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THE S&P 500 IS NEARING THE HIGH FOR THIS RECOVERY RALLY. ANOTHER DOWN-LEG WILL COMPLETE THE CORRECTIVE PATTERN.

Two weeks ago our headline was "some further upside is possible but the S&P 500's recovery rally is approaching major overhead resistance." We proposed that the bulk of the gains "have already been made, although some sectors will continue to do well and outperform." And we concluded that further weakness would eventually appear, and that "a prolonged base-building process needs to occur before the next major bullish up-leg can start."

The S&P 500's rally gained an impressive 35% in five weeks, taking the Index up towards its 200-day Moving Average. Most other major market indices in New York performed similarly. The NASDAQ is the outstanding performer, regaining a foothold above its 200-day moving Average, and signalling that it is going to be a leading participant when the bull market finally resumes.

While the percentage gains have been large, the overall quality of the rally presents a more mixed picture. Daily advance/decline figures remained strong until the past few days, but volume is weakening – we had a 1-10 Upside/Downside day last Friday - and the rally has been concentrated in a narrow range of sectors and stocks including some large-caps. At no time during the rally have more than 20% of NYSE stocks been able to trade above their respective 200-day Moving Averages. Most importantly, as we expected, the S&P 500 has begun to slow down as it reached towards the two-thirds retracement area and a long-standing zone of overhead resistance.

The S&P 500 is not overbought. Upside momentum remains in good shape and investor and advisory sentiment, as measured by AAII and Investors Intelligence, is lacking confidence (a contrary indicator) so further modest gains are possible before this recovery rally finally ends. Some bargain hunters who took positions near the March lows will look to take profits and most of the fuel from recent buying by corporate insiders is probably used up. A small extension of the pullback of late last week could be followed by choppy trading within the 2,700 to 3,000 zone for much of May. However, at some point the S&P 500 is going to probe down below 2,700 (the final "C" down-leg) and retest towards the March 23rd low – likely the 2,500 to 2,600 area. Some panicky selling may occur if the 2,700 level is breached. This might take as long as mid-June to unfold. <u>But this is all part of the necessary time needed to build a sustainable base prior to launching the next major up-leg of this bull market</u>.

Toronto's S&P/TSX Composite Index has broken above its 50-day Moving Average and is nearing its two-thirds retracement level. Participation in the rally is reasonably good, with two-thirds of Index stocks reaching above their respective 50-day Moving Averages. Golds, and some Energy and Technology stocks have been among the leaders but Toronto is still being slowed down by the under performance of the large Banks. Further gains are possible in the short term but the S&P/TSX Composite Index will probably need to retreat back to at least the 13,000s before its corrective pattern finally comes to a close.

New York is well advanced in the middle "recovery" phase of this bull market correction. Some further gains for the S&P 500 are achievable in May, possibly enabling the Index to get near its 200-day Moving Average. But <u>as this rally extends, risk is growing</u>. We continue to expect that another declining phase – the final "C" down-leg – will be seen before the correction ends, likely in June. Encouragingly, the odds are lessening that the next pullback will challenge the March lows. Once the base is built, the secular bull market will start a more sustainable upside move.

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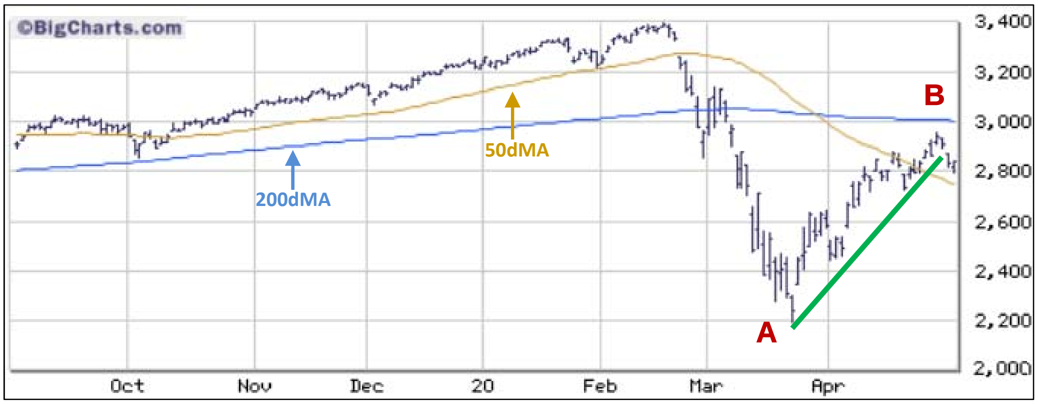
S&P 500



