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Commentary

Market Opinions and Topics of Interest

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The S&P 500: Time For A Change In Thinking

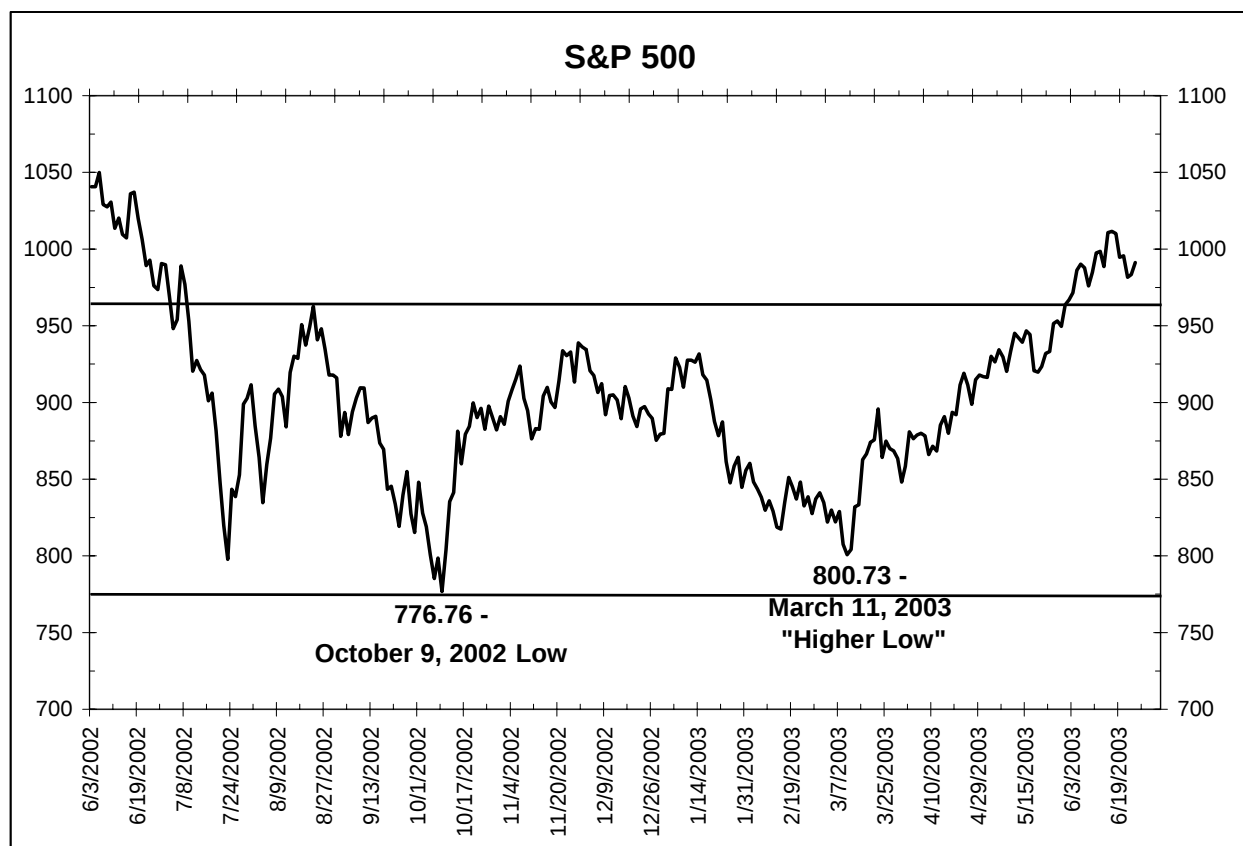
Earlier this month the S&P 500 broke out to the upside after 10 months of sideways trading. This breakout gives us reason to believe a bull market in stocks is now underway (see the chart below). Ironically, due to the nature of the recent sharp rise, we anticipate that the market is due for a correction in the near future.

This scenario is significant for the financial community because it suggests that "now is the time" to view movements in the stock market with a different "style" of thinking. A drop in stock prices should be viewed as corrective in nature – not as a resumption of the three-year downtrend.

