Volume I Issue 7

Bull Bear Review[sm] *with*

Michael J. Chapman, CFP

Provident Capital Management's Chief Investment Officer

317-705-1999

02/20/07 When Bad News is Good and Perception Verses Reality

In last week's column I mentioned that the number of items for concern was really down to three: **1.** The Commitment of Traders reports shows the "smart" money (large commercials) is betting on a down move. **2.** The housing market fall out and **3.** Various overbought sentiment indicators are at levels that produced tops in the past. Friday's release of new housing starts, down 14.3%, for January was a big shock. The lowest estimate was about 6% above the actual number. Because the FED is concerned about inflationary pressures bad news becomes good. Perhaps a slow down in consumer spending will off set wage price inflationary pressures and the FED won't have to raise interest rates is how the thinking goes.

Let's see, we have housing data suggesting a slow down in consumer spending and the most recent ISM Manufacturing index showing a slow down in manufacturing. This market is facing some serious head winds. I still expect the Standard and Poor's' 500 cash index (S&P) to finish its extended run up by late February and then make a strong contra seasonal move down into May. Breaking the support levels discussed under "Trends" below will be the first indication that the expected move has started.

The new highs on various indexes are making headlines and the perception is that the market is strong. But, the reality is that this market is slowing down. The S&P500 cash index is up a measly 9 points for the month of February and the Nasdaq 100 index is at price levels reached last November.

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 1,433 and 12,560 respectively.

The recent cold snap has caused a rise in **oil prices** back up to nearly $60/brrl. However, because the price

BULL BEAR REVIEW 02-20-2007 SPX 1.458 NDX 1.834 DJI 12.755

Bull (up)	Bear (down)
Liquidity and Free Cash Flow	Commitment of Traders
Trends	Insiders Selling
Leeb Oil Index	Inverted Yield Curve
Presidential Election Cycle	Housing Market Fall Out
Seasonals (Up Nov. 1 thru April 30)	Investor Psychology
	Investor Complacency (VIX)
	Pattern (Time & Price)

of oil moved up sharply from February to August of 2006 we are still trading below year ago levels. The price of oil verses one year ago has been lower for the last twelve 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."

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) still heavily short and betting on a down move.

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

Three-month treasury bills are yielding more then 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 then 70% bullish) and the investment advisers are bullish (Investor intelligence shows 51 bullish and only 21% 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 the second longest bull market in history. We are 991 trading days from the October 2002 lows (4 years 4 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.

The Market is now at a significant balance point in price and time. Additionally, the Elliot wave folks are suggesting that the **market pattern** now favors a top and a strong move to the down side is imminent.

For the near term (through March 07) 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

Terms of Use

The use of this newsletter is subject to the terms and conditions specified herein. If you are unable or unwilling to agree to the terms as stated do not use the newsletter or download the materials. The newsletter is just the opinion of the writer and should not be construed to be anything more than opinion. You are free to agree or disagree with the writer of the newsletter.

No Investment Recommendations or Professional Advice

The material in this newsletter is intended to be informational only and should not be considered to be an investment recommendation or professional advice regarding investments. The material should not be used as a basis for investment decisions. Investment decisions are highly personal decisions and depend upon a number of factors including but not limited to age, financial situation, investment objectives, financial acumen and risk tolerance. You are solely responsible for determining whether you wish to make a particular investment or pursue a particular investment strategy.

No Tax of Legal Advice

The material in the newsletter is not tax or legal advice. We are not licensed attorneys or CPAs. If you need legal advice or tax advice you should personally consult an attorney or CPA regarding your specific legal of tax situation.

Disclaimers of Warranties

Provident does not make any express or implied warranties about the content of the newsletter including but not limited to implied warranties of merchantability, fitness for a particular purpose, or non-infringement. The material in this newsletter is made available to you "as is" and "as available" and Provident does not warrant that any defects or inaccuracies will be corrected. There is no warranty that the newsletter will meet your needs, or that it will be timely or error free.

Limitation of Liability

Provident shall not be liable to you or anyone else for any consequential, incidental or indirect damages (including but not limited to lost profits, trading losses or damages) that result from the use of the information in this newsletter. The limitation may not apply to you depending upon what state you live in.

Provident shall not be liable for any damages to or viruses that may infect, your computer equipment, software, data or other property on account of your access to, use of the newsletter or from downloading of any materials, data, text, images, video or audio from the newsletter or any sites linked to the newsletter.

Timeliness

The nature of markets is that they change constantly. The information contained in this newsletter is only presented as of the date of the letter and the information may become out of date. Provident does not assume any obligation to update the newsletter or any of the information contained in the newsletter.

Copyright

Non US Residents

The material in this newsletter is intended to be made available only to persons residing in the United States. Nothing in the newsletter shall be considered a solicitation to buy or an offer to sell a security, or any other product or service, to any person in any jurisdiction where such an offer, solicitation, purchase or sale would be unlawful.