



Markets This Week

May 20, 2006

In This Issue:

- [Investment Idea](#)
- [Quiz](#)
- [Our Results](#)
- [Market Highlights](#)
- [Behavioral Finance Indicators](#)
- [Answer to the Quiz](#)

Investment Idea

Question:

Should I buy good companies or companies that are good investments? Is there a difference?

Answer: Yes there is a great difference! Good companies are not necessarily good investments (many people confuse the two, though). For instance, let us consider Google (symbol GOOG) (Chart 1).

Chart 1. Google's Price Per Share (1 Year)

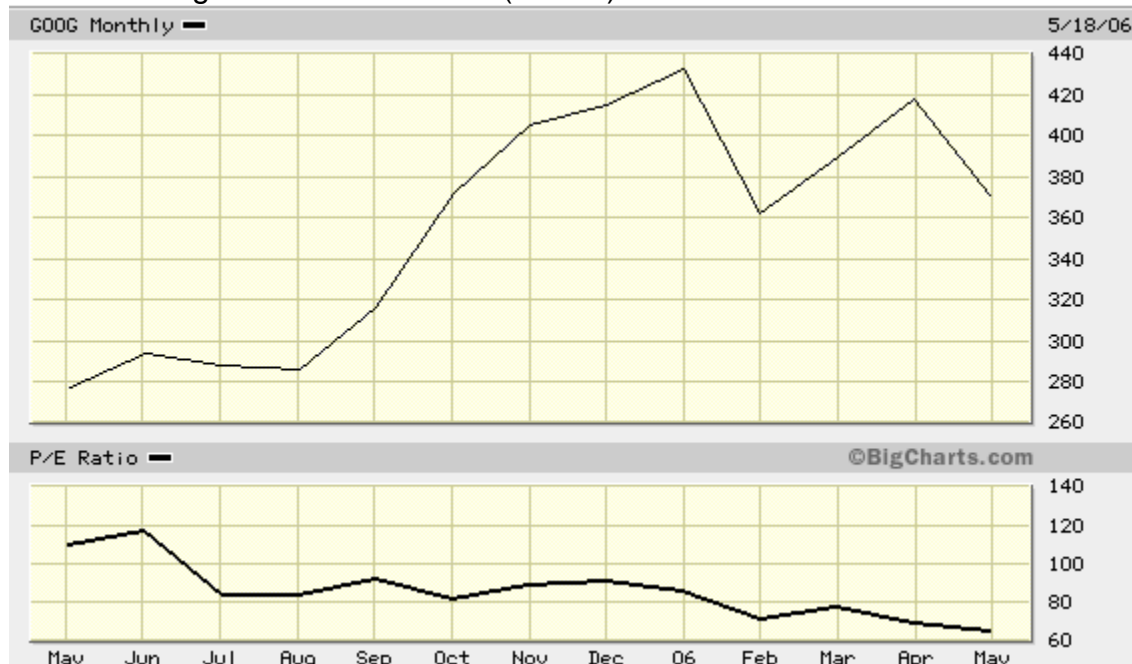


Chart courtesy of BigCharts.com

We agree that Google is an excellent company with a high growth potential but it may not be a good investment given that it is currently trading at \$370 and its P/E (Price/Earnings) ratio of 65 is already pricing in the high future growth. On the other hand, if the share prices of Google were to decline to \$100 with a P/E ratio of 18, we could conclude that Google is not only a good company but at this price it also becomes a good investment.

Quiz

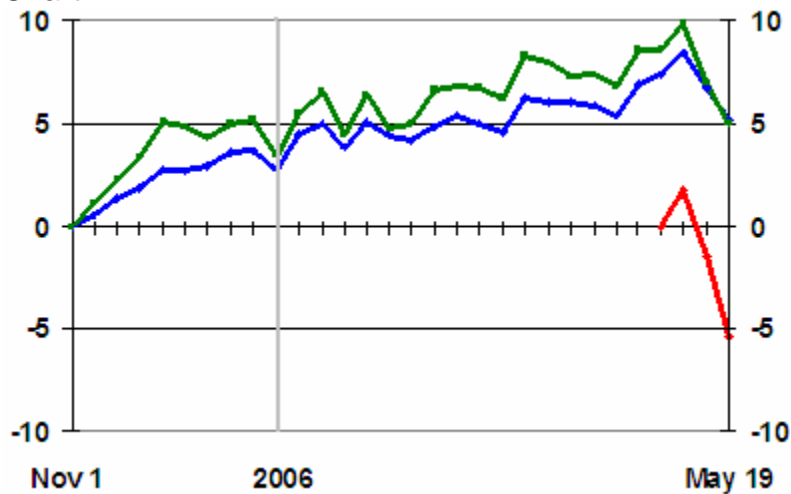
What is one of the most common valuation methods of determining if a company is a good investment?