Furthermore, due to the technical nature of this breakout, we would look for the market to establish an initial upside target for the S&P 500 of 1,150 (more on this later).

Why We Think The Market Has Broken Out

The S&P 500 breakout from 10 months of sideways trading was significant because it was the first time the market made a higher low (March 11, 2003) and a higher high since the all time peak in March 2000. Such a pattern is the basic definition of an "uptrend" and confirms the 776.76 low on October 9, 2002 was a significant bottom.



Bull Market Beginnings

The chart below shows the percentage gain of the S&P 500 during the first 200 days of all bull markets as defined by Ned Davis Research.

The thick black line represents the current rally since the October 2002 low. Although the current bull market had a slow start, it is comparable to the average gain of all bull markets after a similar number of days passed right now.

Where Is The S&P 500 Ultimately Headed?

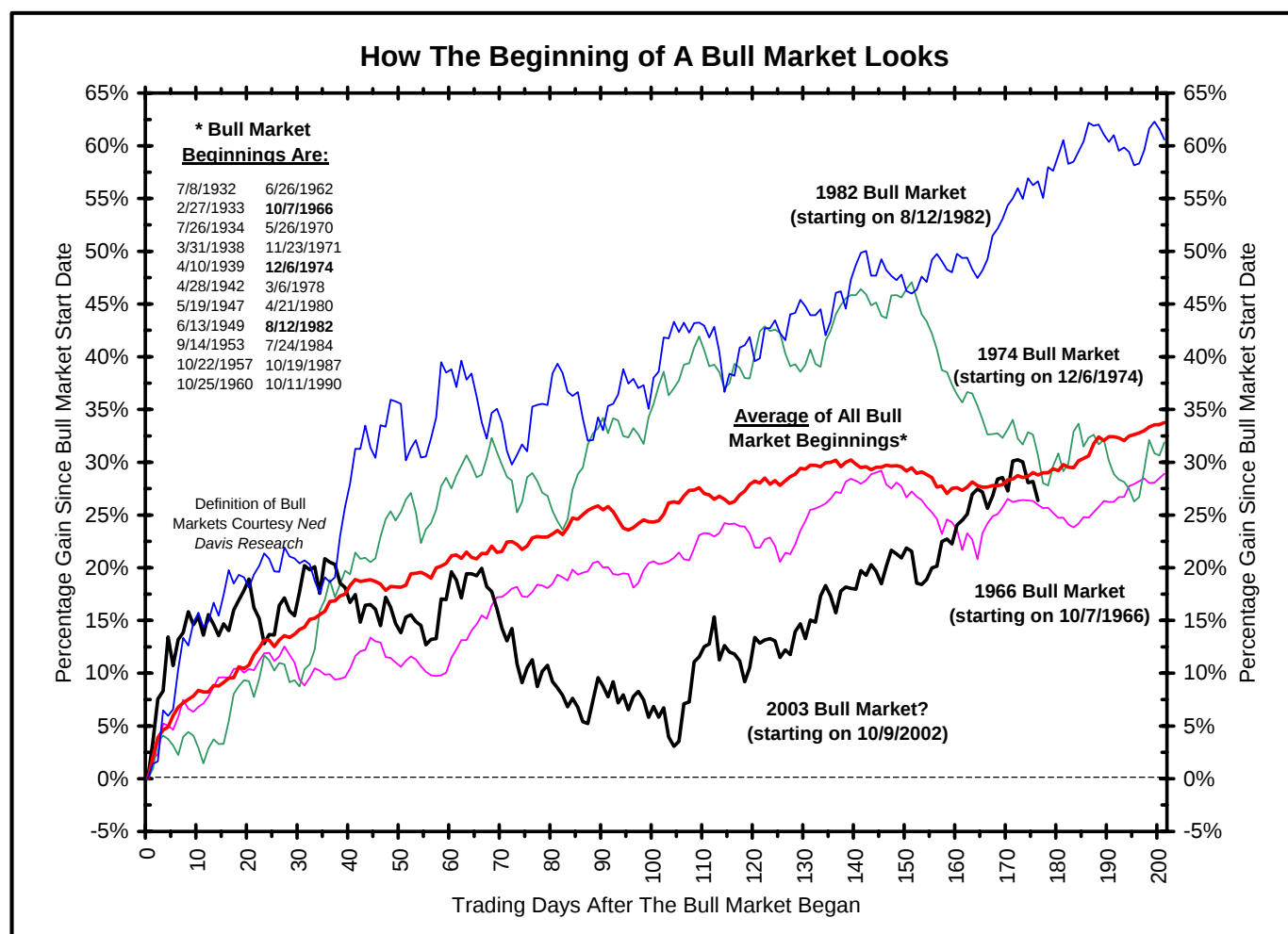
If a new bull market is underway, how much higher can it go? Our analysis suggests a target of 1,150 to 1,155. We arrive at this range via three methods:

