



MARKET COMMENT

A NEW BULL PHASE IS ON THE HORIZON, BUT FIRST A NARROW TRADING RANGE

June 29, 2010

In our last Market Comment (MKT-169, June 17) we suggested that the end of April correction was coming to a close. Long term oscillators in the major market indices had reached oversold levels and were beginning to turn up. Market sentiment, usually a contrary indicator, had turned decidedly negative, with many forecasters expecting further declines. Insider buying was turning more positive. The correction itself had been running for about seven weeks, which is a common length of time for a pullback. The major U.S. market indices had retraced almost one-third of the 2009-2010 bull market's entire advance, another normal occurrence, and several short-term cycles (the 21-, the 70- and the 105-day) were due to bottom.

For the past few weeks, as the correction unfolded, the major market indices were walking along a precipice, defined by their respective 200-day moving averages. For the first time since the bull market began in March 2009, each of the major market indices that we follow revisited its 200-day moving average and moved below it. The danger for the bull market's viability was that if extensive time was spent below the 200-day moving average, the average would gradually build up as a zone of resistance, capping any attempts at sustained rally. However, at the moment, the bulls should be relieved on two counts. First, the major market indices did not go further than a few percentage points below their moving averages; second,

they spent only a few weeks doing so. The last month's action looks increasingly like a successful repair job by the bullish forces. The bull did not fall off a cliff, as many feared he would.

The May-June correction holds at least three insights about this bull market.

1. *The "fat finger, flash crash" of May 6th was misunderstood by many.* The market drama on the afternoon of May 6th was not the bell-ringing end of the 2009-10 bull market, or the climax low of a quick correction. It was, in fact, the end of the first downward leg of a more complex and prolonged corrective process. The panic thrust occurred after just a few days of corrective action – the "climax" nature of May 6th would have been more convincing if such action had occurred after a more prolonged period of correction. The mini-crash would also have been more significant had it been preceded by a major period of negative internal momentum divergences as the markets peaked in April – these divergences did not occur.

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2. *Dow Theory remains an important indicator for the health of this bull market.* On June 7th the Dow Transports closed at new lows for the corrective period, but not lower than in February, 2010. At the same time, the Industrials had a slightly lower low. Had the Transports also fallen below its February low, a Dow Theory sell signal would have been generated. But the Transport average held, meaning that an important non-confirmation appeared. *Dow Theory continues to indicate that the major underlying trend is bullish.*

3. *The February 2010 lows are now established as the key pivot point for the bull market.* They have been tested at least once, and had this test failed, a bearish pattern of "lower highs and lower lows" would have begun, and the 200-day moving averages in the major market indices would have started to turn downwards shortly thereafter. Of course, the successful testing of the February lows means that *they must remain intact for the bull trend to remain in force.*

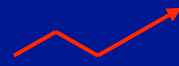
What is likely to happen over the summer months and beyond?

The markets shrugged off any possible negative effects from quadruple witching at the end of last week; short- and medium-term cycles are turning positive; positive divergences have appeared in internal momentum indicators in the major market indices during the month of June; and the respective 50-day moving averages of those indices continue to be above the 200-day moving averages. This provides a good foundation for at least a modest rally back towards the April 2010 highs. It is likely however, that fewer stocks will participate in this next phase of the bull market.

This is a middle-aged bull market and *some stocks have reached the end of their advance and are rolling over.*

Important dates to watch are the maturation of the 21-day and 70-day cycles on July 2nd and, looking way ahead, the coincident maturation of both the 70-day and 39-week cycles on October 15th. This suggests that mid-October could be the springboard for the next major upleg potentially lasting into 2011.

In sum, after a normal correction phase that lasted a couple of months, a window of opportunity to re-enter bullish positions has appeared. Shrewd stock selection and sector rotation will carry an increasing reward for investors as the bull proceeds. Stop-losses, tied to levels of risk tolerance, are essential in this environment.



S&P/TSX

(Daily chart with 50- and 200-day moving averages)



In our late-April look at the S&P/TSX Composite Index we noted a deteriorating technical conditions (negative internal momentum, declining number of stocks making new 52-week highs, and a generally laborious performance in the previous month). We concluded that the Toronto market was ripe for either a period of marking time, or a pull back to about the 11,500 level.

The pull back started almost immediately after that Market Comment. The 11,400 to 11,500 zone turned out to be the support zone for the May-June correction. This was about a two-thirds correction of the February to April advance (A-B). However this did not pose a major challenge to the February 2010 lows (except for a quick intra-day plunge in late May) and the S&P/TSX Composite Index spent very little time below its rising 200-day moving average. Of the three North American major market indices that we review regularly in the

Market Comment, the S&P/TSX Composite Index made the smallest rise for this bull market (a gain of 65% from the March 2009 lows) and has corrected the least amount (about 24%) in the last two months. This may be an indication that the Toronto market will be relatively strong compared to other markets in the next bull advance.

Only a move below the February lows - meaning anything below 11,000 - would alter the overall bullish picture.

Our Point and Figure Target of 14,000 remains achievable. The more immediate task for the Toronto market is to spend more time near its 200-day moving average and then launch an assault at the April highs above 12,300 in the fall.



S&P 500

(Daily chart with 50- and 200-day moving averages)



The S&P 500 Index's recent action has driven home the importance of the February lows as the key support area for this bull market. The 1,040 to 1,050 zone was revisited twice during the correction, in late May and early June. In between these tests, the Index rose back to its 200-day moving average, encountered resistance, and fell back.

The decline of the past two months represents a correction of almost one-third of the entire bull market advance from March 2009. This is a normal degree of retracement of a bullish move. In the past week, the S&P 500 Index has made an attempt to exceed and stay above its still-rising 200-day moving average.

The declining 50-day moving average – just below 1,140 – will likely pose further resistance to rallies. Above this, the 1,170 area – where the first attempt at recovery in mid-May stalled – will act as additional

resistance. And beyond that, the April highs at 1,220 will be a final resistance area.

The most important point to watch on the upside is the ability of the S&P 500 to move above its currently declining 50-day moving average, stay above it, and gradually turn the 50dMA upwards. That will be a signal that the bull market is well into a new up leg.

The S&P 500 has successfully tested its February 2010 lows and frightened the bears for the moment. The Index now needs to re-establish its bullish credentials. A period of time spent in the low 1,100s, on either side of the 200-day moving average, may be necessary for the bullish forces to rebuild strength. The February lows must hold.



DOW JONES INDUSTRIALS

(Daily chart with 50- and 200-day moving averages)



As we pointed out in the late-April Market Comment, the Dow Industrials was in an over-extended position, having risen sharply with little pause from the February lows. The subsequent corrective action closely mirrored the S&P 500. The Dow Industrials peeled back its entire bull market advance by about one-third and tested – successfully – the crucial February lows.

Our Point and Figure target for the Dow Industrials is 12,300. Ideally, the Dow should spend some time building strength in the low 10,000s, preparing for an initial move back to the April highs above 11,200.

The upside resistance points identified in the discussion of the S&P 500 are similar for the Dow Industrials: the declining 50-day moving average (about 10,580) and the recovery peak of the mid-May rally (about 10,900). The Dow Industrials must stay above 9,800 to remain bullish.