- A) A tip from a broker
- B) Price momentum shown on a chart
- C) A high P/E ratio
- D) A low P/E ratio

Answer at the bottom of the newsletter.

Our Results (Cumulative %)

Chart 2.



| Symbol | One-week % | Since Inception % | We Bought On | We Sold On | Expected Return % | Risks | Reasons |
|-----------------------------------|--------------|-------------------|--------------|------------|-------------------|--------|------------------|
| Members Info | -4.70 | -6.26 | May 1, 06 | - | Market + 4 | Medium | Trend investing |
| Members Info | -3.25 | -4.46 | May 1, 06 | - | Market + 2 | Low | Investment style |
| InvestWELL Picks (Average) | -3.98 | -5.36 | | | | | |
| Passive 60/40 | -1.46 | | | | | | |
| S&P 500 | -1.87 | | | | | | |

Last week, our **InvestWELL Picks** declined by 3.98%, which was more than the general market. The InvestWELL Picks holds only two positions, which exposes InvestWELL Picks to greater volatility.

Since the inception on Nov. 1, 2006, the conservative 60/40 portfolio has achieved a higher return and lower volatility than the S&P 500, again proving the value of diversification and good risk management practice.

Market Highlights

May 14 – May 20, 2006

- In the last week, the US equity markets continued to decline and attempted to find a new support level. Given that the market is currently quite oversold, we are expecting a rebound in the upcoming weeks. Please see the Behavioral Finance Section for more information.

Charts 3 & 4. S&P 500: 5 Years and Last 10 Days



Charts courtesy of StockCharts.com

- The Canadian markets declined more steeply than their American counterparts (Charts 5 & 6). The tide has likely turned for commodities.

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



Charts courtesy of StockCharts.com

- During the last week, gold prices declined steeply from \$725 to \$657 per ounce. This is a significant drop happening in the background of weakness in equity price. Usually, as investors flee from equities they look for safe havens such as bonds, gold, etc. We find that if a stock/commodity reacts negatively to what is believed to be positive news, it often signals underlying weakness.
- Morgan Stanley Chief Economist Stephen Roach (a.k.a. the Perpetual Bear) believes that there's a speculative bubble in commodities, and it's not a matter of if it will burst, but when. Mr. Roach pointed out that the jump in prices of materials in the past few months is reminiscent of charts of dot-com stocks in late 1999 and 2000. InvestWELL Financial also believes that easy money in commodities has already been made.
- Oil prices declined to \$68.53 on indications that OPEC will not cut the output. Perhaps we will see lower gas prices during the summer of 2006.

Worth Watching

- The Indian mutual fund industry has grown multifold from a single mutual fund in 1964 to 29 Asset Management Companies in 2005. However, Assets Under Management (AUM) as a percentage of GDP are still only 8% while the typical ratio in developing countries is 30 – 50%. India's financial markets clearly have room to grow as the middle class continues to improve its standard of living and foreign investors pile in.
- The housing market is deflating while the price increases of new homes are actually below the inflation rate (Chart 7).

Chart 7. Median New Home Price (3 Month Average)

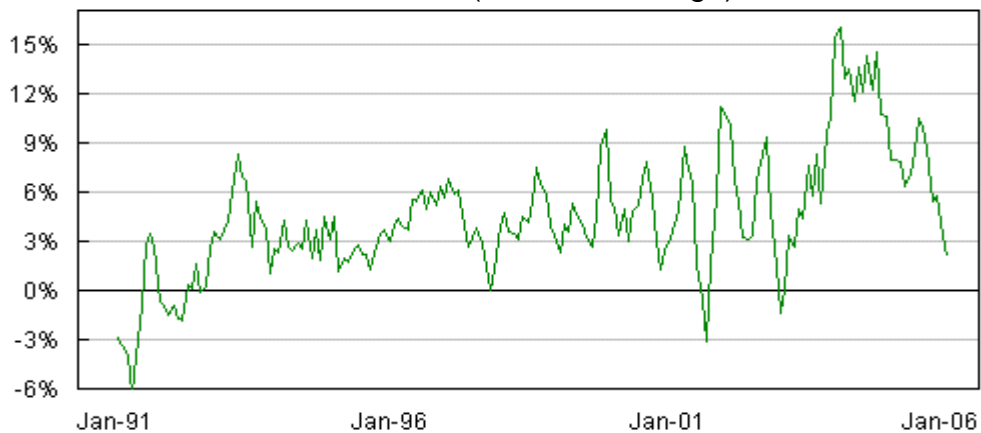


Chart courtesy of Briefing.com

Behavioral Finance Indicators (see explanation)

