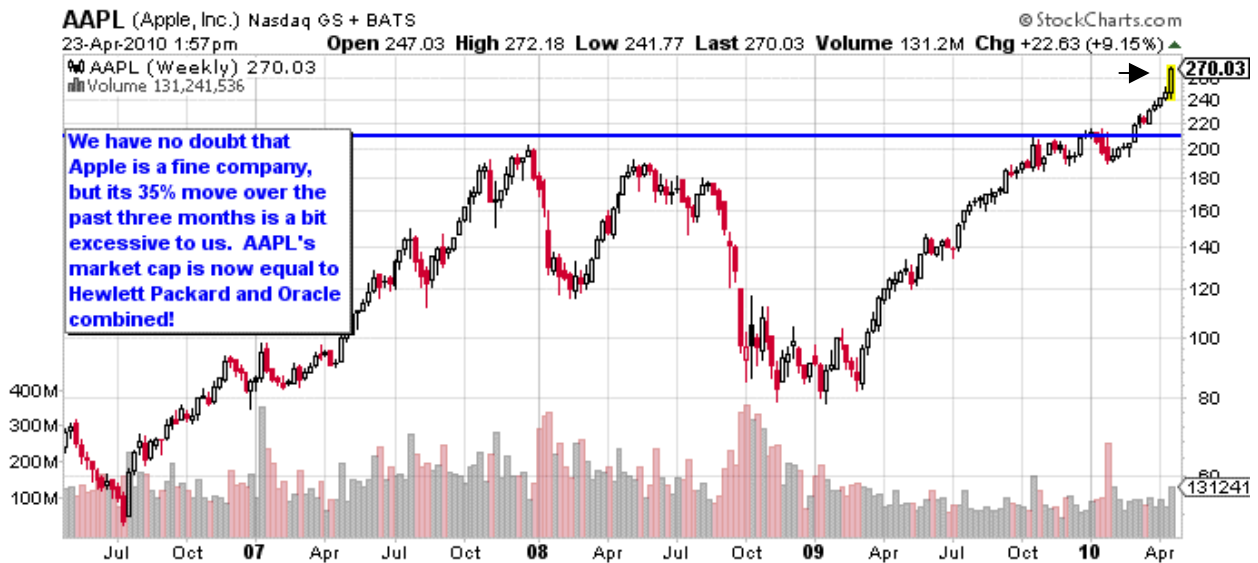




The Starboard Side Report

The week ending April 23, 2010

We feel that the market may soon be hitting a key inflection point where early cyclical stocks in the financial, technology and consumer sectors start to pass the baton to mid-to-late stage cyclical stocks like industrials, materials and energy. We have started to see some of the stock prices of favorite retailers and consumer technology companies going parabolic in recent weeks. This indicates that we may be in the final blow-off stage of early cyclical leadership. Below is a picture story of the big move that early cyclical stocks have already had.



DECK (Deckers Outdoor Corp.) Nasdaq GS + BATS
 23-Apr-2010 2:03pm

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DECK (Weekly) 157.32
 Volume 2,957,668

Open 135.08 High 158.39 Low 130.69 Last 157.32 Volume 3.0M Chg +21.32 (+15.68%) ▲

