

PHASES & CYCLES™

MARKET COMMENT

(S&P/TSX – 14095; S&P – 1522; DJI – 13545; NASDAQ – 2616)

A SELLING OPPORTUNITY BEFORE A CYCLICAL DESCENT

INTRODUCTORY SUMMARY: We entitled our last Market Comment “A Summer Rally in the Making” and singled out Energy and Metals as the most likely leaders. Indeed, the North American markets have done very well by staging a complete recovery from the early June lows. Now the bulls need determination and strength to show how far they are willing to carry this late-stage rally before autumn.

MARKETS NOW: An early June decline did not derail the market from its bullish tracks. The main indices have staged a speedy recovery toward their May highs, led by the Energy and Metal sectors – traditionally late-cycle movers.

All major technical trend measures remain positive: the key indices remain well above their rising 200-day moving averages and their supporting trend lines. However, the positive influence of the 39-week cycle could only nurture positive action until mid-July/early-August, since, at that time two important events usually occur; the end of the “summer-rally” and the option expiry date on July 20th. In the past, these events have accompanied market turns.

We see two possible scenarios for the markets in the next few weeks:

First Scenario - the North American indices muddle through to new highs but stop short of any major move. Therefore, in the upcoming weeks, we may witness a lengthy topping process, which would lead to an anticipated “sharp shock” in the fall. This scenario includes the possibility of a number of mini-rallies and declines that may provide a platform for skilled traders, but long-term investors should choose to exploit any such rallies to reduce market exposure.

Second Scenario – the markets continue to rally higher without any pause. The North American indices accelerate their advance with resource-driven Toronto leading the way higher. This kind of explosion to the upside would create dangerous conditions of euphoria and upside exhaustion and lead to a possibly short but painful blow off in the fall.

In sum: Whether the market chooses to accelerate its advance or just “hang on” to the current levels and build a top formation, long-term investors should take all opportunities to lighten their positions in anticipation of better bargains in the fall.

As cited in the past, one of the unique features of this bull market has been its ability to surprise to the upside. This urge to rally has been fuelled by a prolonged hesitation among investors to recognize the bull market. However, during the last few weeks we noticed a visible change on the part of one group of market participants as distrust gave way to recognition and acceptance. The high point of this was the most recent shift among a few prominent market strategists, who have abandoned their multi-year bearish stands and joined the bullish ranks. To put it another way, we have started feeling increasingly uncomfortable as the bullish train we have been riding in the last five years got increasingly crowded.

While market professionals have finally started embracing the bull market, the public has yet to show any signs of euphoria. The latest sentiment survey from the American Association of Individual Investors (AAII) shows that the bears outnumber the bulls (43.7% vs. 37.3%) even after an impressive rally toward May highs!

So what will it take to get the laid-back public excited? Maybe a sudden acceleration of the advance outlined in our second scenario could inject euphoria into the public.

STOCKS COMMENT: The markets' "upside leadership" remains concentrated in Energy and Metals.

The exception would be uranium stocks, which gathered huge attention in the March/April period with front-page articles in the Canadian and US media. There wasn't an investor unaware of the opportunities available in uranium – the guarantee of a lengthy consolidation. This correction period is underway now.

Very interesting developments are taking place in the Gold sector – our other favourite. The successful tests of the May lows in the Gold indices hint at the possibility of a major breakout from the confines of a two year trading range.

At the same time, numerous metal stocks have already had breakouts and are on their way to significantly higher targets: Great Basin Gold (GBG), Freeport McMoran C&G (FCX), Compania de Minas (BVN) or Freegold Ventures (ITF), to name just a few.

Please consult our BUY&SELL list for more ideas from these sectors.

