### Market Elements

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Page</th>
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<tbody>
<tr>
<td>October 11, 2013</td>
<td>NEW Market Elements</td>
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### Relative Strength Filter

<table>
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<tr>
<td>October 15, 2013</td>
<td>NEW Steel Now 3rd Decile – NUE, SCHN, VALE</td>
<td>9</td>
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<tr>
<td>October 11, 2013</td>
<td>Gold Shorts – SSL, DGC</td>
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<td>October 10, 2013</td>
<td>European Banks Part II – Breaking Out</td>
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<tr>
<td>October 9, 2013</td>
<td>You Know You Are in Trouble When</td>
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<td>October 8, 2013</td>
<td>Debt Woe Waining – Not U.S., but European Banks</td>
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<td>October 7, 2013</td>
<td>Take It Out on Materials</td>
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<td>October 4, 2013</td>
<td>Industrial Internals &amp; Transportation Infrastructure</td>
<td>15</td>
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<td>October 3, 2013</td>
<td>Aerospace &amp; Defense – Too Close to the Sun</td>
<td>16</td>
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<td>October 2, 2013</td>
<td>Sell Small Cap Value Traps to Buy Earnings Growth</td>
<td>17</td>
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<tr>
<td>October 1, 2013</td>
<td>Wireless Breaking Out of Decade-Long Base</td>
<td>18</td>
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<td>September 30, 2013</td>
<td>Cashing Up With Staples – GIS, CPB, SAFM</td>
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<tr>
<td>September 27, 2013</td>
<td>Looking for Trouble, Financials Again</td>
<td>20</td>
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<td>September 26, 2013</td>
<td>Staples for Sale</td>
<td>21</td>
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<tr>
<td>September 25, 2013</td>
<td>U.S. Financial Weakness Part 2 – JPM, C</td>
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<td>September 24, 2013</td>
<td>U.S. Rate Relief : Sell Financials to Buy Some UTs</td>
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### Focal Points

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<tr>
<td>June 24, 2013</td>
<td>Tighten Up</td>
<td>24</td>
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This report was prepared by an analyst(s) employed by BMO Nesbitt Burns Inc., and who is (are) not registered as a research analyst(s) under FINRA rules. For disclosure statements, including the Analyst's Certification, please refer to pages 30 to 31.
Most equity indices added to Thursday’s gain; the MSCI World Bank index edged to a new high; golds weighed on the TSX.

US default tea leaf watch: Oct bills continued to climb down from Thursdays 50bps peak while Dec yields made new highs; corporate default indices improved for the 2nd day; safe haven yields were little changed.

BRL and INR added to Thursday’s gain while EM volatility broke back below its 150d MA; the yen fell for the 4th consecutive session; DXY and EUR maintained recent ranges.

Gold & silver both sank over 2% (gold tripped a circuit breaker); corn fell to a new 3y low; base metals rebounded.

Source for all data and graphics in this publication: BMO Capital Markets, Bloomberg, Thomson

* H/L = at a new closing 52- wk High/Low; */# = within 10% of the 52- week High/Low. Colour codes are inverted for bond and sentiment indications.
Daily Charts
3-Month View with 26-Day Bollinger Bands and 150-, 200- and 50-Day Moving Averages

- The Asia dollar index used to be a good indication of “China bull/bear”. It’s forming a nice consolidation, and is breaking above MAs.
  - We are going to watch it a bit closer.
  - It jibes with the strength we are seeing in the Baltic Dry, and steel stocks, and the stickiness in inflation expectations.
- Down goes default risk, down goes gold.
Intra Day Charts
2-Day 1-Minute View

Currencies
U.S. Dollar Index

Commodities
D.J.-UBS Commodity Price Index

Bonds
U.S. 10-Yr Bond

Equities
MSCI World Index

Yen

Gold (Spot)

U.S. 5Yr 5Yr Forward Breakeven

S&P 500

Euro

Crude Oil (WTI)

Japanese 10-Yr Bond

S&P/TSX Composite

Asia Dollar Index

Natural Gas (NMX)

Canadian 10-Yr Bond

CDX North American Inv. Grade Index

Canadian Dollar

Copper (CMX)

German 10-Yr Bund

VIX

Australian Dollar

Nickel (LME 3Mo)

Italian 10-Yr Bond

DOOM: 1M Yen IV (AUD,EUR,USD)
Daily Sector Charts
3-Month View with 26-Day Bollinger Bands and 150-, 200- and 50-Day Moving Averages

- **Canada** – at a 52-week high: Consumer Discretionary, Financials.
- **Europe** – at a 52-week high: Financials, Telecommunications Services.

