implied volatility in options premium responded to this increase in intra-day experienced volatility with a modest increase as well of about 2%, as measured by the VIX. There were some noteworthy trades. A sizeable 3-way trade was indicative of the put calendar spreads. The October 1025 and 1075 puts were sold 6,000 times each and the March 1075 puts were bought 8,000 times, which likely represented a long October position being moved out to March and reduced in the process. In another typical protection trade, the November 1100 puts were bought vs. selling the November 1200 calls for a net debit of $7.50 2,500 times.

ETF – The market sustained a selloff after opening in positive territory to close slightly down on the day. Options trading was considerably light due to encouraging economic news. The day can be summarized by mixed trading although we did continue to see investors buying volatility in some products. For example in EEM one investor made a long-term volatility play through purchasing 5,200 Jan 2012 60 calls delta neutral, while in another trade paper bought Jan 44 puts 6,000 times delta neutral. Additionally in SLV, an investor bought 6,000 Jan 2012 20 calls vs. selling 6,000 Jan 2012 13 puts delta neutral. In other trading investors sold volatility in XLK (Tech) through 10,000 Jan 23 straddles, while separately paper sold 5,000 Dec 23 Calls. In SPYs, a buyer of 30,000 Oct 113 puts emerged and in IWM an investor bought the Nov 67 / 62 put spread 20,000 times. Lastly, we noted downside buyers in XRT (Retail) by purchasing 5,000 Dec 41 puts and selling 10,000 Dec 36 Puts.

CURRENT IMPLIED VOLATILITY / CURRENT HISTORICAL VOLATILITY

Rank	*9/24/2010*	*9/27/2010*	*9/28/2010*	*9/29/2010*	*9/30/2010*	*30-Day Implied Vol*
1	FDO	FDO	FDO	DTV	MFE	5.28
2	DTV	DTV	DTV	FSLR	DTV	23.80
3	MKC	APOL	MKC	APOL	MKC	32.51
4	HSP	MKC	APOL	PG	MDP	54.82
5	FSLR	FSLR	FSLR	CLX	CLX	18.86
6	APOL	PNW	PTV	FDO	PG	16.21
7	PG	PG	PG	PTV	FSLR	43.18
8	MJN	MJN	KMB	MKC	APOL	51.03
9	KMB	KMB	STZ	MJN	PTV	7.94
10	CA	Q	MJN	STZ	RSH	40.27
11	JNPR	VRSN	Q	KMB	FDO	25.36
12	CLX	CA	VRSN	RSH	MJN	37.24
13	VRSN	STZ	RSH	HSP	STZ	28.90
14	AAPL	AAPL	AAPL	CA	HSP	33.92
15	STZ	HSP	CL	VRSN	KMB	15.63
16	PCS	RSH	CA	MYL	BMC	35.54
17	PEP	CL	CEPH	HRS	HRS	32.61
18	CL	PCS	CLX	CL	PEP	16.64
19	QLGC	CEPH	PCS	AAPL	SWY	29.42
20	HRS	HRS	AMZN	PCS	CA	29.58
21	NTAP	CLX	CTXS	TGT	MYL	28.72
22	TGT	WAG	DF	PBI	AMGN	31.51
23	RSH	QLGC	MYL	SWY	MAT	32.47
24	GIS	AGN	NTAP	BMC	VRSN	29.29
25	MAT	PEP	HSP	AGN	QCOM	28.94
	PX	MAT	PEP	NTAP	AGN	
	WFMI	GIS	AGN	DF	PBI	
	AGN	TGT	QLGC	CTXS	TGT	
	NKE	NTAP	WAG	AMZN	PCS	
	WAG		PNW	Q	AAPL	
	HSP		HRS	CEPH	CL	
	APOL					
	Q					

BIGGEST MOVERS

Top 10		30-Day Implied Vol	Bottom 10		30-Day Implied Vol
MFE	6708.36%	5.28	NTAP	-12.59%	43.75
GME	48.50%	35.25	TLAB	-9.69%	35.15
MDP	44.52%	54.82	NU	-7.24%	18.65
MKC	32.07%	32.51	DV	-7.15%	45.79
SHLD	23.61%	43.96	TSN	-6.70%	34.92
IFF	21.67%	25.96	FHN	-6.18%	36.26
S	19.34%	50.90	CF	-5.66%	44.79
QCOM	18.95%	28.94	CEPH	-5.22%	30.33
ABT	17.79%	16.39	OXY	-5.17%	26.85
KIM	16.62%	37.58	DF	-5.03%	45.33

We ranked the S&P 500 companies from the highest to lowest 30 day implied to historical volatility ratio. Above we identify the 10 most positive and negative movers.

The table to the left represents the 25 highest 30 day implied to historical volatility ratios within the S&P 500 companies. The green represents names new to the list while the red represents names that have fallen out.

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Exchange-Traded Funds/Indexes

Prior Day Peformance of Largest ETFs by Assets

Name (Net Assets*)	Ticker	Category	Daily Return
SPDRs	SPY	Large Blend	-0.24%
SPDR Gold Shares	GLD	N/A	-0.03%
iShares MSCI Emerging Markets Index	EEM	Diversified Emerging Mkts	0.58%
iShares MSCI EAFE Index	EFA	Foreign Large Blend	-0.74%
iShares S&P 500 Index	IVV	Large Blend	-0.30%

Prior Day Top Volume ETFs

Name	Ticker	Category	Shares Traded
SPDRs	SPY	Large Blend	263,617,526
PowerShares QQQ	QQQQ	Large Growth	106,897,816
Financial Select SPDR	XLF	Specialty - Financial	101,839,958
iShares Russell 2000 Index	IWM	Small Blend	74,274,248
Direxion Daily Financial Bear 3X Shares	FAZ	Bear Market	59,041,912

