SHIELDS & COMPANY
MEMBER NEW YORK STOCK EXCHANGE
EQUITIES PERSPECTIVE

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DJIA: 10,366

Something's happening here . . . what it is ain't exactly clear. Buffalo Springfield's lyric didn't have the stock market in mind, though for this market the lyric somehow seems appropriate. Meanwhile, Dubai's little repayment issue seems but one of many facing commercial real estate. Having just lived through the subprime meltdown the worst part of the bad news was the reflexive response, "it's contained." Whether that's so or not even now isn't clear, but it is clear the stock market doesn't seem to care, and that's impressive. What makes it so is the market's seemingly deteriorating technical background. It's one thing for a healthy market to shake off bad news, but this market hasn't looked all that healthy for a while – the pattern of divergences, weak volume and the like. A background where bad news might seemingly be embraced, rather than ignored. Instead, the market continues to push higher, sort of.

Among the things not exactly clear is how the market can rally so broadly, when it rallies, with no volume. For that matter, with no volume it's not clear how the market can rally at all. Considering the upheaval last March, it's not surprising to see volume decline as the rally progressed. Generally speaking, however, after a selling-climax volume unwind, volume tends to pick up. At present we're seeing measures of total volume fall to new lows in a rally that has taken the Dow to a new high. You can argue a new high is a new high, who needs the volume. A new high is a new high but, the theory goes, it can easily and quickly reverse when there's no real buying/volume. Another explanation for the lack of volume is that it's there, you just can't see it. Hence the term, "dark pool." If that's the case, that could be just as bad as no volume, or worse. If the rally is predicated on "black box" dynamics, rather than just go away they could reverse.

Meanwhile, the Advance-Decline Index is yet to confirm the new highs in the big-cap averages, the "average stock" continues to lag. As we pointed out last time, however, there's the idea of divergence versus diverging. When the market rallies it does so with better than average breadth, breath isn't "diverging." That breadth hasn't made a new high can't be ignored, but we would worry a lot more if these 100 point rallies saw breadth that was flat. The Russell 2000, another good proxy for the average stock, hasn't surpassed the mid-November rally let alone the September-October highs. The Banks are pretty much in the same position, and that is a worry. This started as a financial mess that turned into an economic mess. The former had seemed out of the way. Divergences can persist, big-time momentum takes time to unwind, and so on. But divergences are a sign that the unwind has begun. And, eventually they lead to overall market weakness, the average stock drags down the stock averages. The keyword here, of course, is eventually. In the meantime it's important to recognize that, by definition, divergences mean the market is more selective.

Tis the season where things get tricky, lots of crosscurrents as they say. But surely by now you've heard it said that December is the best month of the year. Then, too, the fact that you've heard it tells you there's a lot of complacency around. Investor's Intelligence reports newsletter bears at the third lowest level in 20 years. And while the economic recovery seems on track, corporate insiders, those who should know, don't seem to believe it if their selling is any guide. Most other sentiment measures either are neutral or bearish, bearish for the market that is. And then there's that mountain of cash on the sidelines, or is it? Based on numbers from the American Association of Individual Investors, from 45% at the March low cash is back down to 25%, the 22-year mean. The Rydex Funds show a similar pattern. Cash in its Money Market Fund was highest in March, the point at which risk aversion peaked. The 7% correction in July followed the low point in cash, after which cash diminished as the market moved higher. Right now cash is at its lowest level so far. This isn't the fist time that "sideline cash" has been a rallying cry for complacency. Newspapers around the time of the Great Depression, when like now the market was enjoying a 50%+ rally, made much of the cash on the sidelines. The market then dropped 80%.

Friday's employment report, whether good or bad, likely will serve up an opportunity for the market to do pretty much what it was going to do anyway. There seems plenty of evidence that the extent of this rally isn't justified though, of course, that evidence will be ignored provided the market keeps rallying. But, is it a rally based on "black box" dynamics, the dynamics of chasing the trend, and sticking to those correlated trades? Whether up or down, why is breadth always so one-sided? And why are Monday's suddenly so special? In this year's second half price gains on Mondays are double those of the other four days. Something's happening here but, there's always something. We're all waiting for some explosive move above S&P 1110 resistance, but we're still in this trading range. Meanwhile, a break below the range at 1085 would be a real concern.

