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North American Marketletter

MARKET COMMENT

(S&P/TSX - 11616; S&P – 1276; DJI – 11028; NASDAQ – 2262)

A TALE OF 2 BULLS, AND 2 CORRECTIONS.

BUT NOT '2' WORRY LONG-TERM YET.

Our last Market Comment introduced some short-term cautionary notes. The positive indications arising from the much-followed "January Barometer" were complicated by the continued narrowing leadership in this mature bull market, and the beginning of the "roll over" phase of the 39-week cycle. We forecast a "small pause", and for the bull to engage in "resting phases" more frequently in the months ahead.

Our forecast proved prescient. The major market indices are now in one such "resting phase." After three months of strong up-trending this was to be anticipated. With every correction, no matter what its size, bears are coming out of hibernation to proclaim the end of the bull market. Yes, there are some excesses of *short-term* optimism starting to develop, most notably in some of the Gold stocks, but overall market sentiment remains remarkably muted. The bulls are not over-confident – the recent declines have quickly depleted the ranks of the bulls according to the latest Investors Intelligence figures (down from 60.4% to 48.9% in recent weeks).

In the meantime, as the bull market nears the final stages of its remarkable run of the last few years, it is increasingly less useful to analyze the "North American major stock indices" as a single block. The Toronto market, with its greater weighting of late market leaders such as Golds and Energy, continues to diverge in several ways from the major U.S. indices. We detail this on page 2.

Overall, the bull market leg 5E is still in good shape. The 200-day moving averages are still sloping upwards, and the recent rallies have opened considerable room for corrections to take place without damaging the overall bull trend. Major support levels have not been violated. The weekly charts look strong, with no major internal momentum divergences that we might expect to see if *the major top* was upon us.

In sum, continue to keep the bullish faith – with the proviso that the number of stocks in the bull column will continue to diminish. Another buying opportunity, especially in the Gold, Material and Energy sectors, should emerge shortly.

David Tippin
Ron Meisels

Why does the headline refer to "2 bulls and 2 corrections"? The answer that there are increasingly diverging markets on each side of the border, which demand increasingly divergent approaches.

In our recent "Thought for the Day", we noted that the sharp drop in Toronto on February 7 was much more drastic than in any of the US indices. The Toronto market had a rise in previous months that far exceeded any of the major US market indices – about twice as much in fact. From October to early February the S&P/TSX Composite Index put in an extraordinary "trending" performance, with very few successive down days. Not so in the US, where the S&P 500's progress was much more halting, especially after the end of November. In other words, the recent rallies looked different in character.

Toronto then set itself up for a correction of what might be viewed as a "too far, too fast" rally. This has come in the form of a sharp downward move. What goes up higher and more rapidly, tends to come down faster. New York's rally upwards was more leisurely, and the recent correction – besides starting nearly a month earlier – has been more gentle and time-consuming.

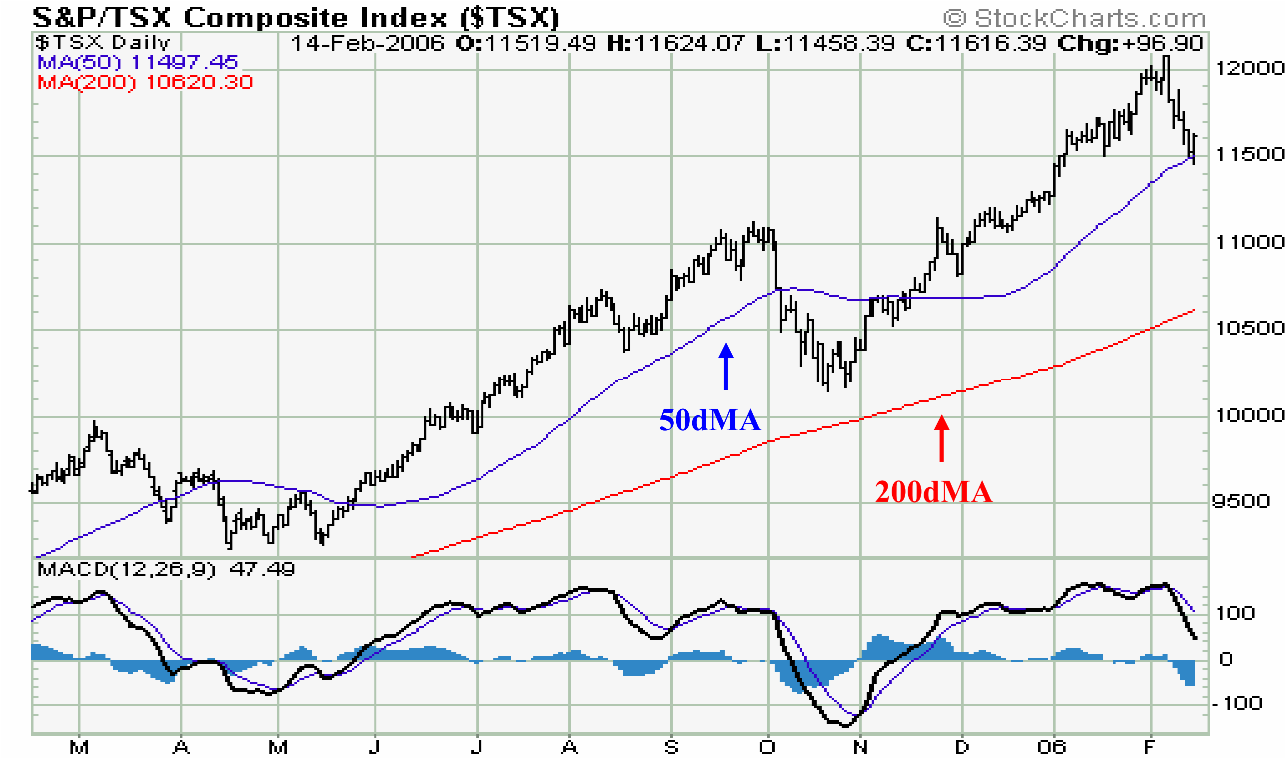
Both the US and Canadian markets remain bullish. In both markets, some sectors have ended their bullish moves and are in distribution phases. But the important divergence from an investment standpoint at this late stage in the bull market is the relative *volatility* factor. In the US markets, the major source of sharp trending moves would likely be the technology-related sector. That sector had its period in the limelight in the *previous* bull market, and shows few signs of taking a leadership role at this stage in the current bull market.

