

PHASES & CYCLES®

MARKET COMMENT

(S&P/TSX - 11372; S&P - 1250; DJI - 11045; NASDAQ - 2133)

The Market says: I am Over-sold

SUMMARY: May and June brought a drastic pullback in the North American markets, which included a number of panic sell-offs. It resulted in a number of “exhaustion” days and brought about an extremely “oversold” condition (see below).

Most of the evidence listed below now suggests that this correction has run its course and the markets are now in a basing phase, leading to a summer rally. It is the strength of this rally, or lack thereof, that will bring about new 2006 highs, or create a “cycle failure.”

Markets before April-May: Since October 2005, the markets have been moving with such vigor that a major gap developed between them and their respective 200-day moving averages (200DMA). In Toronto (S&P/TSX) the move was fuelled by the Resources and the gap equalled 1313 points (or about 12%); in New York (S&P 500) it was 71 points or about 6%. Then, a corrective move set in starting in early April in Toronto and in early May in New York.

The objective of a corrective move in a bull market is to eliminate the gap, to bring the markets “back into line” to the correct appreciation rate, to provide a new (lower) buying range. It is done by tempering optimism, by creating a bearish atmosphere, by creating fear, in other words, to bring about an over-sold condition.

Markets after April-May: How do we know when the market is oversold? What way does the market manifest this oversold condition? During late May and early June the following conditions were observed to suggest a major oversold condition:

- The percentage of stocks above their 10-week moving average in New York fell below 20% ^(*). The last time this occurred was in October 2002 - at the beginning of the current bull market!
- The number of bullish market letter writers declined from 53% to 36% and the number of bearish writers increased from 25% to 35% ^(*). They met in the middle. The last time this occurred was in October 2002- at the beginning of the bull market!
- There were almost no New Highs and an abundance of New Lows. The last time this occurred was in October 2002 - at the beginning of the current bull market!
- A day when Declining Volume was 90% of the Total Volume was followed shortly by a “reversal day” when Advancing Volume was 90% of Total Volume.

^(*) Supplied by Investors Intelligence

- The VIX Index (a bottom indicator) rose to 24, a level not seen since early 2003, near the beginning of the current bull market.
- The sell-off on Monday before Option Expiry coincided with the day that most individual investors received their May statements! Cries of “They did it to me again” added to the already existing fear.
- Loblaw and Weston continued to trade lower – not an event that occurs at the beginning of a bear market.
- The first week of June was the culmination of the 39-week cycle. Such a culmination always brings extremes.
- A bear was on the cover of not only Barron’s but even on the Economist.

