



MARKET COMMENT

THE CURRENT OVERSOLD CONDITIONS SHOULD INITIATE THE START OF A NEW UPLEG

July 3, 2011

Every bull market has its own way of fooling the majority. What better way of doing so than faking its own death!

The nine-month rally that had a start at the 2010 lows awakened the bull in many market participants. However, by February 2011 this surge in the "blue sky ahead" crowd was accompanied by weakening momentum, technical divergences and lethargic market moves. It didn't take long before the markets gave in and began a well-overdue correction. Soon, many thought the market would decline and throw as many people as possible off the bullish bandwagon. Not this time. The pullback took a horizontal route in most markets, marking time and waiting for the 200-day moving average (200dMA) to catch up. It was a lengthy, frustrating and confusing route, but highly effective in extinguishing the bulls.

Since mid-February the S&P 500 and DJIA have stayed within a horizontal trading range with clear battle lines drawn between the bulls and bears. The early decline in March was followed by a slow upward move toward marginally higher highs, but the lack of momentum soon turned it into another decline toward the previous lows and toward the 200dMA.

Toronto, as usual, had to differ. This resource-packed Index decided to go a little bit farther in its corrective effort than its U.S. counterparts. The S&P/TSX composite dipped below its own 200dMA in a classic A-B-C (down-up-down) formation. This move below the 200dMA has caused quite a stir among market commentators and resulted in calls for the start of a bear market.

A similar dip below the rising 200dMA occurred in London, but the FTSE 100 Index continues to trade in a well-defined horizontal trading range. The most recent decline found support just above the lower boundary of the trading range. The most recent dips below the 200dMA in London and Toronto caused some bearish vibes, with some commentators calling for the start of a bear market. Once again, the bull market is fooling the majority.

The weight of technical evidence points to the conclusion of the current correction and the start of a new upleg as outlined on the following page.

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Where are the markets now?

Positive signals have begun to appear in many indicators. The percentage of stocks above their 50dMAs has declined from an early April high of 77.2% to the current 26.7%, which is as low as it was at the beginning of major uplegs in March 2009 and July 2010. The On-Balance-Volume (OBV) shows a bullish divergence in New York: volume did not decline at the same rate as the Index. Intermediate-term cycles point to an important low during mid- July: both the 21-day and the 105-day cycles will mature on July 15th. For the longer-term, the markets will get a boost when the 39-week cycle matures on July 8th. The Dow Theory also supports an upside resolution from the current standoff as neither the Transports nor the Industrials Index declined below the March lows. The price action in many individual stocks is also encouraging: most have arrived near their 200dMAs and are in the midst of base-building. Last but not least, the VIX rose to 24.65 on the same day that the S&P 500 hit its lowest reading since April.

It appears that the market succeeded in injecting some fear and doubt into the situation. Despite a relatively mild correction, strengthening technicals, and renewed buying on the dips, investors appear to be entrenched in their "let's see what happens next" mentality. The latest survey by Investors Intelligence puts the bulls at 39.8% and the bears at 26.9%, quite a retreat from the early April numbers of 57.3% and 15.7% (as reported by Investors Intelligence). The American Association of Individual Investors (AAII) statistics show about equal numbers of bulls and bears, from a mid-April reading of 44% and 29%. In the past, equilibrium between bulls and bears presaged important market turns.

What is likely to happen next?

North American markets have already reached oversold conditions. All major market indices are either retesting their 200dMAs or major support levels. It appears that the S&P500 Index has already bottomed last week. However, some further bottoming action can still be accommodated comfortably in all indices in the early part of July, as the above mentioned cycles mature.

After the bottom, we should look for signs of confirmation that a new bull market rally is underway. A move above the 50dMA would be a good start. In the case of Toronto and London, a trip back above their 200dMAs would be top priority. Of course, as we always say, investors should always be prepared for any eventuality.

Where are the buying opportunities?

In the early days of this bull market almost all sectors and stocks participated in the advance, but the next few months will belong to careful stock pickers. There is no better time to separate wheat from the chaff than during a correction. Strong stocks usually pull back toward their 200dMAs/ trendlines and find support there (a sign of strength – ACCUMULATE), while weaker stocks violate those support levels (a sign of weakness – AVOID).