1. The first measure is simply based on the width of the 10-month trading range. From a high of 965 in August of 2002, to a low of 776 in

October 2002, this trading range had a span of 189 points. Adding 189 points to the upper end of the range (965) gives us an upside target of 1,154.

2. From the all time high of 1,527.46 on March 24, 2000 to the low of 776.76 on October 9, 2002, a 50% retracement is 1,152.11.
3. The third measurement is based on the four-year [Presidential Cycle](#) since 1928. According to this cycle, the S&P 500 has rallied an average of 48.8% from the low of the second year of the Presidential term to the peak during the third year of the term. A 48.8% increase from the October 2002 low (776.76) projects to 1,155.82.

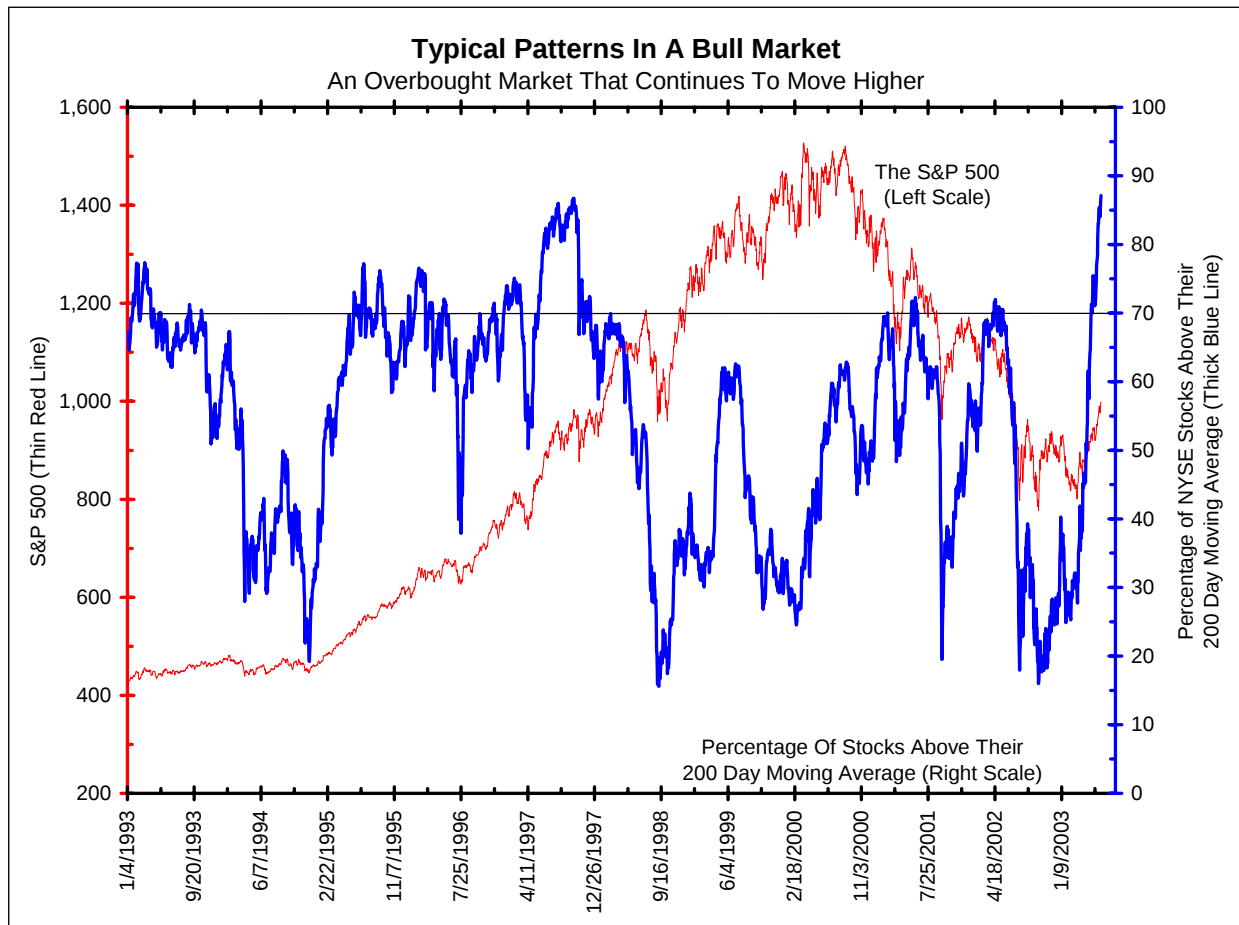
Three different methodologies that arrive at similar price targets increase the likelihood the target will be met.



