



# Markets This Week

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June 10, 2006

In This Issue:

**Investment Idea**

**Quiz**

**Our Results**

**Market Highlights**

**Behavioral Finance Indicators**

**Answer to the Quiz**

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## **Investment Idea**

Question: In researching individual companies, what is the value of information from primary sources (e.g. talking to customers, suppliers, etc.)?

Answer: The information from primary sources can be very valuable but obtaining it can also be time consuming.

Please remember that in investing you want to have some form of advantage over other analysts and investors. Most of the researchers rely on the secondary sources (e.g. media, a company's marketing material, etc.) and as someone once rightly put it "in investing, knowing what everyone knows is not worth knowing". One form of gaining an advantage is to go where others are not venturing.

For instance, by talking to a store manager you find out that many customers are returning the company's new products which are defective. Thus, you might have gained valuable information that is not yet reflected in the share price. If you act now, you can make some money before the information becomes public knowledge.

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## **Quiz**

Which of the following is an example of obtaining information from primary sources?

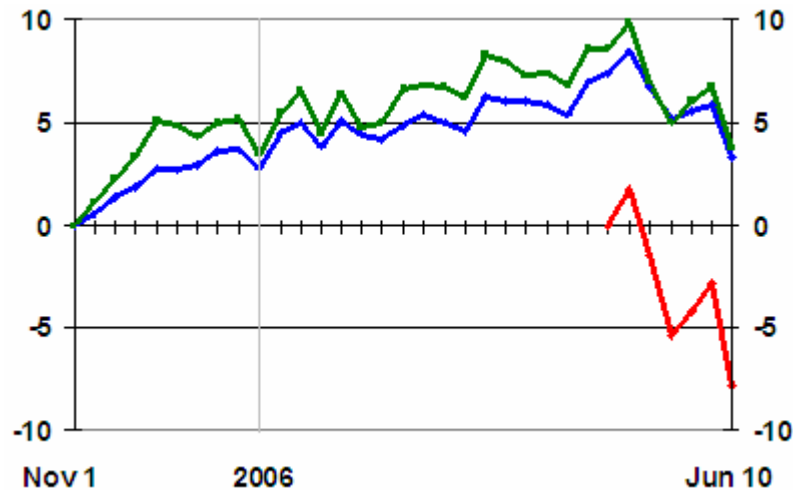
- A) Technical analysis
- B) Fundamental analysis

- C) Talking to a credit rating agency
- D) Talking to the CEO's secretary who was just downsized

Answer at the bottom of the newsletter.

### Our Results (Cumulative %)

Chart 1



Symbol	One-week %	Since Inception %	We Bought On	We Sold On	Expected Return %	Risks	Reasons
Members Info	-6.44	-9.80	May 1, 06	-	Market + 4	Medium	Trend investing
Members Info	-3.88	-5.91	May 1, 06	-	Market + 2	Low	Investment style
<b>InvestWELL Picks (Average)</b>	<b>-5.16</b>	<b>-7.85</b>					
<b>Passive 60/40</b>	<b>-2.51</b>						
<b>S&amp;P 500</b>	<b>-2.79</b>						

Last week, the market did quite poorly and our **InvestWELL Picks** underperformed the general market. Last weekend, we advised our members to take short positions with price limit orders. Unfortunately, the market did not advance and our short positions did not get filled.

### Market Highlights

#### Jun 4 – Jun 10, 2006

- Last week, the US equities started dropping as of Monday, despite a great degree of negative news (Chart 2 & 3). Most of our indicators show that the current market is ready for a rebound, which offers a strong short-term

buying opportunity. It may indeed be the case but we also believe the markets will be generally weak in the next few months.

#### Charts 2 & 3 S&P 500: 5 Years and Last 10 Days



Charts courtesy of StockCharts.com

- The Canadian equities have followed the US markets in one direction - down (Chart 4 & 5). The Canadian employment data was very strong with 97,000 new jobs and the unemployment rate dropping down to 6.1%, the lowest rate in 32 years. We believe the Canadian economy has found its "sweet spot" and will likely continue to do well, at least for another year.

#### Charts 4 & 5 TSX Canada: 5 Years and Last 10 Days



Charts courtesy of StockCharts.com

- Dow Jones Indexes announced that it will expand its existing index family by launching the Dow Jones BRIC 50 Index, a blue-chip index that tracks the performance of the 50 largest and most liquid companies from BRIC

(Brazil, Russia, India and China). This could potentially be a very good product that combines both the high growth potential as well as the high quality of companies.

- The European Central Bank raised its key lending rates from 2.5% to 2.75% signaling that the rates will likely continue to go up in an effort to continue curbing inflation after the surge in oil prices.
- As the one-year long ban on issuing new shares was lifted last month, Chinese stocks had their biggest drop in more than four years on concerns that the end of a ban on new share sales will sap demand for existing equities. In economics 101, when supply is greater than demand, prices normally adjust downwards.
- The Federal Reserve has reported that Americans increased their household debt at an annual rate of 11% in the first quarter, the fastest growth in nearly 20 years. No wonder the level of the Household Debt keeps climbing up!

