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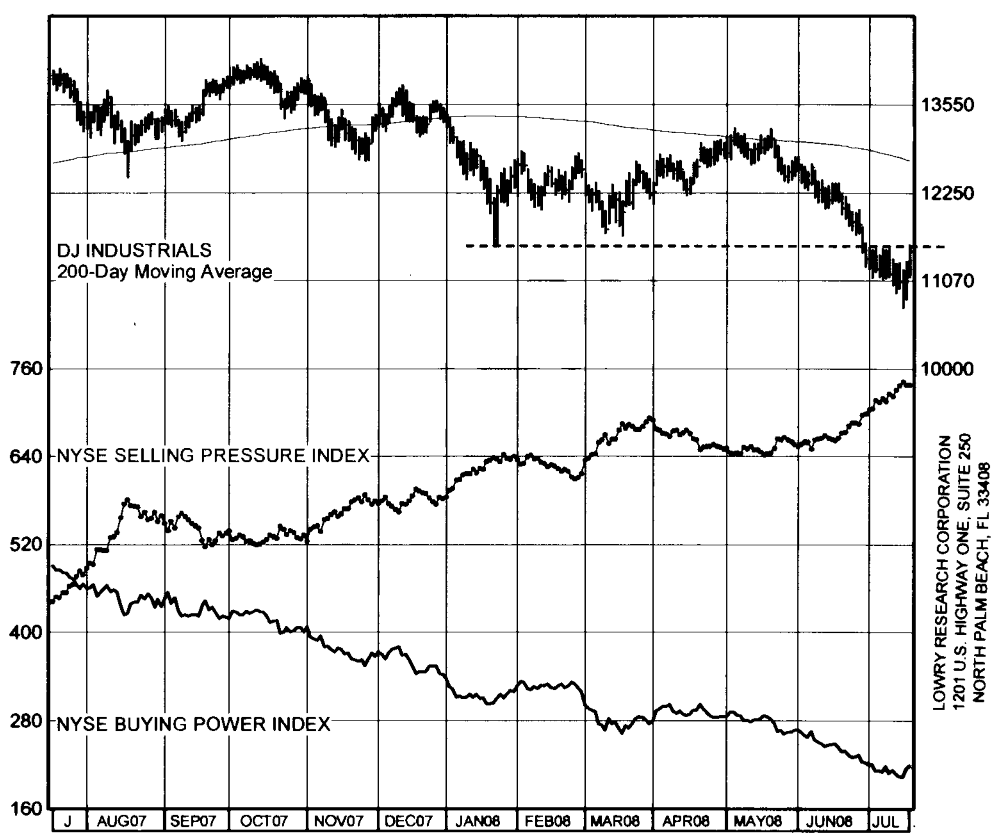
# CAPITAL MARKET UPDATE

July 21, 2008

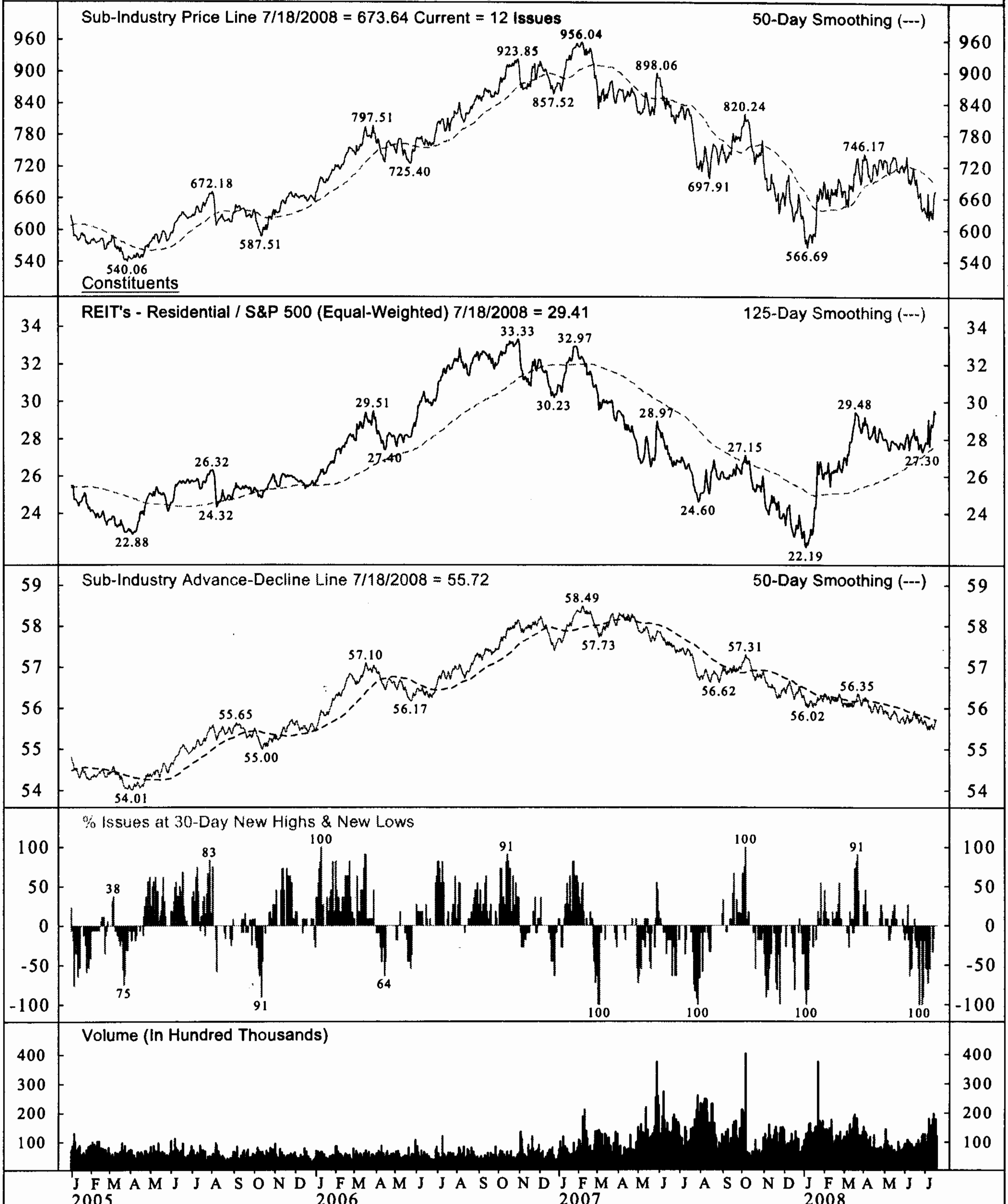
***SUMMARY AND CONCLUSION:* Our Short Term model for domestic equities went Positive last week, along with a few equity sub-models, thus catching the explosive rally of the last few days. Our Intermediate Term Stock index shot up to a high Neutral 51½%, suggesting that Wednesday may have marked an Intermediate Term bottom as well. However, we need to observe another day or two of trading before officially upgrading the Intermediate Term to Positive. Global bourses have shown less improvement, and are clearly not yet Positive. The Long Term outlook for equities remains Negative. The Models for Government and High-grade Corporate Bonds remain Negative across all time frames, both domestic and global. Our Gold and Commodities models are mixed. Our Gold models are all still Positive, but one of our Commodity Index models went Negative last week, and the other is close to doing so. We do not have a model for Crude Oil per se, but we have been looking for a 25%-35% bull market correction in the Energy Commodities. Also, our sub-model for Energy Stocks went Negative a fortnight ago. These developments enhance the immediate prospects for equities and diminish those for Commodities. Our models for the US Dollar remain Negative across all time fames, but we are not now comfortable in this venue.***

