



Bull Bear Reviewsm with Michael J. Chapman, CFP



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- **Earnings, catalyst for new highs**
- **Large Cap Stocks lead the way**
- **Stage set for new all time highs in S&P**
- **Short term consolidation then higher**

In my April 4th posting I stated that earnings might well be the catalyst to send the market to new highs for the year and that has proven to be the case. The market continues to discount a plethora of bad news; housing foreclosures, rising interest rates, the carry spread, and the geopolitical environment. This market wants to move higher.

The liquidity factor, which I have had on the bull side of our ledger since last November, continues to provide the fuel for higher prices by way of mergers, acquisitions, and stock buy backs. Ken Fisher notes in his March Forbes column that this phenomenon has resulted in over a trillion dollars of once available stock being taken off the market. Economics 101, as quantity of supply declines prices rise.

Nearly all of the gains for the year 2007 have been produced in the seven trading days between the close April 11th and the close April 20th. The year-end close for the Dow Jones Industrial Average and S&P 500 index was

12,463 and 1,418 respectively. The April 11 close for each index was 12,450 and 1,438. Seven trading days later (April 20th) the two indexes closed at 12,962 and 1,484 up 4.2% and 3.2% respectively.

The 30 large Dow Industrial stocks are starting to outperform the broader indexes. This tends to happen in the final stages of a bull market and is a warning sign.

The stage is set for a move to new all time highs by the S&P 500 index. The highs made in 2000 were 1530 to 1552 and we are only 67 points (4.5%) away. The commercials are still heavily long against a heavy short position by the large speculators (a.k.a. hedge funds) if price continues to move higher it will force the large speculators to buy back their positions and provide enough buy power to take the S&P to my 1,566 target. Once new highs are made I expect a big move to the down side.

Prices are currently extended (2% above their 21 day moving average) and may need a small correction before the move to new highs. The correction could be as much as a 2% to 3% move down or we could simply work side ways for several weeks.

The danger of a hard landing and recession has not gone away. It is just a matter of time until the market refocuses on these issues; but for now all indicators point higher.

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Bull (up)

Trend

Liquidity and Free Cash Flow

Leeb Oil Index

Seasonals (Up Nov. 1 thru April 30)

Commitment of Traders

SPX 1,484 NDX 1,846 DJI 12,962

Bear (down)

Inverted Yield Curve

Housing Market Fall Out

Major Cyclical low due late 4th quarter

On The Upside

Trends are all positive. My proprietary trend indicator is up. Additionally, the slope of the 21, 50 and 200 day moving averages is up. Richard Russell in his Dow Theory News letter publishes his trend indicator and it is up and moving to new highs. The Utility and Transportation index hit a new high last week. As long as price remains above **12,715** in the Dow and **1,465** and **1,819** in the S&P and Nasdaq 100 indexes respectively, all lights are green.

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 has continued 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.

Oil prices are \$65/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 twenty 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.”

There is a strong up **seasonal** from November 1 through April 30th. We will soon loose the benefit of this up seasonal but do not face a strong down season until the month of June.

The Dow Jones Industrial Utility and Transportation indexes are in an up trend and just made new highs.

On the Downside

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. February New-home sales in the U.S. fell to seven year lows (Bloomberg March 26). Housing inventories are at a 16-year high (8.1 months at the current rate of sales).

The 3.3-year **cycle low** is due late in 2007 early 2008. This cycle low has marked many significant lows over the past twenty-five years including the 1987 crash low.

Your Bull Bear Review Analyst,

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