

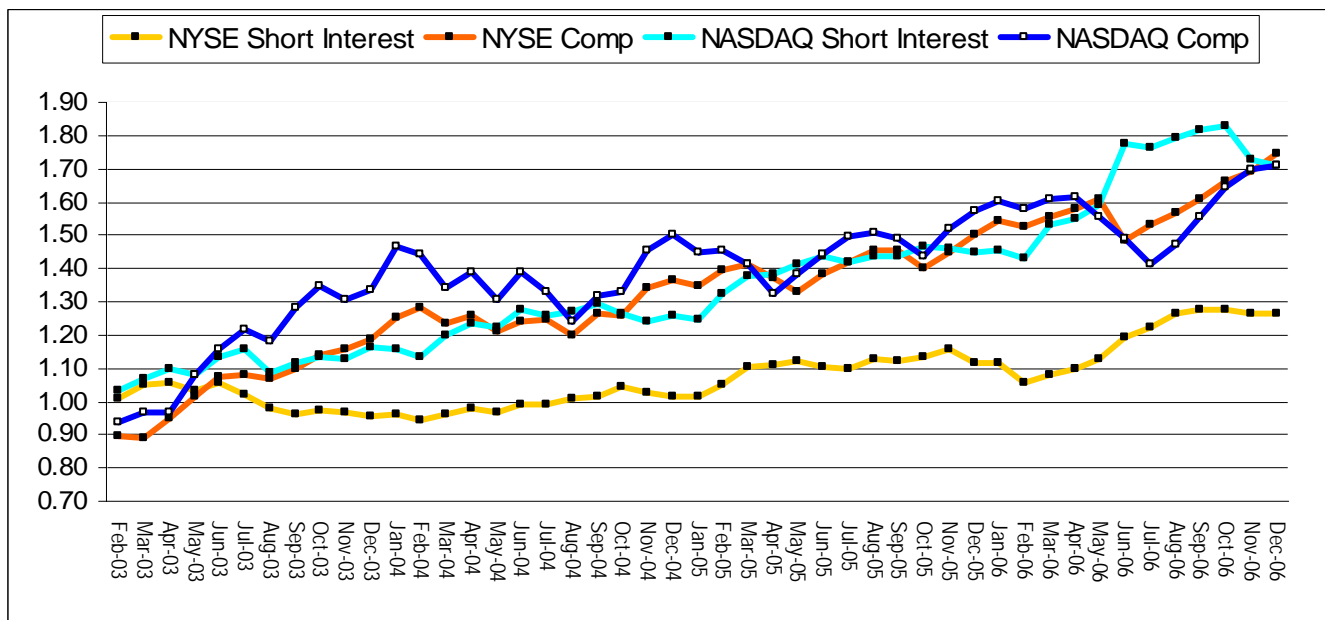
Short interest flattens December 30, 2006

Short interest essentially stayed put in the last month. The change on the NYSE was less than 5M shares and the change on the NASDAQ was just 80M shares.

NYSE short interest for the period between mid-November and mid-December gained a scant 0.05%. The value of the NYSE composite index added 2.84% during the same period.

NASDAQ short interest dropped 1.15%, the second decline in as many months. The NASDAQ Composite was up 0.57% during the same period.

