Shields & Company
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EQUITIES PERSPECTIVE

May 15, 2009
DJIA: 8,331

Green shoots . . . turning a little brown? News that retail sales fell in April sent stocks reeling Wednesday. The drop in sales was unexpected, not a good thing when stocks are up. Of course, there's more to the weakness than a little bad news. Things had become, how should we put it, a little sloppy. It began last Thursday when volume expanded in the weakness, then failed to expand in Friday's strength. That set the stage for Monday's weakness, and Tuesday's Dow rally with negative breadth set the stage for Wednesday's weakness. Like many things, of course, it's all quite clear in hindsight. The correction, such as it is, is still quite modest and, after the run, hardly a surprise. However, we are a bit surprised by the extent of the weakness in some of the Tech stocks, specifically the Semiconductors. You never like to see a leadership area give up too much. That said, the SOX Index did manage Thursday to bounce off of its 50 day moving average, a positive sign.

The weakness could have been better, so to speak. The 5% drop in the averages is only a flesh wound, and didn't break the recent uptrends. It was Wednesday's 8-to-1 breadth that could have been a little less one-sided, were it a perfect world. And then, even more importantly, there's volume. You never like to see volume expand in weakness. But, what's done is done and, in the event, the weakness to this point is still quite modest. We also feel strongly that more than any decline, it will be the subsequent rally that will offer the most telling commentary on just how weak or strong the market is. And that's when volume is even more important. No matter how much the market is up, the worst thing that can happen is a rally without expanding volume, a rally without real buying. Breadth is also important. You don't want to see a rally that leaves half the stocks behind, even if volume is good.

If the market's recovery is premised on the idea that things like jobless claims will diminish, that idea pretty much vanished Thursday morning when claims surged. And yet, unlike Wednesday's reaction to retail sales, Thursday was a decent day, though volume was clearly missing. When you think about it, what could be more related than having a job and retail sales? The market's differing reaction to these numbers suggests this is pretty much just technical stuff. After the 30%+ rally the market was ready to come down, and used the retail sales as an excuse. But, since the uptrend is still intact, it ignored pretty much equally bad news Thursday. No doubt the market is discounting an economic recovery but, realistically, any such recovery seems some time off. And, in fact, it is widely recognized the market bottoms six months or so before the economy, so you wouldn't expect to see too much good news just yet. It seems likely we'll push higher, or at least muddle through, into the summer. And then we'll figure out whether the market's discounting has been wrong or right.

If the first, the Semi's, shall be last, it's only fitting that Drug stocks should rally. As measured by the Pharmaceutical HOLDR's Index, the stocks even managed a small gain in Wednesday's weakness. Johnson & Johnson (55) makes up 25% of this index, Pfizer (15) 15%. Knowing Pfizer as we all do, the breakout and rally there is quite impressive. With 90% of the S&P companies having reported first quarter earnings, health care is the only sector to show a year-over-year gain. At important turns like early March, it's typical to see "down the most" turn into "up the most." But it's important to see participation broaden, including investment grade names and not just $5 Bank and Tech stocks. There is always some degree of rotation in markets, but this move to quality, even if they're laggards, has to be considered a positive. Along with the Drug stocks, a number of Food stocks are acting better as well – see, for example, the breakout and gap in Kraft (25).

Energy stocks came down this week about as fast as they went up the week before. One area that did hold up better than the others, and moved to a new high Thursday, is unleaded gasoline futures. As measured by UGA, an ETF, gas is up almost 80% from the December low. To give you an idea of the damage here, however, a move back to the low 40's would only be about a 50% retracement of last summer's peak. It's hardly a surprise that the refiners have improved as has the sector generally. If down the most often becomes up the most, its surprising theses stocks haven't done better. Another commodity area acting well is Agriculture. As measured by market vectors ETF (MOO), there's been very little weakness, and a move above 35 should signal a resumption of the overall uptrend.