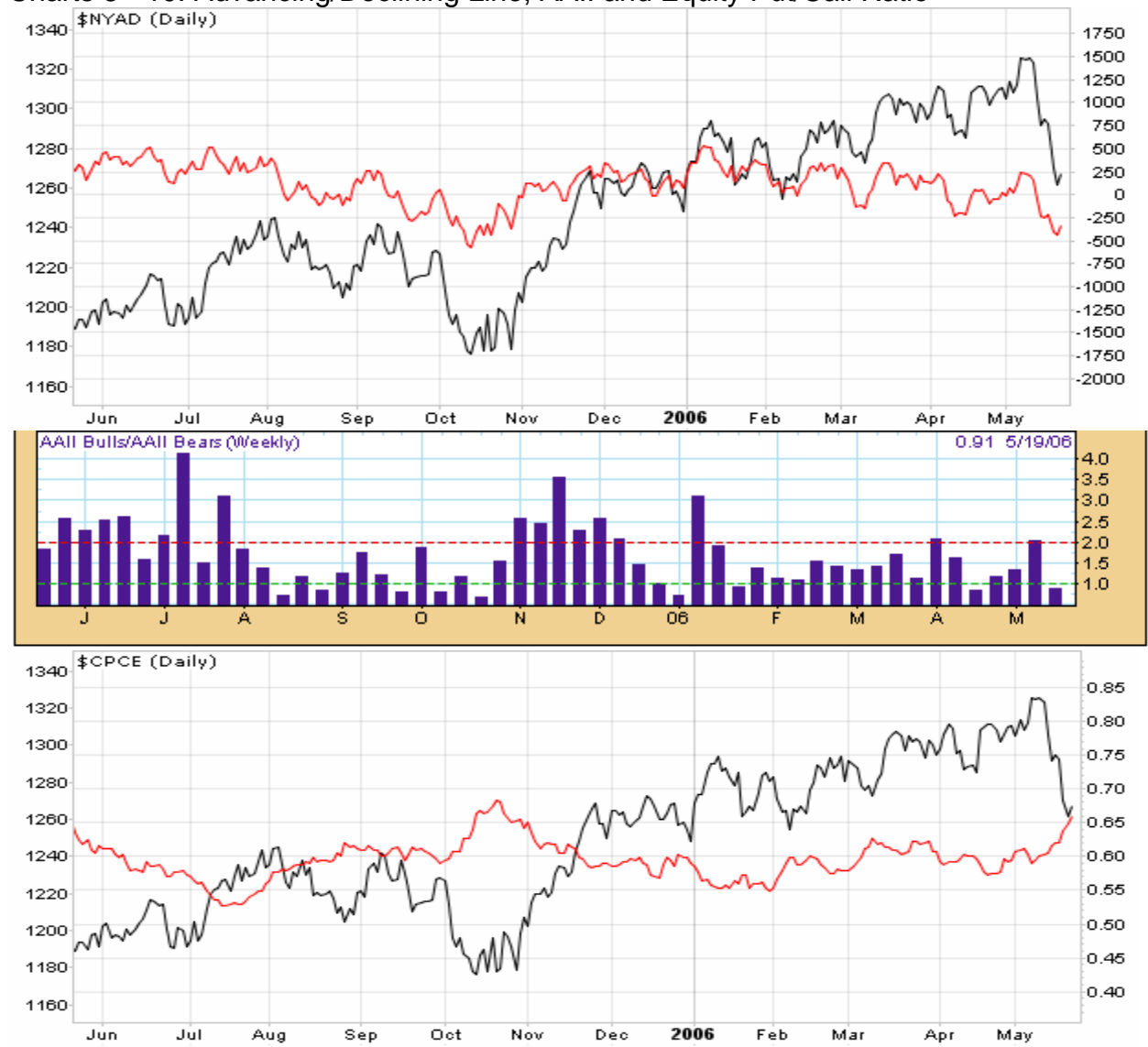
Equities had another bad week with declines across the board. We believe the stock markets will likely rebound in the upcoming weeks. However, the upward thrust will likely not be as strong as the recent downward adjustment.

Our opinion regarding the upcoming rebound is based on the behavioral indicators below (Charts 8 – 10).

Please consider the following factors:

- Chart 8 – the divergence between prices (black line) and the advancing/declining line (red line) is narrowing.
- Chart 9 – a low confidence of small investors (as represented by AAll, i.e., the ratio of bulls/bears). Small investors are usually a contrary indicator.
- Chart 10 – the rising put/call equity ratio indicates that small investors are losing their 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:

D is correct.

Companies with a low P/E ratio are the most likely candidates for being good investments given that the P (Price) component is relatively low. Please remember not to confuse good companies with good investments.

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