



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



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02/27/07 - What a difference a day makes.

- Uptrend in stocks is broken
- Bonds now in uptrend (good for stocks)
- Still plenty of liquidity
- Volatility picks up (good for trading)

Yesterdays 3.5% drop in the S&P index took out 3 months of gains and left the index down 1.4% for the year. **Trends** in equities are sideways at best, and may within the next two weeks turn down.

The silver lining in all this is that the 10 and 30-year bond are now in strong up trends (rates are declining). Additionally, the markets are pricing in a rate cut by the fed as early as June.

Yesterday's sell off overshadowed last Friday's \$44 billion leverage buy out of Texas Utilities (TXU). The significance of this deal is that it demonstrates the large amount of liquidity provided by private equity firms (See discussion on liquidity below).

I look for sideways to lower markets into May and expect volatility to remain high. This means expanded

daily trading ranges and makes for a much better trading environment then the past three months have been.

### 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. A recent *Fortune Magazine* article discussed the ten biggest private equity firms. By their calculations, these top ten firms have \$250 Billion in cash. They will borrow up to 10 times that amount in doing their deals (hence the term "leveraged buy out"), which means they have buying power of \$2.5 Trillion. This should add tremendous **liquidity** to the market thus driving it higher during good times and supporting it during sell offs.

The recent cold snap has caused a rise in **oil prices** back up to nearly \$60/brrl. However, because the 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 thirteen weeks. Stephan Leeb, editor of the *The*

**BULL BEAR REVIEW 02-27-2007**

**SPX 1,412 NDX 1,771 DJI 12,300**

#### Bull (up)

#### Bear (down)

**Liquidity and Free Cash Flow**

**Commitment of Traders**

**Leeb Oil Index**

**Insiders Selling**

**Presidential Election Cycle**

**Inverted Yield Curve**

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

**Housing Market Fall Out**

**Bonds in an Up Trend**

**Investor Psychology**

**Investor Complacency (VIX)**

**Pattern (Time & Price )**

*Complete Investor*, noted 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. It will be interesting to see if they cover their shorts on this week’s strong down move.

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

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 50% bullish and only 22% bearish). These are contrary indicators at levels that have produced tops in the past.

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.

I have been suggesting since late December that this market would top by late February. It appears that a move to the down side has started. ***This is not a low risk market environment.***

Your Bull Bear Review Analyst,

Michael J. Chapman, CFP

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