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THE GURU'S CORNER

Rising rates

Commentary: Household names offer potential refuge

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NEW YORK (S&F) -- Good news for workers and perhaps for President Bush, but maybe bad news for stocks: The March jobs report was much stronger than expected.

The bond market took this as a serious warning of inflation, as evidenced by a sharp one-day rise in long-term interest rates. (The Federal Reserve has a high degree of control over short-term rates, but short of extraordinary government intervention, the bond market sets the levels of long-term rates.)

Stocks too have been weak since the April 2 jobs announcement. Apparently the threat of higher interest rates is so scary to stock market investors as to outweigh the possible economic benefits of a stronger job market.

Improving employment opportunities could result in improved consumer confidence and spending, for example, and might help mitigate the effects of any future slowdown in economic growth.

It remains to be seen whether the stock and bond markets' reactions at this time will prove to be prescient or unjustified. Although inflation itself jumped in March, with consumer prices up a full 0.5 percent, other economic data are not consistent with the imminent threat of higher rates.

But almost all observers agree that inflationary pressures will mount, if not now than in the near future. As a result, the Federal Reserve will eventually act to push interest rates higher and slow down the economy to try to control inflation.

Last year's winners included stocks whose prospects are leveraged to the rate of economic growth-cyclical stocks. The strategy for a rising rate, inflationary environment should emphasize stocks that are relatively immune to the effects of a slowing economy.

One such sector is consumer staples. These companies are household names -- Gillette, Procter and Gamble, Coca Cola etc. They make products that most people will continue to consume regardless of the economic environment. As a result, their rate of corporate profitability is regarded as potentially stable.

Investors can purchase a basket of consumer staples stocks using available exchange-traded funds. Of the ETF's available to track this sector, the iShares Dow Jones U.S. Consumer Non-Cyclical Fund ([IYK: news, chart, profile](#)) has been the strongest during the past year.

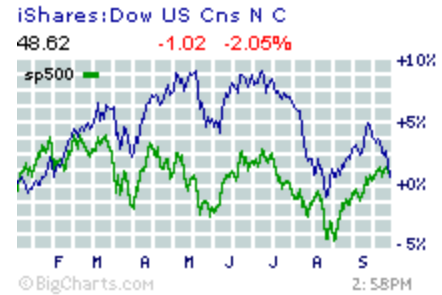
In addition to the fundamental reasons to consider the sector, the technical analysis situation is also relatively positive for this ETF. The chart below shows that while the Standard & Poor's 500 Index ([SPX: news, chart, profile](#)) basically hit its peak in February, IYK went on to make a new high in April.

The better intermediate term strength in IYK compared to the S&P 500 index is also revealed in their positions relative to their 21-day moving averages. The S&P 500 (on April 15) closed at its moving average,

while IYK closed almost 1.8 percent above its moving average.

Also encouraging in the near term-The S&P 500 index has fallen 2 percent from its April 5 high, while the IYK has basically held its ground.

Conclusion: Investors should consider purchasing IYK at \$53 or below. Based on historical rates of stock market profitability during election years, a year-end target of \$60 is projected.



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