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**THE BULL IS TRYING TO EXTEND ITS BREAKOUT.
STOCK SELECTION NARROWS.**

The headline in the last Market Comment two weeks ago was "The upside breakout confirms the bull market, notwithstanding the corrective action." Towards the end of January the S&P 500 finally poked its head above a six-week consolidation zone and hit the 2,300 level. A small pullback was then followed by a modest move to yet more new all-time highs. The Dow Industrials, the NASDAQ, the NYSE Composite and the S&P/TSX Composite Index all made further new all-time highs in early February.

<u>The case for the bull market remains compelling, and recent action reinforces it</u>. One year ago, on February 11, the S&P 500's "Leg-5 up" began, rising from the intra-day low at 1,810. All of the action since then has been a series of "higher highs and higher lows" with the rising 200-day Moving Average offering support. Within Leg-5 the latest advance began in early November and the recent action re-confirms that this three-month move is also taking the form of higher highs and higher lows. The ability of the S&P 500 to remain above its 50-day Moving Average throughout this rally shows the underlying strength of the market. The new highs in the daily NYSE advance/decline line also confirm that this advance has a broad base of support.

From early December to late January the S&P 500 moved sideways in a tight trading range. Had this pattern broken down and launched a correction, it could have taken the S&P 500 down to its 200-day Moving Average (a potential 6% decline). Instead the move above 2,300 indicates that the bulls have enough buying power to resist the bears.

H<u>as the possibility of a correction been eliminated completely? We think not</u>. The negative momentum divergences still persist, and new 52-week highs and upside volume are not expanding. Sentiment is getting more bullish – the *Investors Intelligence* survey of investment advisers shows 62.7% bulls, its highest reading in this bull market! Confidence is also increasing – the Volatility Index (VIX, the "fear index") is at low levels last seen in 2007. Cyclical pressure will remain on the markets through March. The S&P 500 continues to hug the upper line of its trend channel, which is normal and positive, but any drastic move above it could create a sharp reversal.

In **Toronto**, contrary to our short-term expectations that a small pullback was needed, the S&P/TSX ignored its internal weaknesses and zoomed to a new all-time high. The big Banks and Materials stocks are leading the way, Energy stocks are lagging. The S&P/TSX Composite Index continues to fulfill its historical role as a late bull market leader. Toronto has further upside potential before this bull market ends.

In sum, the S&P 500 appears to have avoided some potholes on its bullish road – for the moment. The recent consolidation period has ended with a grudging and somewhat tentative upside breakout, which looks like an extension of the advance that began last November. An *acceleration* of the uptrend well into the 2,300s, on increasing volume and with more stocks making new 52-week highs, would be the ideal clincher for the bulls.

But the bull market still has to deal with its internal weaknesses, its downside cyclical pressures and the dangers of a "buying climax" (see page 2).

Investors should not chase stocks at these levels. Pullbacks will offer opportunities to buy technically-strong stocks. See our List of Investment Ideas.

David Tippin, Ron Meisels

S&P 500

The S&P 500's advance last week above 2,310 suggests that the Index is trying to move higher. The consolidation period of December/January appears to be in the process of being resolved to the upside.

For the past two months the S&P 500 has been tracking its long-existing rising trend line (see red line). To date this trend line has acted as a ceiling on higher prices, keeping extreme activities in hand. As long as the S&P continues in this manner, new highs, advances will be normal. However, a sudden, extreme, short and sharp move above this line would create a "buying climax", which would be a drastic and negative development, instantly creating a sharp reversal.

The 50-day Moving Average offers good support at 2,265. The pattern of higher highs and higher lows remains intact as long as the S&P 500 remains above 2,230. A more significant change in the pattern would only occur if there is a breakdown below 2,185. The S&P 500 can easily tolerate a small pullback in the weeks ahead without disrupting the overall positive pattern.

The S&P 500's challenge is to break out through the overhead resistance posed by the upper boundary of its trend channel. If this occurs, on increasing volume, then it is blue sky territory for the bulls.

S&P/TSX Composite Index

Two weeks ago we said that "Toronto's most pressing issue is whether the negative divergence in internal momentum is going to undercut the overall up trend." The S&P/TSX Composite Index's response was to bounce off the support of the 50-day Moving Average and then move to new all-time highs.

Toronto continues to move higher within its trend channel and the S&P/TSX Composite Index has remained above its 50-day Moving Average for nearly three months. This is a sign of a very strong market. There is good initial support in the 15,250 to 15,300 area.

The rising 200-day Moving Average offers further support just under 14,700. It would require a decline below 14,300 for the bull market structure to be undermined.

Toronto seems determined to go higher and fulfil its late bull market mission as a strong performer. The 15,000 level should contain any pullbacks. But with the internal momentum situation gradually improving, a move to at least 16,000 is possible in the near-term.

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