

PHASES & CYCLES®

MARKET COMMENT

(S&P/TSX – 13580; S&P – 1463; DJI – 13249; NASDAQ – 2620)

**THE BULL MARKET IS BACK.
THE “LIFT-OFF” PHASE HAS ARRIVED.**

Our forecasts concerning the likely behaviour of North American markets during the latter half of 2007 is looking ever more prescient. We said:

- The markets were likely to stumble during the summer – they did in July.
- A “short, sharp shock” would follow – it did in August.
- An apparent “recovery rally” would fail – it did in October.
- Further weakness would occur into a significant low – very possibly right now.

When the markets bounced back in early autumn, optimism had grown that the bull remained alive and well. But the failure of that recovery rally certainly put a damper on market sentiment. Credit market and recession concerns were no longer a “wall of worry”, but instead were viewed as further gloom and doom. A sense of growing fear was in the early winter air. Then, as the markets slumped through November, one could feel the pessimism increasing amongst many market participants. And right before U.S. Thanksgiving, the Dow Industrials made a new post-July closing low, confirming the action in the Dow Transports – a Dow Theory sell signal. Or was it?

The post-U.S. Thanksgiving action seems to have turned the tables on the bears. Prior to last week, the markets were as oversold as they were at the low point in August 2007, and in a similar oversold condition as they were at the

outset of the bull market in October 2002! In these circumstances, a reversal was a real possibility. The advances from a deeply oversold condition on November 27 and 28 (with NYSE advancing/declining volume at over a 20:1 ratio) had the look of an important turning point.

This turn of events is not surprising to us. In our last Market Comment we suggested that time was running out on the bears. We suggested that the selling was occurring against the backdrop of the “declining” phase of the 39-week cycle. Last week’s action suggests that the cycle is now in its bottoming phase, with the markets satisfying both price retracement and “time” requirements. Although we would like to see even more skepticism and negativity in the days ahead to confirm our case, time is very likely up for the bears to do further significant damage in 2007.

If the cycle is now bottoming, then a “Christmas rally” looms as a clear possibility. Final confirmation of a trend reversal will come once the major indices go above their 50-day moving averages and turn those averages upwards.

The late-2007 buying opportunity we have been anticipating is at hand. It may last for a year and a half, but compared to the 2002-2007 period, this will be increasingly selective, requiring careful attention to sector and stock selection.

The ups and downs of the major market indices between July and November of this year now reveal more clearly just where the markets sit in terms of the major bull/bear cycle. Here is what we can now conclude:

1. North American markets made a significant top in the summer of 2007.
2. The rapid decline in August was followed by a quick recovery, which included an important “breakout” point in mid-September. For the perpetual bulls, this was a clear sign that “buying the dip” – a wise strategy since late 2002 – was once again the way to go.
3. The failure of that recovery rally in October, at or slightly beyond previous highs, was the first indication that “buying the dip” after a major multi-year market advance was a strategy that came with increasing risk.
4. The second indication that all was not well with the bulls came when the September “breakout” points on the major market indices were pierced on the downside in October. This action negated the importance of those breakouts, and suggested further downside action.
5. The entire action from July to November can now be seen to be corrective in nature. The correction has unfolded as an “A” (initial decline), “B” (failed rally) and “C” (final decline). It is one of the most severe corrections in terms of time and price that has been seen since the bull cycle began in 2002.

Just how oversold did the markets get in November? MACD internal momentum readings on the S&P 500 were the most negative seen since 2002. The Investor’s Intelligence data on advisory sentiment shows that during the month of November the percentage of bulls declined to around 47%, with the percentage of bearish advisors rising to 29%. While there is room for further pessimism, the figures are at levels from which trend reversals have occurred in the past. Similarly, the percentages of stocks in Toronto and on the NYSE that are above their respective 50-day and 200-day moving averages

