

PHASES & CYCLES[®]

**THIS MARKET HAS A RELENTLESS QUALITY.
THE AUTUMN MONTHS MAY DISAPPOINT THOSE BEARS
WHO EXPECT A SIGNIFICANT CORRECTION OR A NEW BEAR MARKET.**

The last six months. Following the panic low of early March 2009, North American markets have put on an impressive show. The major market Indices have done three important things in recent months. First, the Indices have exceeded the short-term upside resistance that was created by the market action of October 2008 to May 2009. Secondly, the upside advance has succeeded in penetrating the Indices' respective 200-day moving averages (200dMAs) and turned those averages upwards. And finally, the advance of the past six months has, for each of the four major market Indices we detail in the following pages, occurred within a powerful upward sloping trend channel.

We called this a 'mini-bull' market in the Market Comment of mid-April. The technical condition of the advance did deteriorate in the May-June period and we expressed some doubts at the time whether the advance could continue in the summer. But the uptrend has reasserted itself and, as the Market Comment has said previously, this bull had no appetite for a summer vacation. The ability to overcome technical weakness is a very positive sign for the markets. So much so, in fact, that we will no longer call this a "mini-bull"!

WE DECLARE THIS A FULL BULL MARKET.

The current technical conditions. This is a time to recall the old market adage 'the trend is your friend.' The most important technical feature of the markets is its sustained up trend, the making of new recovery highs, and its ability to climb the psychological 'wall of worry'. There are a number of positive supporting features:

- Selling waves have been limited in duration and have been easily overcome by renewed buying,
- The Dow Industrials and Transports have made new recovery highs, generating a Dow Theory buy signal (which in this case is a confirmation of the bull trend).

The 200-day moving averages (200dMAs). In addition to these positive factors, an important aspect of the 200dMAs of the major

market Indices should be noted. At the moment, 200 days worth of previous market action takes us back to November 2008. From that point until the end of April 2009 the prices of the major market Indices were below current levels (i.e., they were in a prolonged trading range).

This means:

- That, for the next few months, these lower prices will be deducted from the moving averages, and will be replaced by higher numbers making the averages move higher,
- That, unless there is a full-fledged market crash this autumn, the 200dMA will move higher and continue to offer support to the major market Indices,
- That, should there be a fall weakness, the rising 200-day moving averages should come to the rescue of the bulls.

Do the technical clouds on the horizon matter? There are, of course, some technical indicators that offer not quite as rosy a view of the markets. There are some minor negative divergences beginning to appear in internal momentum measures such as the MACD indicator. The percentages of stocks above their respective 50dMAs are at high levels. The number of stocks making new 52-week highs in New York is faltering (but this is partly related to the precipitous nature of the declines of late 2008). Volume, even accounting for the usual declines associated with the summer months, has been subdued.

Do these add up to a 'sell' indicator? We think not. In the initial stages of important advances, many market indicators can register 'overbought' readings, and/or give negative divergence readings as the markets make higher highs. This is normal. Acting solely on these indicators tends to cause participants to exit the markets prematurely and miss out on further advances in the bull market.

The underlying upward price trend is intact at the moment and that is the most important indicator of all.

Why the bears might be disappointed in the autumn.

North American markets are about to enter the historically challenging – and often dangerous – September/October period. A 39-week cycle will also mature in September. After six months of strong advances against a skeptical sentiment backdrop, there is a widespread feeling that the markets are going to encounter difficulties over the next couple of months. The bears are already trotting out their arguments that the March-August period has satisfied minimum requirements (e.g., at least 33%) for a partial retracement of the previous declines, with the implication that the bear market is about to reappear.

It is unlikely that the markets are going to conveniently satisfy all of those who expect either:

- a major correction that will present a renewed buying opportunity at bargain basement prices (the bullish view), or
- a collapse to new lows (the bearish view).

An alternative scenario – one which would bring the biggest surprise of all – is that the market uptrend could persist and even accelerate, not weaken, in the next few months, as portfolios become more fully invested for year-end accounting purposes. This would coincide with the beginning of a new 39-week cycle (which usually has the strongest momentum) and could mean that the major market Indices will actually penetrate their existing trend channels on the upside.

How does this bull market fit into the longer-term secular bear market scenario?

We have initially characterized the extended rally of 2009 as a ‘mini-bull’ market.

However,

- looking at the strength of the markets;
- their ability to overcome resistance areas;
- the existence of two “golden crosses” (as mentioned in our MKT-215);
- the significant bases that have been laid down since November in a vast number of stocks in both markets;
- the fact that these stocks are now breaking out (moving above) these bases;
- the significantly higher Point & Figure targets visible from these bases;
- the emergence of the 2-to-1 Advance/Decline buy-signal mentioned in our last Market Comment;

suggests that this bull could run for quite a while!

