SHIELDS & COMPANY
MEMBER NEW YORK STOCK EXCHANGE

EQUITIES PERSPECTIVE

October 24, 2008
DJIA: 8,691

That was just a test . . . one hopes. The 11% rally following the Oct 10 low gave way to a test of that low, and the subsequent rally gave way to yet another test of that low Thursday. This idea of a "test of the low" is not unusual following waterfall declines that end in a capitulation or a climax low. The success of the test, as it happens, isn't measured by whether or not the low holds, in this case 8451 in the Dow on a closing basis. Indeed, in the case of waterfall declines and climax lows, a lower low is more the norm than the exception. The success of a test is measured by selling pressure. Did the test produce greater downside extremes in momentum, fewer New Lows, and that sort of thing. In that regard, the Wednesday-Thursday action wasn't bad – 1300 New Lows Thursday versus 4000 on October 10.

Someone said the test is worse than the initial or climax low. If, indeed, selling pressure is less in a test, on the surface that wouldn't seem to make much sense. Yet, it does feel that way and maybe that's the point. If October 10 was the give-up in terms of selling, this is almost the give-up in terms of hope. The selling seems relentless, the volatility maddening – you can't trust a move up, or down. And, as you would expect, many who were bullish most of the way down now see the likelihood of Dow five or six thousand. Anything is possible but, then too, it's typical for opinion to follow price. And, of course, that's all the more true at extremes, like where we seem now. As Ned Davis put it recently, sentiment is a "fat pitch," better the low in 2000.

In the category of, they hold until they don't, Homebuilders have been conspicuous in their poor performance, and that's quite a feat. Obviously few areas have escaped the market weakness and there's little that hasn't broken in terms of the charts. But the Homebuilders had held and held and held, seemingly ignoring end of the world sort of bad news. In July as a group they basically held the low they made back in January, but that changed this week, with both the January and July lows now history. Perhaps even more importantly, the weakness has taken out the July uptrend, and as was the case with the January uptrend and the late '06 uptrend before it, this means the rebuilding process will have to start again. Like just about anything these days, the weakness doesn't preclude a sharp reflex rally. However, for this the root of the problem, that is, housing, the break in these shares isn't a good sign.

Historical technical or fundamental levels matter little when people have to sell. That seems the case with Hedge Funds. Apparently caught in the commodity meltdown, that meltdown itself now seems the result of forced liquidation. Gold is at 13 month low, rather than the safe-haven play you might expect. Of course, that's in part due to the strength in what has become the safe-haven play, the dollar. Then, too, with one of the world's weakest economies Japan has one of the world's strongest currencies, due in part to the carry-trade unwind. The decline in Japan Thursday night helped spark pretty much a world-wide rout, another test or worse with the market limit down before Friday's open. There's nothing that can be done about forced selling, forced by margin calls, redemptions, or plain old fear. But the selling will get done, and then we rally.

Some years ago a Dr. Dyer suggested that an individual mark down on a sheet of paper all those matters which concerned him or her at that moment. And, then, three to six months later, they were to look at that list and see, in retrospect, how many of those worries were still worth worrying about. One thing that brings this to mind, of course, is the recent 50% decline in Oil and other commodities – so much for runaway inflation. And not that long ago there was fear of Fed tightening while instead the Fed has been force-feeding the system with liquidity. Clearly there are serious problems to be resolved, but by now most of those seem known – that's why we are where we are, down 40%. The market is as stretched as it gets on the downside and the feeling is bleak. We suspect that 3-to-6 months will provide a different perspective.

