



# Markets This Week

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June 24, 2006

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## Investment Idea

Question: There are three ways of constructing an index. Which type of index offers the best potential for individual investor?

Answer: Let us first define the three ways of constructing an index:

1. Price-Weighted Index e.g. Dow Jones Industrial Average

Stock A = \$2. Accounts for 20% of the index

Stock B = \$8. Accounts for 80% of the index

2. Equally-Weighted Index e.g. many ETFs

Stock A = \$2. Accounts for 50% of the index

Stock B = \$8. Accounts for 50% of the index

3. Capitalization-Weighted Index e.g. S&P 500

Stock A = \$2; shares outstanding = 50; market capitalization =  $2 * 50 = 100$ .

Stock B = \$8, shares outstanding = 5; market capitalization =  $8 * 5 = 40$ .

Therefore,

Stock A accounts for  $100 / 140 = 71\%$  of the index

Stock B accounts for  $40 / 140 = 29\%$  of the index

What does it mean to you?

In a long-run, small capitalization stock indexes tend to outperform the general market. Therefore investors should hold more Equally-Weighted Indexes as they give a greater weight to small caps. At the same time, buying a broadly diversified index protects from the risk of holding an individual company.

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## Quiz

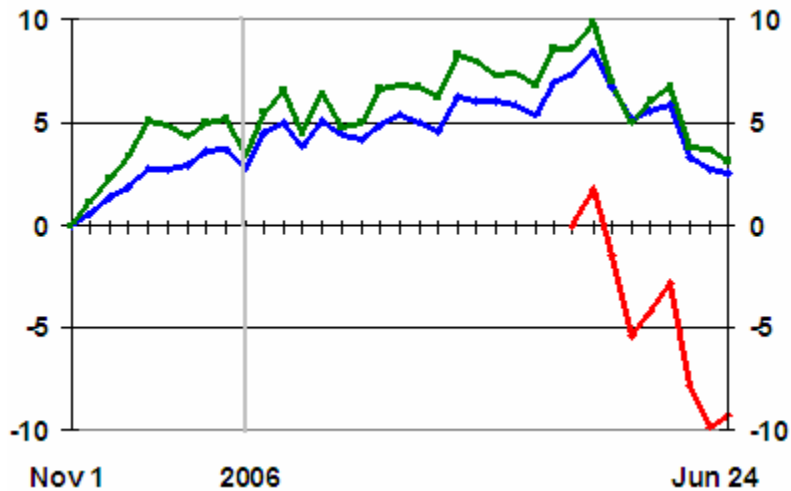
What is the market capitalization of the company XYZ with 200 shares outstanding trading at \$10 per share?

- A) 2,000
- B) 20,000
- C) 1,000
- D) 10,000

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	1.12	-11.38	May 1, 06	-	Market + 4	Medium	Trend investing
Members Info	0.05	-7.21	May 1, 06	-	Market + 2	Low	Investment style
<b>InvestWELL Picks (Average)</b>	<b>0.59</b>	<b>-9.29</b>					
<b>Passive 60/40</b>	<b>-0.18</b>						
<b>S&amp;P 500</b>	<b>-0.56</b>						

Last week, **InvestWELL Picks** managed a small gain while the general market declined.

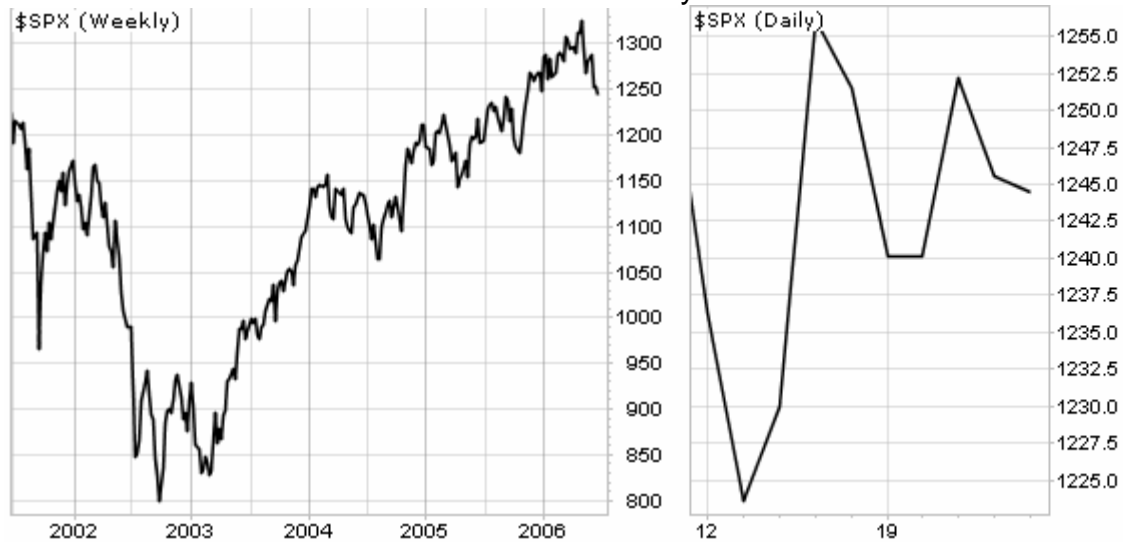
## Market Highlights

### Jun 18 – Jun 24, 2006

- Last week, the US equities attempted to stage a rally but finished the week only with a modest decline (Chart 2 & 3). It does appear, however,

that the market has managed to build a relatively strong support which will be crucial for a successful development of any rally.

