

PHASES & CYCLES®

**THE BULL MARKET CORRECTION IS STILL IN PROGRESS.
A RE-TEST OF THE FEBRUARY LOWS REMAINS LIKELY.**

Our Market Comment climbed aboard the new bull market shortly after it began in March 2009, has remained firmly there ever since, but after a strong performance by North American markets for the balance of the year, we sounded a cautious note in early 2010. We pointed out that such factors as declining internal momentum and overly bullish sentiment could cause the markets to have a 'moderate correction.' That correction began in mid-January and is now in its fifth week.

The correction so far has had one down-leg (the 'A' phase) to a climax low on February 5, followed by what appears to be a recovery effort (the 'B' phase) for the past two weeks. Looking at the major market Indices, the action of the past five weeks has followed a similar pattern:

- The Indices have pulled back in the 'A' down-leg below their rising 50-day moving averages, and have now spent the longest time below these averages since the bull market began nearly a year ago. This factor alone indicates that this is a correction that demands close attention.
- The respective pullbacks have taken the market Indices closer to their rising 200-day moving averages, but without threatening those averages.

- The important lows of late October/early November 2009 have held.
- The recent 'B' wave recovery rally has taken each Index back up towards its 50-day moving average.

Looking at the larger picture, since mid-January the 'A' down-leg behaved as we forecast to correct the discrepancy between the levels of the Indices and their 50- and 200-day moving averages. For example, in mid-September, 2009 the S&P 500 and the S&P/TSX Indices were approximately 170 and 1780 points above their respective 200-day moving averages, whereas by February 5th, 2010 the gap narrowed to 41 and 60 points! Therefore, this recent behaviour can be viewed as nearing the culmination of a necessary multi-month process.

Market participants should anticipate that there will be one more downward phase before the current corrective period ends, completing an 'A-B-C' (down-up-down) pattern. When the correction is finished, the next advance should take the major market Indices to new 2009-10 bull market highs.

If this is what happened in the 'A' phase, what about the past two weeks of recovery? And what is likely to happen next?

The 'B' wave has been interpreted by some bulls as signalling that the correction is over and that a significant new up move has begun. We are not so optimistic in the short-term. The markets have moved up on modest volume and have quickly entered short-term overbought territory. Upside potential for the near future appears limited and the markets will have to deal with some near-term upside resistance formed by the action in November and December of last year. This may require more preparation and base-building, although sentiment, as measured by the Investors' Intelligence advisory figures, is already in a cautious 'recovery mode', with the percentage of bullish advisors remaining at relatively low levels (35.6%, down from a high of 53.4% on January 12th).

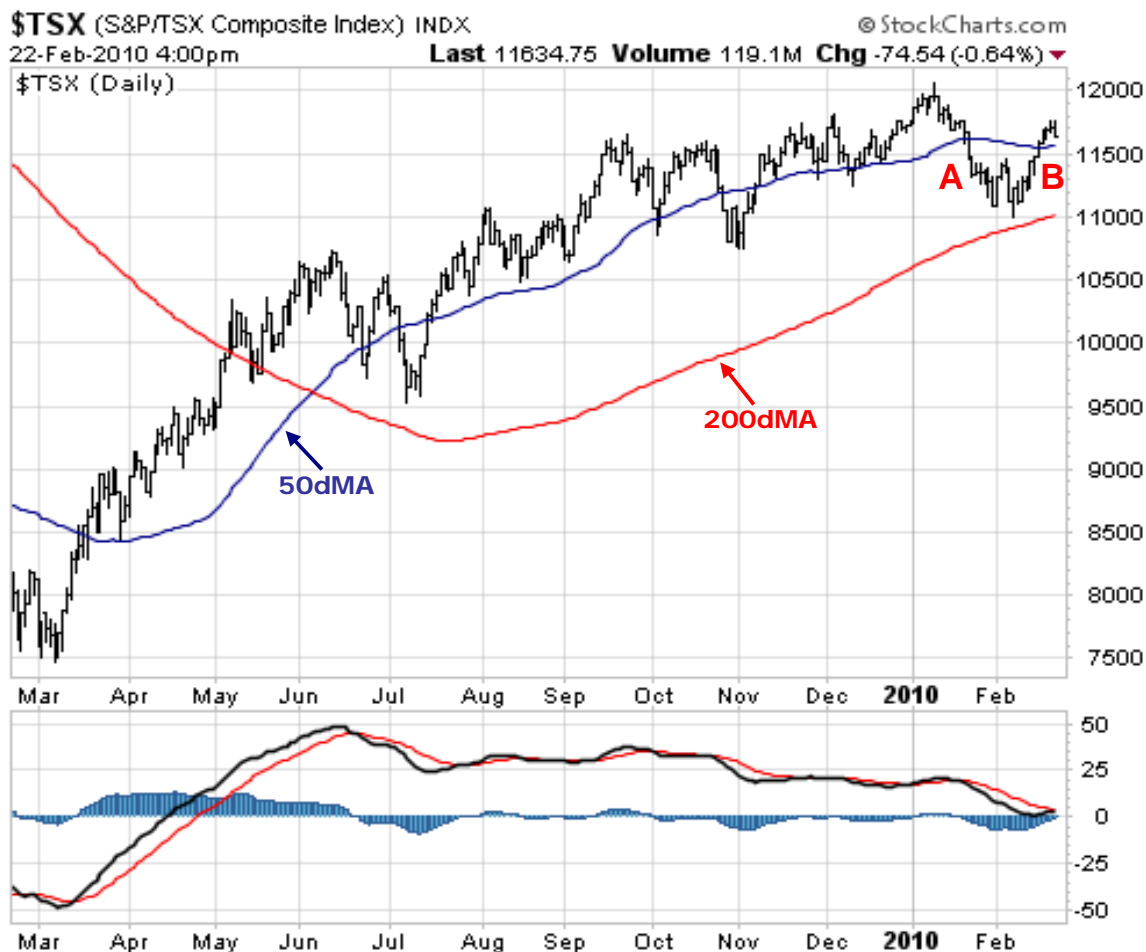
Therefore we expect that when the current rally ends, it will be followed by the final 'C' phase – another corrective move. The good news about this final down-leg in the corrective pattern is that it should be modest in terms of price damage. The major reason for this expectation is cyclical. We noted in the previous Market Comment our view that the