Prior Day Top Performers

Name	Ticker	Category	Daily Return
Barclays GEMS Index ETN	JEM	N/A	6.54%
ProShares Ultra DJ-UBS Crude Oil	UCO	N/A	5.21%
Direxion Daily Latin America Bull 3X Shs	LBJ	Latin America Stock	3.68%
iShares Dow Jones US Consumer Goods	IYK	N/A	3.35%
ProShares UltraShort MSCI Pacific ex-Jpn	JPX	Bear Market	2.85%

S&P 500 Sector ETFs

Sector	Ticker	1-Day Perf	YTD Perf	Sector	Ticker	1-Day Perf	YTD Perf
Energy	XLE	0.04%	-1.68%	Telecomm	IYZ	-0.09%	8.84%
Health	XLV	-0.26%	-1.90%	Technology	XLK	-0.39%	0.39%
Industrials	XLI	-0.38%	12.56%	Consumer Discretionary	XLY	-0.27%	12.23%
Utilities	XLU	-0.32%	1.16%	Financials	XLF	-0.18%	-0.39%
Consumer Staples	XLP	-0.36%	5.33%	Materials	XLB	-0.40%	-0.64%

Currency ETFs

Currency	Ticker	1-Day Perf	YTD Perf	Currency	Ticker	1-Day Perf	YTD Perf
Australian Dollar	FXA	-0.14%	7.69%	Mexican Peso	FXM	-0.61%	3.67%
British Pound Sterling	FXB	-0.46%	-2.98%	Swedish Krona	FXS	-0.34%	6.02%
Canadian Dollar	FXC	0.47%	1.89%	Swiss Franc	FXF	-0.65%	5.08%
Euro	FXE	0.01%	-4.97%	USD Index Bearish	UDN	0.00%	-1.74%
Japanese Yen	FXY	0.22%	11.22%	USD Index Bullish	UUP	0.00%	-1.04%

VIX ETNs

Name	Ticker	1-Day Perf	YTD Perf
iPath S&P 500 VIX Short-Term Futures ETN	VXX	2.13%	-49.25%
iPath S&P 500 VIX Mid-Term Futures ETN	VXZ	1.24%	12.79%

Fixed Income ETFs

Bonds	Ticker	1-Day Perf	YTD Perf
Aggregate	AGG	-0.04%	5.3%
Investment Grade	LQD	0.28%	0.39%
High Yield	HYG	0.50%	2.11%
1-3 Year Treasuries	SHY	0.01%	1.70%
7-10 Year Treasuries	IEF	-0.12%	11.75%
20+ Year Treasuries	TLT	-0.07%	17.38%

Others

ETF	Ticker	1-Day Perf	YTD Perf	ETF	Ticker	1-Day Perf	YTD Perf
Gold	GLD	-0.03%	19.20%	Crude Oil	USO	2.65%	-11.33%
Silver	SLV	-0.42%	28.79%	EAFE Index	EFA	-0.74%	-0.65%
Natural Gas	UNG	-2.69%	-38.89%	Emerging Markets	EEM	0.58%	7.83%
				SPDRs	SPY	-0.24%	2.48%

Major Index Changes:

S&P SmallCap 600 constituent WSO will replace HEW in the S&P MidCap 400, while SMCI will replace WSO in the S&P 600 after the bell. HEW is being acquired by AON.

ETFs in the Headlines and Blogs:

- Gold & Metals ETFs Reaching Critical Mass in Size - http://247wallst.com/2010/09/30/gold-metals-etfs-reaching-critical-mass-in-size-gld-iau-sgol-phys-pplt-sivr-pall-slv/

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- U.S. Dollar Is 'One Step Nearer' to Crisis, Yu Says - http://noir.bloomberg.com/apps/news?pid=newsarchive&sid=aoB6cWYcz8Yo
- Survey Says: Are Americans Ready to Spend Again? - http://smallbusiness.aol.com/2010/09/28/survey-says-are-americans-ready-to-spend-again/
- The Highest Paying Work from Home Jobs - http://www.focus.com/fyi/finance/highest-paying-work-home-jobs/

Calculated Risk

- Kansas City Fed: Regional Manufacturing Activity rebounded in September - http://www.calculatedriskblog.com/2010/09/kansas-city-fed-regional-manufacturing.html
- Chicago PMI increases in September - http://www.calculatedriskblog.com/2010/09/chicago-pmi-increases-in-september.html
- Weekly Initial Unemployment Claims decrease - http://www.calculatedriskblog.com/2010/09/weekly-initial-unemployment-claims_30.html
- Fannie Mae and Freddie Mac: Serious Delinquent Rates decline - http://www.calculatedriskblog.com/2010/09/fannie-mae-and-freddie-mac-serious.html

The Big Picture

- Florida's Ongoing Foreclosures Nightmare - http://www.ritholtz.com/blog/2010/09/florida%e2%80%99s-foreclosures-nightmare/
- Is Gold a Dollar Phenomenon? - http://www.ritholtz.com/blog/2010/09/is-gold-a-dollar-phenom/
- Housing Finance: "Understand What Broke, Keep What Worked, Discard What Didn't" - http://www.ritholtz.com/blog/2010/09/understand-what-broke-keep-what-worked/

The Baseline Scenario

- TARP Is Gone – But May Soon Be Back - http://baselinescenario.com/2010/09/30/tarp-is-gone-but-may-soon-be-back/

Bespoke Investment Group

- Individual Investors Not Buying Into the Rally - http://www.bespokeinvest.com/thinkbig/2010/9/30/individual-investors-not-buying-into-the-rally.html
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