

PHASES & CYCLES®

SPRING-CLEANING SHOULD GIVE WAY TO A HOT, BULLISH SUMMER

INTRODUCTORY SUMMARY: In the early stages of a new bull market, every weakness is viewed as the start of another decline. The late spring weakness, in particular, gave the bears confidence. They puffed out their chests and preached the "sell in May and go away" mantra.

Technical and cyclical evidence suggests otherwise; the recent decline is merely a spring "cleanup" that offers an opportunity to reposition portfolios for a hot and bullish summer.

MARKETS NOW: The rally that lifted the North American markets from the mid-March lows was so intense that many areas of the market needed a rest. The pullback began in mid-May but with slightly different outcomes for Toronto and New York.

The Toronto market, the leader of the latest advance, refused to give up its gains and chose to consolidate instead. The pause has been taking place above the *rising* 50- and 200-day moving averages, not far from all-time high levels. This close proximity to the only resistance should help the S&P/TSX composite to reach new highs shortly and remain the leader of this bull market.

The US indices, which experienced a more subdued rise, bounced off their falling 200-day moving average and fell below their 50-day moving average. Even though this is not comforting for bulls like us, this is not unusual in the early days of a bull market. The lack of

a strong presence in the resource stocks put the DJIA and S&P 500 in an underprivileged position in relation to their Canadian counterpart.

During late-June/early-July investors should notice a major improvement in the markets' general health. Our cycle analysis suggests that the markets will have an opportunity to set a major rally in motion during this time. The advance should quickly draw undecided buyers into the market and turn this junior bull market into a strong and powerful achiever with machismo.

A bullish scenario is a difficult proposition to accept for many market participants, given the current economic situation. Nevertheless, this is how bull markets start and proceed – against all the odds – with a bag full of surprises and fireworks on summer evenings.

At the same time, as we have said many times in the past – this is a moody, picky bull who rewards those who pay attention to the right sectors and stocks.

In the last few weeks, the market has undergone a spring-cleaning in preparation for a hot, bullish summer.

Investors should use the current weakness as an opportunity to expunge all remaining "debris" from their portfolio and focus on the right stocks instead. If this bull market had a maxim, it would be STOCK SELECTION.

STOCK COMMENTS: While the 2002-2007 advance was generous and included almost every area of the market, the new bull market has been much more selective. This was clearly visible during the first months of this year. Stock selection is, and will probably remain the theme for the rest of 2008.

BANKS

Bank stocks took advantage of the new bull market and managed a short-lived bounce. However, given the negative long-term technical credentials, investors should continue to avoid the sector in general. For those who need exposure to this sector, the best of the worst are the Bank of Nova Scotia (BNS) and Toronto Dominion Bank (TD).

ENERGY

As one of the leaders of this bull market, the Energy Sector put on a strong performance during the last four months. Huge breakouts from consolidation patterns resulted in spectacular gains in many individual stocks.

In the short-term, the Energy sector may undergo a sharp pullback – a perfectly normal, healthy development.

This should be viewed as an excellent opportunity to energize any lagging portfolio with the right selection of these stocks. Please see our list of Recommended Stocks for candidates.

MATERIALS

As another pupil of this bull market, the Material Sector has also done very well. Mining stocks have had a strong recovery from their mid-March lows and they are well positioned to lead the market for the rest of the year.

Gold stocks, now in the midst of a pullback, should join the advance shortly and lead the market in the second half of the year. Use the current weakness to accumulate leading stocks. Please see our list of Recommended Stocks for candidates.

Stock selection is not a popular concept nowadays. The popularity of index investing and an abundance of index-oriented instruments such as ETFs make it difficult for investors to focus on individual names. However, those who recognize the selective nature of the current market environment and latch on to a "stock selection" philosophy will reap the most benefits in 2008.

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