

by Stephen Brennan

Beware Bear Rallies

In early March many commentators labeled the recession as over – “if it ever really happened” – and ordained a new bull market. Only one little item got in the way of this new bull market, as the first quarter earnings season revealed that at least when it comes to corporate earnings there is still a recession. My advice then and now is to remain bearish on stocks, especially technology stocks. As I write this article, the Nasdaq is down about 15 percent and the S&P 500 has lost more than 5 percent for the year – so far, so good for my accuracy.

I am also still leery of semiconductor stocks as April ends. Take a look at the sectors that will drive semiconductor consumption: telecommunications, wireless and IT, for example. As I write this, the year-to-date performances for companies like Nokia, Sun and IBM are horrible, while the stocks of telecom equipment providers have cratered. Fortunes for these companies need to turn around to create a true upturn for the semiconductor industry. What is more, the stocks of semiconductor capital equipment makers have outperformed that of their customers, the chip manufacturers, leading me to worry even further about underlying weakness in the demand drivers for the sector.

GETTING THE BIG DECISIONS RIGHT

The biggest driver of returns in your investment strategy is getting the big decisions right, like selecting style and sector. For example, the telecommunications sector is down 30 percent so far, while oil services stocks are up more than 20 percent for the year. In my April column I noted that value stocks with boring accounting practices would look increasingly attractive to investors. The small cap value style, as tracked by the Russell 2000 Value Index, is up more than ten percent for the first four months of the year. Some long positions on these stocks, with stop/loss orders, have been a nice combination with some short positions on large-cap growth stocks in the Nasdaq.

Most investors focus on picking stocks, but picking the right sector or style is more important. The investment management firm I advise uses Exchange Traded Funds (ETFs) to focus much of its portfolio on investment themes – style, sector or even country – based on macro-economic drivers and technical analysis, without actually picking specific stocks. But

using such products is also an option open to individual investors, and it's one you can apply to semiconductor stocks. A Semiconductor HOLDR (SMH), for example, is a security that can trade like a stock and represents ownership in AMD, Altera, Analog Devices, Applied Materials, Amkor, Atmel, Broadcom, Intel, KLA-Tencor, LSI Logic, Maxim, Micron, National Semiconductor, Novellus, SanDisk, Teradyne, Texas Instruments, Linear, Vitesse and Xilinx.

SECTOR AND STYLE EXPOSURE

ETF's are relatively new, but investors should consider how they could best employ these tools. One can use them to add diversity to individual equity selections and reduce stock-specific risk

or go so far as to construct a comprehensive long/short equity portfolio that seeks to reduce both stock-specific and market risk. The price movement for the SMH, for example, looks like a mirror image of the Philadelphia Semiconductor Index (SOX). So if you think you know which way the industry is going, but you don't want to fall victim to any company-

specific issues, like a big customer order falling through or a negative court ruling on an IP issue, this is a great way to gain exposure.

On that note, in my last column I noted that some telecom stocks like Corning at under \$7 were worth keeping an eye on in case I'm wrong about further problems for the economy. (The technicals – other than a pretty solid floor – have so far not been compelling.) The Broadband HOLDR (BDH) is an excellent way to gain exposure to telecom infrastructure stocks when the time is right. You can find out more about these products, which include investment style products such as Russell 2000 Value iShares (IWN), at the American Stock Exchange Web site at www.amex.com. In regard to my bearish outlook, I will revisit it when the S&P 500 (SPDRS: SPY), Dow Jones Industrial Average (DIAMONDS: DIA) and Nasdaq (Nasdaq 100: QQQ) consistently trade above their 200-day moving averages. ■

About the Author

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