



Markets This Week

April 15, 2006

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Investment Idea

Question:

What is the impact of a lower pre-holiday market volume on prices?

Answer:

Negative. The market volume means a number of shares being sold / bought. A lower volume suggests fewer potential buyers are interested in taking a position.

In general, the market needs volume to push prices. However, usually the volume declines significantly ahead of some holidays such as Easter and Christmas as many investors become less interested in buying/selling shares. Please consider the accompanying chart 1 for comparison of prices (black line) and volume (in green bars) during the pre-Easter week.

Chart 1. S&P 500: Prices and Volume (Last Month)



Quiz

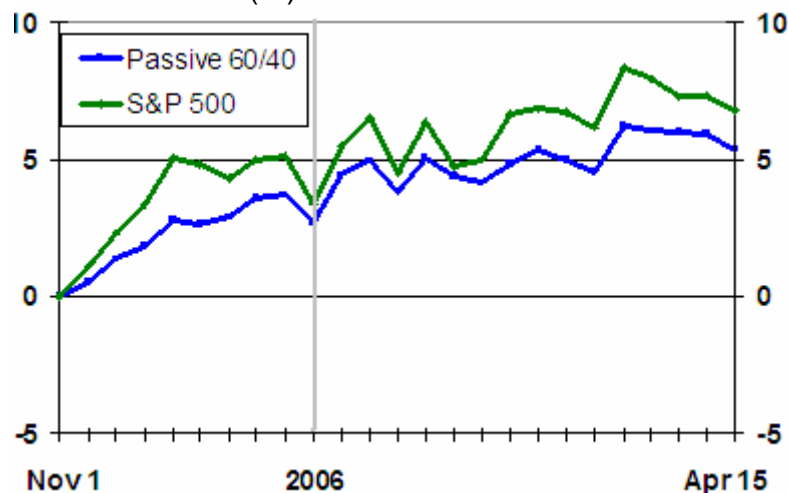
Why does a lower pre-holiday volume usually lead to lower prices?

- A) Lack of interest
- B) US dollar depresses the equity prices
- C) A high level of buying by institutional investors
- D) Insufficient supply of shares

Answer at the bottom of the newsletter.

Our Portfolio

Chart 2. 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 declined in tandem.

Market Highlights

April 8 – April 14, 2006

- This week, the US market continued its descent from the recent high. Although, the long-term fundamentals remain healthy, we believe the market formed an important top at the start of April and will be looking for a new support level in the near term (Charts 3 & 4). Please see our discussion in the Behavioral Finance Indicators section.

Charts 3 & 4. S&P 500: 10 Years and Last 10 Days



Charts courtesy of StockCharts.com

- The Canadian markets finished the week only marginally lower, supported by the “usual suspects”, namely resources and financials (Charts 5 & 6).

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



Charts courtesy of StockCharts.com

- Gold has finally traded above \$600 per ounce. The rally is driven by the following factors: high energy prices fuelling inflationary expectations, tension in the Middle East and global terrorism.
- Last month, home sales declined 20% in Florida, 15% in California and 19% in Washington D.C. The real estate industry blames a number of factors, including a sell-off among investors and worsening affordability due to soaring property prices and rising interest rates. It appears that the industry forgot one other factor called the “business cycle”.

- Have you ever heard of Tim Horton's (symbol THI), the Canadian coffee shop that went public at the end of March 2006? It was initially priced at \$27 per share (and oversubscribed by 1000 times). It opened trading at \$37 per share and has drifted lower ever since. See chart 7.

Chart 7. Tim Horton's Since IPO



Worth Watching

- Professor Jay Ritter from the University of Florida has constructed a database containing more than 6,000 IPOs that came to market between 1980 and 2002 (see the table below). The buyers of companies with higher sales lose less money (relative to the overall stock index) than those whose companies have lower sales. Yet the real winner is the financial industry which sells IPOs and collects millions in proceeds.

Sales over 12 months prior to going public	3-year return relative to overall stock index (annualized)
Less than \$10 million	-49.2%
\$10-\$20 million	-30.7%
\$20-\$50 million	-24.3%
\$50 to \$100 million	-1.4%
\$100 to \$500 million	-6.7%
Over \$500 million	-3.2%

N.B. Please keep in mind that this extensive database was collected over 22 years. In general, during bull markets IPOs are flying off the shelf as many investors purchase them without considering their actual value.

