

Market Timing

Led by Oil and Financials, the Canadian TSX index drops 772 pts (7%) in October alone...

We apologize for being a few days late in sending out October's update, so much was happening this month in the markets, we wanted to wait right to the last day on Monday of this week, before we offered our comments.

As you all know, since the first quarter of 2005 we have been cautious about the market outlook and especially in regards to the oil/gas and income trust sector. By our analysis, the oil sector had been in extreme overbought territory for a long time and was the main, if not the only driver, of the TSX's gains for 2005. October brought part of the long expected correction dropping the index to 10,188, making its year to date gains up 10.8%. With the 5.3% gains we captured in the TSE to March plus the interest we have earned on the proceeds to date, we are just 4% behind the index in performance to October 31 for 2005. However our analysis suggests that we are not through with this leg of the TSX's correction just yet.

Our discipline has kept capital out of these highly volatile markets for the past several months. This has been a benefit in protecting your money. For those of you who are thinking "surely to God there must have been other places on the globe that have seen excellent returns to Canadian investors this year?" The answer is NO!

In Canadian dollar terms the S&P 500 (500 of the best companies in the US) is negative for the year. The Dow 30 (largest 30 companies in US), and the NASDAQ are negative for the year. What about over the pond? The EAFE (Europe, Australasia and Far East) representing over 700 non-North American companies is also negative for the year.

The love affair with long bonds and income trusts is coming to a nasty conclusion. As our analysis previously cautioned, the Income Trust Index unit (IDX. UN) dropped 15% in value during the past month. This means those holding it (not our clients) have given back all of the year's income distributions, and have lost an additional 8% of invested capital.

Are we getting closer to a buy? Yes! Of late we have seen signs of strength in some of the US indices, but the when is yet to be determined as the forces of supply and demand



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battle this out over the next few days and weeks.

MORE RATE HIKES IN STORE!

This month marked the 12th consecutive rate hike by the US Federal since they started tightening back in June 2004. The overnight lending rate in the US is now 4% vs. the 1% it started from over 16 months ago. In Canada our overnight rates moved up as well to 3.5%. Current expectations are for the overnight rate in the US is to move to 4.5% and in Canada to 4% by the spring of 2006. The risks around this forecast are that outbreaks of above-target inflation may require the Feds to go further than these expected levels to keep prices contained in the comfort zone.

Central bankers have been issuing a good deal of "hawkish sentiment" in recent communications where in they conclude that our economies are now running at full capacity. This may seem like a good thing, but in economic speak it means they must be vigilant in continuing to raise interest rates in order to combat the anticipated inflation bouts that spring from economies at full production and full employment. Post-Katrina, the re-build is just starting to show up in demand numbers. How much inflation this alone will add to the stew, is unknown.

While the rate hikes are needed between now and the first half of 2006 to contain inflation, most commentators are also in agreement that these hikes and the inevitable slowing they will bring also present risks of recession half way through 2006. The question as always, is just how soft can this landing be in 2006/2007?

We stay tuned...

Good News Announcement: Cory's thesis on Translating Confirmation Tools is being published in the *Journal of Technical Analysis*, New York, New York in January 2006.

In creating part of the technical analysis rules for our risk management system, Cory noticed that it was beneficial to use a shorter confirmation count for indicators in a contracting market than one uses in an expanding market. He observed that like a wave of water cresting, markets tend to peak to the right of centre. This is called translation bias. In testing this thesis over 20 years of data, he dubbed this revised indicator, the Translated Moving Average Crossover or TMAC. He recently submitted his thesis to the Market Technicians Association in New York and they asked that he allow his work to be published in the *Journal of Technical Analysis*, which is the most prestigious professional journal for market technicians in the world.

This will be coming out in January 2006, and he has already been asked to present his thesis as a guest lecturer to the Canadian Society of Technical Analysts in the New Year as well. We are proud of him...in little old Barrie... (but we are not telling him that, or there would be no living with him.)

Best Regards,

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