Contrast this with the Canadian market. As we have repeatedly said, the Gold and Energy sectors should lead this bull market to a rousing conclusion, and they are of course more heavily weighted in the S&P/TSX Composite Index than in the major US market indices. This is where we expect the volatility to be strongest in forthcoming months. If so, we should anticipate that the Toronto market will continue to show relatively sharp moves – both to the upside and downside -- in comparison to the US markets.

The key words looking ahead are "dynamic" and "selectivity." Once the current corrective period is over, new bull market highs should be achieved in both Toronto and the US. The rewards should be greatest in the Energy, Material and Gold related stocks, but strong nerves will be required to ride out the bumps along the way.

THE TORONTO COMPOSITE INDEX

(S&P/TSX – 11616)
(Daily chart with 50- and 200-day moving averages)



Toronto, as we noted in the last Market Comment, is an "extended" market – and we think it will become even more extended before the bull move ends.

We also forecast that the index might correct sharply towards its 50-day moving average in the short-term. As the January rally continued, internal momentum weakened, as measured by MACD (which has now rolled over). The market was ready for a tumble, and that is still unfolding.

But as we have stressed repeatedly, there is plenty of room to accommodate a correction at this point. The S&P/TSX Composite Index rose 1935 points from October to early February. A one-third correction of this rally will take the index back to about 11,440, roughly the current level of the 50-day moving average. Should this level not provide sufficient support, the next correction target would be the one-half level of the previous rally, or about 11,100. This would still leave the index comfortably above both its rising 200-day moving average (currently at about 10,600), and the bottom of the long-term trend channel (about 10,200).

The Toronto market is having a deserved rest. It has yet to complete its corrective period, but the volatile nature of this market is such that investors should be ready to return quickly to the bull side, concentrating on the Energy, Material and Gold stocks.

THE S&P 500 INDEX

(S&P 500 – 1276)
(Daily chart with 50- and 200-day moving averages)

The S&P 500 index has now been correcting for one month, and currently rests just below its 50-day moving average. There is good near-term support in the 1250-1270 zone. The lower boundary of this zone represents about a one-third correction of the October-January rally.

A 50% retracement of that rally would take the index down to the 1230 level, very near the rising 200-day moving average and the major bull market up trend line.

The MACD internal momentum indicator has turned negative, following a negative divergence, but it has yet to indicate that the current declining phase is at its end. So we should expect some more pause in this market.

As we said last time, the S&P 500 appears to have built a base for an assault on 1300 and beyond. Following completion of the current correction, the immediate target is the recent high at 1295, and above that the next Point & Figure target of 1360.

THE DOW JONES INDUSTRIALS

(DJI – 11028)
(Daily chart with 50- and 200-day moving averages)

One month ago when the Dow Industrials hit the 11,000 level we said that the Industrials major task was to establish itself firmly above this level. We thought this task might take some time to accomplish, so we suggested to "expect some backing and filling on either side of the 11,000 level by the Dow Industrials in the short-term, followed by a renewed push to new bull market highs."