**Stocks:** Our June 9th update pointed out two very significant developments. One was that a Bradley Date had just become active, which suggested a probable cyclic top for asset classes such as Crude Oil and the *Dow Jones Transports* that were making all-time highs into that date. The other key fact was that *Lowry's* "Buying Power" had just hit an all-time *low* (below). Since Buying Power has never made a new low 8 or 10 weeks *after* a major Stock market low, the odds were that the March lows would not hold. These omens proved right as Stocks went on to make new multi-year lows in July.



***We still own Apartments. They are never big gainers, but in this low-return environment, their 8% year-to-date looks pretty good.***

## NDR REIT's - Residential Sub-Industry vs. Breadth Indicators



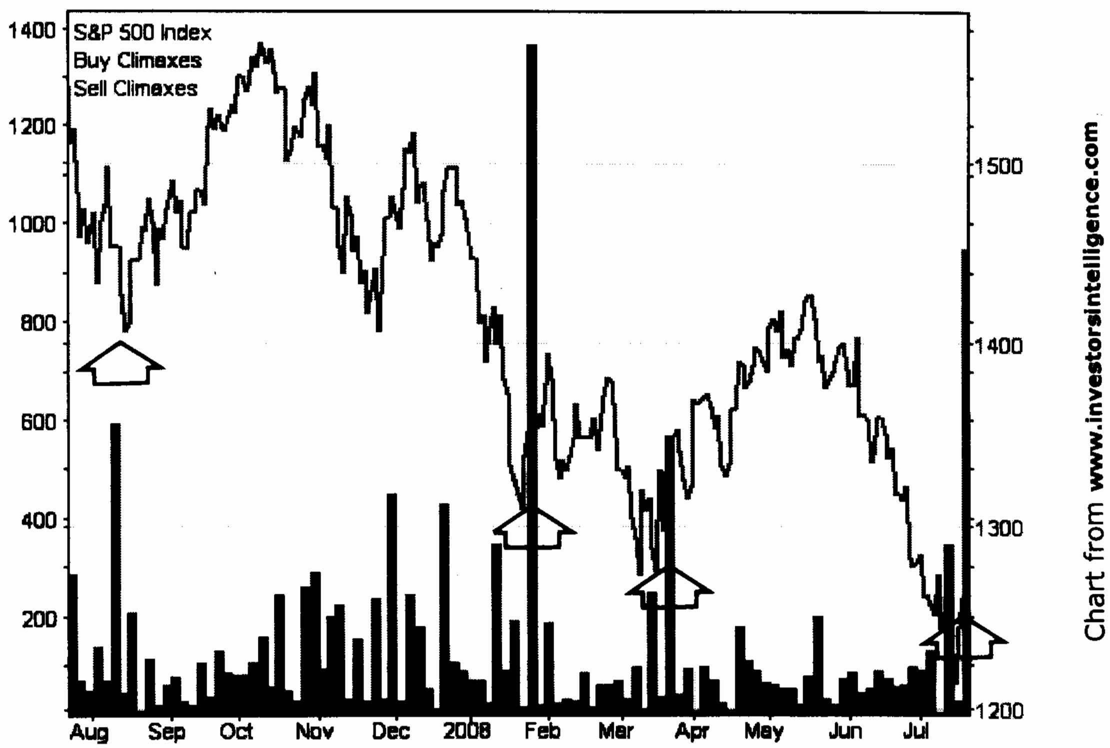

Sub-Industry Performance Analysis Dates:
(2/02/1981 - 7/18/2008)
Current Mode Entry Date: 6/17/2008