- Last week, the chief economist of NAR (National Association of Realtors) stated “Home sales will move up and down somewhat over the remainder of the year but stay at a high plateau”. We recall that in 1929, just before the collapse of the stock market, one of the top US academics also used the phrase “The stock prices have reached a permanently high plateau”.

Behavioral Finance Indicators (see explanation)

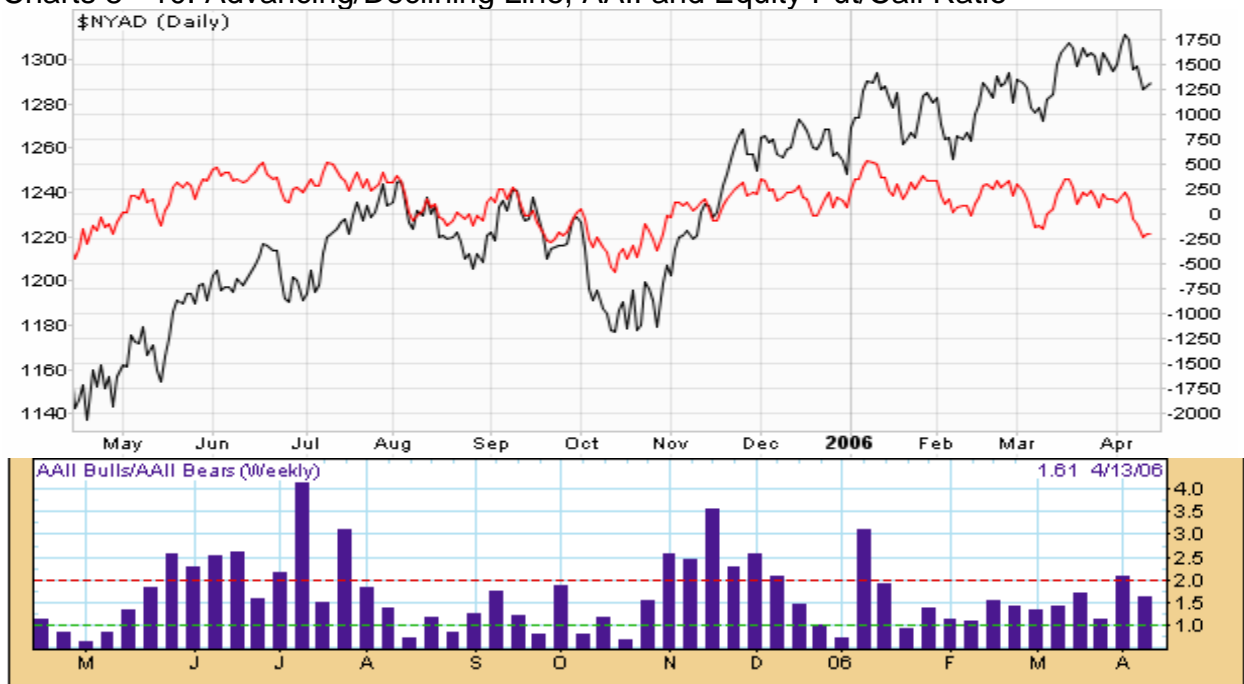
It appears that the equity markets formed an important top at the beginning of April and are looking for a new support level. As we stated last week, the advancing/declining line, points to a divergence between prices and fundamentals. In addition, other sentiment indicators are showing that the majority of unsophisticated investors (who are usually wrong at major market turns) are still showing a fair bit of confidence.

For a historical comparison, please look at August 2005 on Charts 8, 9 and 10.

Please consider the following factors:

- Chart 8 – the divergence between prices (black line) and the advancing/declining line (red line) since January 2006
- Chart 9 – the confidence of small investors (as represented by AAll, i.e., the ratio of bulls/bears is not low)
- Chart 10 – the declining put/call ratio indicates that small investors are showing confidence that the market will advance (red line)

Charts 8 - 10: Advancing/Declining Line, AAll and Equity Put/Call Ratio





Charts courtesy of StockCharts.com and DecisionPoint.com

Answer to the Quiz:

A is correct.

The market finds it very hard to advance if there are few buyers willing to take positions. In other words, general apathy is bad and enthusiasm is good for stock prices.

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