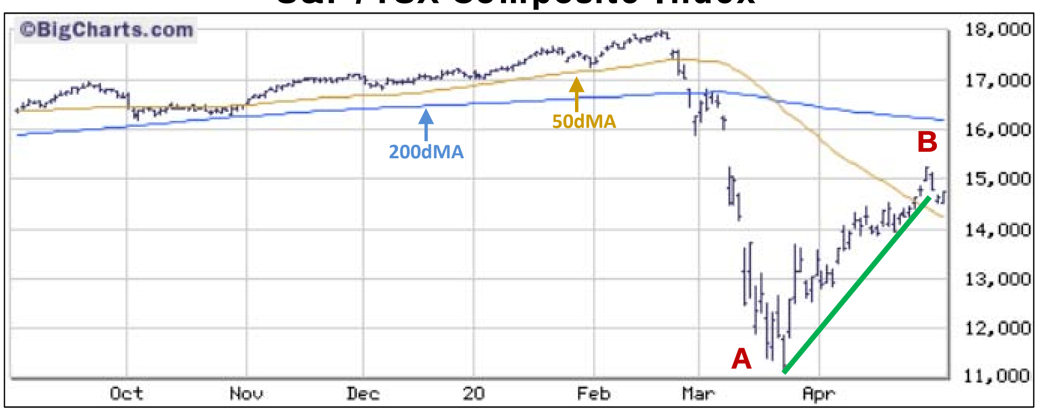
The S&P 500's extensive advance off the March 23rd low took the Index very close to both its two-thirds retracement level and its 200-day Moving Average. The large gains made in such a short time make it almost certain that the S&P 500 requires at least a pause to gain its breath.

The huge "A-down" decline to late-March has now been followed by a substantial "B-up" recovery phase. It is highly likely that this recovery phase has seen the best of its gains; the up-trend line was violated at the end of last week. It is also highly likely that a final "C-down" phase – which we expect to get underway later in May – will be much less volatile than the one in March.

A trading range between 2,800 and 3,000 may precede the early stages of "C-down", since considerable overhead resistance appears near 3,000. The 2,500 to 2,600 area might be the final low point for the correction.

A very strong April should gradually give way in later May to choppy and range-bound activity. A full retreat to the March low of 2,192 is <u>not</u> expected. The next four to six weeks should see the completion of the base-building process.

S&P/TSX Composite Index



The 15,700 level is the two-thirds retracement target for the S&P/TSX Composite Index and last week the Index came close to this area. The 50-day Moving Average posed little obstacle as Toronto rallied, but the pullback of late last week has quickly brought the S&P/TSX Composite Index back towards this Moving Average. As with other Indexes, some further limited upside is possible but Toronto is getting quite stretched after a five week rally.

The S&P/TSX Composite Index should see support appear first at 14,000. Below this, the 13,000 to 13,500 zone should offer additional support.

Our preferred scenario involves a combination of further upside probes towards the mid- to high-15,000s in the coming weeks, along with pullbacks below 14,000.

The S&P/TSX Composite Index is likely approaching the latter stages of its "B-up" recovery rally. We expect this will give way to another period of relative weakness – by no means as volatile as the initial decline in March – which will be an essential part of the base-building process. This should also allow some of the laggard sectors, such as the big Banks, to strengthen in preparation for playing a more active role in the next major bullish up-leg.

Dow Industrials

Last week the Dow Industrials broke above its 50-day Moving Average and the 50% retracement target (our maximum recovery objective) but failed to go much higher, stopping well below the two-thirds retracement level. Upside resistance was encountered near the late-February low point of the first decline from the all-time high (an example of support then turning into resistance). This is also an area of longer-term resistance.

The Dow Industrials still has the potential to reach as high as the two-thirds recovery target (about 25,800). The declining 200-day Moving Average is at 26,500. However, we doubt the Dow Industrials has the immediate strength to reach either of these two levels since its uptrend-line was violated recently.

After over a month of sharp advance, a number of small rallies and pullbacks and further base-building is likely to complete the entire correction process.

Support should come at 22,000 and then at 21,000.

We expect that the Dow Industrials will trade in a choppy manner between 21,000 and 25,000 for the next few weeks. This trading range will be part of the process of building a base for a new bullish up-leg.

FTSE

A month ago our assessment of the FTSE suggested that the attempt at a recovery rally from its mid-March lows would eventually peter out. We saw a potential for the recovery rally to reach a 50% retracement level near 6,300, but we concluded that another re-test of the 4,800 to 5,000 area, a long-term support level, was very likely.

The FTSE was able to get above its one-third retracement level in April but its recovery rally has yet to achieve the 50% target at 6,300. A momentary probe above the declining 50-day Moving Average was quickly pushed back. Lack of upside volume is not helping the recovery's cause.

The FTSE is not overbought and further upside progress towards 6,300 is possible, but above that level the FTSE would encounter more resistance in the high 6,000s, (the two-thirds recovery area and where the declining 200-day Moving Average will soon be located). Near-term support is at 5,600 and 5,400.

More base-building is needed for the FTSE. We expect an eventual retreat towards 5,400, and possibly into the low 5,000s as the March lows and long-term support are re-tested.