SHIELDS & COMPANY
MEMBER NEW YORK STOCK EXCHANGE

EQUITIES PERSPECTIVE

January 4, 2008
DJIA: 13,057

If Santa Claus should fail to call . . . bears may come to Broad and Wall. So says the Stock Trader's Almanac, referring to the so-called "Santa Claus" rally period. That period stretches between the last session before Christmas and the first two trading days of the New Year. What with program trading, hedge funds and the like, it's a bit hard to put much credence in such lore. Come to think of it, though, "sell in May and go away" worked rather well last year. And, the fact is, most bad years start absent a rally in this period. Not only have we failed to rally this year, the market has been outright weak, losing about 3.5%. The first five trading days of the year also often offers a good guide to January's performance, and January as a whole has a good record of forecasting the year as a whole, especially when it's down. Nothing is carved in stone, of course, but what is unusual or different can be telling. The S&P was down in both November and December, the first time that's happened since 1974. It would seem that much more unusual, and worrisome, if January were down as well.

Market history is one thing, but market action is where it's at. And, as you know, of late we haven't been terribly fond of the market's action. In a word, it's about the divergences in breadth - the idea that the average stock doesn't act as well as the stock averages. And the problem is, rather than the strong dragging up the weak, the weak eventually drag down the strong. Stocks may bottom together but they peak a few at a time. That's why breadth turns down before the averages. Of course, divergences can string out for some time, but the outcome is more or less inevitable. Like many things in the market, the housing bubble among them, most will come to believe these divergences don't matter, just when they matter. At a practical level, however, it's clear they matter even now. Even on the NYSE less than a third of all stocks are in medium term uptrends, that is, above their 200 day moving average. Daily New Lows run double and triple daily New Highs. It's not so easy to make money.

Of course, if last year was any guide, making money is less about the market and more about the parts of the market. Just take a look at Financials versus Energy, a real study of bull market versus bear market. In the case of the Financials there was no place to hide, while in the case of Energy almost any commodity stock would have worked. And then there was the Consumer sector, the marked difference being between Consumer Discretionary (XLY) versus Consumer Staples (XLP). Though they've weakened a bit recently, Consumer Staples could have another good year given their international exposure against what looks to be another tough year for the dollar. Whether the commodity play lasts is a little harder to say, though for now little looks better. The risk there seems a slowdown here, or in China, either or both of which could easily occur. The poor action in most stocks, including many Chinese stocks, likely means there's something not good out there.

And then there's the Apple (196) question. Can Apple again do what it did in '07? We think not and it's nothing personal to Apple and, shame on us, the chart's not even bad. But there are a couple of things. For one the Apple chart has taken on that parabolic look of Cisco (38) back in early 2000. And just as back then everyone thought Cisco was forever, when it comes to technology we're here to tell you, nothing is forever. Aside from that philosophical insight, there's again the matter of these divergences. It's Apple, Google (680) and Research In Motion (114) that the rest of the NASDAQ is diverging against. If, as we've suggested, divergences eventually get to everything, it seems very likely that weakness will find its way to these stocks as well. At the least, it might be time to change Technology horses here. Of all things Microsoft (35) now looks much like Apple at the end of '04, when it too was emerging from a four year base. And think about it, Microsoft instead of Apple. Now there's a contrary opinion.

It's a new year. Time to lose weight, get more exercise, and avoid subprime, the problem that seems to just keep on going. Partly in response to the latter, several Banks made new lows Thursday, just when you might have thought that by now the worst had been discounted. Yet, despite the problems both obvious and ongoing, the averages have held the November lows, even the Advance Decline Index (breadth) has held the November lows. Against the bad news, warnings of hundreds of thousands of foreclosures, $100 oil and leading economists warning of recession, it's almost impressive that the November lows have held as they have. Then, too, they only hold until they don't, and breaking those lows would pretty much seal the deal that a downtrend/bear market was in place. It could easily work out that this year is the opposite of last – down in the first half, up in the second.