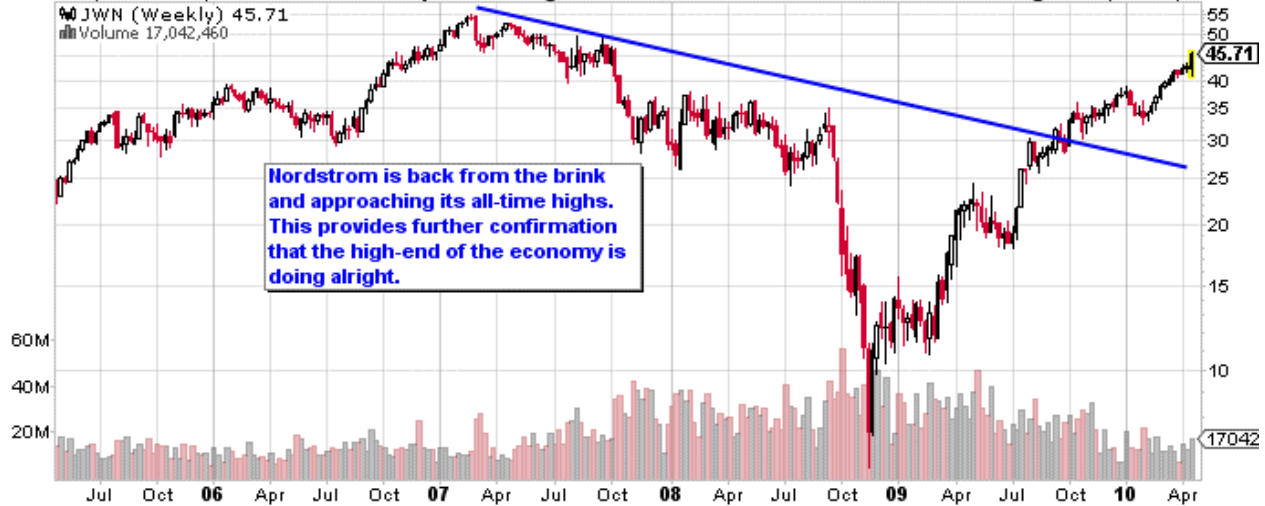


JWN (Nordstrom, Inc.) NYSE + BATS
 23-Apr-2010 2:09pm

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JWN (Weekly) 45.71
 Volume 17,042,460

Open 42.63 High 45.94 Low 41.03 Last 45.71 Volume 17.0M Chg +2.76 (+6.43%) ▲

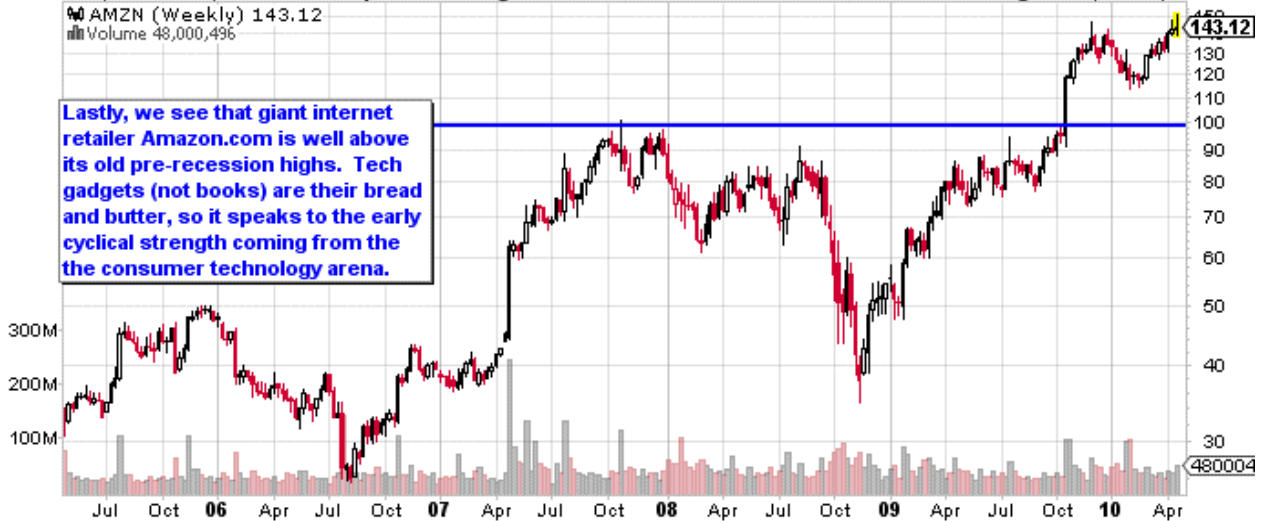


AMZN (Amazon.com, Inc.) Nasdaq GS + BATS
 23-Apr-2010 2:15pm

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AMZN (Weekly) 143.12
 Volume 48,000,496