How Does The Beginning Of A Bull Market Act?

As the S&P 500 was marching toward the 965 level (the upper end of its 10-month trading range), several indicators of market sentiment and

momentum were flashing warning signals. They were suggesting the market was about to peak and continue its three-plus year decline. One such indicator is shown below – the percentage of NYSE stocks above their 200-day moving average.



Since 2000, each time the percentage of stocks above their 200-day moving average approached 70%, the S&P 500 peaked and continued its broader downtrend. However, in early June the S&P 500 continued moving higher and this indicator broke out and reached 85+% -- a level last seen during the bull market year of 1997.

This is typical of the beginning of a bull market. A market flashes an overbought extreme and ignores it. When this happens, it suggests a market is taking on the characteristics of a bull market environment. In other words, it no longer tops at "bear market levels" (70%), but now will go to "bull market extremes" of 85+%.

However, new bull market or not, all overbought extremes eventually have to be corrected. **This suggests the current rally is unlikely to move all the way to 1,150 or 1,155 without a meaningful correction first.**

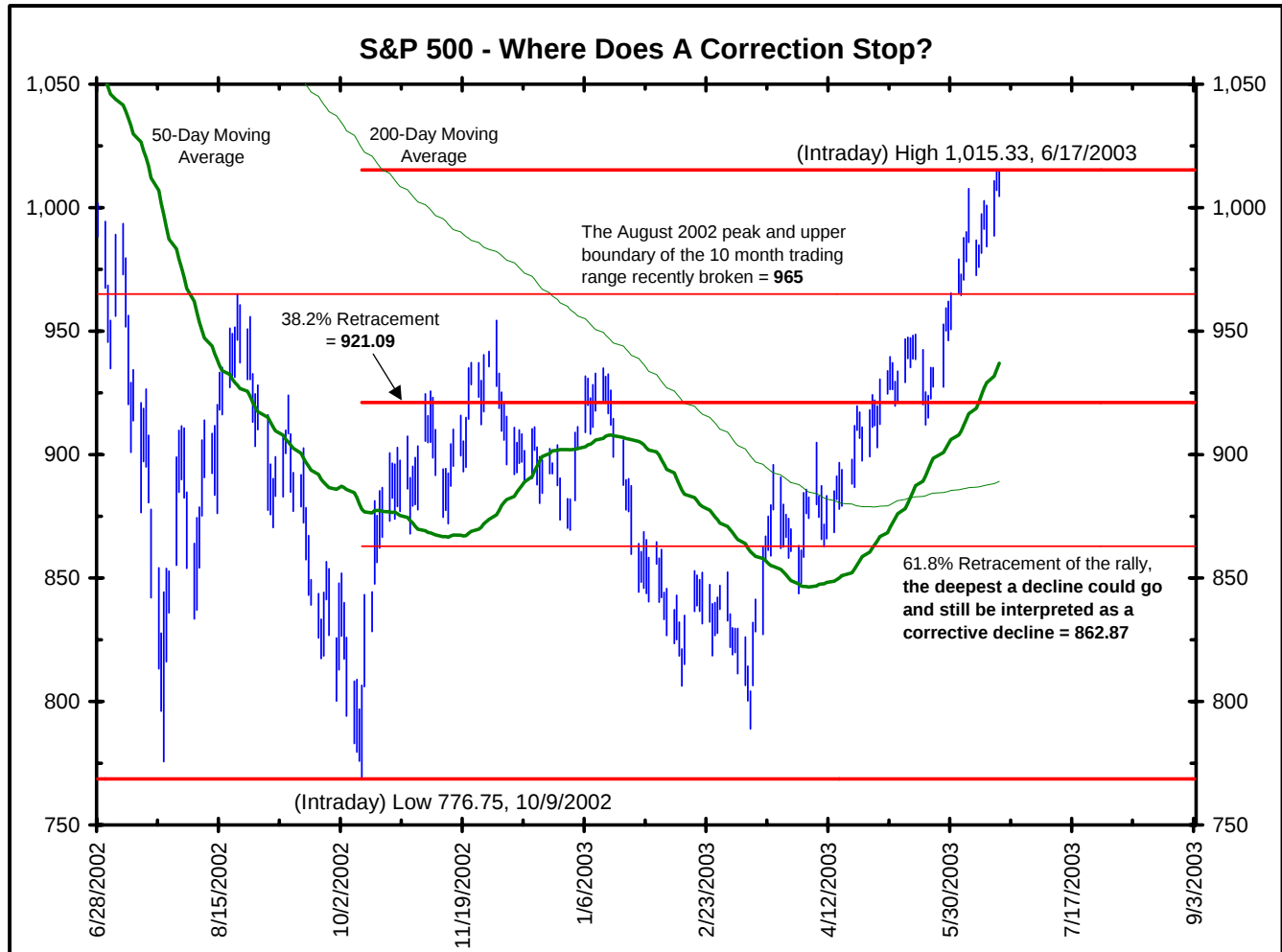
What Would Future Weakness In The S&P 500 Mean?

Up to a point, a decline in the S&P 500 should now be viewed as a correction in a bull market. Thus, there are a few likely places for it to end and for the next move higher to begin. They are as follows (and highlighted on the next page):

