WELLINGTON SHIELDS & CO.
MEMBER NEW YORK STOCK EXCHANGE

EQUITIES PERSPECTIVE

December 31, 2015
DJIA: 17,604

If you forecast for tomorrow what happened today … you're right two-thirds of the time. This is true of weather forecasting, but as for the stock market, who knows? However, in 2010, an economist named Andrew Haldane presented something similar when it comes to stock prices. In this case, each month you go long or short based on whether the previous month was up or down. Over a 130-year period, $1 turned to $50,000 via this method, while the same $1 invested via a dividend discount model turned into 11 cents. It was better to buy high than to buy cheap. Many studies document the success of momentum versus mean reversion. As per October and November, overbought doesn't mean over. Oil stocks were inexpensive and yet, have become more inexpensive. Forecasting is all but impossible, observing is not so hard. All the net gains in stock prices come when the 50-day moving average is above the 200-day. We forecast that this will continue.

In the stock market, the past does repeat. It repeats because human nature repeats, and this makes forecasting tempting. The market has narrowed which in the past has led to overall corrections. This is not so much a forecast as it is a historical observation. The timing here is where it becomes tricky. Market peaks take time, they're a process. Using those 50- and 200-day moving averages as a guide, the Russell 2000 is negative and the Transports are as well. Given that these have leading tendencies, it seems right to be concerned if not outright cautious. The S&P is not yet clear. It would easily move decisively in a Santa Claus rally or the lack thereof. Adding to the confusion is the position of stocks above their 10-day moving average. For virtually the entire year, the market has had trouble when this measure is above 80%. Then, too, if like October the market can surpass this little roadblock, it would be a good sign.

December hasn't exactly followed the script. The second week typically is down, and it was. The third week typically is up, and it too was down. Disturbing here were the back-to-back declines of 1%, very unusual in the second half of any December. The last such occurrence was 2007 and, before that, 2000. If you detect a pattern, you're correct – it happens in bad markets. Regardless, the market is almost always higher in December's second half. However, it is another worry about next year, if it's more worries that you're looking for. For our part, we can make do with the divergences in the Advance-Decline Index and the percent of stocks above their 200-day moving average. The Advance-Decline Index peaked in April, stocks above their 200-day moving average peaked in July 2014. New Highs peaked in May 2013. Divergences can go on for a long time. Indeed, they usually wear you out – you grow tired of hearing about them. Tired yet?

Aside from the market itself, another place where some mechanics might be applied is Apple (107). The company and its products might be loved, but its stock is often controversial. The numbers are compelling, it's the growth that raises concerns. The stock sells more on a perceived product cycle than it does on earnings. The latter always seem to rise but not always the stock price. In 2012, a nine-month correction lopped 40% off the price, and the stock could be in another such correction here, though this gets back to forecasting. If forecast we must, we'll just say the stock won't go a lot higher until it gets back above its 200-day average around 120. Meanwhile, a stock like Amazon (689) has a mechanical problem of another sort. The stock is about 35% above its 200-day moving average, not far from where it peaked last July. Amazon can go as long as the market goes, but at these stretched levels, it at least needs a decent market.

Old bull markets can't be defined chronologically. However, there is a characteristic which to the best of our knowledge defines all old bull markets and that is, they narrow – fewer and fewer stocks persist in uptrends. This is why measures like the Advance-Decline Index, a directional measure of all stocks, and the Russell 2000, a price measure of secondary stocks, are leading indicators. The "average stock" peaks before the stock averages, but eventually the big-cap averages are dragged down as well. The Russell 2000 peaked in mid-June and, after a relatively poor rally from the October low, remains down 10%. There is something called the "January Effect," which is the tendency for secondary stocks, especially beaten-down secondary stocks, to do better in December and January. There seems little of this so far but, as they say, hope springs eternal. There always will be exceptions, but generally speaking, in 2016 secondary stocks should be avoided in favor of the big. Always of overriding importance is group selection – think Biotechs and Pharma this year versus Energy and Materials – and here we favor Defense and the "defensive."

