



Markets This Week

April 8, 2006

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Answer to the Quiz

Investment Idea

Question:

What is the fastest growing investment segment?

Answer:

Private equity - as many institutional investors are gradually diversifying away from the traditional asset classes (i.e. stocks, bonds and cash) and moving to alternative assets.

What is private equity? Private equity, unlike public equity, is held privately and not traded on the public stock exchanges. In comparison with public equity, private equity is less liquid, subject to much less scrutiny by authorities, and offers about a 3 – 7% higher return per year. Currently, the growth of private equity, especially in emerging markets, is nothing short of phenomenal. For instance, in 2005 private equity firms raised an unprecedented US\$21 billion in emerging markets, which is 3.5 times the US\$6.1 billion raised in 2004.

N.B. The alternative asset class is comprised of the following 4 segments: hedge funds, real estate, commodities and private equity.

Quiz

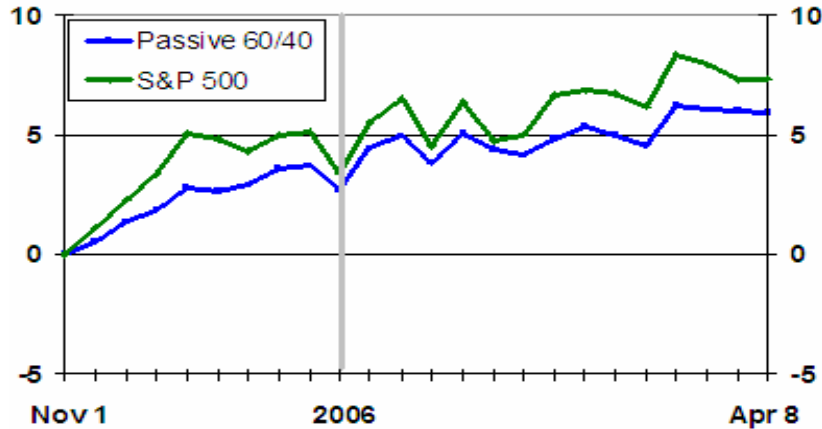
Which feature is not available for investors in private equity?

- A) High returns
- B) Good corporate management

- C) Lack of media attention
 - D) Liquidity
- Answer at the bottom of the newsletter.

Our Portfolio

Chart 1. Cumulative Returns (%)



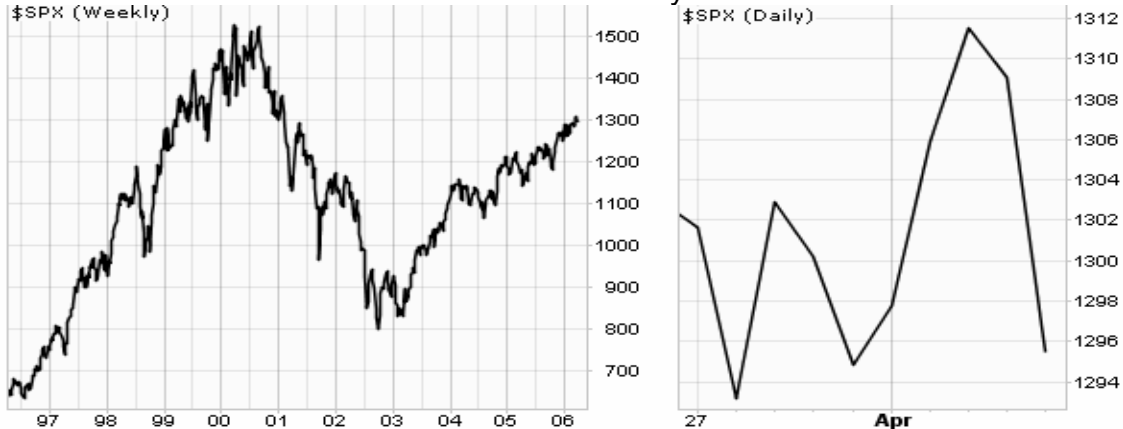
Since inception, in terms of return, the S&P 500 has outperformed our passive and conservative 60/40 portfolio. Last week, both the S&P 500 index and our portfolio were largely unchanged.