**S&P 500**

**S&P/TSX Composite**

**S&P Europe 350**
## Market Elements

### Market Movers – Largest Daily Percentage Moves

#### S&P Global 1200 ex U.S. & Canada

<table>
<thead>
<tr>
<th>Name</th>
<th>Symbol</th>
<th>% Chg</th>
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<th>Symbol</th>
<th>% Chg</th>
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<tbody>
<tr>
<td>AMEC PLC</td>
<td>AMEC</td>
<td>2.3%</td>
<td>Tesoro Corp</td>
<td>TSO</td>
<td>3.6%</td>
</tr>
<tr>
<td>CNOOC Ltd</td>
<td>883 HK</td>
<td>1.9%</td>
<td>CONSOL Energy Inc</td>
<td>CNX</td>
<td>3.8%</td>
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<tr>
<td>Origin Energy Ltd</td>
<td>ORG AT</td>
<td>1.9%</td>
<td>Marathon Petroleum Corp</td>
<td>MPM</td>
<td>3.0%</td>
</tr>
<tr>
<td>Subsea 7 SA</td>
<td>SUBC</td>
<td>-0.7%</td>
<td>Marathon Oil Corp</td>
<td>MRO</td>
<td>-0.6%</td>
</tr>
<tr>
<td>WorleyParsons Ltd</td>
<td>WOR AT</td>
<td>-1.2%</td>
<td>Noble Corp</td>
<td>NE</td>
<td>-0.7%</td>
</tr>
<tr>
<td>Sapem SpA</td>
<td>SPM IM</td>
<td>-4.4%</td>
<td>EnESCO PLC</td>
<td>ESV</td>
<td>-0.7%</td>
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<td>Toyo Seikan Group Holdings Ltd</td>
<td>5901</td>
<td>4.2%</td>
<td>Cliffs Natural Resources Inc</td>
<td>CLF</td>
<td>3.7%</td>
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<tr>
<td>Oji Holdings Corp</td>
<td>3861 J</td>
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<td>Dow Chemical Co/The</td>
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<td>Nippon Steel &amp; Sumitomo Metal</td>
<td>5401</td>
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<td>Ball Corp</td>
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<td>Cerex SAB de CV</td>
<td>CEMEX</td>
<td>1.7%</td>
<td>CF Industries Holdings Inc</td>
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<tr>
<td>Sociedad Quinua y Minera de C</td>
<td>SQM</td>
<td>-1.8%</td>
<td>Mosaic Co/The</td>
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<td>Clariant AG</td>
<td>CLN VX</td>
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<td>Newmont Mining Corp</td>
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<tr>
<td>Qantas Airways Ltd</td>
<td>QAN J</td>
<td>4.6%</td>
<td>Quinta Services Inc</td>
<td>PWR</td>
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<td>FANUC Corp</td>
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<td>Masco Corp</td>
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<td>Melita Corp</td>
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<td>Eaton Corp PLC</td>
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<tr>
<td>BAE Systems PLC</td>
<td>BAV LN</td>
<td>-3.2%</td>
<td>ADT Corp/The</td>
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<tr>
<td>Firmecamnica SpA</td>
<td>FNC IM</td>
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<td>Fastned Co</td>
<td>FAST</td>
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<td>PostNL NV</td>
<td>PNL NA</td>
<td>-4.4%</td>
<td>Iron Mountain Inc</td>
<td>IRM</td>
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<tr>
<td>APA Group</td>
<td>APA AT</td>
<td>1.2%</td>
<td>Wisconsin Energy Corp</td>
<td>WEC</td>
<td>1.2%</td>
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<tr>
<td>Cielo SA</td>
<td>CIEL BS</td>
<td>3.2%</td>
<td>Hewlett-Packard Co</td>
<td>HPQ</td>
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<tr>
<td>Telefonacionileabolat LM Ericsson</td>
<td>ERCB</td>
<td>-0.6%</td>
<td>Salesforce.com Inc</td>
<td>CRM</td>
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<td>Alcatel-Lucent/France</td>
<td>ALU FP</td>
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<td>Electronic Arts Inc</td>
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<td>Yahoo Japan Corp</td>
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<td>Micron Technology Inc</td>
<td>MU</td>
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<td>Oi SA</td>
<td>OIBR</td>
<td>4.5%</td>
<td>Frontier Communications Corp</td>
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<td>Portugal Telecom SGPS SA</td>
<td>PTC PL</td>
<td>3.9%</td>
<td>Windstream Holdings Inc</td>
<td>WIN</td>
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<td>America Movil SAB de CV</td>
<td>AMXL</td>
<td>2.5%</td>
<td>Crown Castle International Corp</td>
<td>CCI</td>
<td>0.8%</td>
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<tr>
<td>Deutsche Telekom AG</td>
<td>DTE GY</td>
<td>-1.3%</td>
<td>Veronica Communications Inc</td>
<td>VZ</td>
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<td>Telecom Austria AG</td>
<td>TK A V</td>
<td>-1.5%</td>
<td>AT&amp;T Inc</td>
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<td>Orange SA</td>
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<td>CenturyLink Inc</td>
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<tr>
<td>Tokyo Electric Power Co Inc</td>
<td>9501 J</td>
<td>1.0%</td>
<td>ONEOK Inc</td>
<td>OKE</td>
<td>-0.1%</td>
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<tr>
<td>RWE AG</td>
<td>RWE GY</td>
<td>-2.1%</td>
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<tr>
<td>E.ON SE</td>
<td>EOANGY</td>
<td>-3.0%</td>
<td>FirstEnergy Corp</td>
<td>FE</td>
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**Bold** = move of more than 5%