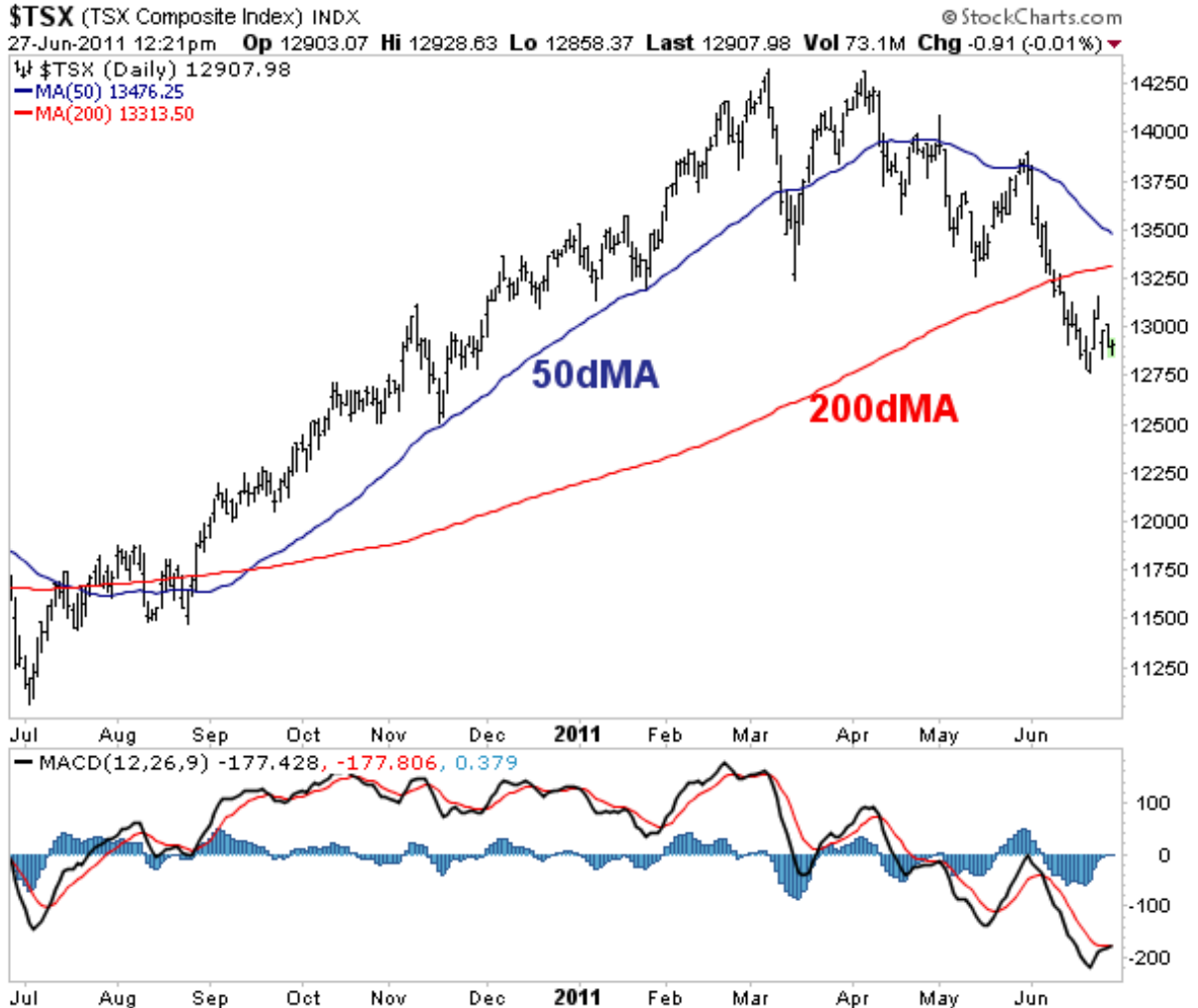
If the market follows its usual sector rotation formula, New York should lead the next rally. Given the age of this bull market, however, we anticipate the Toronto market will take over later on. This may be associated with renewed strength in the Energy sector and later, toward the end of the summer, some strength in Golds.

The markets have near-perfect conditions to resume their uptrend. Since in a bull market surprises happen to the upside, be ready for a summer surprise.



S&P/TSX

(Daily chart with 50- and 200-day moving averages)



This is the Index that caused all the stir among market commentators. Up to late June, the corrective action in the S&P/TSX Composite was subdued and well mannered, but when the Index dipped below its rising 200dMA, a flood of bearish comments followed. This baseless reaction was expected. Many forget that it's the direction of the 200dMA that is of prime importance, not whether the Index dipped below it or not. In the case of the S&P/TSX, the 200dMA is clearly moving upwards, confirming a bullish uptrend. Of course, a prolonged stay below the 200dMA would be negative because it would lead the average to flatten and eventually turn down. At this point,

however, such an event is highly unlikely (*).

In the last two weeks the Toronto Index has been working to establish a short-term bottom around the 12750 mark. A move above the resistance at 13,150 would set the stage for a recovery and an eventual return above the 200dMA.

