SHIELDS & COMPANY
MEMBER NEW YORK STOCK EXCHANGE
EQUITIES PERSPECTIVE

January 15, 2010
DJIA: 10,711

Mark McGwire on drugs . . . Liberace gay? Who knew and, apparently, few knew those Alcoa (16) earnings would disappoint. With aluminum prices higher a "beat" looked like a sure thing – just look at that chart. Throw in China's call for Banks there to set aside more reserves, and it made for a nasty Tuesday. China's move also came as a surprise though, perhaps in anticipation, the stock market there has been unchanged for six months. While Tuesday's Dow loss was only 37 points, 2.5-to-1 negative breadth and expanding volume made for Tuesday's nastiness. As has been pretty much the case since July, however, it was one and done on the downside. Wednesday's rally saw even better breadth, and it fit the typical pattern in another way – no volume. To our unending surprise, even without volume the market seems to be doing just fine.

If China's stock market seems stalled, that certainly isn't true of their economy. China exports through December surged 54% and imports 107%. This seeming disconnect is not all that unusual and could become relevant to our market as well. We may not be China but we are on the mend. Still, the good can get priced-in, just as the bad got priced-in last March. World Semiconductor sales have increased at an 86% annual rate over the past nine months, and are approaching a new high. Yet the Semi stocks were among the weakest in Tuesday's selloff, losing more than 3%. As measured by the SOX Index, there's a little break in the short term uptrend, but no real damage to the overall trend. Short term, of course, much will depend on the market's take on the Intel (21) earnings. Intel reached a new high in Thursday's trading, but in reality it's still a trading range. If the stock can take good news and really break out, that would be impressive.

Investor sentiment is a lot like valuations, it's not easy to know when enough is enough. Looking at price/sales or price/dividends the market isn't cheap. Then too, as 2000 and 2007 proved, it may yet become a whole lot less cheap. Much the same is true of sentiment or investor psychology. Rising markets result in rising optimism, that's only normal. It's extremes in optimism that cause problems, and some measures seem to be getting there. The American Association of Individual Investors showed the current allocation to stocks around 64%, the highest since October 2007. But more importantly, the 15% monthly jump in stock allocation was the largest in the survey's 22 year history. The Rydex Funds Bull/Bear Ratio is the highest in seven years, even after Tuesday's selloff. And the latest Investor's Intelligence survey shows a new five-year high in net bullish opinion among the newsletters they poll. It's noteworthy too that only a couple of other times were newsletters this bullish going into earnings season, and in both cases the market moved lower. When expectations are high, even good news sometimes isn't good enough.

Each year Byron Wien publishes his "Ten Surprises," a list of unlikely sort of things to which he assigns a reasonably high probability. Go back to last January, for example, he nailed the big rally in equities. While most have heavy bets this year on China, Brazil or Australia, Byron expects Japan to do well. As is the nature of his list, that's not exactly high on anyone's list given their protracted bear market and never ending economic woes. Ah for those days when the world's ten largest Banks were Japanese, and the palace grounds in Tokyo more valuable than the entire state of California. Unfortunately, Banks there also came up with a novel concept that proved their undoing – rolling loans gather no loss. In the event, the Japanese market has been doing quite well of late. Meanwhile, the "reflation trade" countries like Brazil are lagging. That's more like two surprises.

Next week begins with a big disadvantage – no Monday. For whatever reason, Monday has been higher 11 weeks in a row, often gaining twice as much as the other four days. But the real focus for a while will be those earnings reports. Most should be good, and sentiment numbers say most expect that to drive the market higher. Time will tell, to coin a phrase, but keep in mind it's not the news, it's the market's reaction to the news that counts. Good news and little or a poor reaction means the news was priced-in, and that means risk. Given the sentiment background, there's reason for some caution, but no need to look for trouble. The trend is up, most days most stocks go up – there are no important divergences. It would take a couple more days like Tuesday, weakness with volume, to say things have changed. And it would take weakness back below S&P 1120, the top of the recent trading range, to call the uptrend into question.