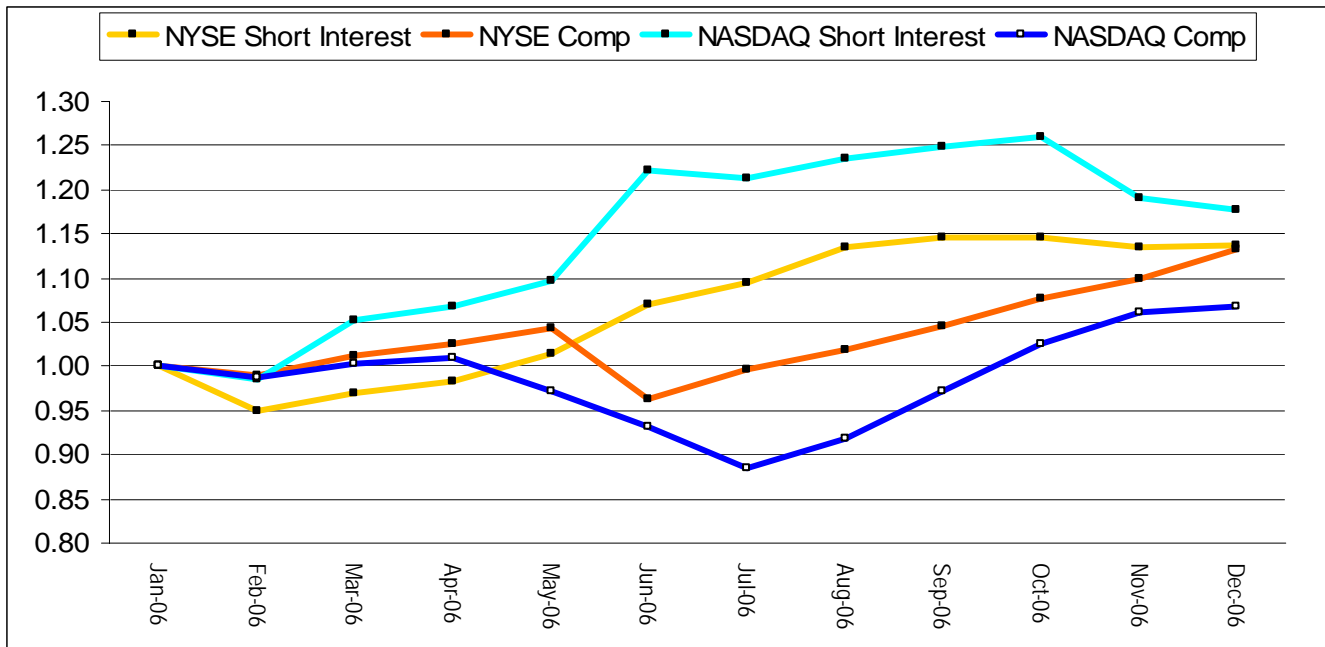
The graph we've been using appears below. It uses January 2003 as an index year (for no reason than that was a complete year bull market and the first year where we collected data. We're not certain the graph is anything more than informational, but we believe it is worth pointing out the pattern of the indexed NASDAQ Comp (in dark blue) after each time it was eclipsed by the indexed value of the NASDAQ short interest (light blue).



The broad separation between short interest on the NASDAQ and the value of the NASDAQ comp appears to be a potential indicator of future market gains over the last 3+ years. In the past few of these articles, we noted that if you eyeball it with a bullish bent, *for fun only mind you*, the pattern suggests the NASDAQ comp needs to push 3000 to duplicate the previous patterns. The other thing that could happen to close the gap, of course, is an abrupt decline in NASDAQ short interest like we had the last two months. Still, a *for fun* eyeballing of the chart pattern suggests at least a couple of months of NASDAQ gains are ahead.

If the chart is at all predictive, it seems to indicate January and February will be good for NASDAQ stocks but that they might run into trouble in March and/or April.

Now that 2006 is complete, we have the same graph for only the 2006 data:



We're honestly not sure you can make anything of such a short time series, but we thought we'd share it anyway.

November saw the semi-annual rebalance of the **NASDAQ Biotech Index (NBI)** index, so it is more difficult than normal to draw firm macro-level conclusions from the latest short data. The 176 stocks in the NBI as of as of the short interest cut-off date saw their average short interest decrease by 1.25%. The NBI lost 1.59% during the same period. Short interest of the NBI as a percentage of overall NASDAQ short interest gained to 12.29%, but that is a result of the rebalance more than anything else.

Short interest in the **IBB**, the iShare ETF for the NBI, rose 9.59%. The **BBH**, a HOLDr ETF approximating the **AMEX Biotech Index (BTK)**, saw short interest drop 2.81%, the sixth drop in the last five months.

There is a debate in the marketplace concerning whether short interest data are even relevant in an environment seemingly dominated by zero-volatility/income funds. The argument for irrelevance asserts all these short positions are little more than hedges necessitated by the massive volumes of call sales characterizing modern markets.

We maintain that short interest carries both explicit and implicit costs, so it does matter. The higher stocks go, the more it matters. Further, the volume of outstanding calls in biotechnology stocks is dwarfed by outstanding short interest. So even if the irrelevance argument is true for the overall market, it is clearly not true in the biotech sector.

We freely acknowledge the rise in short interest will not *cause* a rally, only accelerate one already underway. So, short interest is like most of the macro concepts tossed around by market mavens (high debt, low savings, Fed liquidity, inflation, deflation, stagflation, etc.). None are immediately actionable, but each is arguably worthwhile to consider when you are determining your portfolio's risk profile.

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