



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



### Provident Capital Management's Chief Investment Officer

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- **Volume is back**
- **Large Cap Growth leading the way**
- **Housing situation continues to deteriorate**

Last week the major indexes exploded to the upside on higher volume. The DJI and S&P indices were up 3%, but the real story was the 6% increase in Investors Business Daily's (IBD) top 100 leading stocks index. In that index, 61 of the 100 stocks had weekly increases in both price and volume. The four-day pull back since last Wednesday's high has been on lighter volume each day (bull market trading). I'm betting that by the next time I post we will be at new highs for the S&P 500 and DJIA indexes. The NDX hit a new high Tuesday.

A quick glance at IBD's mutual fund page shows large cap growth stocks have been the leading stock class since mid June. This group has underperformed since 2000 and is due to cycle back into a leadership position.

The release of the August housing stats shows a bad situation getting worse. Building starts and building permits hit a 12 year low. Home sales hit a 5 year low and there is now a 10-month supply of homes for sale. Source IBD. The S&P Case/Shiller 10 city index shows the price of houses

fell 4.5% in July - the worst month since 1991. All this bad news and the market drifts lower on light volume? The market has discounted the economic implications of this story and wants to move higher.

#### 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. Stops on a weekly close only basis for the S&P 500, Dow Jones Industrials, and Nasdaq 100 indexes are 1,498, 13,000 and 1,942 respectively.

The **commercials** added to their long position and the large speculators added to their shorts last week. The epic battle continues. It appears that it will take a move to new highs to get the large spec's to cover their shorts.

#### 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

**BULL BEAR REVIEW 09-26-2007**

**Bull (up)**

**Liquidity and Free Cash Flow**

**Commercials Net Long**

**Stocks in Weekly Up Trend**

**SPX 1,521 NDX 2,083 DJI 13,820**

**Bear (down)**

**Inverted Yield Curve**

**Housing Market Fall Out**

**Seasonals**

**Rising World Interest Rates**

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

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 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 with out triggering a recession. Housing inventories are at a 16-year high (10 months at the current rate of sales). Existing home sales are at a 5 year low. Both new and existing home sales are down 10.6 percent verses 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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