latest 39-week cycle bottomed at the same time as the end of the 'A' down-leg in early February. If this view is correct, any further downside action will struggle against the upward forces of the new 39-week cycle.

This means that the worst-case scenario might be a re-test of the early February lows. These lows could hold, or be penetrated modestly on the downside. Such market action would take the Indices towards their 200-day moving averages and near to the October/November 2009 lows. The 50-day moving averages of the major market Indices, under this scenario, should turn slightly downwards, but still remain above the 200-day moving averages. If this relationship changes – that is, if the 50-day moving averages make a significant downside cross of the 200-day moving averages, then there will be a need to re-assess the overall market outlook.

During this 'C' down-leg the behaviour of internal market momentum indicators such as MACD should be watched closely for signs of a positive, bullish divergence. A sustained move at any time above the mid-January highs would signal that the next major advance of this bull market has begun.

S&P/TSX Composite Index



From its peak on January 11th, the S&P/TSX Composite Index declined in its 'A' wave by nearly 1100 points to its February 5th intra-day low. This first phase of the expected 'A-B-C' decline corrected the March 2009 to January 2010 advance by about 22%.

From the February 5th 'reversal' day, the Toronto market has now climbed back above its 50-day moving average, which has flattened out after rising for about ten months.

There is very strong support in the 11,000 zone, which marks the area where the two most recent declines – October 2009 and February 2010 – ended. The 200-day moving average is also in this zone.

Overhead resistance remains in the 11,800 to 12,000 zone. A breakout above 12,100 would indicate that a new major up leg in the bull market is underway.

The behaviour of the S&P/TSX Composite Index in relation to its 50-day moving average bears close scrutiny. If the correction has already ended, the 50-day moving average will act as support to the Index. If the correction has a 'C' down leg, the average will act as resistance. Expect a re-test of the 11,000 zone over the next few weeks, to be followed by new bull market highs.

S&P 500 Index



The S&P 500 Index has behaved in a manner very similar to the Toronto market for the past several weeks. The S&P 500's decline from mid-January to early February was about 105 points on an intra-day basis, representing an approximately 20% retracement of the bull market's advance. As in Toronto, the S&P 500 has recently put on a 'B' wave rally, taking the Index back up to its 50-day moving average. The MACD indicator has turned positive, indicating that the 'B' wave may have more room to run on the up side. This may, however, be limited by the fact that the S&P 500 has moved very quickly into short-term overbought territory.

The 1,030-1,050 zone, as well as the 200-day moving average which currently intersects at 1025, should provide excellent support for the bull market. Only a decline below the 1,000 level would be cause for concern for the bulls.

The most likely short-term scenario is that the recovery rally will peter out shortly, and be followed by a move to the downside completing the 'A-B-C' correction. This may involve a test of the February lows. The upside target for the bull market remains at a minimum of 1,250.