The last few weeks' action shows that the DJI is in this "backing and filling" period. The Dow has fluctuated between its previously-tested support zone around 10,750 and the 11,000 level. The Dow's action since last October now looks like the beginnings of a "flag" formation, with a strong rise in October and November (the "flagpole"), followed by a trading range or consolidation ("the flag").

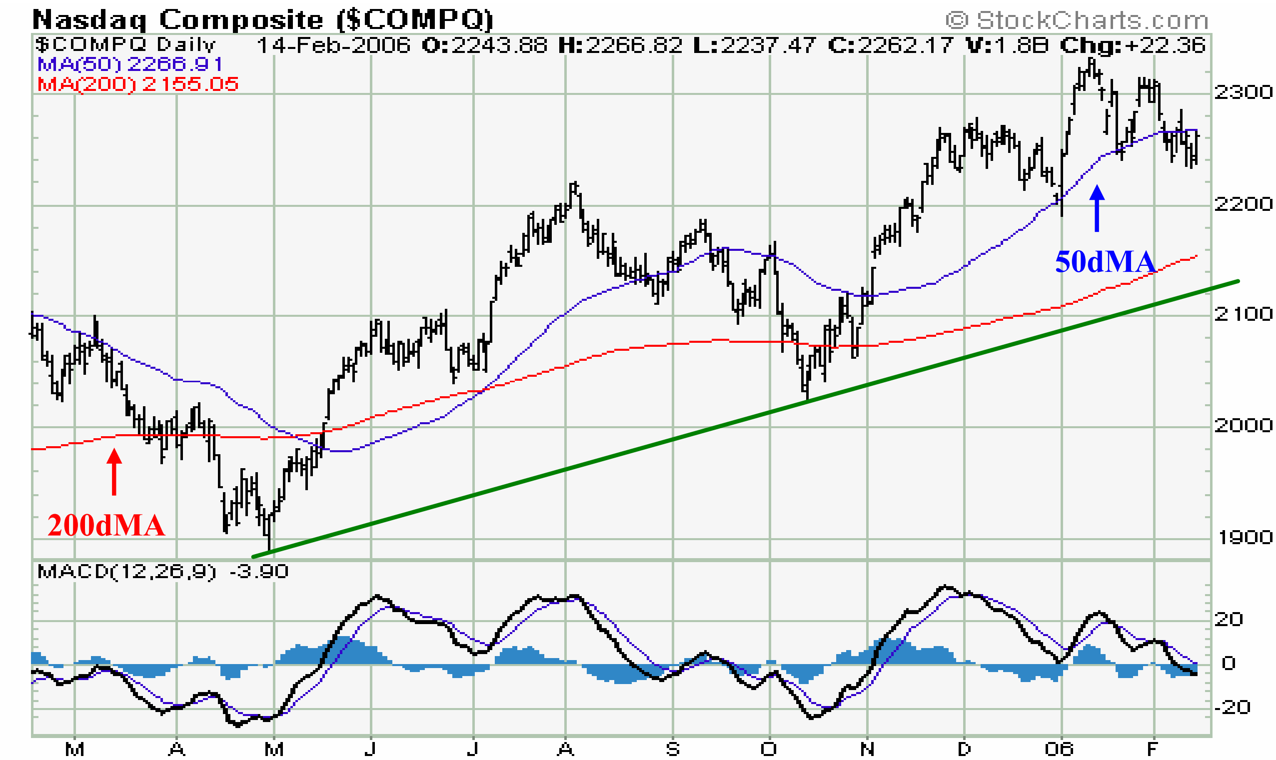
The question is, which way will the Dow move? The market is not at extreme oversold levels, so further declines are possible in the short-term. The Dow Transports, which made a new high in late January, has *not yet* been confirmed by the Industrials.

We still think the Industrials have an upside breakout in their future. If so, the flag will prove to be a "consolidation" pattern separating two up moves. The 10,500-600 level provides good long-term support (the zone that includes the 200-day moving average and the long-term bull market trend line).

Look for the Dow Industrials to take their cue from the S&P 500. When the S&P 500 hits a new high at 1300, the Dow Industrials should be ready to break out into the low 11,000s.

NASDAQ COMPOSITE INDEX

(NASDAQ – 2262)
(Daily chart with 50- and 200-day moving averages)



In early January, we said that "where the S&P 500 and the broader market go, the NASDAQ will follow." This has certainly been the case for the past few weeks, as the NASDAQ's action closely shadowed the S&P 500.

The NASDAQ is in a corrective period, but is by no means at extremely oversold levels. The index has retraced nearly one-third of the October-January rally (which would be about the 2230 level). If further correction is needed, the index could reach the 50% retracement level, or about 2180 – just above the 200-day moving average. Further support is provided at the 2120 level, which is the location of the major bull market trend line.

The NASDAQ shows no indication that it is going to be a "late bloomer" of this bull market. Expect it to track the action of the S&P 500 in terms of both direction and strength.