



Markets This Week

July 15, 2006

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Investment Idea

Question: What is neglected-stock effect and how can I benefit from it?

Answer: The neglected-stock effect is supported by a substantial amount of financial research showing that stocks that are not widely followed by the investment analysts tend to outperform the market. These stocks tend to fly under the radar screen, but often display strong fundamentals.

In investing, the value is often in the eye of the beholder and stocks that are subject to the neglected-stock effect are undervalued, since the investment community does not talk about them.

We have just learned that Claymore Advisors LLC has filed for the first ETF, which will track 250 U.S.-traded stocks with little or no analyst coverage. This is a brilliant idea and we will notify our readers when this ETF becomes available.

Quiz

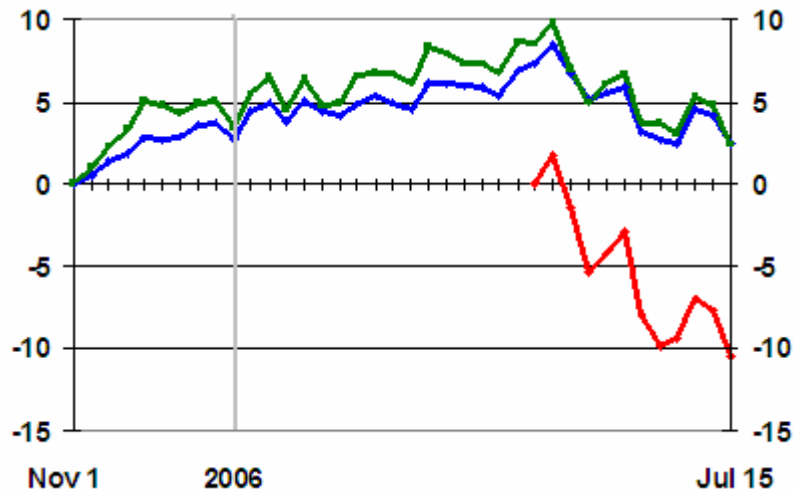
Why does the neglected-stock effect work?

- A) It has strong technical patterns
- B) It follows what the majority of investors are buying
- C) It offers a value orientation since the majority of investors do not know about it
- D) It is not subject to typical regulations

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	-4.74	-14.59	May 1, 06	-	Market + 4	Medium	Trend investing
Members Info	-1.37	-6.26	May 1, 06	-	Market + 2	Low	Investment style
InvestWELL Picks (Average)	-3.05	-10.42					
Passive 60/40	-1.49						
S&P 500	-2.31						

Last week, **InvestWELL Picks** declined more than the market and has been underperforming the market since equities started to decline in May 2006. InvestWELL Picks contains only 2 positions, which means it is subject to a greater volatility.

Market Highlights

Jul 9 – Jul 15, 2006

- Last week, the US equity markets suffered heavy losses (Chart 2 & 3) due to the escalating violence in the Middle East, the terrorist attack in India, and news of explosions in Nigerian oil pipelines, which sent the crude oil prices to US\$78 per barrel. Before the negative news was priced into the market, it looked like equities were ready to climb up. Currently, the market is heavily oversold and we believe it may offer some selective buying opportunities.

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



Charts courtesy of StockCharts.com

- Last week, the Canadian equities declined in tandem with the US market on geo-political concerns (Chart 4 & 5). In addition, the Bank of Canada surprised many with its decision to hold interest rates steady, despite the strength of the Canadian economy.

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



Charts courtesy of StockCharts.com

- The Bank of Japan raised interest rates for the first time in almost six years, forecasting sustained growth in the world's second-largest economy, and an end to a decade of deflation. The benchmark overnight rate went from almost zero to 0.25%.

- Gold rose to a six-week high as investors bought the metal as a safe haven and a hedge against inflation, after escalating violence in the Middle East pushed crude oil to a record.
- Some energy analysts predict that the price of crude oil could reach \$100 per barrel this year, given a supply disruption event, such as an oil-line sabotage or a hurricane in the Gulf region.

Worth Watching

The Morningstar Investment Conference is one of the best events of the year for fund investors. We have decided to present the five main conclusions regarding the state of the mutual fund industry:

- Beware the attraction of short-term bets when looking for long-term outcomes
There have been countless studies of fund investor behavior showing that typical consumers don't do as well as the funds they buy. The discrepancy is caused mostly by losing confidence in a fund and jumping around, constantly trying to make headway with whatever is hot today.
 - When it comes to information, 'availability bias' is a problem
Investors frequently ascribe significance to short-term performance numbers, or watch the flow of money into various asset classes, thinking they say something important about long-term trends; frequently, this is how people wind up missing out on gains and buying into declines.
 - About half of all funds available today deserve to die
The exhibit hall featured a number of companies whose best products could charitably be called mediocre, but realistically should be described as awful. Many firms created funds simply more for their ability to sell them rather than their capability for managing them well.
 - Expect large-cap stocks to hit their stride in the next 12 months
Large-cap stocks -- particularly for value-oriented investors -- are about as cheap as they have been in a long time, having lagged small-cap stocks for six to eight years.
 - There's a balance between running with the herd and being so contrarian you're wrong
In plain words, that means that when all of the experts start loving, for example, large-cap stocks, that doesn't mean it's time to bail out of everything else. Diversification allows you to participate in the best of the market, no matter which way certain asset classes are running.
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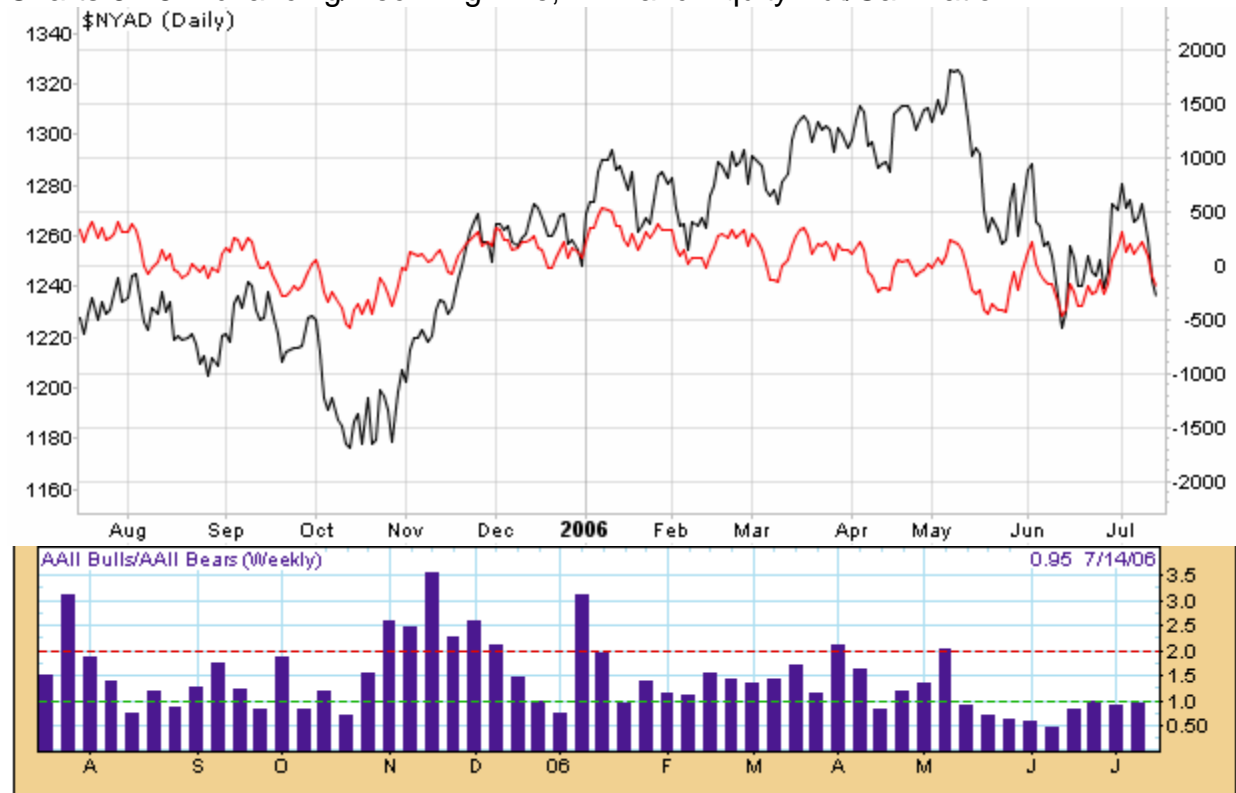
Behavioral Finance Indicators (see explanation)

Following the recent downturn, our indicators are giving buy signals (Charts 6 – 8). We understand that the recent decline in equity price is related to the geopolitical problems. However, some of the best buying opportunities materialize when the great majority of retail investors are selling indiscriminately and in panic.

Please consider the following factors:

- Chart 6 – the prices (black line) and the advancing/declining line (red line) have converged and it may be even argued that the recent divergence is pointing to a high probability of an upward move.
- 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 – a high put/call equity ratio indicates that small investors have lost 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:

C is correct. It has a value orientation since the majority of investors do not know about it. As one true investment professional put it, “if you have heard about this stock, we probably do not own it”.

Thank you for reading Markets This Week.

Please feel free to share it with your friends.

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