

Traders Notes for April 16th 2008

Prepared by;

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Semiconductors: Trading Opportunity: Maybe; Investment Opportunity: Probably Not

This morning the market has a positive tone after Intel's (INTC-N-\$20.91) better than expected earnings report. While we are happy to see a 'ray of sunshine' in this otherwise cloudy market, we are not busy writing a handful of 'buy' tickets. Like the airline industry, which we profiled in our trading note on April 15th, we question whether semiconductors are attractive as a long-term investment.

Every new industry goes through a period where demand dramatically outstrips supply. When this is occurring companies can charge whatever price they want and profit margins go through the roof. However, the windfall period comes at a price.... high profit margins encourage new competition and additional investment in capacity. Ultimately supply catches up with demand, pricing power falls, and what was once a 'growth' industry becomes a 'cyclical' industry. We think the semiconductor industry has passed this inflection point and is now a 'cyclical'. As a cyclical, investors will only want to buy the sector or any of its constituents when they believe the economy is about to enter a new period of expansion, which is not what we are predicting. Below are a few sobering facts regarding semiconductors that we derived from their relative price graph below.

- Over the last 15 years, an equally-weighted composite of semiconductor companies, has outperformed the market for only three brief periods.
- Two out of three of the occasions occurred when we came out of a recession: 1994-1995 and 2003. The only other period of outperformance was 1998-1999 and was tied to the technology bubble, which we do not expect to be repeated.
- In the last 15 years, semiconductors outperformed the broad market only 1/3rd of the time (5 out of 15 years). In 9 out of 15 years the group has significantly underperformed the market.
- While periods of outperformance were significant, they were more than offset by the significant periods of underperformance.
- Those who choose to 'buy and hold' the group for the entire 15-year period would have underperformed the market by nearly 30 percentage points.



Chart Courtesy StockVal

Bottom Line: Semiconductors, in our opinion, are a cyclical industry. Since we do not believe the next economic expansion is 'right around the corner' we see little reason to position semiconductor stocks in portfolios for anything but short-term trading opportunities. We recommend long-term investors remain on the sidelines with regard to this group.

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