SIB
4403

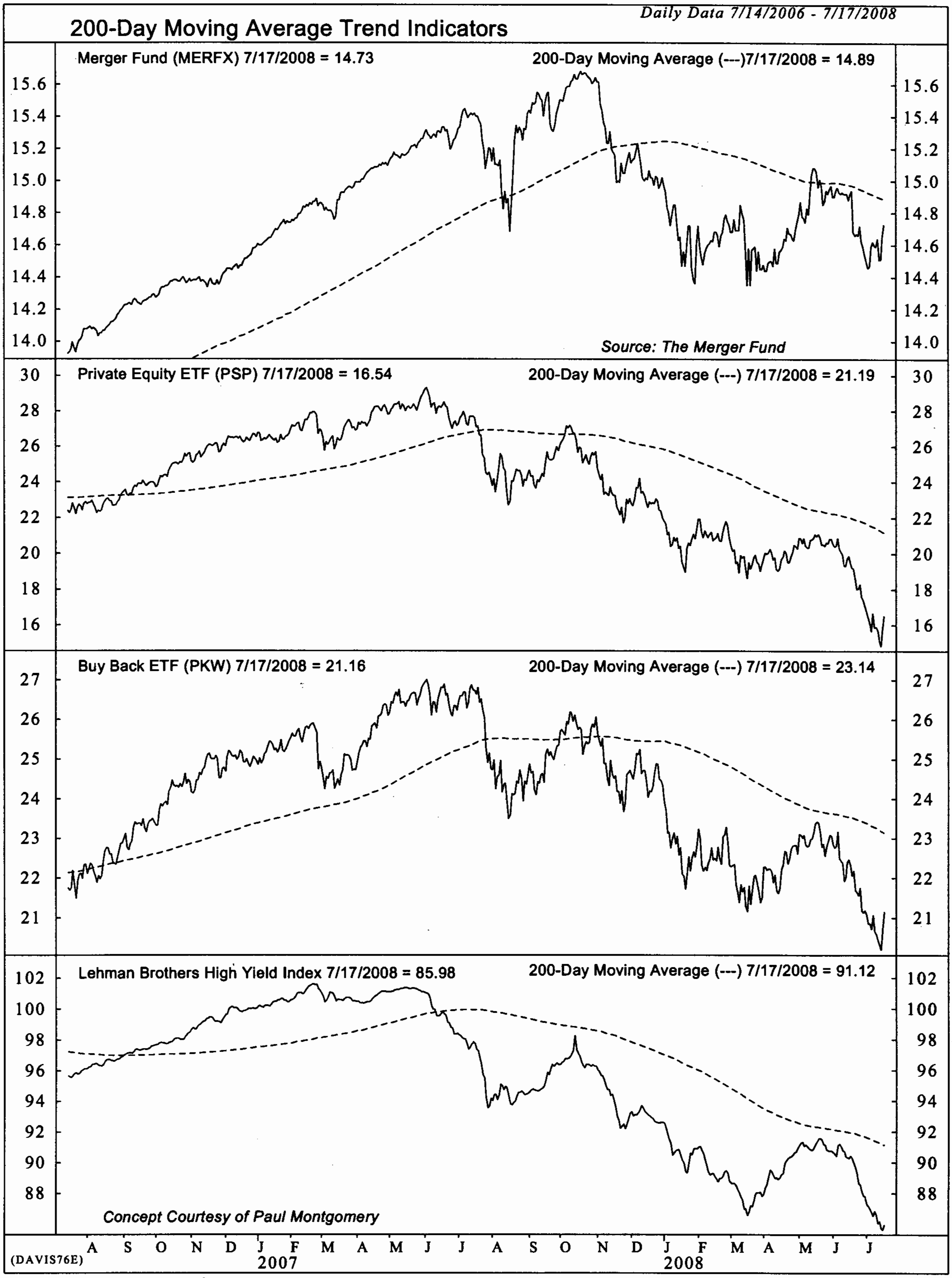
| Performance When Price, A/D & RS Lines are: | % Gain/Annum | % of Time |
|---|---|---|
| Three Above Smoothings | 10.7 | 30.3 |
| * Mixed Signals | 6.8 | 45.7 |
| Three Below Smoothings | 2.2 | 24.1 |