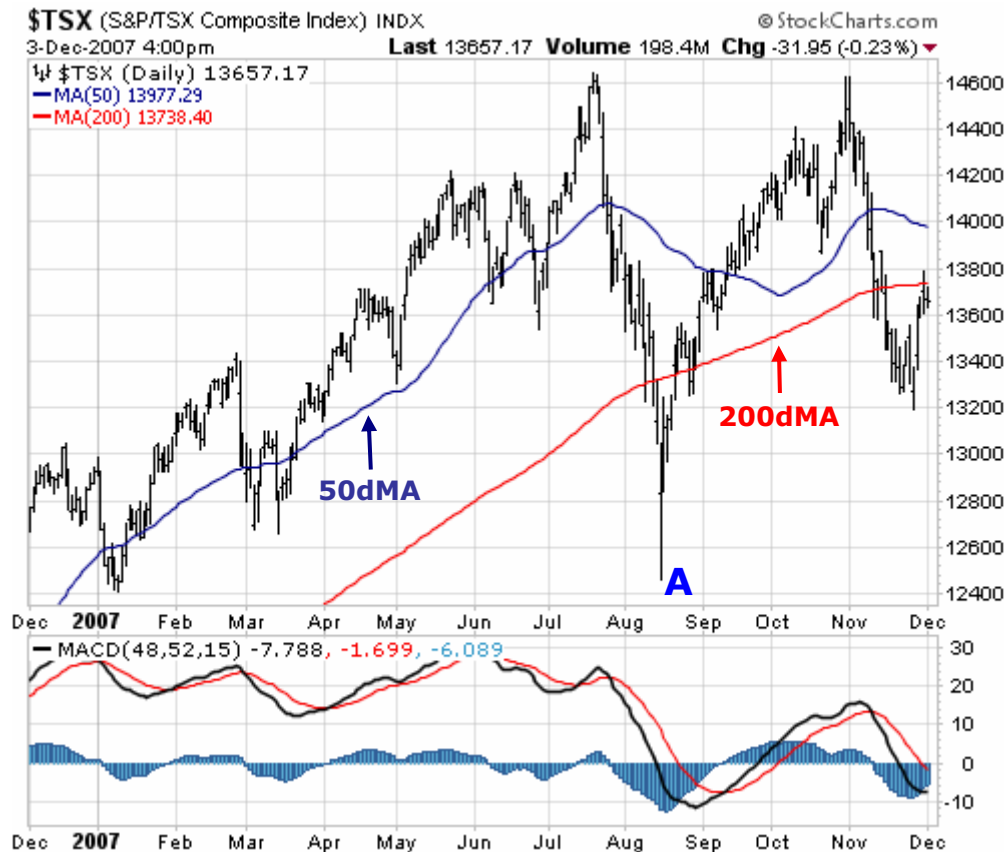
were also at historic low levels last week. In fact, based on the above readings, a case could be made that a “double bottom” has already occurred. (More about this on subsequent pages.)

The “double bottom” feature is important. The quick rise of last week is probably unsustainable in the short-term. It would be healthy if the late-November lows were re-tested successfully, as this would provide a good foundation for a sustained advance into 2008. A small pullback in the next week or two may occur. Sentiment-wise, we would like nothing better in the next few weeks than to see under our market Christmas tree more statements proclaiming that an extended bear market has arrived!

Stock selection: We believe that the next rising tide will not lift all boats equally. The next bull phase is likely to be fragmented, with significant differences in performance of sectors and individual stocks. Indeed, some stocks appear to have entered into an extensive bearish period. Among the most attractive stocks for the next rally are: (1) those that have held up well during the correction – particularly stocks that have remained near or above their rising 200-day moving averages; and (2) stocks emerging from extended basing periods. Our Buy/Sell list contains many stocks in both of these categories.

In sum, North American markets appear to have ended an extended period of healthy correction and are poised to move upwards. Some “backing and filling” may be necessary before the markets get truly in gear on the upside. The rising portion of a new 39-week cycle should support a multi-month but selective advance through the first quarter of 2008. The selectivity of the next bullish phase may mean modest overall movements in major market indices, but with significant advances for some individual stocks.

THE TORONTO COMPOSITE INDEX



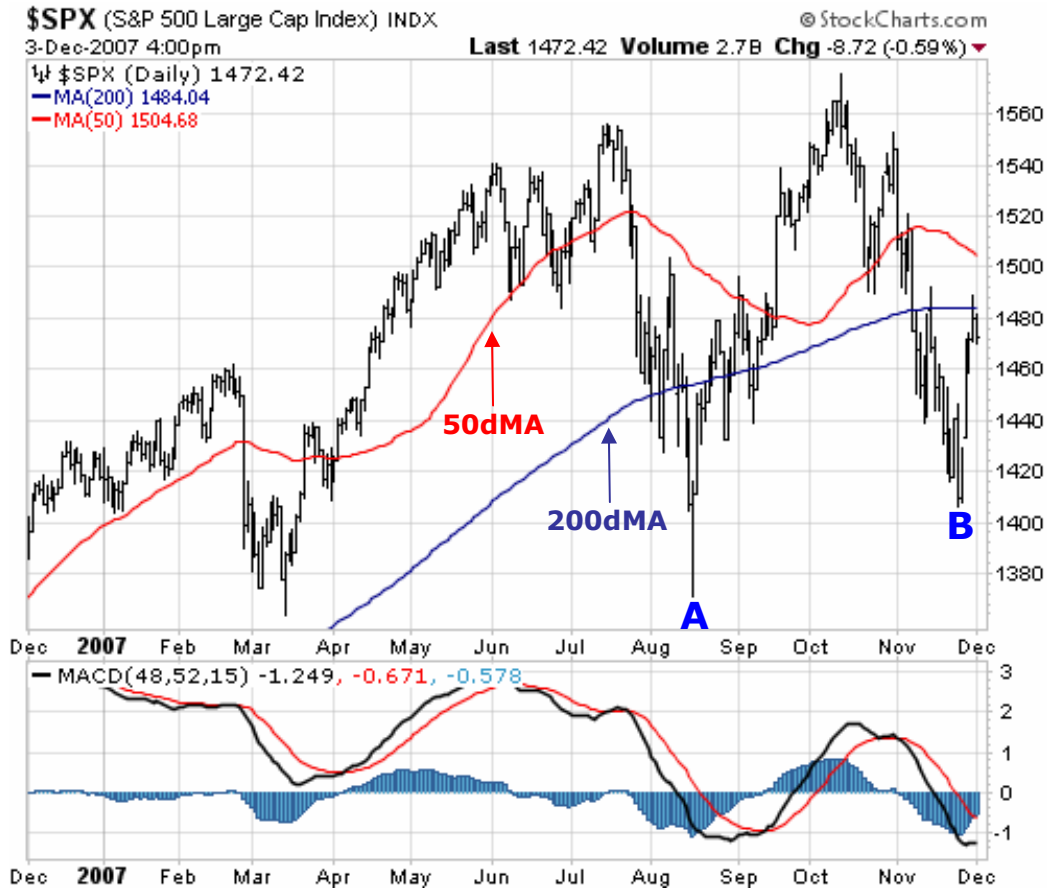
The attempt by the S&P/TSX Composite Index to set a new high in late October was repelled at the level of the previous July high. The rally into late October was on declining internal momentum compared to the July peak, and the November sell-off was by no means a surprise in reaction to this negative internal divergence. The “bottoming” action in the last week occurred in the vicinity of the August lows (A), slightly below the 200-day moving average. This is not quite a “double bottom”, but reasonably close. The number of Toronto stocks making new 52-week lows has lessened between the lows of August (420 new lows) and late-November (227), indicating that fewer stocks have been pushing the S&P/TSX Composite Index downwards recently (positive divergence).