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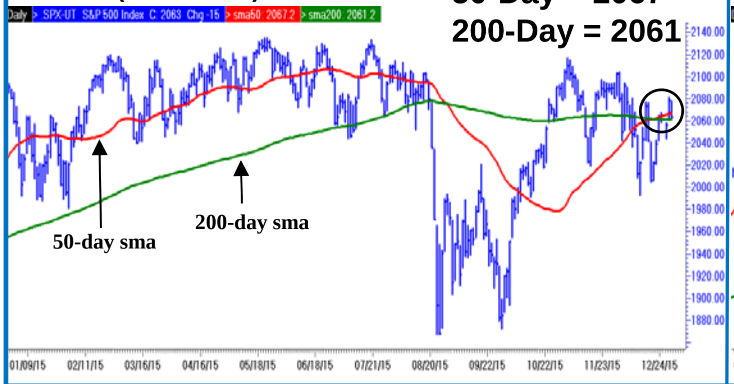
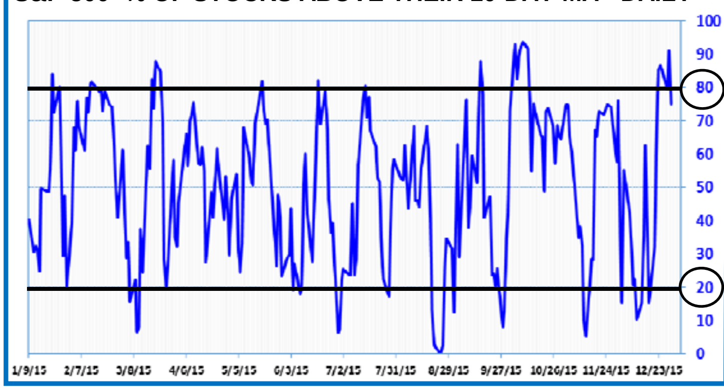
S&P 500 (SPX – 2063) – DAILY



NASDAQ 100 (NDX – 4652) – DAILY

S&P 500 -% OF STOCKS ABOVE THEIR 10-DAY MA - DAILY

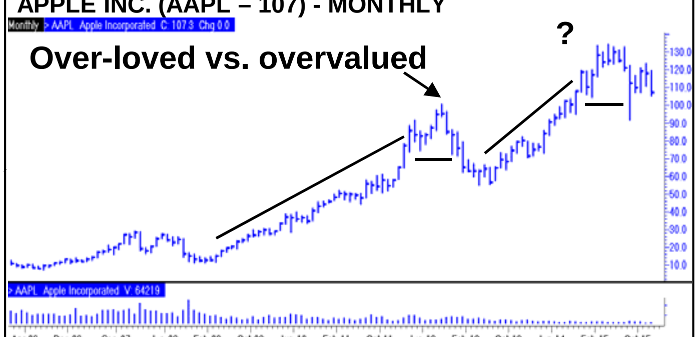


S&P 500 -% OF STOCKS ABOVE THEIR 200-DAY MA - DAILY

AMAZON.COM INC. (AMZN – 689) - DAILY

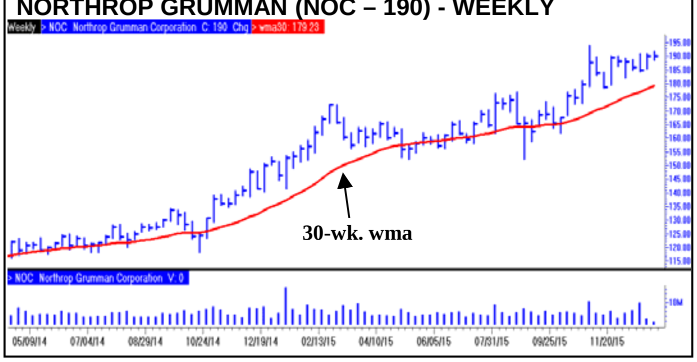
ADVANCE-DECLINE INDEX - DAILY

APPLE INC. (AAPL – 107) - MONTHLY



RUSSELL 2000 INDEX (RUT – 1150) - WEEKLY

NORTHROP GRUMMAN (NOC – 190) - WEEKLY



KROGER COMPANY (KR – 42) - WEEKLY