

PHASES & CYCLES®

HIGHER LEVELS TO COME, BUT FIRST A SMALL PAUSE

INTRODUCTORY SUMMARY: In our last Market Comment we wrote, "The bull is ready to run." Although this junior bull, shy but eager to perform, chose to appear bit-by-bit in New York, it didn't leave any doubts about its intentions in Toronto. Springing out of the gate, its pace was so intense that it now needs a pause to catch its breath.

MARKETS NOW: In the last few weeks we have focused on long-term market cycles, sentiment indicators and price patterns to detect a major market turn. Recently, we listed a number of technical signs to watch in the early moments of this bull market. *First*, we said that we would be looking for markets to move up in a clear pattern of higher highs and higher lows. *Second*, we argued that the position of major market indices relative to their 200-day moving averages was a key indicator in judging the major trend. *Finally*, we anticipated that the bears would tag any rally as "just an upward correction" and any weakness as a signal for the resumption of a bear market ("see, I told you so!").

The strong performance of the last four weeks fulfilled all these conditions, and by doing so, provided further evidence that a new bull market is, indeed, developing.

The major indices are moving up in a clear pattern of higher highs and higher lows. The market refuses to react to negative news, which, in a different environment, would have sent stocks sharply lower. The US indices are shaping upward; their 50-day moving averages have risen above their 200-day moving averages. The Toronto index - already one step ahead - has already surpassed both the 50- and 200-day moving averages and cleared the road for more gains. The flow of negative news keeps the bears confident and relaxed, blissfully unaware of the unfolding events.

For more details on sentiment indicators please see page 2; and for Sector comments see page 3.

The markets have completed their base and orchestrated a rally, which provides further evidence that a new bull market is at hand. In fact, the speed of the recovery was so intense that some areas of the market are already in need of a breather. Any minor pullback would provide an excellent buying opportunity in selective areas and stocks.

As usual in the early stages of the advance, the Toronto market took a different approach from its American counterparts. The S&P/TSX composite, with its greater weighting of Golds and Energy, had a rise that far exceeded any of the major US market indices. In fact, the Toronto index had such a good start that it breached its 50- and 200-day moving averages at the first attempt. It was the only major North American index to do so. However, the initial (nearly vertical) up-move could be viewed as a "too far, too fast" rally. A correction, healthy and necessary, would help the index to reinforce the newly gained ground. This could serve as a platform for the next up-leg.

The progress of the S&P 500 was much more halting. We forecast that the prime objective of the recovery move was to get the US indices out of their trading ranges and closer to their 200-day moving averages. This is exactly what happened. All major indices are now above their own rising 50-day moving average and are bumping against their respective 200-day moving average. We expect that after a brief consolidation the next surge should confront this resistance and put the indices firmly above it.

The *sentiment* indicators, a contrary tool, continue to suggest a long-term buying opportunity. The dramatic sell-off in March has clearly affected the mood of investors. Back then, the Investors' Intelligence sentiment data showed the bulls at the 30% level, while

the bears were a clear majority at 44%. These numbers clearly suggested a major long-term buying opportunity, similar to the one that occurred in October 2002. Although the most recent data shows a tie between bulls and bears, it continues to indicate that the base-building process is in the works.

It is always helpful for a young bull if the mood remains half-hearted. We have said repeatedly that a rally accompanied by bad news would be a great stimulant. The dose of negative news would keep the bearish investors well nourished and oblivious of the existence of the new bull market. We didn't have to wait long to see this process at work. The news from General Electric (GE) – to the liking of the bears – has sent the major moving averages sharply lower and renewed the fears of market collapse. However, just as expected, the sell-off did not last and within three days the Indices were back to their previous levels. In addition, it was music to our bullish ears to see a recent headline (in bold letters) "The all-clear signal still some time away" from a well known economist!

We anticipate more events of this sort in the future and such events should be viewed as an excellent buying opportunity in technically strong stocks and sectors.

STOCK COMMENT: While the 2002-2007 bull market was an "all together now" type of advance, *stock selection* is the theme for now. It has been clearly visible in the last few weeks.

For example, the Banks had their own "five minutes" but they barely managed to bounce off their recent lows. This was expected, because the majority of Banks continue to show negative technical credentials. In general, the sector should be avoided.

At the other extreme, Energy stocks staged a truly amazing performance in the last few weeks. The advance was broad and produced hefty gains for those who hitched onto the bullish ride. We anticipate that the bulk of the gains in this new bull market will come from carefully selected Energy stocks. To

participate, use any and all weakness as a buying opportunity.

The Material group is also doing well. Within this group, gold stocks had a strong rally but they are now in the middle of a pullback. They may require some rest before the next upleg.

In sum, the potential is building up for the bulls to blow their trumpets and break down the bearish walls. Toronto's effort to overcome its 200-day moving average has already paid off handsomely. Now, as the S&P/TSX composite rests, it is up to the US indices to get going.

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