Market Highlights

April 1 – April 7, 2006

- This week, the US market had a change of heart. At first it moved up strongly then it took a big dive last Friday (Charts 2 & 3). Friday's employment data was a bit stronger than expected with 211,000 new jobs however the previous month number was revised down. Thus, the combined result was in line with expectations.

Charts 2 & 3. S&P 500: 10 Years and Last 10 Days



Charts courtesy of StockCharts.com

- The US equity market has been stuck in a trading channel since January 2004. We believe there is an increased probability that, in the near term, the market will decline towards the lower band of the channel (Chart 4). Please see our discussion in the Behavioral Finance Indicators section.

Chart 4. The Channel since 2004.



Chart courtesy of StockCharts.com

- The Canadian markets finished the week marginally up due to higher resource prices and strong macroeconomic fundamentals (Charts 5 & 6). The Canadian employment data was very strong with 51,000 new jobs added, and a corresponding unemployment rate of 6.3% (the lowest since 1974). The Canadian dollar has gained over 50 basis points on this news.

Charts 5 & 6. TSX Canada: 10 Years and Last 10 Days



Charts courtesy of StockCharts.com

- Bond yields continue to go up (while bond prices decline) as increases in crude oil and other commodity prices add to inflation worries.
- It appears that economic recovery in Japan is gaining solid traction. The Bank of Japan's Tanken survey of business confidence shows significant improvements. In addition, the Nikkei index continues to set new highs.

Worth Watching

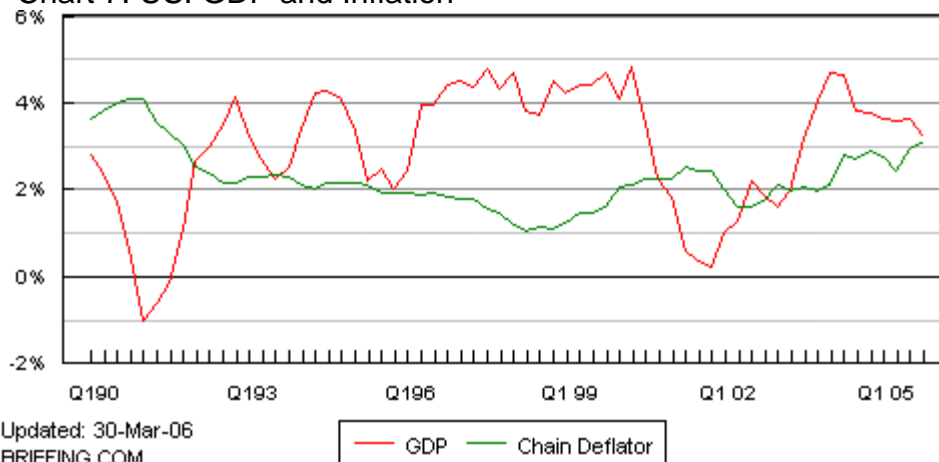
- Americans are very optimistic by nature. More than 4 in 10 are somewhat confident they will have enough money to retire comfortably. Sadly, more than half of Americans have less than \$50,000 in their nest egg (excluding the value of primary residences estimated at \$160,000). Considering the insufficient safety net after retirement, many experts suggest having about 20 times the annual pre-retirement income set aside to enjoy a comfortable retirement. The line-ups for lottery tickets are already forming.
- Despite not having even one mile of expressway 18 years ago, China now has the second most extensive highway network in the world, behind only the United States. The current Chinese industrialization is quite comparable with the situation in Western Europe after WWII. As a result of the Marshall Plan, Western Europe got a head start towards solid economic progress combined with a comfortable standard of living. We believe China is on its way to repeat the example set by Western Europe.

Economic and Valuation Indicators

Economic Performance

The US economy continues its steady course, albeit at a slower rate than that seen a couple of years ago (Chart 7). The inflation rate is steadily rising but it is still moderate by historical standards.

