PHASES & CYCLES®

SOON, YOU'LL HAVE TO PAY HIGHER PRICES TO ENTER THE MARKET.

INTRODUCTORY SUMMARY: The majority of investors and commentators seem to agree that this is a full-fledged bear market. The daily flow of negative financial and economic news gives this notion credibility and widespread acceptance.

The markets, however, are defiant. Following a swift rebound from the January lows, they have been holding strong and firm. Why would the markets ignore the bad news? Because, as usual, the markets climb a "wall-of-worry". **The cyclical and technical evidence is overwhelming: the worst may be over, the markets are gathering strength and the final blow to the bearish forces may come any time now.**

MARKETS NOW: In mid-January, based on cyclical and technical evidence, we forecasted a cycle low for late January/early February. This idea was supported by technical indicators such as the long-term oscillators, the divergence in the MACD and the favourable sentiment data.

Indeed, the low arrived on January 23rd, with a powerful "reversal day" action. The recovery rally lifted the North American indices out of their lows in convincing fashion. The advance was strong and persuasive although it played out differently in Toronto and New York. The S&P/TSX composite index, propelled by Energy and Gold stocks, rallied back toward its overhead 200-day moving average. The DJIA and S&P 500 indices, which suffered more damage during the preceding months, remained below their 200-day moving averages despite a nearly 10% rise. Such gains in a short period required consolidation. The backing and filling we witnessed subsequently was part of a bottom-building process during which the markets gathered strength in anticipation of an upside breakout.

Events usually unfold over a certain period and involve:

- The establishment of a terminal low (*achieved on January 23*);
- An initial recovery rally (*completed*);
- A test of the previous low on reduced trading volume (*completed*);
- A move above the 50-day moving average (*already achieved in Toronto and about to occur on the S&P 500*);
- A move above the 200-day moving average (*realised in Toronto, not yet achieved in NY*).

The key to the completion of the current bottoming/testing process is upside momentum. This would be a day when the markets generate "breakaway momentum" – a historical gain on a large upside volume when advances are more than four times the declines. Precedents suggest that such large-scale buying should lead to more gains and a new upside phase. Of course, the bullish outcome is dependent on the markets staying above their January lows. Watch for the falling 200-day moving averages, which are posturing as a deterrent for now.

The markets act as though they are "sold out" and are in transition to a new bullish phase. The mid-January reversal, the strong follow-up rally, and the current healthy consolidation support this idea. The more time the markets spend near current levels to gather strength, the more powerful the next move should be.

PAC-08-033; MKT-180; February 29, 2008

Olaf Sztaba, Ron Meisels

STOCKS COMMENT:
The sector analysis also flags a bottom. The groups most affected during the last few months (Financials and Homebuilders) reached new lows but ended the month higher on record volume. This is a sign of accumulation – a transfer of shares from weak hands to strong hands. **If the commentators are right and this is a bear market, why did these sectors reverse in January on record volume?**

The rally out of late-January lows did not lift all boats equally. This uneven market action supports our stand that stock selection will be paramount during the next market phase. The focus should remain on stocks that sustained their good technical standing during the corrective period.

ENERGY. Despite hostile market conditions, the litany of complaints, daily media reports of its demise, the strength of the Energy sector continues. In fact, this is one reason why Energy stocks should thrive. Consult our BUY&SELL list for individual stock selections.

GOLD AND GOLD STOCKS. Our work suggests that these should advance and be the strongest performers in 2008. However, even within this group, the right stocks could make a difference. Buying should include stocks with extended base patterns such as Barrick Gold, Goldcorp and Pan American Silver and among juniors such as High River Gold and Eastmain Resources.

BANKS have gone through a very difficult period. While some stocks suffered more than others, they all became heavily oversold and now are approaching levels from which a recovery could be initiated. **Look for our upcoming report on this Sector.**

While the 2002-2007 advance lifted nearly all sectors, the current up-phase is most likely to be selective and uneven. It is probably going to be a bull market of individual stocks.

FINAL SUMMARY: ***The cyclical and technical evidence is overwhelming. The markets are consolidating and gathering strength, a situation that drives the bears up the wall. The final blow to the bearish forces may come any time now.***

Phases & Cycles Inc.,
2020 University, Suite 1903, Montreal, QC H3A 2A5
Tel.: (514) 393-3653 E-mail: RonMeisels@phases-cycles.com www.phases-cycles.com