Is it possible to look for the repeat of the 2002-2008 bull market? Probably not; the bull market could end unexpectedly and investors should maintain prudent stops (consistent with their risk tolerance) on all long positions. However, given the significantly higher Point & Figure targets mentioned above, it is possible to expect a normal, two-year long bull period.

In sum, the advance of the last six months still has plenty of doubters, and many expect the rally to fall flat on its face in the autumn. But this bull market has built an underlying strength.

There may be pauses and pull-backs along the way, but the markets appear to have potential for further upside. Provided a stop-loss strategy is implemented, investors can continue to ‘buy the dips’ in strong sectors and in strong stocks.

S&P/TSX Composite Index



The Market Comment of early August highlighted the many positive features of the technical position of the S&P/TSX Composite Index. A pattern of higher-highs and higher-lows was well established, the 200dMA had turned up, and two 'golden crosses' had occurred (the 21dMA crossed above the 50dMA and the 50dMA crossed above the 200dMA – see our MKT-215).

The Toronto market now has a very clearly defined up trend, bounded by two parallel lines. The lower support line is at about 10,500, and the upper boundary is above 12,000. Early August saw a brief pullback, which met good support at the rising 50dMA. The

Index's rate of advance has slowed slightly in the past two months compared to the 'blastoff' of the March-May period, but this is to be expected.

The next significant event for Toronto should be a move toward the top of the rising trend channel. The rising 50dMA (currently at 10,500) should provide support in the meantime. Even if there is a decline below this, the early-June levels should provide serious support.

The next upside target for the S&P/TSX Composite Index is 11,500 – 12,000, which is achievable within the existing trend channel pattern.

S&P 500 Index



The chart of the S&P 500 Index presents a very strong technical picture at the moment. By moving above the 950 level, the S&P 500 has burst above the 'neckline' of a massive "inverse head and shoulder" pattern that had formed between November 2008 and July 2009. The Index has moved strongly above its now-rising 200dMA and is advancing within a well-defined upward trend channel, similar to the one characterizing the Toronto market. The S&P 500 has now re-traced over 40 per cent of its 2007-09 bear market decline.

The upper trend line of the rising trend channel is at about 1150, which coincides with our immediate target for the Index. The inverse head and shoulders formation projects a minimum target in the low 1200s.

There is a small negative divergence in internal momentum indicators (MACD, etc.) forming at the moment and this, combined with the fact that the Index is well above its rising 50dMA, may provide the ingredients for an eventual pullback, which could challenge the mid-August low of about 980. The lower trend channel line and the 50dMA are in the 955-960 area and these should provide excellent near-term support.

The S&P 500 has some very visible upside targets in the 1150-1200 area and is in a good technical position to achieve them in the months ahead.

Dow Jones Industrials



The technical position of the Dow Industrials is very similar to that of the S&P 500 Index – an “inverse head and shoulder” pattern has been exceeded on the upside, the Index is well above its rising 200-day moving average, and a visible trend channel is containing the bullish action. The potential weaknesses in internal momentum and in the distance the Index is above its 50-day moving average, are the only worries.

The Dow Industrials (DJI) and the Dow Transports (DJT) have both exceeded their respective previous secondary highs and therefore the Dow Theory, which we mentioned previously, has flashed a bullish confirming signal.

The action of the DJI is shallower than that of the S&P 500, which may be due to its construction. The upper trend line for the Dow Industrials is near 10,250 and the lower line is at about 9,000. The Index could easily move within this range without disrupting the overall bullish outlook. The rising 50dMA, which is at about 8,900, should provide support for any minor correction.

The “inverse head and shoulder” pattern projects an upside target of about 11,500. If the Dow Industrials can successfully contain any near-term correction, the overall technical strength of the Industrials suggests that this target is achievable by the end of 2009.

NASDAQ Composite Index



When we last looked at the NASDAQ Composite Index in early July (at the 1,787 level), we noted its relatively strong technical position compared to other major market Indices. We also drew attention to some short term technical weaknesses and suggested that holding above the 1,750 level would be a critical test. The NASDAQ continued to weaken in early July, but held the 1,750 level. This provided the platform for a strong rally through the balance of July and most of August.

We also said in the July Market Comment that if the NASDAQ succeeded in moving above 1,900 this would indicate that the bullish trend was intact. This is exactly what occurred. The NASDAQ now lies within

an upward sloping trend channel, above its rising 50-day moving average.

August has, however, been a deceptive month. The NASDAQ is up for the month as a whole, but the internal momentum readings have declined significantly. This may be the harbinger of a near-term decline which could easily pull the Index back towards the mid-August low of 1,930. At the same time, there is good support at 1,900, provided by the lower trend channel line and the 50dMA.

The NASDAQ looks vulnerable to a short-term pullback, but with the overall bullish picture still looking strong, a move to the upper reaches of the trend channel (currently above 2,100) is still very possible.

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