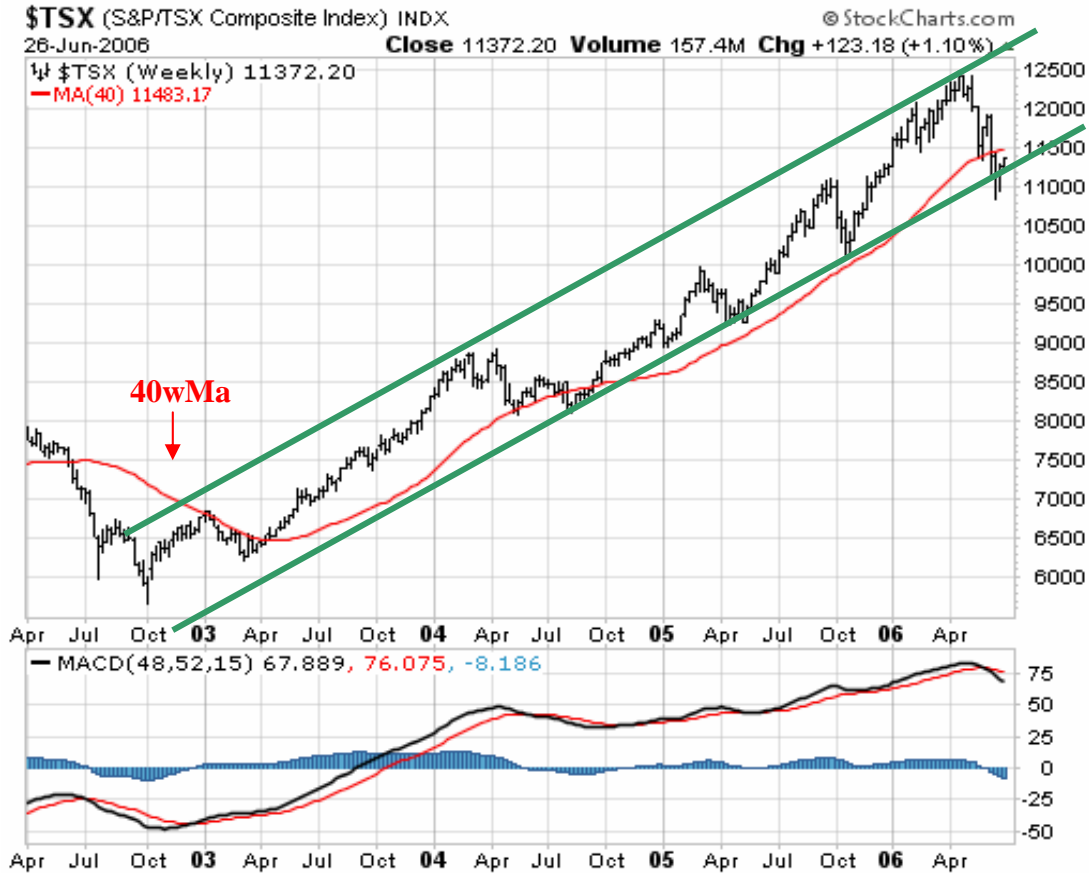
The Markets in July and August: The power of the 39-week cycle has now created a release in the downward pressures and is now neutralizing the bearish conditions. The result of the oversold conditions, together with the power of this cycle, should soon create a move back towards the April-May highs. If the follow-through is positive, new highs could be

achieved by the end of August, leading to just a small setback in September and October, but not to any degree of damage. A year-end rally then should achieve new all-time highs in Toronto (and recovery highs on the S+P 500) spilling into the first and maybe second quarter of 2007.

At the same time, if the follow-through is shallow, without a new high in Toronto by the end of August, then the fear of September and October will dominate and the markets will have missed the opportunity to complete the last leg of this bull market. The technical word for this is a “cycle failure”.

Given the oversold conditions, given that the Resource stocks have not yet completed their top-forming, given that a rally to all-time highs will probably induce “latecomers” to finally enter this bull-market (fear turns to greed), given that our Point and Figure targets of TSE 14,000 and S&P 500 1,360 still exist, given that it will take some time to reverse the current oversold condition to overbought conditions, we continue to remain bullish until proven otherwise.

**TORONTO
TSX/S&P**
(Weekly chart with 40-week moving averages)



The S&P/TSX composite index has been moving within a well-defined up-trend channel since October 2002 (see solid lines). The lower line of this channel provided major support during every correction while the upper line acted as a strong resistance. Similarly, during the most recent advance, the index unsuccessfully attempted to break through the upper resistance. A correction resulted from this failure and brought the Index back to the bottom of the channel, to

just below its rising 200-day moving average, near 11,000.

Whether the Toronto market decides not to look back and rally from here or whether to take some time to test the lower line of its long-term channel doesn't matter from the bull's perspective. The potential for the next up-leg remains 14,000.

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



In our last Market Comment we noted that the “up” portion of the 9-month cycle in the S&P 500 has ended and we could expect a pause into a cycle low. We pointed out the 1250-60 zone as the most likely destination for this pullback. The index slightly overshot this level and sold down to ±1220 before it found support.

