SHIELDS & COMPANY
MEMBER NEW YORK STOCK EXCHANGE

EQUITIES PERSPECTIVE

November 13, 2009
DJIA: 10,197

A Burger, a Coke . . . maybe a Smoke. That's what's working. McDonalds (62), Coca Cola (56), Altria (19), these have been the market leaders of late. And you can throw in Wal Mart (53) and your favorite big-cap pharma. All fine companies, but the real key seems that idea of big. That's why the Dow Industrials are leading, outperforming "the market." And that's even the case on the NASDAQ where the NASDAQ 100, the 100 biggest, outperforms the Composite. As multinationals you can argue stocks like Coke have gotten a boost from the weak dollar. It could be that, but we're skeptical. It strikes us as a pattern all too typical of a market whose uptrend is winding down. We've often alluded to the idea that while stocks may bottom together, they peak a few at a time. Typically it's the big-cap stocks, those that dominate the averages, that peak last. Of course this divergent pattern may yet correct itself. And even if not, this pattern is a process, it takes time to unfold. In the meantime, however, it means fewer stocks are going up, or up in any significant way. And, eventually, it also means real trouble.

The Advance-Decline Index, a measure of the breadth of the market, tells you what the "average stock" is doing. And what the average stock is doing tells you pretty much all you need to know about the health of any uptrend. The big stocks, the market averages, eventually follow the average stock, never vice versa. An uptrend should have everything in sync, so to speak. At present the Russell 2000, a measure of mid-cap stocks, continues to lag, so it's not just breadth. And even the Transports haven't made a new high despite the Burlington (98) takeover. However, you can't exactly say breadth has been horrible in the rally – November 5 and 9 each saw almost 2000 net advancing issues. So even if the A-D Index doesn't get it going, we suspect this is the first in a series of divergences. But that's breadth. We don't even know what to say about volume. Measured by volume versus the previous day, and up meaning positive breadth, since mid-October there has been only one up day with expanding volume. In this two week move to new highs in the Dow, only one day saw volume expand.

George Soros on more than one occasion has referred to the U.S. banking system as "bankrupt." While technically correct, it seems fair to say that George likes his drama. So when he recently predicted a "bloodletting" in commercial real estate, it's easy to take that as drama as well. However, when the seemingly more somber Wilbur Ross recently predicted a "huge crash in commercial real estate," that's a bit different. Due in large part to commercial real estate, banks loan quality continues to deteriorate, according to an associate director of the Federal Reserve's banking division. The reason seems pretty basic – commercial real estate properties are not generating enough cash flow to pay off mortgages. Banks, of course, could offer refinancing on a maturing loan, but borrowers with depreciated property assets don't qualify. Never at a loss to avoid a loss, banks more typically extend loan repayment terms. The saying is, "extend and pretend." Pretend things are getting better, and push another crisis into the future.

As many have pointed out, commercial real estate problems aren't exactly a well kept secret. Yet the market, and even most Bank stocks, have moved merrily higher. But a couple if things seem worth keeping in mind. Regardless of the market, the Bank rally may have run its course. Banks and other Financials were the leaders in the last cycle, and leaders in one cycle don't come back to lead in the next. The Tech bubble peaked in 2000, and even a premiere growth stock like Cisco (23) has recouped only about a third of its subsequent drop. And while the Banks have had dramatic recoveries, their action of late is considerably more suspect. Banks and other Financials were clear leaders in the July rally, in the current rally they're clear laggards. The KBW Regional Bank ETF peaked in July, barely surpassing its March peak, and recently broke below a multi-month trading range. As of June 30, 39% of M&T Bank's (63) loan portfolio was commercial real estate, Regions Financial's (5) share was 36%, BB&T (25) 35%, Comerica (29) 34% and Keycorp (6) 25%.

Big upside momentum – 95% of NYSE stocks above their 200 day moving average – takes time to unwind. That has proven true so far, and almost certainly will continue to do so. And the recent rally hasn't been all bad, and not bad at all in the big stocks. Even the dormant Wal Mart, or is that redundant, has come to life. However, we're just never going to be comfortable with a rally that lacks volume. And in this rally breadth has lagged, the Russell 2000 has lagged, the Banks have lagged, the Semi's lag, the Transports and so on – there are divergences. The one thing everyone knows is that the dollar will go down forever. Next to that everyone knows the market will rally or hold up in this seasonally strong year end period. Just why that's so isn't clear, since seasonality hasn't worked all year. There are always excuses for the market to go down, things that have been brewing all along but don't matter in a healthy, divergence-free market. Things have changed, where you want to be in the market has changed. And those changes have added risk to an uptrend that already is extended by historical standards.