Dow Jones Industrials



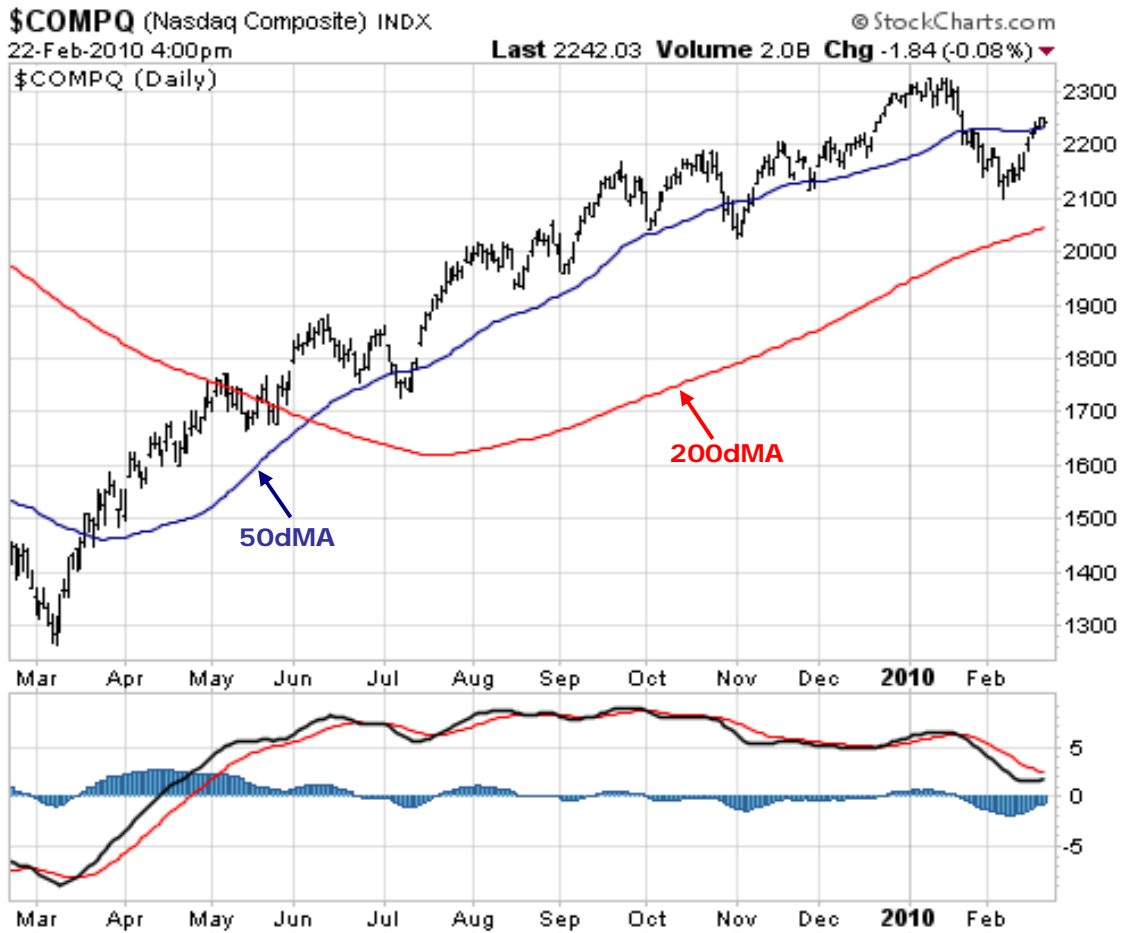
The most important aspect of the recent behaviour of the Dow Industrials is that the initial down wave of the January-February correction was able to hold above the lows reached in late October/early November of 2009. If these lows had been violated on both the Dow Industrials and Dow Transports, then a Dow Theory sell signal would have arisen. The Dow Industrials have now re-traced a good portion of their recent decline, moving back to the 50-day moving average.

In our last look at the Dow Industrials in mid-January, right before the correction started, we

identified 10,700 as a key area. This turned out to be the stopping point for the first major up leg of the bull market. It remains an important resistance level.

Just like the other major market Indices, a re-test of the February lows is likely before the bull market resumes. There is good support in the 9,500 to 9,800 range. The next phase of the bull market's advance should see the Dow Industrials challenge our minimum upside target of 12,000.

NASDAQ Composite Index



In mid-January, with the NASDAQ sitting slightly above 2,300, our Market Comment forecast that the NASDAQ might require a short-term pullback to correct an increasingly overbought situation. The NASDAQ subsequently pulled back by about 200 points, putting the Index at its lowest point in relation to its 50-day moving average since the bull market began in 2009.

The rally from this pullback has, like other major market Indices, taken

the NASDAQ back to its 50-day moving average.

Provided that the 2,000 level is not conclusively violated, the bull market for the NASDAQ can be considered to be intact. We expect that the Index will successfully contain any further corrective action above 2,050, to be followed by an upside probe towards 2,500.

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

© Copyright 2010, Phases & Cycles Inc. All Rights Reserved

The opinions and projections contained herein are those of Phases & Cycles Inc., its principals, associates and employees ("the researchers") and are subject to change without notice. The information contained herein has been obtained from sources that we believe to be reliable but cannot guarantee its accuracy or completeness. This report is not and under no circumstances is to be construed as an offer to sell or the solicitation of an offer to buy any securities. This report is furnished on the basis and understanding that "the researchers" are to be under no responsibility or liability whatsoever in respect thereof. "The researchers" may, from time to time, buy, own or sell securities mentioned herein. "Phases & Cycles" is a registered trademark of 104443 Canada Inc.