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## North American Market Letter

# MARKET COMMENT

(S&P/TSX – 13040; S&P – 1399; DJI – 12216)

**THE FINAL RALLY MAY STILL BE AHEAD,  
BUT IT'S NOT WITHOUT RISKS.**

Since its inception in 2002 we have been one of the most unbending advocates of this bull market. In early February we suggested that the market urgently needed a correction in order to buy extra time for this bull market. We cited the numerous technical red flags, rising optimism and the cycles pointing to late February as the possible low of the 39-week cycle. Therefore, Tuesday's action did not come as a surprise.

Is this the end of the bull market? We don't believe that it is. We believe this stubborn bull may not yet be done. Whether it chooses to pause more or continue higher immediately, it should still be able to deliver one more rally.

One of the most compelling arguments for an extension of the final up-leg of this bull market was the lack of euphoria among market participants. Despite the recent rally to new all-time highs, sentiment readings

did not show any signs of an emotional "rush" into stocks. According to the February 27<sup>th</sup> data from Investors Intelligence, the number of bulls stayed between 50% and 55% year-to-date while the bears did not move out of the 21%-22% range during the same time. This was clearly NOT a manifestation of euphoria. Of course, new data will certainly vary.

At the same time, as page 3 illustrates, 2007 may bring a major surprise. But not for now, the most likely scenario is that the market will have another surprise "to the upside", which would force even the most stubborn bears to give up.

**Sentiment readings suggest that this bull is not done yet, that it is unlikely to give up until it creates the perfect storm of euphoria and excitement.**

February 28, 2007

**Olaf Sztaba, David Tippin, Ron Meisels**

Whether this was a one-day wonder or a multi-day savaging, at least it happened within the time frame of the projected 39-week cycle low. Given the distance between the indices and their respective 200-day Moving Averages there was lots of room for a technical pull-back, yet the market could remain overall positive. It is reassuring that this decline - putting aside the somewhat wobbly and over-extended technical state of the markets - was news-driven (China). Normally, they don't ring the bell at major market tops, shouting 'everyone out of the pool'!

The US market turned in a truly staggering performance. The DJIA and the S&P 500 have been pushing higher for seven straight months, breaking all-time records and surpassing the most optimistic expectations. This enthusiastic picture was nearly perfect, if not for a growing list of technical woes. The US indices outran their 200-day Moving Averages and internal Momentum Indicators created a multi-month divergence. Therefore, Tuesday's action was within the "corrective" scenario.

The question remains about the extent of the damage this pullback has done. Technically, the US market is still vulnerable. The gap between the US indices and their 200-day moving averages is still one of the biggest in this bull market, reaching nearly 10% in the case of the DJIA. Such a discrepancy may still need to be neutralized.

**The correction doesn't jeopardize New York's ability to move higher. At the same time, attention must be paid to the "seventh-year" statistics as described next page.**

Toronto advanced at a much healthier pace, with two major pullbacks already on record in the last several months. This more subtle

approach toward the finale of this bull market gives an advantage to the Canadian market over New York. It is important to note that the Toronto market has historically had the most benefit at the tail end of every cyclical advance and this time should be no different.

**Toronto is in a much better position to lead, since at this stage of the bull market the focus remains on late-cycle performers: Metals and Golds, which have a large weight in the Canadian Index.**

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**STOCK COMMENTS:** Throughout this bull market a nearly continuous Sector rotation occurred to keep the market alive and well. It started with the Oils, which have now been replaced by the Metals and Golds.

While some selective Energy stocks continue to show technical strength, it is the Gold sector that should nourish the next advance. Numerous gold stocks have already experienced powerful breakouts from multi-month consolidation patterns, among them: Eldorado Gold (ELD), Kinross Gold (K), Minefinders (MFL) and Rio Narcea Gold (RNG) to name a few. Others (mostly junior stocks) are completing their base-building phases and should come to life later during the year. Please look for our BUY&SELL list for more investment ideas.

**The good news about such sudden and drastic pullbacks is that they arrive in a hurry and they leave in a hurry. Therefore, use the current opportunity to accumulate the "upside" leaders of the final up-leg of this bull market.**

The seventh year of the decade has an unblemished record of providing bad news and bad surprises (data based on the Dow Jones Industrial Index or equivalent and the results are accurate based on the data provided).

We have examined the market's performance since 1887 and as the table below illustrates, there has not been even one year since 1887 that did not contain a serious (and sometimes disastrous) sell-off.

To be fair, in many of the years mentioned below, the markets had recovered by the end of the year, but almost all the years mentioned below had either a multi-percentage decline or an out and out crash.

On the positive side (if there is one), please note that in eight of the twelve instances the decline only started in the second half of the year.

<b>YEAR</b>	<b>DURATION</b>	<b>DECLINE</b>
<b>1887</b>	<b>May to October</b>	<b>-14%</b>
<b>*1897</b>	<b>September to October</b>	<b>-20%</b>
<b>1907</b>	<b>January to November</b>	<b>-45%</b>
<b>1917</b>	<b>June to December</b>	<b>-33%</b>
<b>1927</b>	<b>October</b>	<b>-11%</b>
<b>1937</b>	<b>August to November</b>	<b>-40%</b>
<b>*1947</b>	<b>February to May</b>	<b>-9%</b>
<b>1957</b>	<b>July to October</b>	<b>-19%</b>
<b>*1967</b>	<b>September to November</b>	<b>-10%</b>
<b>1977</b>	<b>January to December</b>	<b>-18%</b>
<b>1987</b>	<b>October</b>	<b>-20%</b>
<b>1997</b>	<b>August to October</b>	<b>-16%</b>
<b>2007</b>	<b>? to ?</b>	<b>?%</b>

In the three years illustrated with an asterisk the bear market ended in the preceding year (the year ending in 6) and the decline in the 7<sup>th</sup> year was mainly a correction against the ongoing uptrend.