



Markets This Week

July 1, 2006

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Investment Idea

Question: What is a window dressing (in mutual funds) and why should it matter to me?

Answer: Window dressing takes place at the end of each quarter / year. It is an action by actively managed mutual fund managers who buy the recent winners and sell losers to make their mutual fund look pretty (to show them in the quarterly / annual statements).

What does it mean to you?

According to the market efficiency theory, window dressing should never take place but it is only a theory. As we know, mutual fund managers are human beings who care more about their paychecks than returns of unitholders of mutual funds. In short, if the mutual fund does not look pretty, they could lose their jobs. In the long run, however, the window dressing has a negative impact on the returns of holders of mutual funds.

N.B. The concept of window dressing does not apply to index funds since they do not actively buy / sell stocks.

Quiz

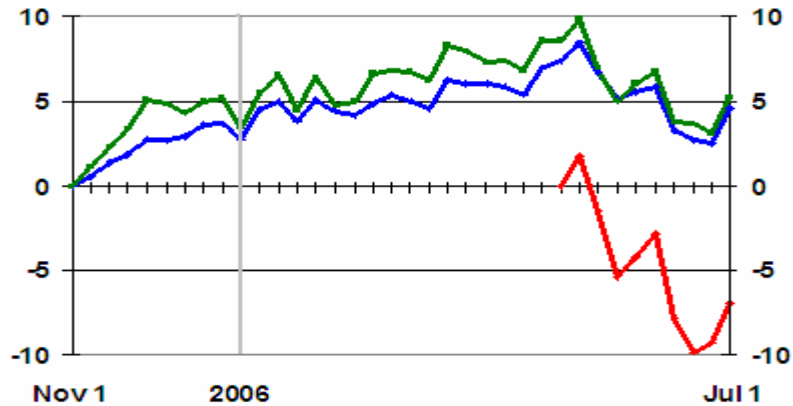
What is the main reason why window dressing has a negative impact on returns of mutual fund unitholders?

- A) mutual funds focus on momentum trading
- B) unitholders generally prefer growth stocks to value stocks
- C) value stocks outperform growth stocks in the long run
- D) mutual fund managers favor their own interest over unitholders' interest

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	2.40	-9.25	May 1, 06	-	Market + 4	Medium	Trend investing
Members Info	2.69	-4.71	May 1, 06	-	Market + 2	Low	Investment style
InvestWELL Picks (Average)	2.54	-6.98					
Passive 60/40	1.96						
S&P 500	2.07						

Last week, **InvestWELL Picks** went up more than the market. Please keep in mind that InvestWELL Picks contains only 2 positions which means it is subject to a greater volatility.

Market Highlights

Jun 18 – Jun 24, 2006

- Last week, the US markets recorded a strong rebound following another raise in interest rates last Thursday (Chart 2 & 3). We believe it is quite likely that the market will advance in the near term, given the depth of the previously oversold condition.

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



Charts courtesy of StockCharts.com

- Last week, the Canadian equities posted gains that have exceeded their US counterparts (Chart 4 & 5). However, the love affair with resource stocks is over and Canadian equities will need to broaden their support to stay strong.

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



Charts courtesy of StockCharts.com

- The number of mortgage applications is down 31% compared with a year ago. It means the lowest level on a seasonally adjusted basis since May 2002. Something is clearly brewing in the real estate sector. We can only hope for a mildly negative impact of the decline of real estate on the overall economy.
- Warren Buffett has surprised many with his grand gesture of turning over the bulk of his celebrated estate (valued at \$37 billion) to total strangers. With gestures like this, who needs communism! Capitalists were not amused!
- The Middle East is enjoying the current oil boom but with restraint, according to the World Bank this week. Middle Eastern countries have learned their lessons and are pouring new profits into economic development. Oil exports have more than doubled over the past three years and the economic boost lifted growth in the region to 6% in 2005, versus 3.5% in the late 1990s.

Worth Watching

- Morningstar has applauded regulators requiring that portfolio managers disclose how much money they have invested in their own funds, a move that has recently allowed investors to see if their manager is paddling in the same boat. The evidence suggests that managers who invest in their own fund do a better job for investors than those who don't buy their own funds. It relates to the issue of incentives, which is quite applicable to our discussion of window dressing.

- A Nobel laureate in economics, Daniel Kahneman, and an economist, Alan Krueger, have found that people with above-average incomes do not necessarily spend more time doing things they enjoy. The authors write that if people continue to think a higher income will make them happier, it may lead to “a misallocation of time,” with people going to such lengths as accepting longer commutes for higher-paying jobs and sacrificing time spent socializing with family and friends. InvestWELL Financial believes they have a point i.e. the importance of the balance between money and time.

Behavioral Finance Indicators (see explanation)

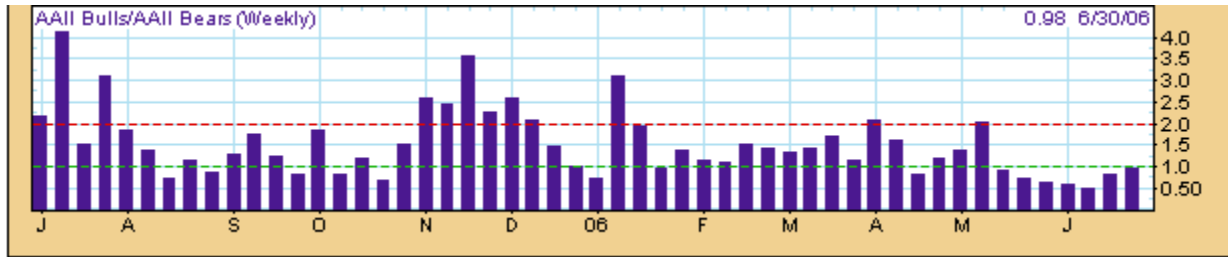
During the previous two weeks, the contrary indicators pointed to a strong oversold condition (Charts 6 – 8). As a result, equities staged a solid rebound and will likely continue to hold the gains in the near term. However, we believe the market will find it quite difficult to climb back to the levels reached last May.

Please consider the following factors:

- Chart 6 – 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 7 – 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 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.

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. Mutual fund managers care about their paychecks more than returns of mutual fund unitholders. This is a classic example of a conflict of interest where unitholders delegate a job to an agent and the agent looks after his interests first, as opposed to doing a proper job for unitholders (i.e. managing their funds well).

Thank you for reading Markets This Week.

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