965: The August 2002 peak and upper boundary of the 10-month trading range the index recently rose above. If the market is as strong as it has been acting recently, **this is a likely place for the rally to resume.**

921: 38.2% retracement of the current rally from the October 2002 low and also the approximate location of the 50-day moving average.

862: The 61.8% retracement of the rally, and **the deepest a decline could go and still be interpreted as a correction in a bull market, rather than the resumption of the three year bear market.**



Conclusion

It took 189 points to establish that the current rally is indeed a bull market (from the 776 bottom to the 965 breakout). It took a move of this magnitude because we had a nearly 800-point, three-year downtrend in the S&P 500 to overcome. Similarly, three years ago it took a decline of a few hundred points to establish the downtrend as a bear market.

These distinctions are important because they help to establish parameters within which to view the market. If stocks are in a bull market, a 50- or 60-point drop would not invalidate the fact that a bull

market has been established. Therefore, corrections of this size should not be viewed as the beginning of a significantly larger sell-off, as they were during the bear market. Rather, a 50- or 60-point drop can be viewed as a "normal" correction in a bull market and a buying opportunity.

The technical nature of the breakout and similarities to other bull markets suggests the S&P 500 is headed higher, with 1,150 to 1,155 as an initial target. Several different measures arrive at nearly the same target. This increases the likelihood this target area will be met – and the bull market will continue.

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