



Bull Bear Reviewsm with Michael J. Chapman, CFP



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- **Trading range market**
- **Economy seems to be muddling through**
- **Intermediate lows now in for financial stocks**

As I said last week, the S&P 500 index is in a trading range from 1,480 on the down side to 1,562 on the upside. We are at the bottom of this range and I look for us to trade out the top side by Thanksgiving.

Early in the week third quarter GDP numbers came in at up 3.9%. This made two quarters in a row at that level and raised concern that the economy was too strong and that we wouldn't get a rate cut at the Fed meeting on Wednesday.

The Fed did cut its rate 1/4 point but made it clear that the economy seemed to be on solid footing. They were most concerned about inflation. On Thursday an analyst put out a sell recommendation on a prominent bank stock and the markets, fearing that "the other shoe in the credit markets" was about to drop, sold off sharply. The Jobs reports this morning gave a little good news to every one. Larry Kudlows sound bite "The greatest story ever told" is ringing in my ears as I see that we added 166,000 new jobs in October, the street was only expecting 80,000, and at the same time had only a .23% increase in wage growth. The

jobs growth number should ease concern about the economy going into the abyss and the Fed should be pleased, given their inflation concerns, that the wage growth rate came in less then expected. Do I hear Goldilocks knocking at the door?

I will go out on a limb and suggest that intermediate lows for most financial stocks are in and that the next 10% move in this sector will be to the upside. The one caveat, pressure from tax loss selling may postpone a rally in this group until January. Financial stocks make up 27% of the S&P 500 index and for this index to reach new highs we need this sector to rally or, at the very least, stabilize and trade sideways.

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** increased their long positions during the October sell off. My guess, I'll know next Friday, is that they were also buyers on this weeks sell off. There large net long position and willingness to step up and buy the dips gives me confidence that we will post new highs in the

BULL BEAR REVIEW 11-01-2007
Bull (up)
Liquidity and Free Cash Flow
Commercials Net Long
SPX 1,496 NDX 2,187 DJI 13,480
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

major indexes before we have a significant sell off.

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 it has been discounted by the market. 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.

Advisor Sentiment is negative. Investor Intelligences reports 52.8% of advisors bullish and only 23.1% 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,

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