By mid July, the decline had been so intense that Stocks had become severely "oversold" by numerous metrics, and at that point the market had an upturn of sorts--not in terms of points gained, but rather in terms of a large number (521) of "Selling Climaxes." These factors, along with multi-decade extremes in pessimism prompted us to issue a Short Term BUY signal, two days before last week's huge rally. But that timely rally now leaves us with the huge problem of determining how *significant* last week's low is likely to be. Is it just a Short term low, or is it an Intermediate term low, or is it a Major low, in which case new all-time highs are in prospect? There is evidence for each of these cases. We initially assumed this to be a Short term low because there were no Cycle Dates last week; whereas three cycles will become active the first half of August, making it a more likely time for a major reversal. However, we may be giving cycles more importance than they deserve. This year "crisis events" and Fed initiatives have given more timely signals than our cycles; e.g., the *SoGen* crisis on January 22nd, the *Bear Stearns* episode on March 17th, and the *Fannie/Freddie/IndyMac* crisis last week. Also, another reason we gave a Buy was the *S&P 500* had been down six weeks in a row. We did not realize it until we read Jason Goepfert, but only three times in history has this average been down seven weeks in a row--and each time led to a major rally. So maybe the recent 6-week streak is a more powerful factor than the August Cycle Dates we have been waiting for.

The same thing may be true of Selling Climaxes. After 521 two weeks ago, we got 959 last week. Note below how large numbers of Buying and/or Selling Climaxes led to intermediate moves in stock prices more often than just short term moves. So while we *did* use Selling Climaxes to catch last week's rally, maybe we underestimated the potential strength of the upturn.



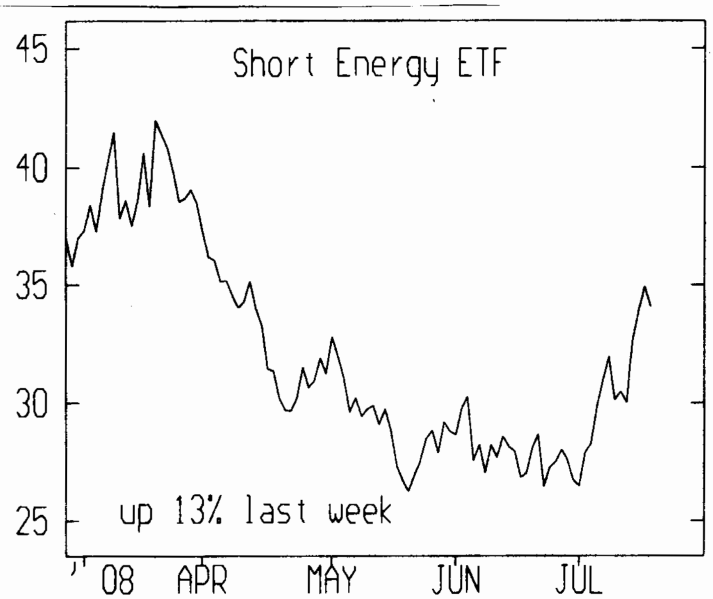
***Financial Engineering "tells" uptick in a bear market***

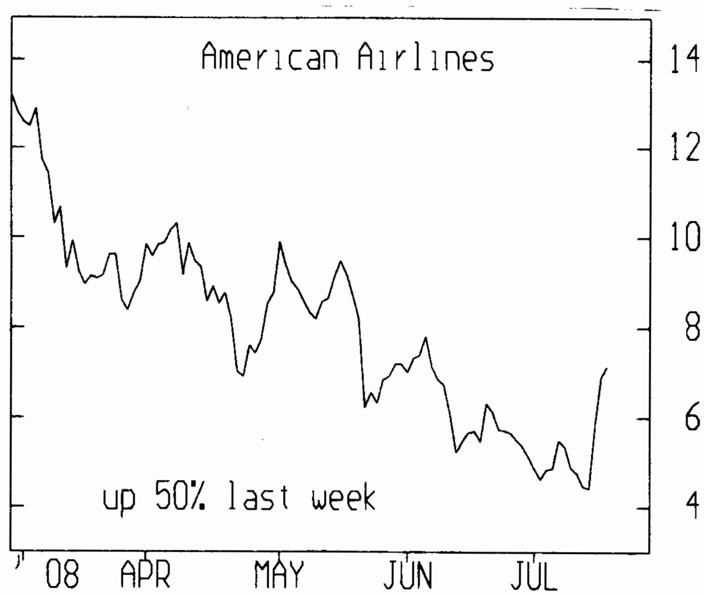


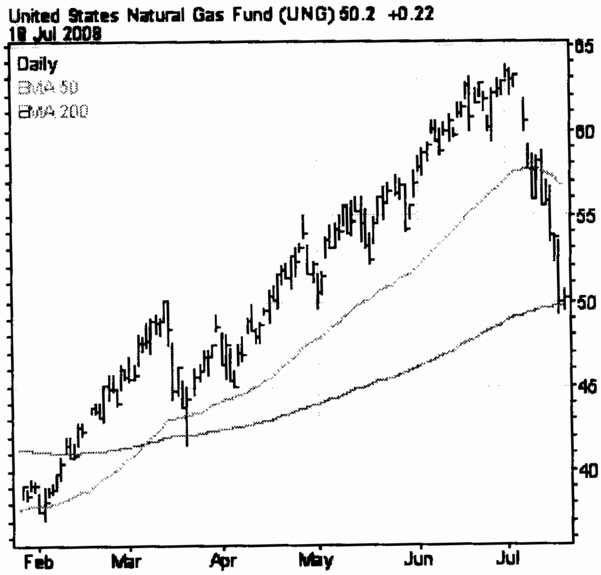
Some other developments hint that this rally may be more than we originally expected. For one thing last week saw the biggest one-day rally in history for the Airline Index and for the Financial Stock Index, along with the biggest one-week decline ever in Crude Oil. These huge gains in Financials and Airlines aren't definitive indications of a new bull run--some of the sharpest one-day and one-week gains in stock indexes have come during *bear* markets; e.g., the *DJIA* in the 1930s and the *NASDAQ* in 2000-2002. But the dramatic changes in *leadership*--Financials and Airlines from down to up, Energy, Foods and Materials from up to down--are characteristic of intermediate term trend changes. We had expected the top in Crude Oil, and we *did*, in fact, suggest the Airlines and the Short Energy ETF as ways to play the expected drop (see below). But we *did not* suggest that the drop in Crude Oil would start an intermediate term bull run for the stock market in general. We may have been remiss in that regard.