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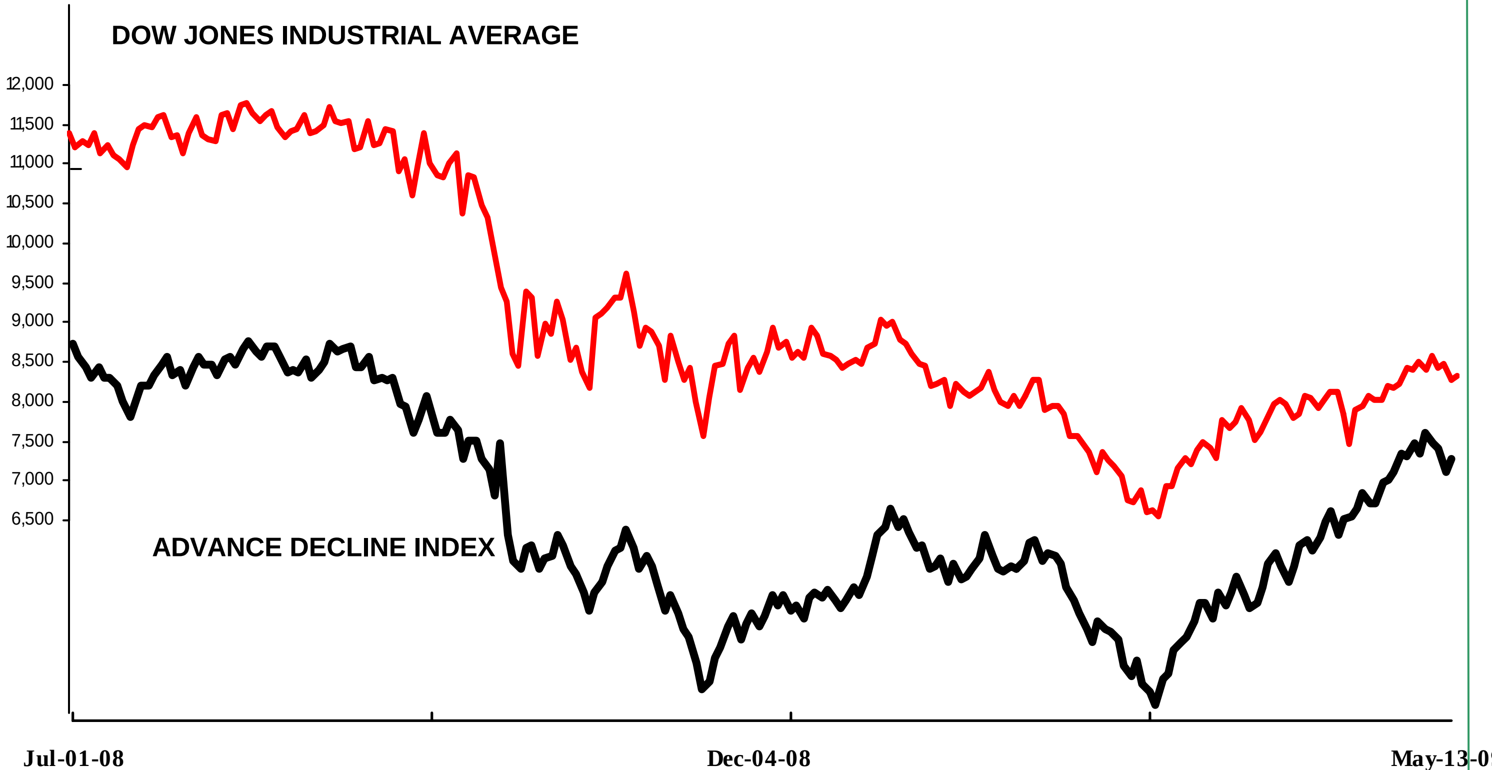
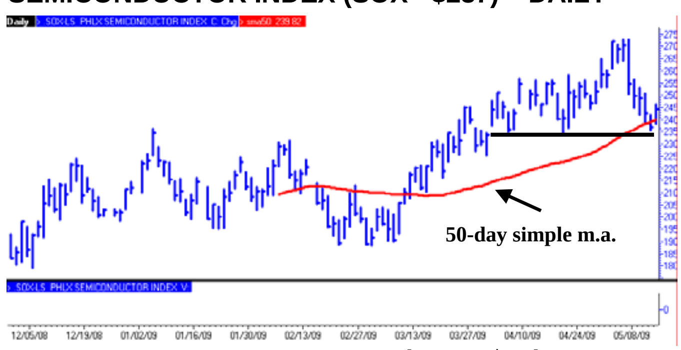
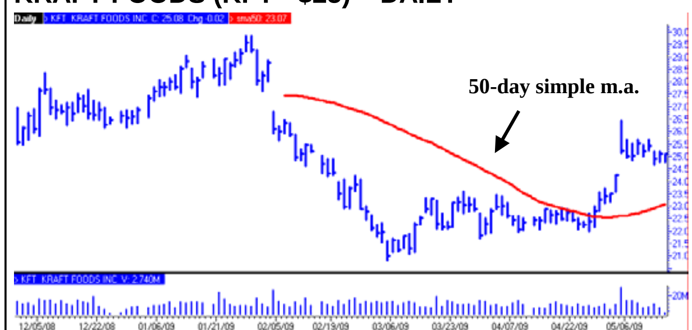
STOCK AVERAGE VS. AVERAGE STOCK



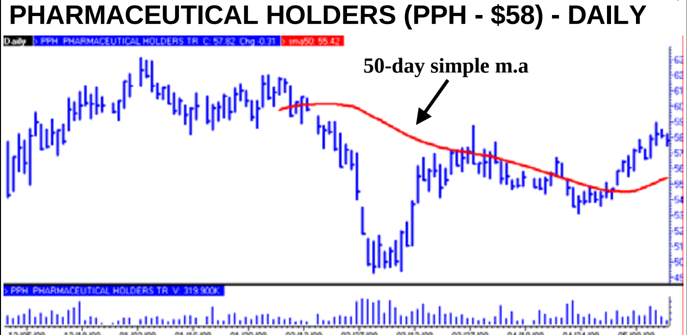
SEMICONDUCTOR INDEX (SOX - $237) – DAILY



KRAFT FOODS (KFT - $25) – DAILY

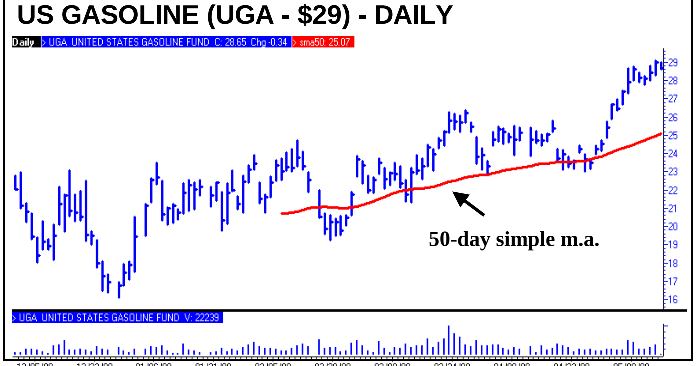


PHARMACEUTICAL HOLDERS (PPH - $58) - DAILY



PFIZER (PFE - $15) - DAILY

US GASOLINE (UGA - $29) - DAILY



AGRIBUSINESS (MOO - $34) - DAILY