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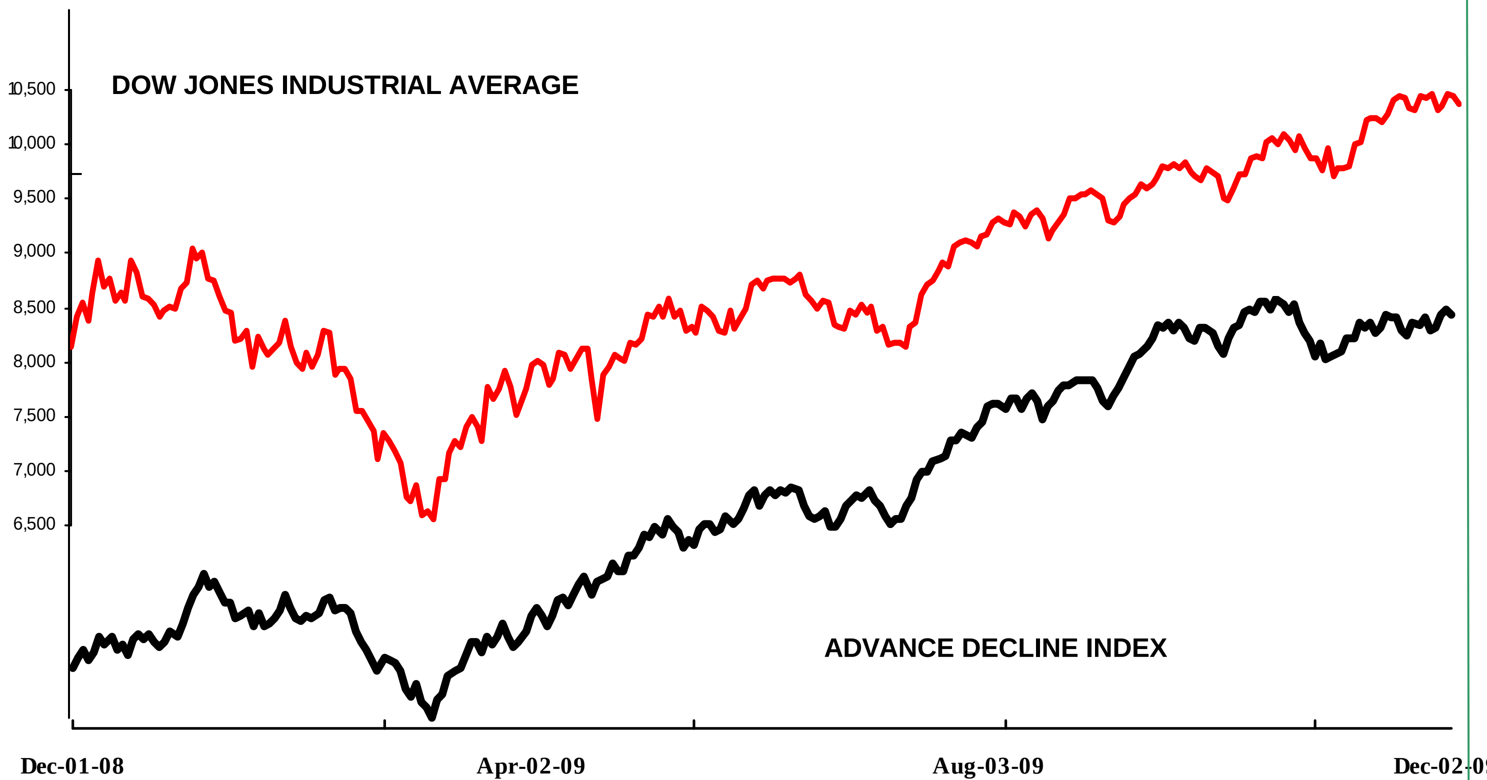
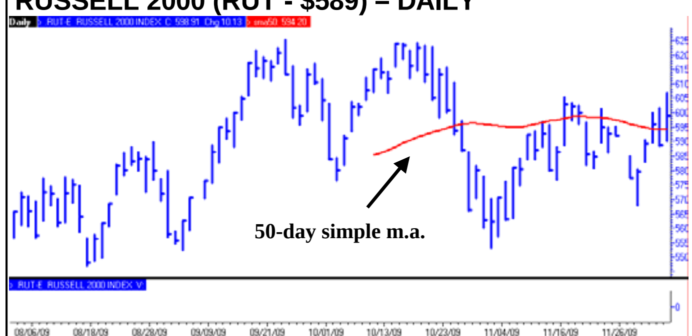
STOCK AVERAGE VS. AVERAGE STOCK



S&P 500 (SPX - $1100) – DAILY

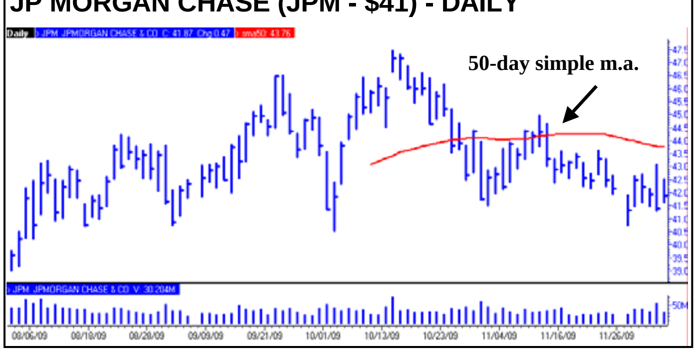
RUSSELL 2000 (RUT - $589) – DAILY



REG BANK HLDRS (RKH - $76) - DAILY

S&P RETAIL (XRT - $35) - DAILY

JP MORGAN CHASE (JPM - $41) - DAILY



WAL MART (WMT - $54) - DAILY