Then again we may not have been remiss, because the *Lowry's* data--which have handled this stock market better than any other protocols for the last year or so--have not yet signaled that we are having anything more than a Short term advance. For example, we have not yet seen typical bottoming action in the form of a string of 9-to-1 down days followed immediately by a 9-to-1 upday. And we have not seen any surge in Buying Power or a collapse in Selling Pressure. In fact, last week when the *DJIA* soared 300, 200 and 50 points on three successive days, Selling Pressure diminished by a very modest 5 points the first day, was flat the second day, and actually upticked a point on the third day. This action suggests that big hands still have stock to sell, and/or that animal spirits have not revived sufficiently to start a major bull campaign.

Not even *Lowry's* is perfect, and so we *could* have just seen a major low. After all, besides all the other bullish developments, last week saw huge volume and near-record lows; we had a 14-year high in pessimism; and newspapers all across the country, on the front page above the fold, pictured a terrified public lined up to try to get their savings out of the bank. All this *could* have just put in a major bottom. Any further strength in our model and we will be forced to add exposure. But for now we have a Short term Buy only.

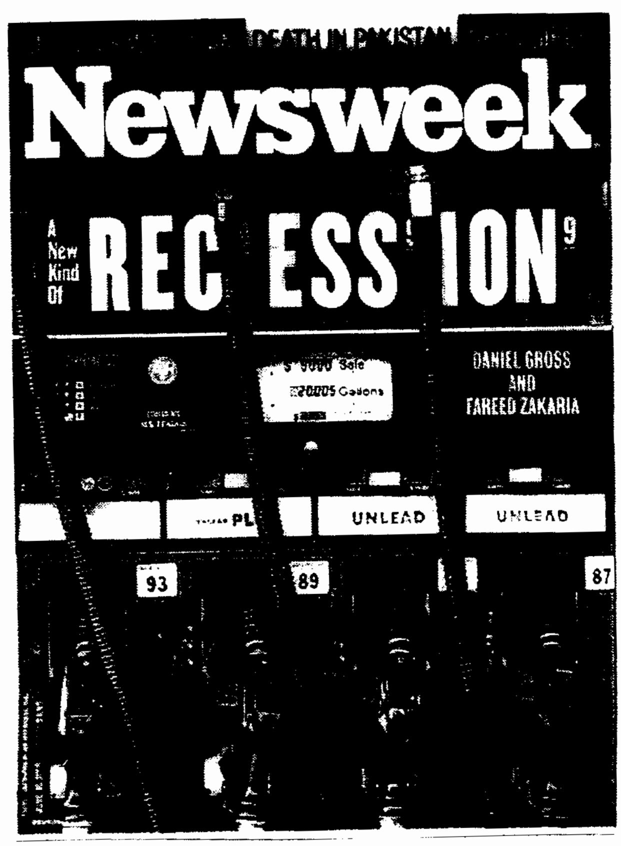





***Natural Gas is off 25% from its high.***

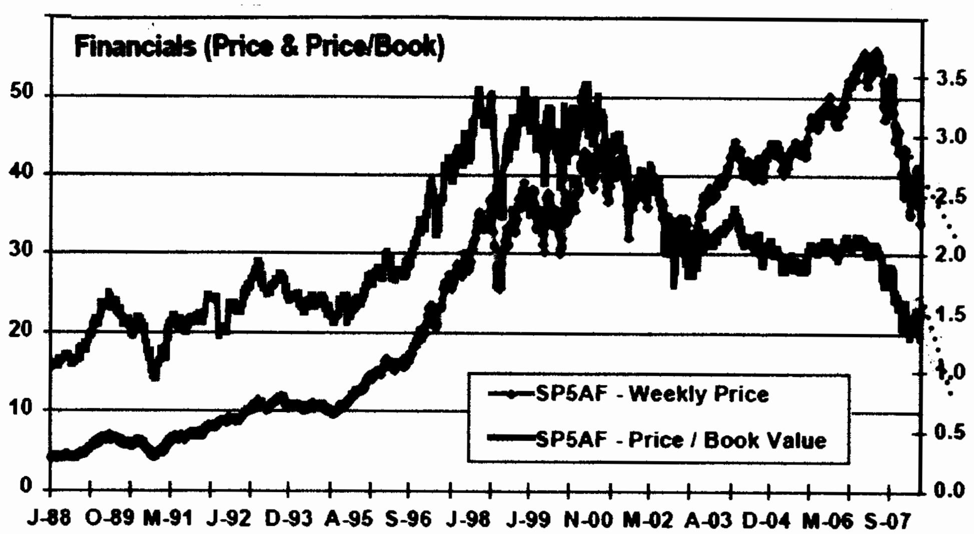
***This Magazine Cover Story in June called for a July top in Energy prices.***