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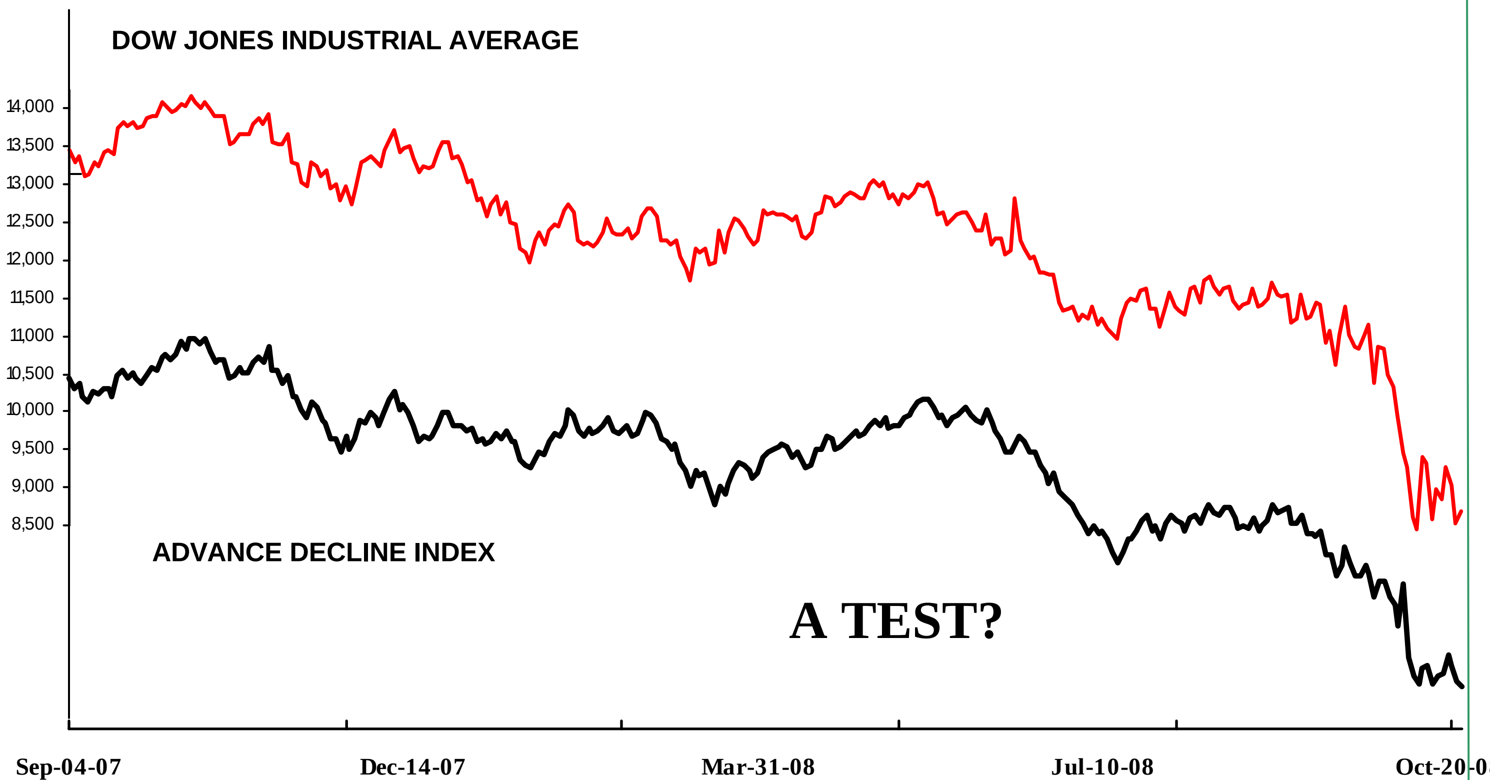
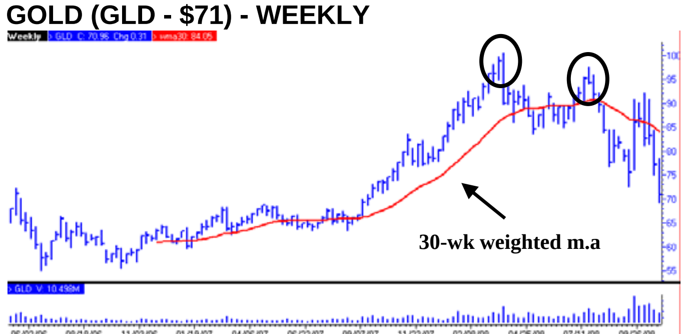
STOCK AVERAGE VS. AVERAGE STOCK



S&P 500 (SPX - $908) – MONTHLY

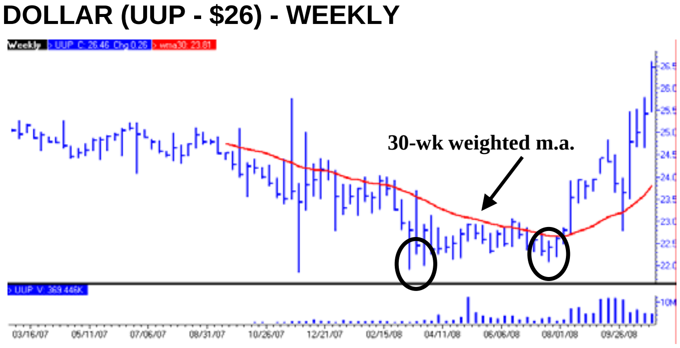
HOMEBUILDERS (XHB - $13) – WEEKLY

GOLD (GLD - $71) - WEEKLY



NATURAL GAS (UNG - $28) - WEEKLY

DOLLAR (UUP - $26) - WEEKLY



COMMODITIES (DBC - $25) - WEEKLY