

PHASES & CYCLES®

**THE MARKETS FACE ANOTHER PERIOD OF WEAKNESS!
DOWN WE GO!**

or

**THE MARKETS JUST HAD ANOTHER NEW HIGH!
UP WE GO!**

WHICH IS MORE ACCURATE?

The action in North American markets since the mid-summer peak has been very volatile: The swift decline that erased more than 10% from each of the major market indices was followed by an equally swift recovery. The index charts for the past few months resemble a "V" formation, which is only rarely seen. In New York the strength of the recovery already took some major indices to new recovery highs and some, such as Dow Jones Industrials, to new all-time highs. Ironically, the Toronto market, the bull market leader for several years, has lagged in the recovery.

Previous Market Comments correctly forecast the market stumble of the summer, and predicted accurately that the decline would be a "short, sharp, shock". We anticipated a recovery attempt but expected this would be followed by another period of weakness (the "C" segment of an A-B-C corrective pattern) that would take the markets into a significant,

although not necessarily a lower low than the "A" segment.

So far this has not occurred. The recovery rally has been stronger and longer-lasting than we expected and, to date, the second down segment, the "C" of the expected corrective pattern, has not appeared. Should our preferred "summer-autumn" scenario therefore be discarded?

Let's look at the evidence.

- On the negative side, the technical indicators show low volume, a rally without conviction, a narrow leadership and a lesser number of new 52-week new highs than in July.
- On the positive side, the Dow Industrials is at a new all-time high and the S&P500 and the NASDAQ are at multi-year recovery highs!

Therefore: should we "fight the tape"?

The evidence leans toward the negative side, which suggests that we should still be worried, cautious and aware of the "other shoe" that could drop. However, since the strength of the rally raised the ceiling, the floor rose with it and now there is a mere 4-4½% downside risk. Therefore, the riddle is not the outlook for another month or so, but the expectation for the longer-term!

As mentioned numerous times before: in conference calls, in personal appearances and in emails, the big picture (based on our 40-year cycle research) continues to suggest a bullish period for 2008 and at least the first half of 2009. Therefore, the conundrum is **not** whether the August low was the start of a new bull market (and we are already in it) and **not** whether we still need a low (the "C" low) to start the next bull market, but what will fuel the markets for the next year, or year and a half!

Therefore, we must look at stocks.

Some, which were pummeled in the first down segment of the correction, have not been able to recover in the recent rally. Typically, these stocks are now below their 200-day moving averages and these averages are

starting to flatten and in some cases turn downwards. This is usually a sign of a period of extended weakness and/or relative under performance. These stocks will need much more time to restart.

A second category of stocks have fared much better. These stocks have corrected but held at or above their 200-day moving averages and have moved higher during the recent rally. Their relative strength signals comparatively better performance in the forthcoming months.

Therefore, we believe that the resolution to the question posed above is in selecting the right stocks and staying with them no matter what the markets will do for the rest of October and November. *To find these stocks, look at our recent buy recommendations and the stocks on our Buy & Sell list.*

While probabilities favor another down-thrust before the corrective action that began in July is over, the major emphasis should now be put on stock selection: choosing the stocks that will lead for the next 12-18 months.

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