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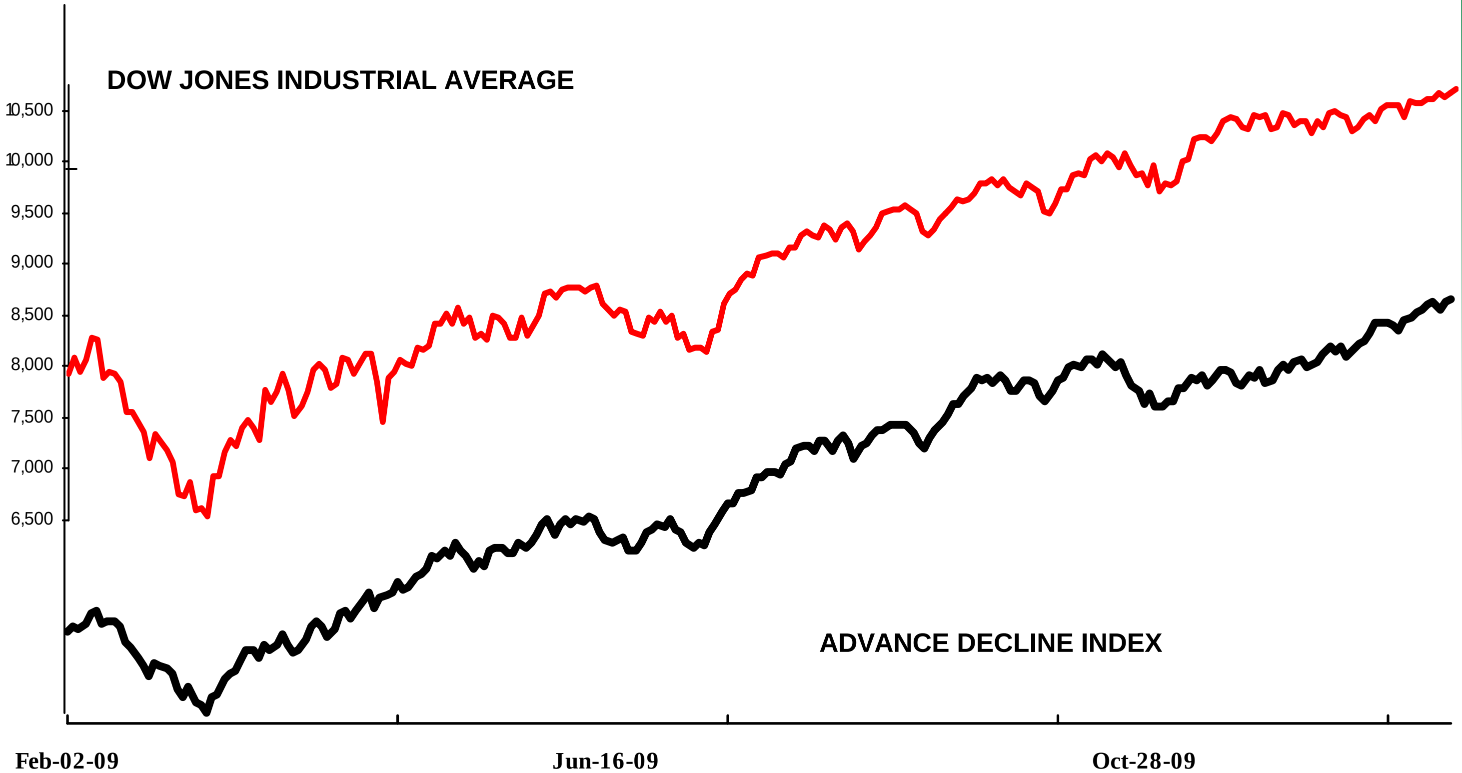
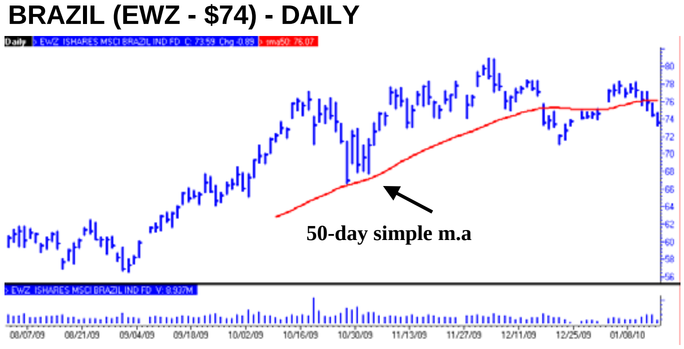
STOCK AVERAGE VS. AVERAGE STOCK



ALCOA (AA - $16) – DAILY

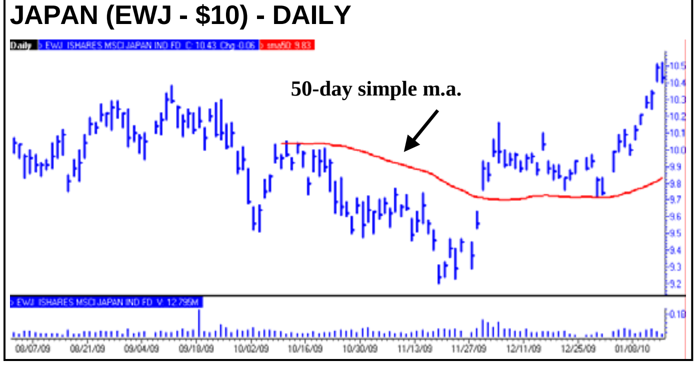
SEMICONDUCTOR INDEX (SOX - $357) – DAILY

BRAZIL (EWZ - $74) - DAILY



INTEL (INTC - $21) - DAILY

JAPAN (EWJ - $10) - DAILY



PANASONIC (PC - $17) - DAILY