



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



### Provident Capital Management's Chief Investment Officer

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- **The squeeze is on**
- **Oil is a concern**

I've been suggesting since June that the imbalance between the record long position of the commercial traders and the record short position of the large speculators, aka hedge funds, would likely resolve itself with a strong move to the upside as the hedge funds were forced to cover their shorts.

Yesterdays 50 basis point cut in both the Fed Funds and the discount rate is the catalyst for this short covering to begin. We will likely see a quick move to new highs as buy stops are hit and shorts scramble to cover.

In our [20 June posting](#), we cautioned that this August through December period would determine if the price of oil is going to have an negative affect on the economy. Steeve Leeb's research shows that it is the year over year percent change in oil, not the absolute price, which weighs on the economy. From 1 September last year through the end of the year the price of oil dropped from \$70/brl to \$50/brl. At the current \$82/brl price we are trading at a 15% premium to year ago levels. If the price refuses to drop between now and year-end, we will be trading at a 64% premium and near the level his research suggests will cause negative stock market returns.

### 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 and buying power now that it appears that the Fed has turned to an easing stance.

**Weekly Trend** has turned up.

**Bonds are trending sharply higher.**

The **commercials** have the large speculators and hedge funds on the run. Their short covering should provide enough buying to carry this market to new highs. This Friday's Commitment of Traders report will be interesting, because it will show activity through Tuesdays big up move.

### 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. July 19 through August 16<sup>th</sup> the major indexes corrected 10 plus

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**Bull (up)**

**Liquidity and Free Cash Flow**

**Commercials Net Long**

**Bonds in Up Trend, Yields Down to 4.53**

**Stocks in Weekly Up Trend**

**SPX 1,525 NDX 2,036 DJI 13,800**

**Bear (down)**

**Inverted Yield Curve**

**Housing Market Fall Out**

**Seasonals**

**Rising World Interest Rates**

**Major Cyclical low due late 4<sup>th</sup> quarter**

percent. 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 likely has another 9 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](http://www.investech.com) to find three great charts that tell the story. Jim updates these charts regularly. Go to [www.lenderimplode.com](http://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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