(*) *The 200dMA is updated every day by adding that day's closing number and removing the closing number of 200 days ago. The red arrow shows the closing level 200 days ago: even if the S&P/TSX stays at current levels, it would take another 50 days before we'd remove any data larger than 13,000!*



S&P 500

(Daily chart with 50- and 200-day moving averages)



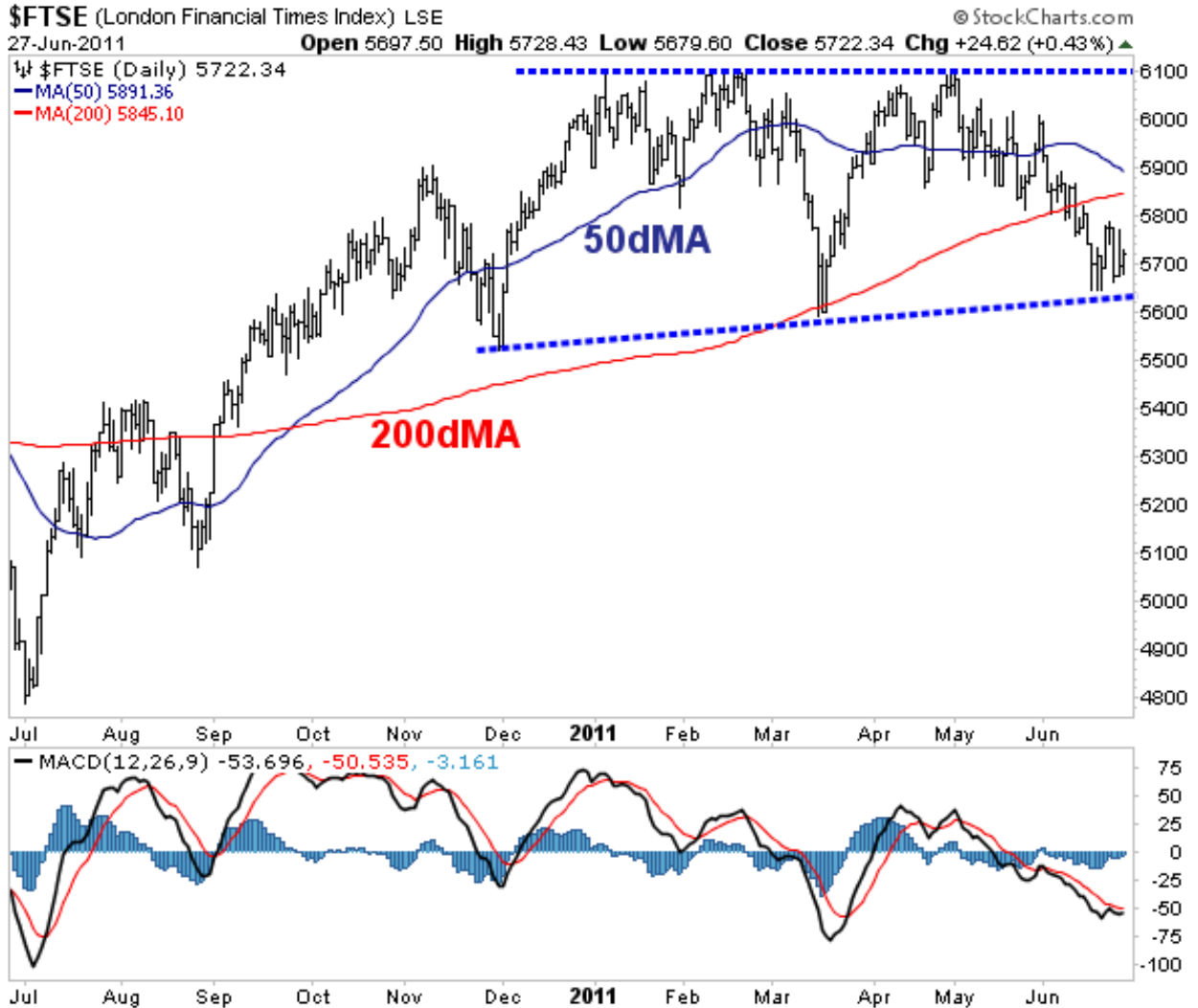
Following the mid-February top, this Index pulled back toward its 200dMA, but stopped short of touching it (A). The mid-March low produced a relief rally with a momentum that carried the Index slightly above its previous high (B). This created a trap, as the Index eventually turned down once again to finish its corrective work (C). During the most recent decline, the S&P 500 touched its 200-day moving average on June 16, which was followed by a relief rally. As this report is being published, the Index has successfully

retested this low. The Index is now sandwiched between its 50- and 200-day moving averages. A decisive move above 1300 and then above the 50dMA would put it back on a bullish track. The crucial support extends from 1260 to 1250, the area which must hold if the bulls are to remain in control.



FTSE

(Weekly chart with 10- and 40-week moving averages)



The FTSE 100 Index has been testing investors' patience since the start of 2011. Range-bound trading between 5600 and 6100 has become the norm. However this lack of action could be deceiving. Keeping in mind "the larger the base, the higher the space" a breakout above 6100 would unlock significantly higher targets. The most immediate task for the Index would be to move up above its 200dMA, currently at 5846.

Obviously, the support near the 5650 level is critical.

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