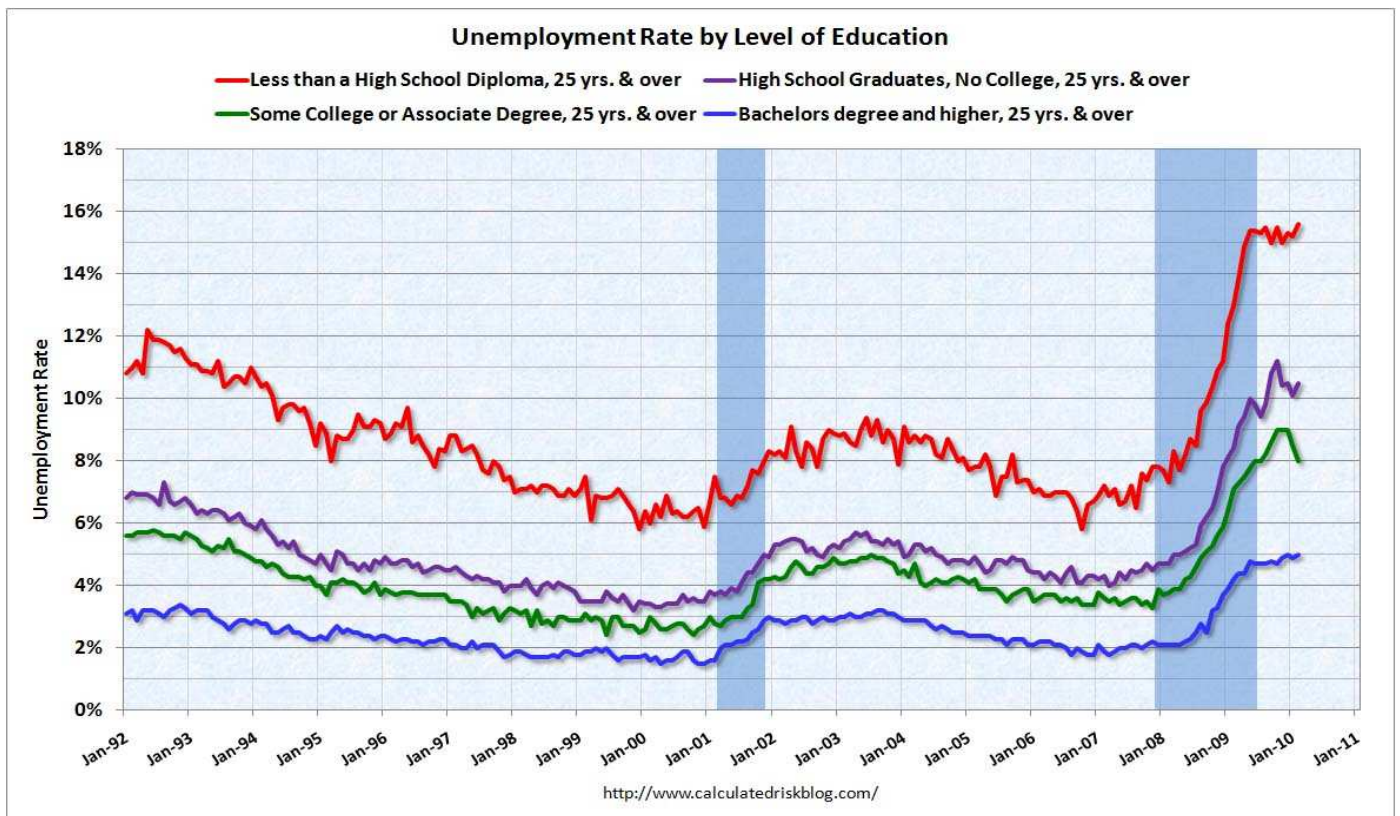
Open 142.35 High 151.09 Low 139.13 Last 143.12 Volume 48.0M Chg +0.95 (+0.67%) ▲



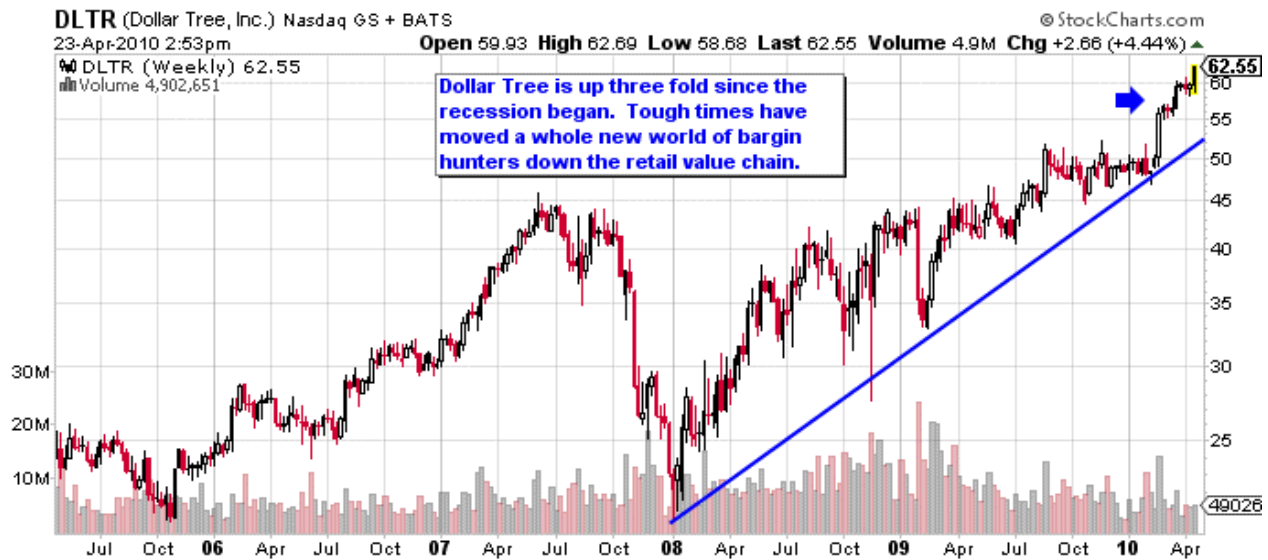
While we admit that this extremely impressive relative strength of the early cyclical stocks has caught us a bit by surprise, it also points to the fact that we have a fairly typical economic recovery in the works (contrary to the consensus). One theme that we see in these charts above is that the higher-end of the US economy seems to be doing just fine. This is backed up by some interesting unemployment stats that we have seen recently. The following quote is from Jeff Saut, Chief Investment Strategist of Raymond James.

