

PHASES & CYCLES®

MARKET COMMENT

(S&P/TSX – 14467; S&P – 1285; DJI – 11382; NASDAQ – 2305)

**NORTH AMERICAN MARKETS ARE BECOMING OVERSOLD.
LOOK FOR A BETTER BEHAVIOR AFTER MID-JULY.**

June provided a very good illustration of two themes which the Market Comment has been emphasizing for many months. First, we have said repeatedly that the resource-intensive Toronto market would be the leader of the North American markets in this bull cycle. Second, we suggested that even within the bullish market sectors, there would be winners and losers – as we said recently, “stock selection is, and will probably remain, the theme for the rest of 2008.”

For the major U.S. market indices, June was a bad month. The S&P 500 and other indices have struggled to find a firm footing beneath their declining 200-day moving averages. The bears were out in force and short-term rallies were used for selling.

But the recent action also contains many positive elements for the bulls. The number of stocks making new 52-week lows was, as of the end of last week, significantly less than in January and March. This is a positive technical divergence. In addition, the percentage of stocks above their 10 and 40-week moving averages are at levels that have historically aligned with market turnarounds.

And then, most importantly, there is the ever-growing gloomy sentiment picture. Two recent examples:

- The Royal Bank of Scotland issued a warning to clients to “Brace for a full fledged crash in global stock and credit markets. A very nasty period is soon to be upon us, so be prepared.”

- And a recent Montreal Gazette headline: “Financial firms may eliminate as many as 175,000 jobs.”

For contrarians, this negativity – especially the expectation that even worse news is just around the corner – is just the type of despair that tends to coincide with market reversals. This is further supported by the latest Investors Intelligence advisory sentiment figures which show that the percentage of bearish advisors (44.7%) now exceeds the percentage of bullish advisors (31.9%). This “crossover” occurs only rarely in these data, and almost always is associated with an impending change in market direction.

Meanwhile, the Toronto market is undergoing a normal correction. After a 26% rally from January to June the Toronto market was due for a healthy correction of its gains – and that is exactly what is occurring. Market action in Toronto, encouragingly, remains above the 200-day moving average – in contrast to the U.S. indices.

The current decline should be the final “washout” phase of the correction in the U.S. equity markets. Cycle and sentiment measures are projecting a positive turn. But the U.S. markets must surmount their hesitancy and come to the bull’s party. Toronto cannot “walk alone” indefinitely without some support from south of the border. Look for the bulls to take centre stage in the summer in all North American equity markets.

THE TORONTO COMPOSITE INDEX



Our short-term forecast towards the end of May was that "A healthy pause to digest recent strong gains is likely for Toronto. Consolidation should take place above the 200-day moving average."

Consistent with these expectations, the S&P/TSX Composite Index formed an intermediate-term three-peak top from mid-May to mid-June (A, B, C). This formation occurred on a negative divergence in internal momentum and has seen the "neckline" of the formation (at about 14,600 – see solid line) broken last week. The Toronto market has also declined below its 50-day moving average for the first time in almost three months. The A-B-C pattern projects a minimum downside target to about 14,100.

Furthermore, a one-third correction of the 26.5% (3172 point) rally from January to June also targets about 14,100. With the 200-day moving average located at about 13,860, it seems likely that this decline will be arrested somewhere in the low 14,000s.

The S&P/TSX Composite Index needs some time to catch its breath and re-build its technical underpinnings. Strength continues to exist in the materials and energy sectors, but the Toronto market's next rally will need to benefit from a supporting boost from some other sectors – such as the banks. The target of 16,000 remains achievable in the summer months.

THE S&P 500 INDEX



In March, the S&P 500 made a successful re-test of its January lows, and that seemed to be the platform on which to build a sustained rally. The two-month advance that followed ran into significant resistance at the 200-day moving average, and now the subsequent decline has taken the index all the way back to its March lows.

The S&P 500's technical picture is mixed. The index is very oversold, but its internal momentum indicators do not yet give a firm sign that the decline has ended.

However, if the S&P 500 is able to arrest its correction in the 1250-1300 zone – which we expect – then it will set up a very strong multi-month base from which to launch a summer rally.

The S&P 500 should turn around to the upside in July. First target will be to surmount the 50-day moving average at about 1370, followed by a probe of the 1400 zone where the 200-day moving average will offer significant upside resistance.

THE DOW JONES INDUSTRIALS



Following its rally off the March lows, we expected that the Dow Jones Industrial average would consolidate its gains somewhere below the 200-day moving average. Instead, the Dow quickly collapsed to a new low for 2008.

Technically, the Dow Industrials has considerable repair work to do. The index is suffering from the weight of its Financial (Banks) components. The immediate task for the Dow Industrials is to stop going down. At the moment the best and most likely zone of support is in the low 11,000s, which dates back about two years. With internal momentum indicators at extreme readings, and the Dow Transports refusing as yet to confirm the recent low in the Industrials, a good snap-

back rally is possible at any time. But, so too is a continuation of the decline into some type of "climax" low.

A longer-term view of the Dow Industrials would note that the index has now retraced nearly 42% of its 2002-2007 bull market. A 50% decline would take the index back to about 10,600, where there is very good long-term support.

We expect that the Dow Industrials will attempt a rally soon, possibly forming a "V" shape bottom. The best that can be expected in the coming weeks is for a return towards the 50-day moving average, which by that time will be in the low 12,000s.

NASDAQ COMPOSITE INDEX



As with the Dow Industrials, five weeks ago our expectation was that the NASDAQ would rest for a period of time just below its 200-day moving average.

Trying to surmount the 200-day moving average proved to be a major obstacle. The second of two attempts in early June resulted in a negative divergence in internal momentum figures. Since then it's been virtually all downhill, as the NASDAQ plunged below its 50-day moving average.

The good news is that the severity of the decline more closely resembles the S&P 500 than the Dow Industrials. Thus far,

the January and March lows have held. As of the end of last week, the NASDAQ had retraced about two-thirds of its March-June rally, so current levels offer some prospect of being near the zone where a decline might stop. Further support is seen in the 2200-2250 area.

The March lows must, and should, hold. If they do, the NASDAQ should then be able to re-build its base over the summer in the area immediately below the 200-day moving average (2300-2500). A sustained decline below the March lows would be a severe blow to any bullish prospects the NASDAQ has for the rest of 2008.

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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