FINAL SUMMARY: *The North American Markets have a "summer opportunity" to rally higher before the start of the anticipated descent from the cycle high, sometime in late-July/mid-August. Therefore, investors should focus on late-cycle movers (Energy, Metals and Golds) and to generating cash for the potential fall bargains .*

THE TORONTO COMPOSITE INDEX



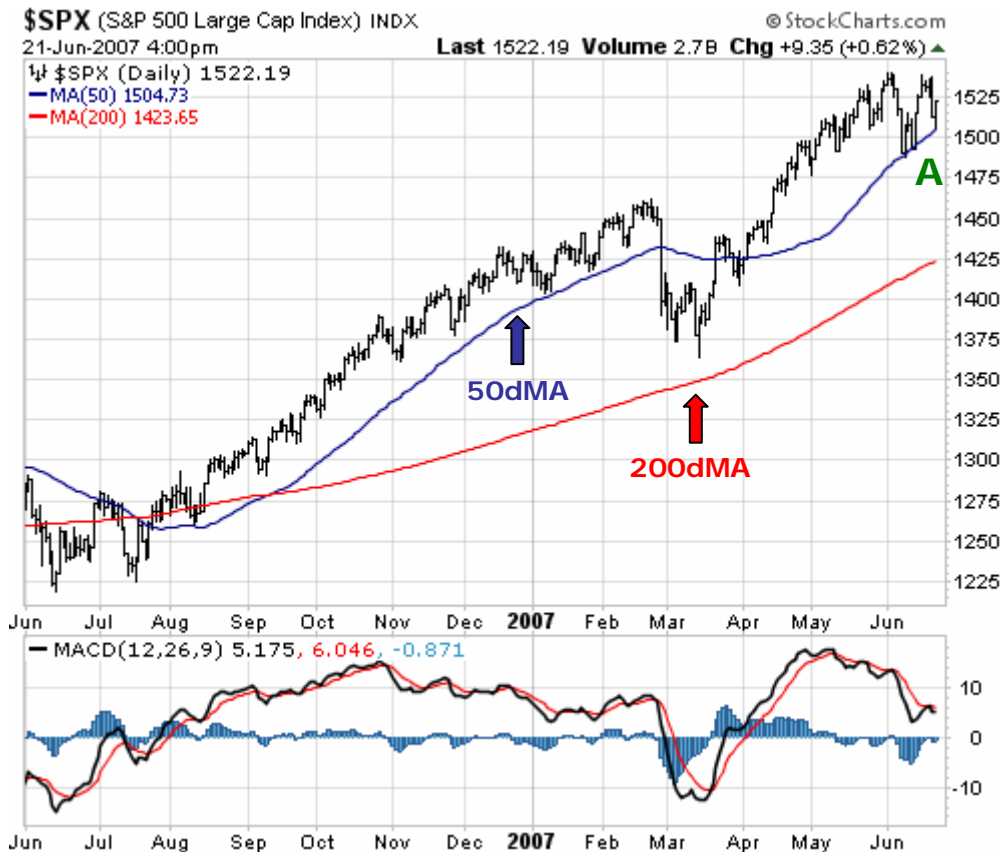
In our last Market Comment we suggested that after reaching our longstanding target of 14,000, the S&P/TSX index is likely to stay in a horizontal range for a while, roughly between 14,000 and 14,250. This may occur due to a battle between the weakening Banks and the strengthening Materials groups.

Since the index is positioned 1,000 points above its 200-day moving average (and well above its major trend line, currently at

13,600) this 1,000-point gap supports our suggestion for a fall decline. However, even a 1,000-point sell-off would still be contained within the context of a long-term bull market.

The Toronto market is home to Energy and Metal stocks – late cycle movers. Therefore, we expect the S&P/TSX Composite to outperform its US counterparts in the final months of this cycle.

THE S&P 500 INDEX



In early June we suggested that “any modest decline should be followed by another push in June toward a new all-time closing high.” This push recently took place (A), but failed to overcome the May highs.

In the next few weeks, the index should have another opportunity to reach higher levels, but it must act quickly because the upside portion of the 39-week cycle should conclude in the latter part of July.

The 50-day moving average may provide support for the index for a while. However,

given the current 100 point gap between the Index and its 200-day moving average (see chart), the danger exists of a short, sharp decline. The MACD indicator (see lower chart) already shows a negative divergence, and any decline below the 50-day moving average (currently at 1505) would trigger negative signals on other technical indicators.

The window of opportunity for the S&P 500 to reach new highs is open until the end of July. Then the downside pressure of the 39-week cycle may be too difficult to resist.

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