



Bull Bear Reviewsm with Michael J. Chapman, CFP



Provident Capital Management's Chief Investment Officer

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- **Correction likely over**
- **New highs by Thanksgiving?**
- **Feds likely to cut rates at October meeting**

The S&P 500 index has corrected 5.5% from the October 11th high of 1,576 to the double bottom lows made October 22nd and 24th at 1490. This is a normal pull back in a rising market. The influence of the down cycle is now past and we are within one week of entering the November through April up seasonal time period. The down move was enough to move Bullish investor advisor sentiment off of its 5-year highs and to push short term technical indicators to sharply oversold levels. Unfortunately, it also took out the stops on the three indexes we track for this letter which means we have moved from an "up trending" market to a "trading range market." With that said, I believe we are at the bottom of the "range" and can expect the market to trade to the top of the range, possibly to new highs, by Thanksgiving.

A 1/4 percent reduction in the Fed Funds rate is the likely outcome of the October meeting of the Federal Reserve board. The Fundamental news hitting the tape shows growth and inflation moderating here in the U.S. On the other hand, China just released a report showing 11.25% growth in GDP. The participants in that market are worried about a

rise in their central banks lending rate. It would be the 7th in a row. The concern is that at some point these rising rates will be enough to cause their market to sell off. I believe that would have a negative effect on our market and is why it continues to be listed on the bear side of our ledger.

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.

The **commercials** reduced their net long position by the equivalent of 19,043 contracts as the markets moved to new highs October 11th. This leaves them at 34% of their five year high mark of 110,943 contracts made in the September 18 report. To get this number we divide the net position of the E – Mini S&P 500 contract by 5, it is 1/5 the size of the regular full sized contract, and then add that number to net position of the full sized contract. You can find the net positions of a large number of indexes and commodities each week at www.futuresbuzz.com or go directly to the Commodity Futures Trading Commission web site at www.cftc.gov.

BULL BEAR REVIEW 10-25-2007

Bull (up)

Liquidity and Free Cash Flow

Commercials Net Long

SPX 1,508 NDX 2,157 DJI 13,615

Bear (down)

Inverted Yield Curve

Housing Market Fall Out

Seasonals Down Through October

Rising World Interest Rates

Advisor Sentiment Extreme

Major Cyclical low due early 1st quarter

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 16th of this year, the major indexes corrected 10 plus percent. Will a 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 7 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. This is becoming an old story and many believe the market has discounted it. However, this story will likely come to the forefront again in the first quarter of 2008 as a very large number of variable rate home loans will adjust upward.

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 through October.

Advisor Sentiment is negative. Investor Intelligences reports 56.9% of advisors bullish and only 22.9% bearish. This is close to a five year extreme and, while not a good short-term indicator, has preceded many market tops.

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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