



Bull Bear Reviewsm with Michael J. Chapman, CFP



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- **Trend turns neutral on crude oil**
- **Market rallies off its 50 day average**
- **Transportation and Utility Averages lag**

Oil prices are no longer in a downtrend and I have removed oil from the bull side of our ledger. Oil prices are attempting to move above the psychological \$70/brrl mark. A year ago, oil (July '07 crude contract) moved from \$70/brrl to \$81/brrl from June 15 through the first week in August and then dropped to \$53/brrl by the 2nd week in January '07. As Stephen Leeb shows in his book, *The Oil Factor*, it is the change verses year ago levels that can cause market sell offs. Between now and the first week of August, oil could rise to \$81/brrl and not be above year ago levels; therefore, the critical item to watch is what happens to the price of oil from the second week of August through the end of the year.

The market rallied off its 50 day moving average last week to close near its 52-week highs. The pull back Monday and Tuesday has been minor and has been on light volume.

Friday night's Commitment of Traders report (COT) showed the commercial still heavily long while the large speculator (hedge fund) is taking the other side and is

heavily short. The stand off continues but favors a move to new all time highs on the S&P 500.

The 10-year treasury yield has backed off from 5.35% to 5.10% but is still in an uptrend. It is one of the most critical elements in determining the future direction of the stock market.

The Dow Utility and Transportation indexes have lagged behind the DJIA on this last move up, and will enter into a weekly down trend this week (unless they take out last weeks highs).

On an international note, the final brigade of the additional 30,000 troops arrived in Baghdad this week, fighting and death toll numbers will likely accelerate. With a void in earnings reports the market mood could be dampened by reports out of Baghdad as our boys go about breaking down strongholds.

On The Upside

Trend is still up in the NASDAQ 100 but has turned neutral on the S&P and DJIA. Stop on the Nasdaq 100 index is **1,864**. It is interesting that the NDX index is holding up better than the blue chip DJIA and S&P500 indexes. Perhaps it is telling us to watch for a move in Large Cap Tech stocks this summer.

BULL BEAR REVIEW 06-19-2007

Bull (up)

Liquidity and Free Cash Flow

Commitment of Traders

SPX 1,530 NDX 1,901 DJI 13,631

Bear (down)

Inverted Yield Curve

Housing Market Fall Out

Adviser Sentiment

Rising World Interest Rates

U.S. 10 year bond in down trend

Major Cyclical low due late 4th quarter

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 in 2007. It may set a private-equity record with \$115 billion in buy outs announced. For the year through May we are at \$315 billion in private equity buy outs (Thompson Financial). Private equity firms and Sovereign Wealth Funds (SWFs) should keep the record merger and acquisition trend in place for the rest of the year.

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. You also have the phenomena of SWFs which Morgan Stanley estimates contain 2.5 trillion dollars. This is adding tremendous **liquidity** to the market thus driving it higher during good times and supporting it during sell offs.

Commitment of Traders released Friday show the large commercial trader net long and the large speculator short. A fast, sharp move to the upside is the likely resolution to this stand off. The buying power to propel this market to new highs will likely come from the large speculator as they cover their shorts and go long. It is possible (not probable) that the commercial trader will be forced to cover which would accelerate a down move. The next two to three weeks should be interesting. Positions are reported on Friday but represent holdings as of the close on the previous Tuesday. It will be interesting to see if the commercials decreased their long positions on this last weeks pull run up in price.

On the Downside

From June of 2006 until late May of 2007, the 3 month T-Bill was yielding more than the 10- and 30-year bond rates. 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 without triggering a recession. Housing inventories are at a 16-year high (8.1 months at the current rate of sales). Existing home sales in March fell 8.4%, the largest amount in 18 years. April new homes sales were back up, but this number is probably misleading. The April new home sales number has been revised lower each of the past three years. Both new and existing home sales are down 10.6 percent versus year ago levels. Jim Stack is doing a good job of tracking the unwinding of the housing bubble. Go to www.investech.com to find three great charts that tell the story. Jim updates these charts regularly. Go to www.lenderimplode.com to track the demise of the sub prime industry.

Investor Intelligence reports **adviser sentiment** is now at a bearish level. Advisers bullish have reached 56.7% while those bearish are at 21.1%. This contrary indicator is not a good short term timing indicator but does add weight to bearish side of the ledger

Restrictive Monetary Policy by China’s Central Bank could be a showstopper. China has a problem with speculation in its stock market. The central planners are aware of the problem and are trying to quell enthusiasm with higher interest rates and restrictive monetary policies. There will be some fallout worldwide when their market corrects.

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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