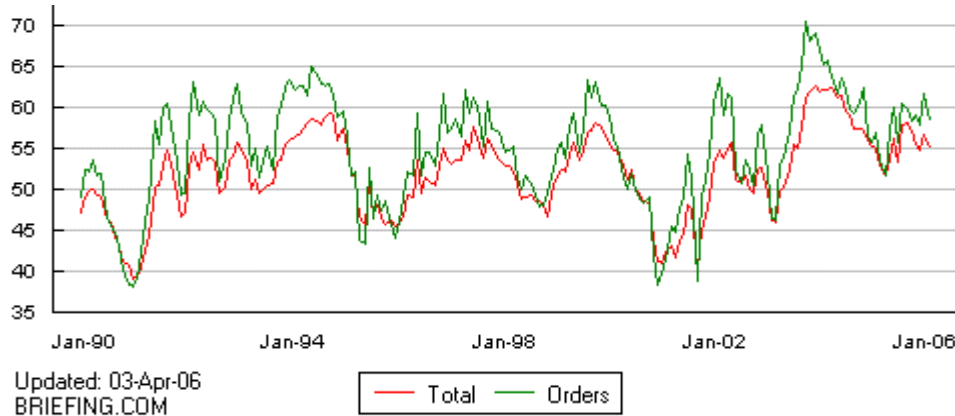
Chart 7. US: GDP and Inflation



ISM

The ISM index is one of the best leading indicators of US economic activity and is viewed as a swing factor preceding economic upturns and downturns (Chart 8). New orders provide the forward read on production and employment. Currently, the ISM index and new orders signal a continuation of economic expansion.

Chart 8. US: ISM Index



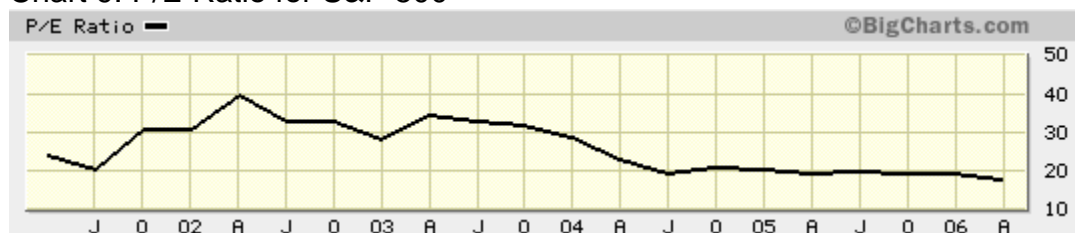
Yield Curve

The shape of the yield curve is often a leading indicator of both economic activity and the stock market. The current upward slope indicates the continuation of economic growth. [View yield curve](#)

Price-to-earnings Valuation

The most common valuation measure for equities is known as the P/E (price to earnings) ratio. Presently, the S&P 500 is somewhat overpriced, but not too overpriced at its current level of 18.12 (Chart 9). The current low inflation rate environment is more supportive of higher valuations because earnings are not reflecting a high inflationary component.

Chart 9. P/E Ratio for S&P 500



N.B. Our analysis focuses mostly on the US economy, given its size and importance. Comparable Canadian data can be found in the Statistics Canada and Bank of Canada databases.

