



## **Bull Bear Review<sup>sm</sup> with Michael J. Chapman, CFP**



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**01/30/07.** Last Thursday's reversal to the down side thwarted the bulls attempt to take the market to new highs. The market had priced in a rate cut by the fed in the first half of 2007. The realization that this may not happen until the second half of the year (if at all in 2007) caused the market to sell off Thursday and Friday.

Thursday's sell off was a distribution day, which makes three in four weeks. We removed this indicator from the "upside" of the Bull Bear Review.

Market tops are normally rounded affairs. This means that they tend to trade in small tight trading ranges, sometimes for months, before starting a sharp down move. That is what I believe is happening now and why I still expect the Standard and Poor's' 500 cash index (S&P) to finish its topping process by mid to late February and then make a strong contra seasonal move down into May.

In preparing for my China trip in April I picked up a copy of Ken Fisher's new Book "The Only Three Questions That Count" (He will be one of the financial speakers on the cruise.) Ken writes a monthly column for Forbes magazine and is CEO of a 30 Billion dollar

money management firm. He's also listed at 297 on Forbes top 400 most wealthy lists. The book is worth picking up it offers good advice on how to make clear-headed decisions with your investment portfolio.

### **On the Upside**

According to Thomson Financial, 2006 was a record year for global merger and acquisition activity, hitting 3.77 trillion and topping the record set in 2000 of 3.44 trillion. This trend should continue into 2007. Our economy is still flush with cash and many high profile companies are yielding 5% free cash flow making them attractive takeover targets.

**Trends** are still up in the S&P and DOW but will turn neutral on a close below 1,403 and 12,330 respectively.

The mild winter is keeping the lid on **oil prices**. The price of oil verses one year ago has been lower for the last nine weeks. Stephan Leeb, editor of the *The Complete Investor*, notes that, "Over the past 30 years, stocks have never fallen more than 5% during the 6 months following a drop in price below year ago levels."

**BULL BEAR REVIEW 01-29-2007**

**SPX 1.420 NDX 1.775 DJI 12.495**

### **Bull (up)**

### **Bear (down)**

**Liquidity and Free Cash Flow**

**Commitment of Traders**

**Trends**

**Insiders Selling**

**Leeb Oil Index**

**Divergences**

**Presidential Election Cycle**

**Inverted Yield Curve**

**Seasonals (Up Nov. 1 thru April 30)**

**Housing Market Fall Out**

**Investor Psychology**

**10 and 30 Bond in weekly down trend**

**VIX making a bottom**

**Pattern (elliott 5 way count complete)**

We are in the sweet spot of the **presidential election cycle**. The average performance of the stock indexes during the third year of the election cycle has been north of 18%. Additionally, there is a strong up **seasonal** from November 1 through April 30th.

## On the Downside

The last **Commitment of Traders** (COT) report showed the large commercial (large financial institutions that use the futures to off set their risk) had the biggest short position since December 1999 (three months before THE top). They continued to sell into the rally last week suggesting that a high is imminent.

Thomson Financial reports that **insiders** sold 35 times more shares than they purchased in November of 2006 and 55 times as many in December.

There are a disturbing number of **divergences** taking place today. The Dow recently made a new high while the s & p 500, the Dow transports and Dow utility indexes did not. The 30-year Bond is in a weekly down trend.

Three-month treasury bills are yielding more than the ten and thirty year treasury bonds and have been since June of 2006. This is what is called an **inverted yield curve** and is an important “red flag” because this condition has resulted in a recession seven out of the last eight occurrences. There has not been a recession since 1950 that was not preceded by a 10 to 20 percent decline in the stock market.

The **housing market fall out** remains the wild card. What we know about the housing market cycles are that the average length of time from peak to trough is 27 months. This down move started in January of 2006 and therefore likely has another 12 months. In the past 40 years private residential construction has never contracted to this extent with out triggering a recession. I’m betting housing will become less of an isolated event in 2007.

Investor psychology is similar to previous market tops. The public is bullish (Market Vane Consensus Index shows greater than 70% bullish) and the investment advisers are bullish (Investor intelligence shows 52.7% bullish and only 20.9% bearish). These are contrary indicators at levels that have produced tops in the past.

The **VIX** index (a market volatility index) recently hit a 13 year low. This tells us that there is very little fear in the market place and a great deal of complacency. This complacency has been brought on by one of the longest bull markets in history. We are 977 trading days from the October 2002 lows (4 years 3 months) in the Dow Jones Industrial Average without a decline of 10% or greater. There have only been five such uninterrupted periods in the Dow’s history. These streaks do not appear to be randomly distributed but instead precede some of the most important highs in market history. The corrections, once these streaks where over, ranged from a mild – 10.6% in 1997 to 25.2% in 1966.

This week we added “**Market Pattern**” to the Bear side of our review. Last Thursday’s high may have completed an Elliot Wave five count and means the market is ready for a corrective move to the down side. The common criticism of Elliot Wave is that it is much easier to see tops in hindsight. While this is true we still need to be aware that the rules have been met for a top to be in place.

For the near term (through mid to late February) the weighting of evidence favors the Bulls primarily because the “Trend” is up. Should we see a break down in price (break of the up trends) then I can make a compelling case for a sharp correction. ***This is not a low risk market environment.***

Your Bull Bear Review Analyst,

Michael J. Chapman, CFP

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