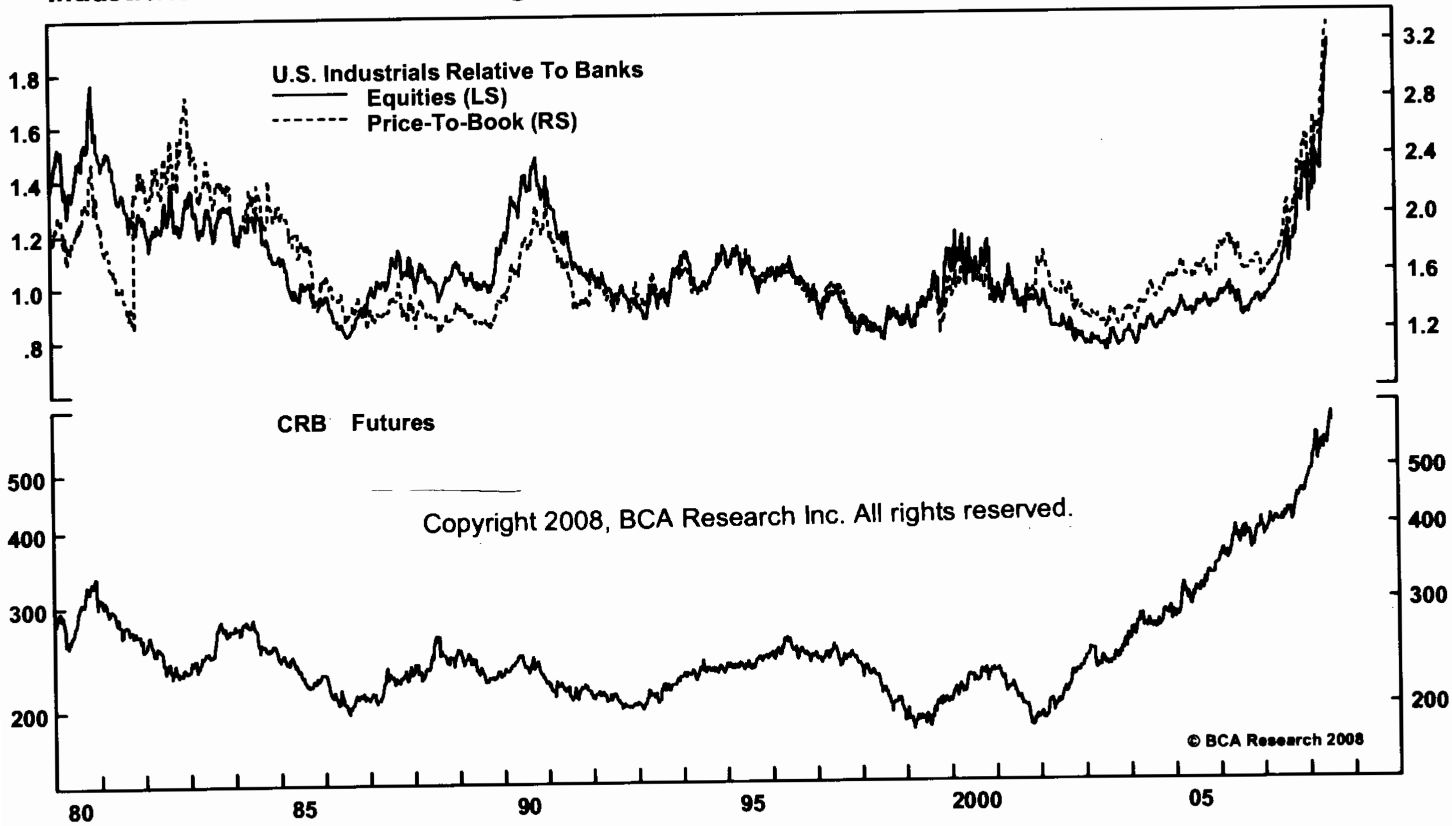
**Bonds:** Our Bond models are all net Negative. Our asset allocation algorithm, which is based on the *Bond/Stock Yield Ratio*, indicates that dedicated portfolios should still be 100% Treasuries/0% Stocks. However, that allocation very likely will be reversed soon if the Intermediate term trend in Stocks has in fact bottomed.

**Gold and Commodities:** These asset classes are very mixed right now. Our models for Gold and Gold Stocks are Positive, but our models for Energy Stocks are Negative. We model two broad Commodity Indexes and one is on a Sell while the other is still on a Buy. We wrote June 12th that the then current **Newsweek** Cover Story, which featured a Gasoline pump, was the most powerful signal possible that Crude Oil was soon to top--only the precise timing remained to be puzzled out. The *average* lead time has been about four weeks, and almost exactly four weeks after this Cover, on July 11th, Crude Oil made an all-time high and then reversed. Cover Story tops are usually good for several quarters, but there are a number of complicating circumstances this time. One is that the long term cycles for Real Assets versus Financial Assets are still bullish. In terms of *time* they started up in 1998 and should have several years left to run. Also, we were looking for only a 25%-35% bull market correction in Crude, but Natural Gas has *already* dropped 25% just during the last fortnight. And during that same short period of time, Energy Stocks have gone from overbought to oversold--based on the percent of issues above their 10-week and their 30-week moving averages. So we covered some of our shorts in Energy.