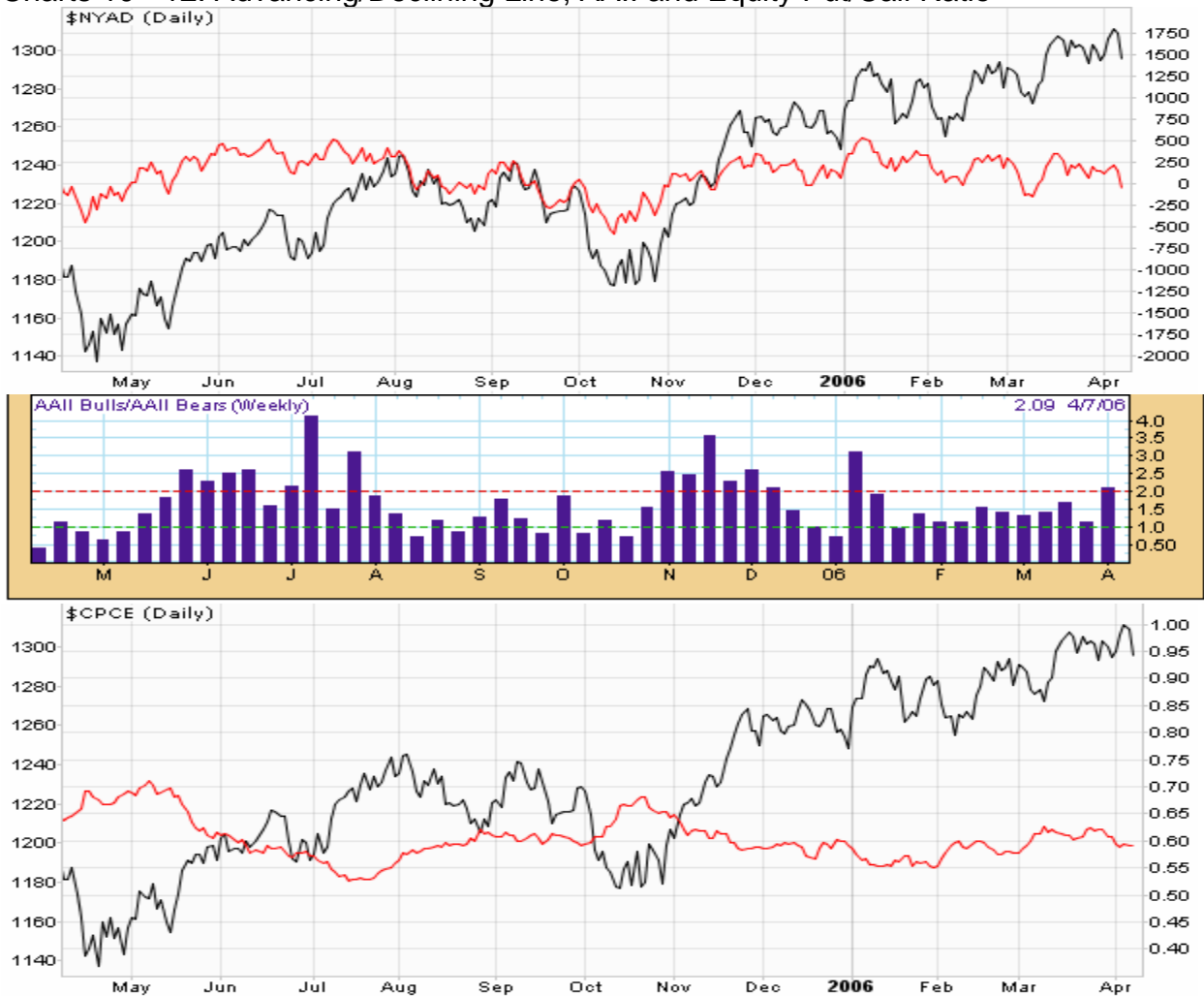
Behavioral Finance Indicators (see explanation)

It looks like the equity market may be ready for a downturn in the short-term. The advancing/declining line signals a divergence between prices and fundamentals, while the majority of unsophisticated investors are showing a rising degree of confidence. For an historical comparison, please look at August 2005 on Charts 10, 11 and 12.

Please consider the following factors:

- Chart 10 – the divergence between prices (black line) and the advancing/declining line (red line)
- Chart 11 – the confidence of small investors (as represented by AAll, i.e., the ratio of bulls/bears is low) is rising
- Chart 12 – the declining put/call ratio indicates that small investors are showing confidence that the market will advance (red line)

