



Bull Bear Reviewsm with Michael J. Chapman, CFP



Provident Capital Management's Chief Investment Officer

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- Rally to mid September then retest lows
- Pre – Holiday light volume trade

The market is following my script (up into mid-September then down into late November). This rally may trade to higher price levels than most expect, so look for at least 1,500 on the cash S&P, 13,700 on the Dow Jones and a double top high of 2060 on the NDX (nasdaq 100). The hedge funds and large speculators have on a record short position and the rally could really take off if they need to begin covering.

Trading volume on this rally has been light, but that is typical of pre-holiday markets. I expect next week's volume to pick up on rising prices and then, the following week, experience a reversal and hard and fast move down. A pattern I have observed in the past is for post holiday trading volume to pick up as price moves one direction. This gives everyone confidence in the new direction and then as everyone is feeling confident the market reverses.

China's Shanghai index traded through the 5,000 level on August 22, despite an interest-rate hike and weakness in other world markets. China has raised its interest rates 6 times in 16 months in an effort to try to stop the excessive speculation. This is one to watch because the hangover,

once this party is over, will affect our market.

On The Upside

There is lots of cash sitting in corporate coffers, hedge funds and Sovereign Wealth Trust. This **liquidity** should provide support during market corrections.

The commercials bought into this sell off, pushing their net long positions to a record level. They don't often lose this game but when they do it can create a hard and fast sell off. I am leaving it on the bull side of the ledger with the caveat that it could be a catalyst for further downside.

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. Recently we had a 10 plus percent correction. Will the recession follow?

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

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Bull (up)

Liquidity and Free Cash Flow

Commercials Net Long

Bonds in Weekly uptrend, yields down to 4.85

SPX 1,458 NDX 1,954 DJI 13,289

Bear (down)

Inverted Yield Curve

Housing Market Fall Out

Seasonals

Rising World Interest Rates

Major Cyclical low due late 4th quarter

likely has another 10 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 (8.9 months at the current rate of sales). Existing home sales continue to fall. Both new and existing home sales are down 10.6 percent versus year ago levels. Building activity is down 24% from 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.

Seasonals are down from late August through early October.

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 fall out 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,

Michael J. Chapman, CFP

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