"As for my trip through Michigan last week, the observation is that there are disparate economic readings. While Battle Creek, Flint, and Detroit are economically abysmal, Kalamazoo, Ann Arbor, and Grand Rapids appear to be doing pretty well. Similarly, one particularly bright portfolio manager, at the State's "Bureau of Investments," opined that there is a rapidly developing disparity in the employment picture for our nation. In his words – we appear to be evolving into a two class system; the unemployment rate for the top decile of wage earners is about 4%, while the unemployment rate for the bottom decile is roughly 30%."

This two tier economy is not healthy for the long-term stability of the country. Populist politics are shaped when these type of battle lines are drawn between the haves and have nots. The chart below from Calculated Risk shows this same situation in a slightly different manner.



As we can see, the unemployment rate for college educated workers has never moved above 5% during this entire crisis. Therefore, it appears as if confidence was all that was missing for this group to get back into the shopping malls. However, for the other half, it still may be a long time before we see them open up their wallets at anything other than the Dollar Store.



On the positive side, we feel that the strength in the retail sector bodes well for those areas of the market that tend to be classified as late stage cyclicals. As mentioned above, these include energy, materials and industrials. Industrials have been the first of these sectors to take off with a gain of almost 20% year-to-date. Based on price action in oil service stocks this week, the energy group may be poised to start outperforming next. The chart below is illustrative of the early cyclical nature of semiconductors versus a later cyclical sector like oil service.



Some may argue that semiconductors are not as much an early cyclical play as consumer stocks, but we believe the argument can be made that the majority of semiconductor profits these days are driven by end demand from the consumer electronics industry. Should the ratio in the above chart break out of the wedge formed at the 0.70 level, then it could be off to the races for the energy sector versus technology.

Sector	Top 2	Mkt Cap	Top 2 Combo Mkt Cap	Total S&P Sector Mkt Cap	S&P Sector Mkt Cap less Top 2	Adjusted Percent of S&P 500
Consumer Discretionary	MCD	76				
	DIS	81	157	1138	981	9.00%
Consumer Staples	PG	184			0	
	WMT	204	388	1191	803	7.37%
Energy	XOM	324			0	
	CVX	163	487	1209	722	6.63%
Financial	BAC	186			0	
	JPM	177	363	1819	1456	13.37%
Health	JNJ	178			0	
	PFE	133	311	1254	943	8.66%
Industrial	GE	202			0	
	UTX	72	274	1157	883	8.11%
Materials	MON	36			0	
	DD	36	72	374	302	2.77%
Technology and Telecom	MSFT	275			0	
	AAPL	241	516	2378	1862	17.09%
Utility	EXE	29				
	SO	28	57	372	315	2.89%

Legacy Bubble/Early Cyclical
Global Buildout/Late Cyclical

Financial, Consumer Discretionary and Technology
Energy, Materials and Industrials

39.46%
17.51%
21.96%

All units in billions



Those sectors that we classify as legacy bubble are also the early cyclical groups. As a result of this better early cycle performance, these sectors have broken out to an unsustainable lead in the S&P sector weightings. They now make up 39.46% of the market versus the late stage cyclicals at only 17.51%. We feel this means the catch-up period of the global buildout group could prove to be very strong due to much better fundamentals and still abundant liquidity.