Our Energy short and Airlines long picks were based strictly on Technicals such as the ratio of Energy Stocks to Financial Stocks, and on Sentiment measures such as Magazine Covers. However, we are not opposed to looking at Fundamentals, and it is worth noting that at last week's lows the Financial Index was around 86% of Book Value and the Airline Index was about 14% of Sales. Admittedly *Bear Stearns* reported \$80 or so of Book Value shortly before it vanished, but the Book of a Financial Index should be somewhat more reliable. And in terms of *price*--though not in terms of *time*--Financials should be approaching the end of their horror story. Also, the Airlines have huge Sales Revenue and huge Operating Leverage. They are now selling for pennies on each dollar of Sales. They might never make a profit, but with this much leverage, any hint of better things to come could send these dogs running--for a while anyway.

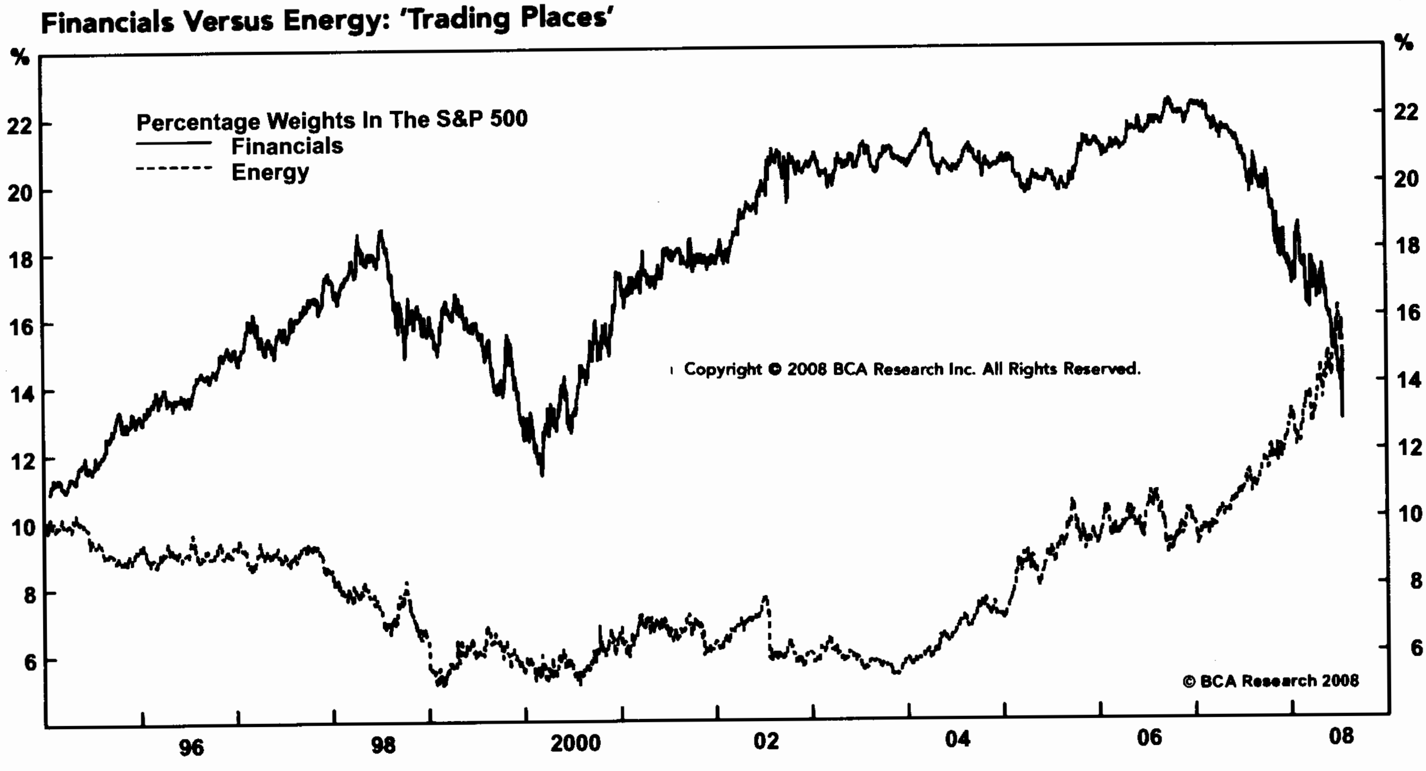


**Industrials Relative To Banks: Long-Term Perspective**

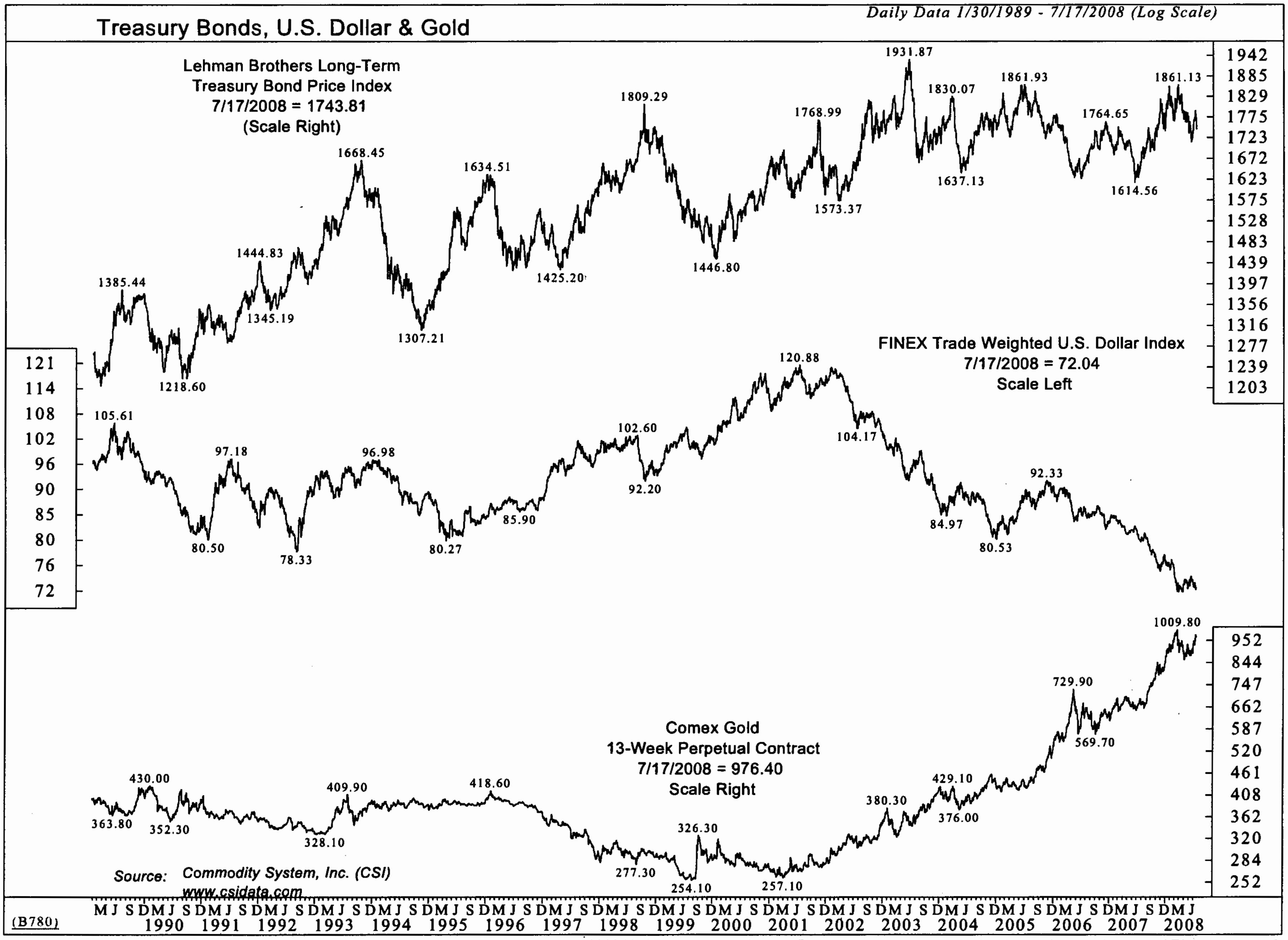



***In terms of Price, Financial Stocks and have gone down far enough relative to Industrial Stocks. And in terms of Price the CRB has risen high enough. And In terms of Price the relative fortunes of Bank Stocks and Energy Stocks appear to have come full circle. In terms of Time, however, Real Assets should have a longer day in the sun than they have enjoyed thus far. We are out for now, not for ever.***

**Financials Versus Energy: 'Trading Places'**



**No obvious trades here**



# CAPITAL MARKET UPDATE

As of July 20, 2008