Charts 10 - 12: Advancing/Declining Line, AAll and Equity Put/Call Ratio



Charts courtesy of StockCharts.com and DecisionPoint.com

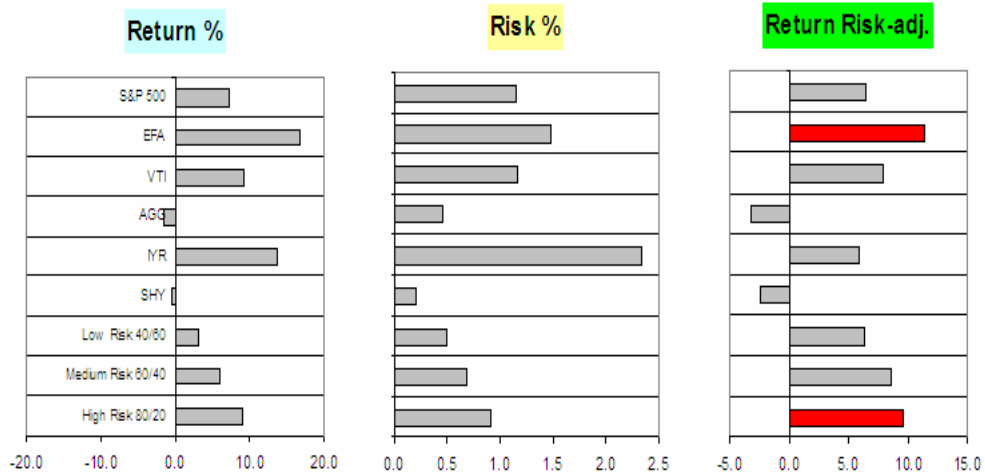
Our Model Portfolios

US Model Portfolios. Conclusions based on Charts 13 - 15.

Since inception, the EFA (Morgan Stanley Index for Europe and Asia) has been the best investment on a risk adjusted basis. Our High Risk (80/20) portfolio has managed to surpass the almighty S&P 500 index. It is quite an achievement given that 84% of mutual fund managers cannot outperform an index.

Note: The names/symbols of securities are provided at the bottom of this section.

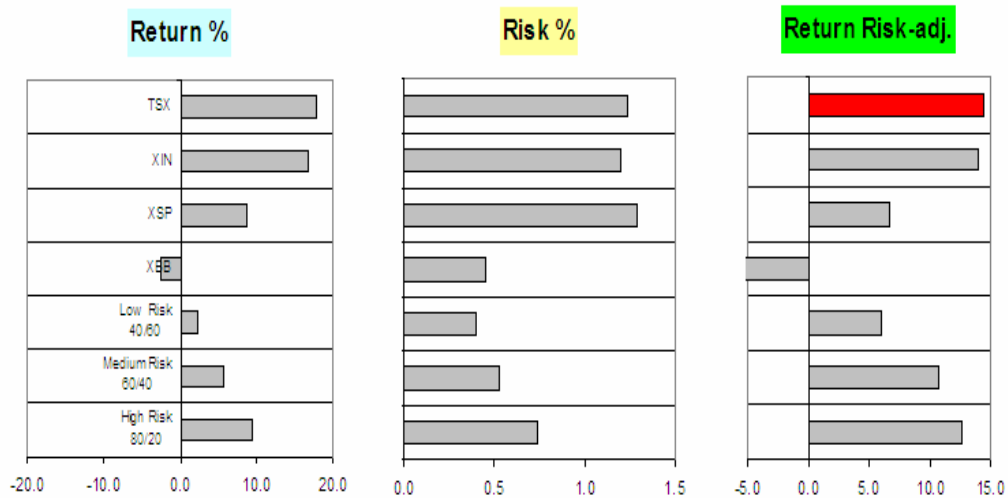
Charts 13 -15: US Model Portfolios



Canadian Model Portfolios. Conclusions based on Charts 16 - 18.

Since inception, the TSX has been the best investment on a risk adjusted basis. It has surpassed our three portfolios, which continue to deliver respectable gains combined with a lower volatility.

Charts 16 - 18: Canadian Model Portfolios



Name	Ticker Symbol
S&P 500	SPX
ishares MSCI EAFE	EFA
Vanguard Total Stock	VTI
ishares Lehman Aggr. Bond	AGG
ishares Real Estate	IYR
ishares Lehman 1-3 yr Treasury	SHY
TSX - Canada	TSX
Canada - Fixed Income	XBB
Canada - S&P 500	XSP
Canada - MSCI EAFE	XIN

Answer to the Quiz:

D is correct.

Private equity is rather illiquid since it cannot be quickly sold on the stock market. In some forms of private equity (e.g., venture capital) investors have to wait for more than seven years before being able to liquidate the position.

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