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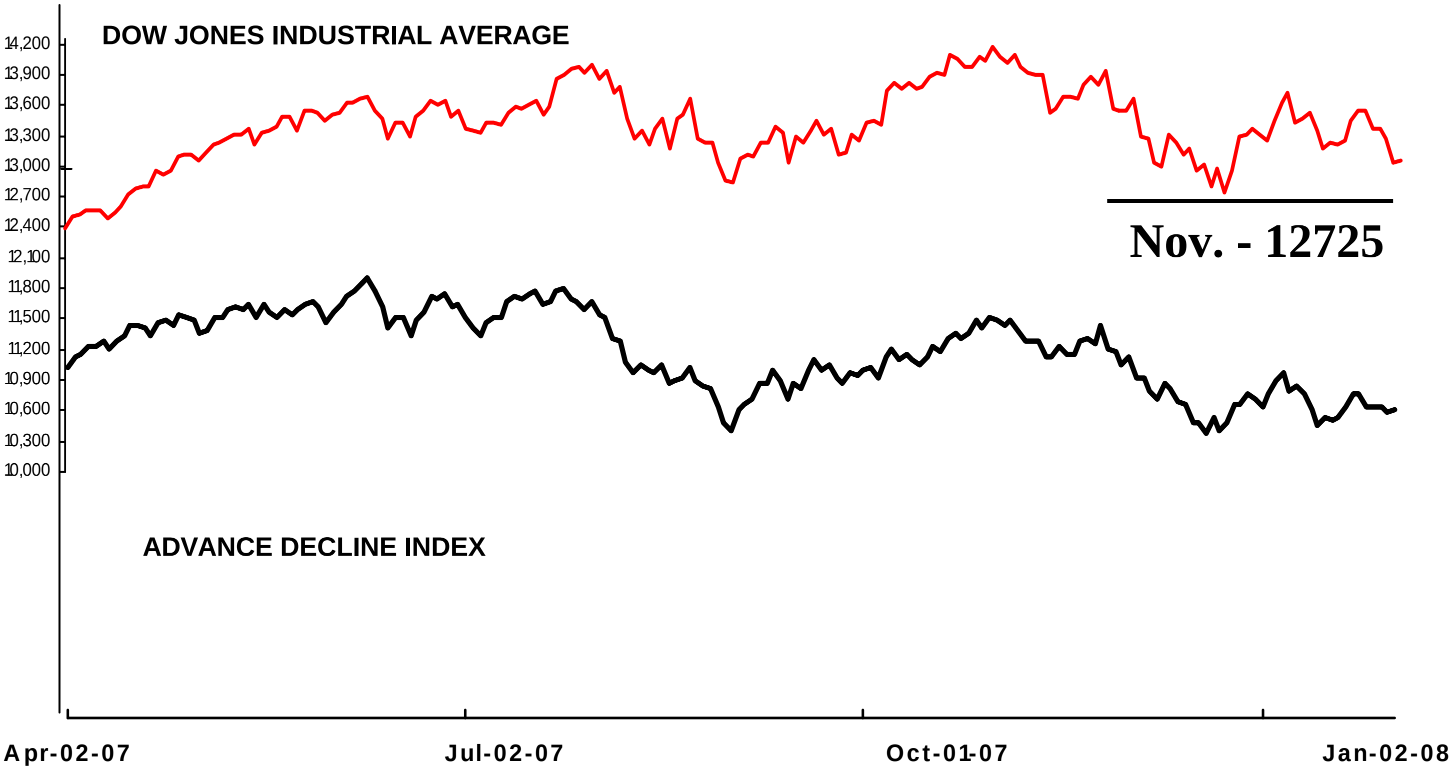
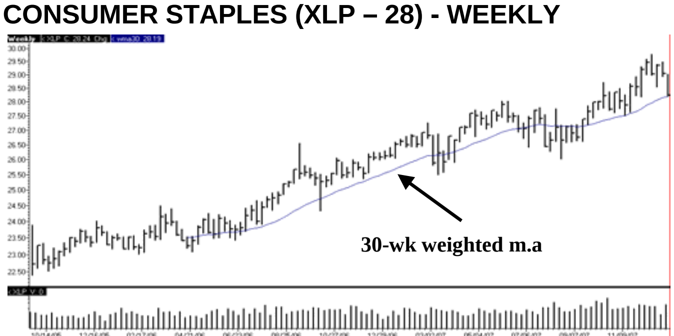
STOCK AVERAGE VS. AVERAGE STOCK



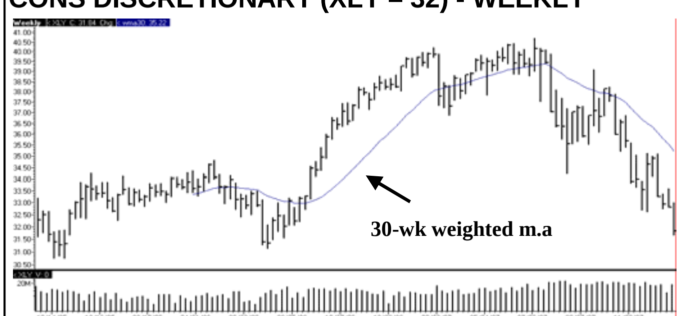
OIL (XLE - 80) – WEEKLY

FINANCIALS (XLF - 28) – WEEKLY

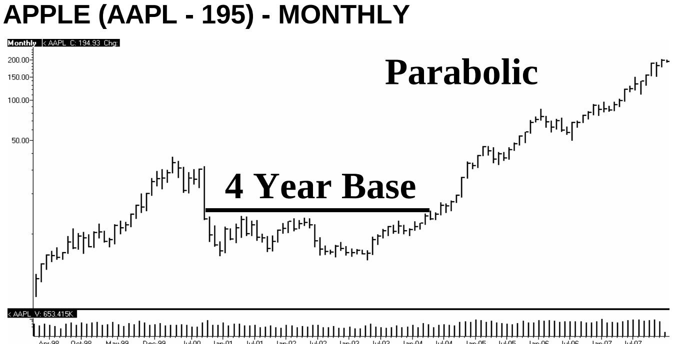
CONSUMER STAPLES (XLP – 28) - WEEKLY



CONS DISCRETIONARY (XLY – 32) - WEEKLY



APPLE (AAPL - 195) - MONTHLY



MICROSOFT (MSFT - 35) - MONTHLY