## MAJOR MODELS

| | | |
|---|---|---|
| Domestic Stocks | Long Term | Negative |
| | Intermediate Term** | Negative** |
| | Short Term** | Positive** |
| Gold Complex | (Short/Intermediate/Long Term) ** | Positive/Positive/Positive** |
| U.S. Treasury Bonds | Long Term | Negative |
| | Intermediate Term | Negative |
| | Short Term** | Negative** |
| US Dollar | Long Term | Negative |
| | Intermediate Term** | Negative** |
| | Short Term** | Negative** |
| Commodities | Net of three models | Mixed |
| Cycle Dates | first two weeks of August | |

## SUB-MODELS

| | |
|---|---|
| NASDAQ-only Stocks | Positive |
| Small Cap-only Stocks | Positive |
| Energy Stocks | Negative |
| Global Developed Market Stocks | Negative |
| Global Emerging Market Stocks | Negative |
| Japanese Stocks | Negative |
| China Stocks | Negative |
| U.S. Real Estate | Positive |
| Global Government Bonds - Hedged | Negative |
| Global Government Bonds - Un-hedged | Negative |
| Emerging Market Bonds | Negative |
| Junk Bonds | Negative |
| Convertible Bonds | Negative |
| TIPS | Positive |
| ZEROS | Positive |
| Capital Market Class(dedicated portfolio)** | Cash over Bonds over Stocks** |
| Domestic Style/Venue/Sector** | LargeCap/USA/Biotech** |
| Bond Put/Call Ratio Level | Neutral |

**these models are currently unstable