### **Worth Watching**

- Harvey Pitt, a former Securities and Exchange Commission boss believes companies should lock away large chunks of the CEO's pay until the end of a contract. Mr. Pitt stated that the current compensation that ties the pay to the share prices favors CEOs over investors. We believe that Mr. Pitt is quite correct in pointing out the CEOs focus too much on short-term (the current share price) and not enough on long-term. Investors would be much better off if the CEOs were compensated based on the value of the company in the future (e.g. 5 years from now).
- According to the report funded by the U.S. Food and Drug Administration, the U.S. spends about \$92 billion every year to cover medical expenses related to obesity. About two-thirds of Americans are overweight and 30% are considered obese; nearly double the rates two decades ago. Carrying a lot of extra pounds can increase the risk of diabetes, heart disease and certain types of cancer. How about a radical idea of making the junk food restaurants pay extra taxes to cover the \$92 billion obesity-related expenses? Such an action would surely lead to healthier society and lower share prices of the junk food restaurants.

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### **Behavioral Finance Indicators** (see explanation)

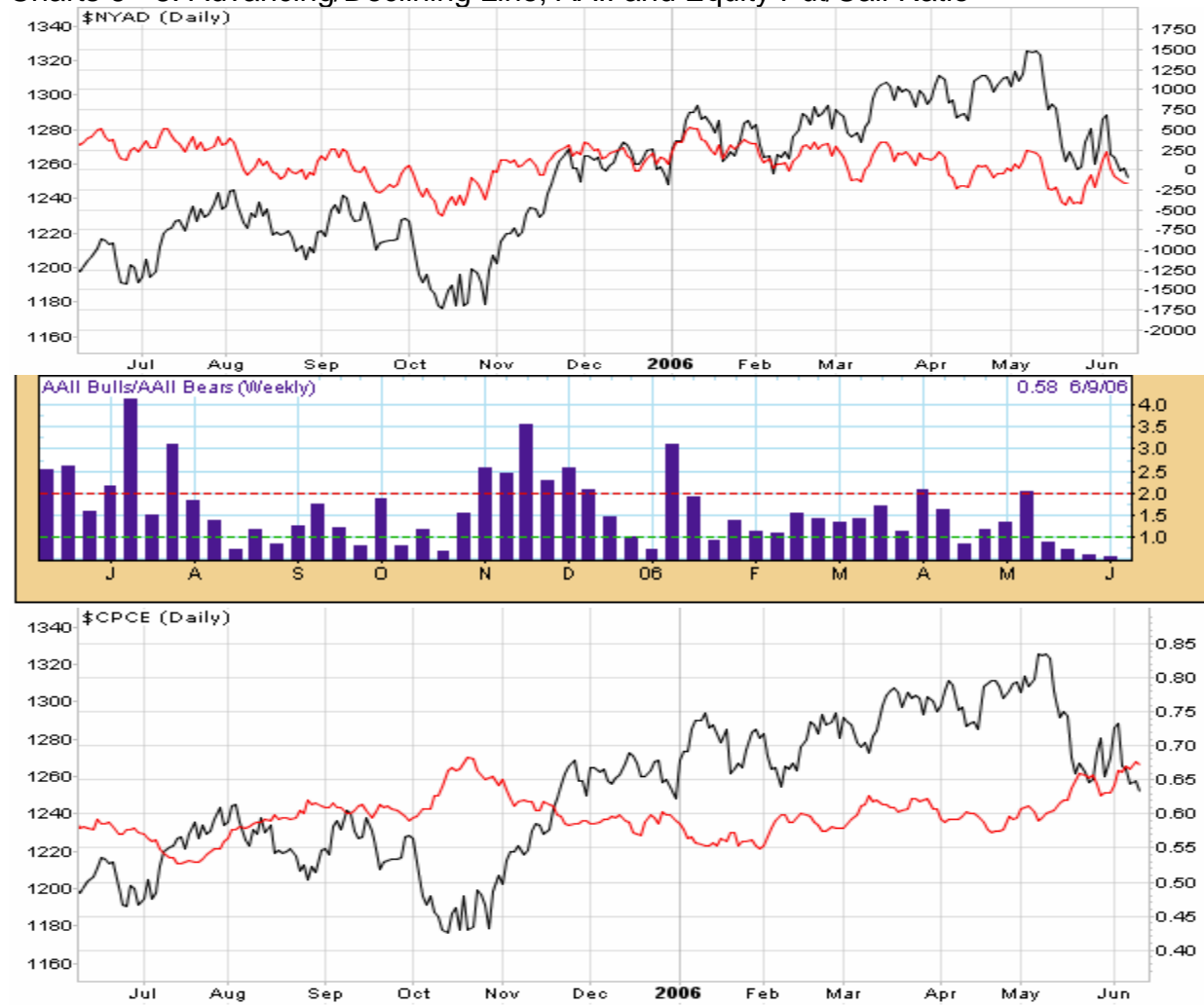
Currently, the markets are presenting a short-term strong buying opportunity. On the other hand, we do not have a case for the intermediate term (several months) strength. The markets were overextending themselves between January and

April this year, and are currently undergoing a healthy correction that may last for some time. In retrospect, it is quite ironic that a month ago, the markets were strongly advancing despite overwhelming evidence of an upcoming downturn.

Please consider the following factors:

- Chart 6 – the divergence between prices (black line) and the advancing/declining line (red line) is tightening but the two started to diverge in February this year.
- Chart 7 – a low confidence of small investors (as represented by AAll, i.e., the ratio of bulls/bears) points to a short-term rebound. Small investors are usually a contrary indicator.
- Chart 8 – the rising put/call equity ratio indicates that small investors are losing their confidence that the market will advance (red line). Again, an excellent contrary indicator pointing to a rebound in a short-term.

Charts 6 - 8: Advancing/Declining Line, AAll and Equity Put/Call Ratio



Charts courtesy of StockCharts.com and DecisionPoint.com

## Answer to the Quiz:

D is correct. Choices A – C are a form of public knowledge. The secretary might be able to give you information that is unknown to the public.

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