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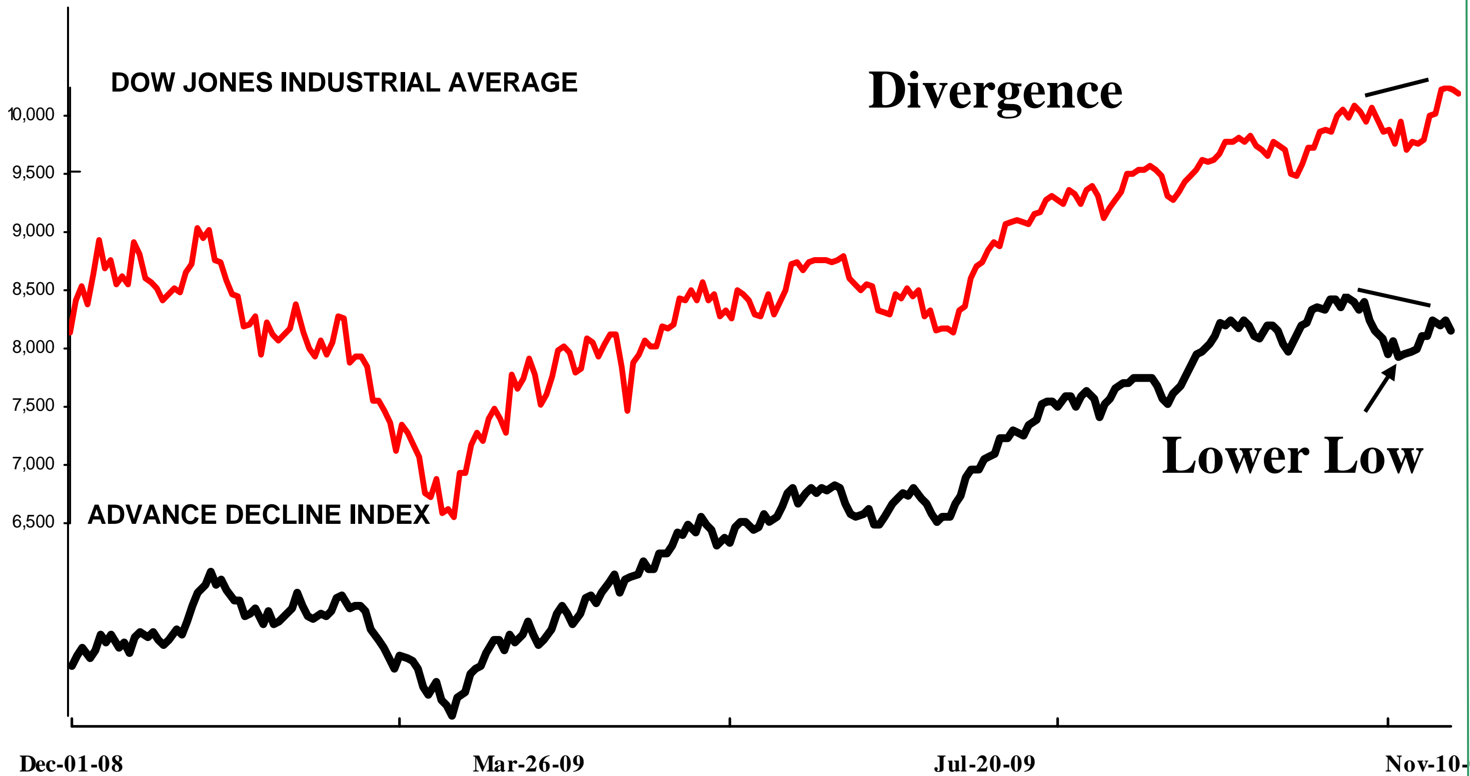
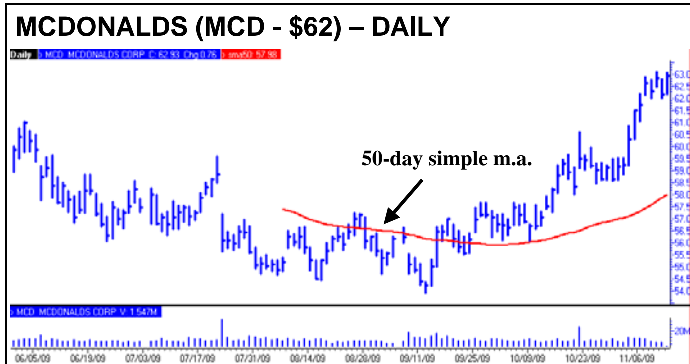
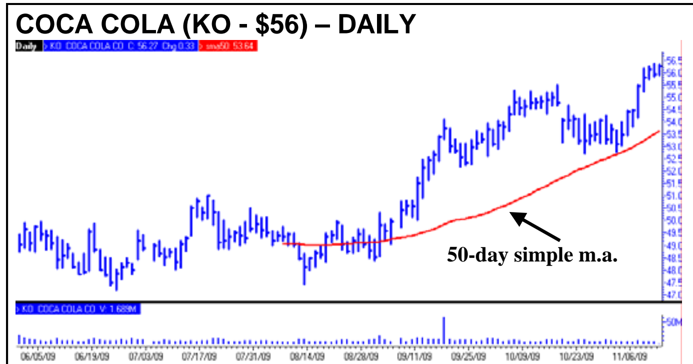
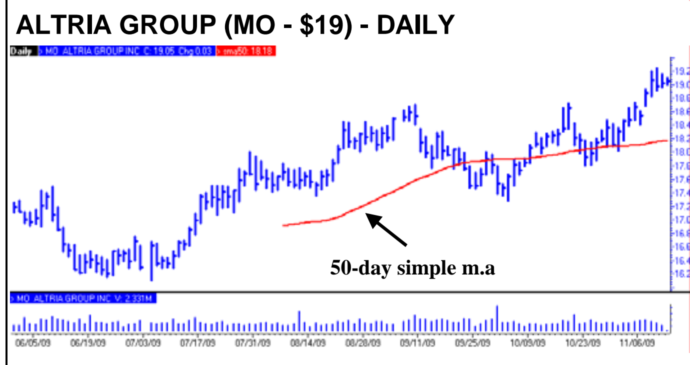
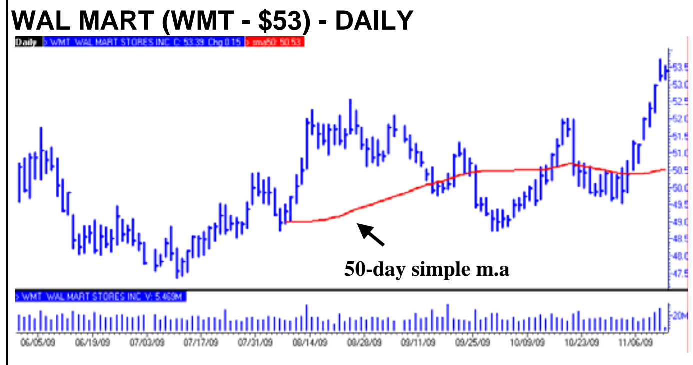
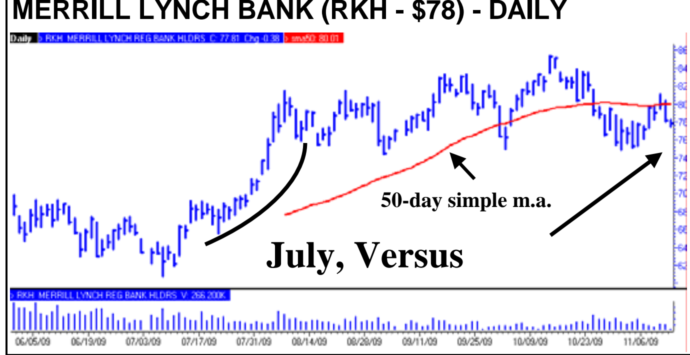

STOCK AVERAGE VS. AVERAGE STOCK
DOW JONES INDUSTRIAL AVERAGE
Divergence
10,000
9,500
9,000
8,500
8,000
7,500
7,000
6,500
ADVANCE DECLINE INDEX
Lower Low
Dec-01-08
Mar-26-09
Jul-20-09
Nov-10-09


MCDONALDS (MCD - $62) – DAILY
50-day simple m.a.


COCA COLA (KO - $56) – DAILY
50-day simple m.a.


ALTRIA GROUP (MO - $19) - DAILY
50-day simple m.a


WAL MART (WMT - $53) - DAILY
50-day simple m.a


MERRILL LYNCH BANK (RKH - $78) - DAILY
50-day simple m.a.
July, Versus

REGIONAL BANKING (KRE - $20) - DAILY
A Kiss Goodbye?
50-day simple m.a.