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



Charts courtesy of StockCharts.com

- Last week, the Canadian equities posted solid gains as investors renewed their faith in the Canadian markets (Chart 4 & 5). In addition, a number of recent economic reports indicate that Canada will likely continue to benefit from strong macroeconomic fundamentals.

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



Charts courtesy of StockCharts.com

- The US crude oil inventories reached their eight-year high, while the price per barrel is about \$70. Eight years ago, the price per barrel was \$16. Times have definitely changed.



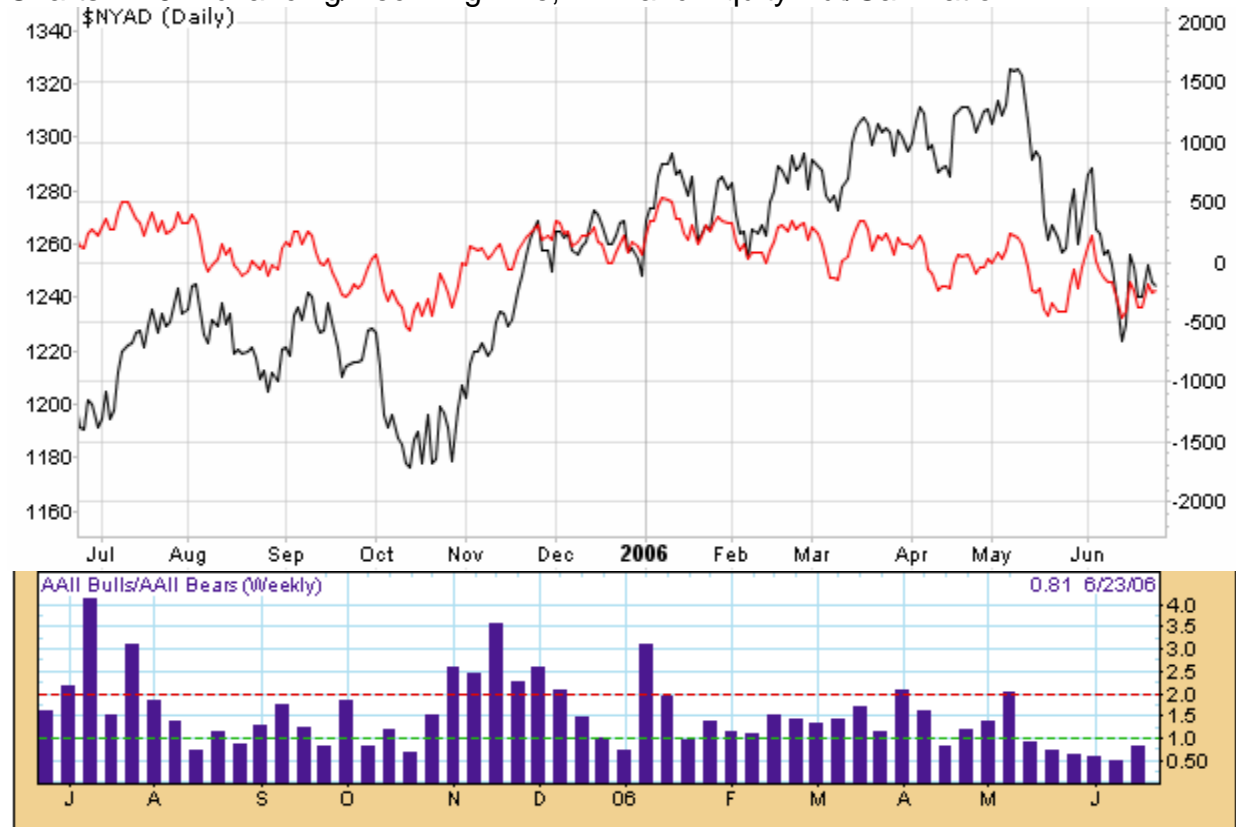
## Behavioral Finance Indicators (see explanation)

According to our behavioral indicators, the equity market is ready for a short-term rebound which will likely happen at the end of June / start of July. In addition, the contrary indicators have been flashing strong oversold signals as the market consolidated at the lower end of the trading channel. However, in a longer-term time frame, the market will find it very difficult to climb back to the levels reached in last May.

Please consider the following factors:

- Chart 7 – the prices (black line) and the advancing/declining line (red line) are converging but the two started to diverge in February this year which signaled that the market was heading for trouble.
- Chart 8 – 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 9 – 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.

Charts 7 - 9: Advancing/Declining Line, AAll and Equity Put/Call Ratio





Charts courtesy of StockCharts.com and DecisionPoint.com

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### Answer to the Quiz:

A is correct. We need to multiply the number of shares outstanding by the current price i.e.  $200 * \$10 = 2,000$ .

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Thank you for reading Markets This Week.

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