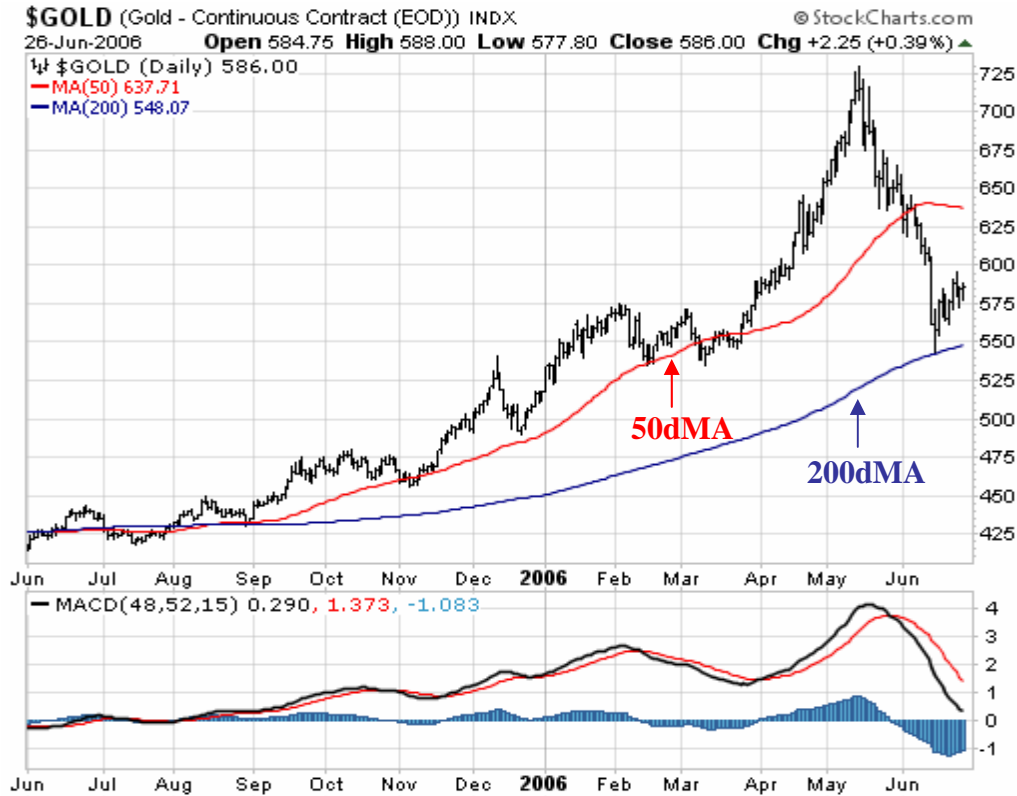
After spending a few sessions just below its rising 200-day moving average, the index is now resting in a narrow trading range.

The S&P500 may do another week of meandering before the 39-week cycle exerts its upward pressure.

The S&P 500 is finding support near its rising 200-day moving average from which further advances are most likely to be launched.

GOLD & GOLD STOCKS

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



In our early-May Market Comment we presented the case for a pullback in Gold and gold stocks. We also noted that corrections in gold stocks could be quite challenging for many investors. Indeed, the gold sector was hit hard. However, such sharp and vicious corrections are not unusual events in this sector and during bull markets; they offer great opportunities for entry and should be viewed as such.

The first indication that the Gold sector is recuperating from its seasonal malaise is the noticeable strength of gold stocks in relation to Gold. This phenomenon usually takes place during the early phase of the advance

and reverses itself (gold stocks lag behind Gold) as the rally ends.

Finally, many gold stocks, after weeks of decline, have arrived at their rising 200-day moving averages – major support levels and baselines from which further advances should take place. In the past, these levels provided an excellent buying opportunity.

Gold and gold stocks are near the completion of a vicious but necessary correction. After an expected “calming” period, gold stocks should lead the yellow metal into a traditionally strong second half of the year.

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