The immediate challenges for the S&P/TSX Composite Index are twofold. First, the index must move up above the 200-day and

then the 50-day moving average, and then have enough persistence to turn the 50-day moving average upwards. Second, the Toronto market must overcome short-term upside resistance in the low 14,000 region. Internal momentum indicators such as MACD are looking better than they have for several months, lending support to our view that the next significant move in Toronto will be upwards. The Toronto market’s long-term outlook remains bullish unless the index moves below its long-term support trend line (dating from the mid-2002 low) currently at about 12,700.

Some further bottoming action in the low 13,000s and high 12,000s may be required to build a sufficient base for a rally, but the next important move should be towards the highs of July and late-October and beyond.

THE S&P 500 INDEX



The S&P 500 was in a similar position as in late-November (B) to where it had been in mid-August (A): declining for several weeks and about 5% below its 200-day moving average. But there were important differences last week compared to where the index was in mid-August. First, the S&P 500 was more oversold than in the summer. Second, the number of stocks making new 52-week lows in late-November was only 630, compared to a massive 1183 in August. The internal downside momentum was smaller.

A “double-bottom” has formed and, as of the end of last week, the test of the August lows near 1400 must be termed a success. The

MACD indicator has now turned positive, suggesting further upside probes. The 1400 area is important, as it includes the 2002-2007 major bull market support trend line. This must hold for the S&P 500’s overall outlook to remain positive. It is possible that a further successful test of this “round number” area will occur.

Immediate upside resistance could be offered by the 200-day moving average in the high 1400s, and the 50-day moving average in the low 1500s but, except for another retest of the 1400 area, the path is open for 1600 and beyond.

THE DOW JONES INDUSTRIALS



Towards the latter half of November, the Dow Industrials looked as if a disaster was waiting to unfold. The Dow Transports, which has been weak for months, had made a new closing low and the Dow Industrials then repeated the pattern. With a Dow Theory “sell” signal in place, the prospects were for further decline.

However, the Dow Industrials, on making its late-November low, actually did so from a position of improving internal strength. A small positive divergence in internal momentum, plus a highly oversold condition in the short-term – all occurring in the zone of

the dramatic low of mid-August – were enough to act as catalysts for a turnaround. The Dow Industrials was quickly able to recover above its 200-day moving average.

The Dow Industrials show good support in the 12,500-13,000 zone, but the rapidity of the recent recovery may require some backpedaling to build strength for a more lasting advance. The Dow Industrials needs to rally and stay above its 50-day moving average (currently around 13,600) in order to provide the basis for an eventual push towards the October all-time highs in the low-14,000s.

NASDAQ COMPOSITE INDEX



The NASDAQ's behaviour relative to the S&P 500, while broadly similar in nature, shows two important differences. First, the NASDAQ's recovery from mid-August to the end of October was considerably more powerful, taking the index up to the top of its major rising trend channel. Second, the November decline was of a shorter duration and did not carry the NASDAQ as far below its 200-day moving average as was the case with the S&P 500.

Taken together, these differences indicate that the NASDAQ is showing strength relative to the S&P 500 and other major market indices. This behaviour may also suggest that technology-related stocks may be leaders in the next bull phase through 2008.

The NASDAQ's rally of the past week was accompanied by positive divergences in internal momentum similar to that seen in other market indices. The oversold condition on the MACD indicator was greater in late November than anything seen since 2001.

The NASDAQ is sitting in a broad upward-sloping trend channel bounded by about 2900 on the upside and 2500 on the downside (which is major long-term support).

The NASDAQ appears to be re-positioning itself to be a market leader in 2008, a status which it has not enjoyed for several years. Expect the index to move between 2550 and 2850 for the balance of this year.

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

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