#### S&P 500

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<tr>
<th>Name</th>
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#### S&P/TSX Composite

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<td>Home Capital Group Inc</td>
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<td>Royal Bank of Canada</td>
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### Market Elements

#### Materials

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### Health Care

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<td>FirstEnergy Corp</td>
<td>FE</td>
<td>-0.1%</td>
</tr>
</tbody>
</table>

**Bold** = move of more than 5%
## U.S. Market Movers

### Energy
- **Symbol**  | **Last** | **% Chg**
--- | --- | ---
ESV  | 54.77 | -0.7%
NGL  | 37.70 | 0.4%
NGLX | 63.57 | 0.5%
NBR  | 17.09 | -2.2%
HAP  | 73.88 | 1.1%
EDC  | 36.60 | 0.2%
PTEN | 23.16 | 1.4%
UNG  | 48.44 | 0.7%
ATW  | 55.76 | 0.5%
PES  | 8.04 | 4.1%

### Industrials
- **Symbol**  | **Last** | **% Chg**
--- | --- | ---
ATI  | 5.25 | 0.3%
IFF  | 53.52 | 4.5%
APD  | 35.43 | 1.8%
ASH  | 16.73 | 2.4%
DOW  | 24.52 | 1.0%
IO  | 21.21 | 0.3%
EXH | 97.13 | 0.8%

### Consumer Discretionary
- **Symbol**  | **Last** | **% Chg**
--- | --- | ---
JCI  | 42.10 | 1.2%
GM  | 34.99 | 0.0%
F  | 17.11 | 1.1%
WDC  | 65.75 | 1.9%
MHK | 129.95 | 8.6%
PMI  | 16.11 | 1.6%
NVR  | 913.58 | 1.2%
WHR  | 140.42 | -0.8%
NWL | 27.81 | 2.1%
MAT  | 41.75 | 1.3%
HAS | 46.72 | 0.9%
COH | 54.59 | 0.7%
FVC  | 196.10 | 0.7%
RL  | 161.34 | -1.4%
NKE  | 73.46 | 0.0%
LVH | 60.83 | 3.1%

### Consumer Staples
- **Symbol**  | **Last** | **% Chg**
--- | --- | ---
CVS  | 59.57 | 1.4%
SNY  | 53.54 | 0.8%
KR  | 41.71 | 2.5%
SWY | 135.65 | 6.9%
WMT | 74.02 | 0.0%
CO  | 115.90 | 2.0%
WBA | 72.20 | 1.2%

### Technology
- **Symbol**  | **Last** | **% Chg**
--- | --- | ---
GOOG  | 879.04 | 1.4%
EBAY | 54.67 | 0.0%
YHOO | 34.15 | 0.8%
AKAM | 51.89 | 1.6%
VNM  | 51.31 | 3.3%
ACN  | 72.71 | 0.0%

### Materials
- **Symbol**  | **Last** | **% Chg**
--- | --- | ---
HCL  | 77.09 | -1.3%
ES  | 19.41 | -0.0%
PAH  | 19.07 | -2.9%
BMY  | 74.27 | 1.2%
BMY  | 62.07 | -0.0%

### Health Care
- **Symbol**  | **Last** | **% Chg**
--- | --- | ---
MDT  | 54.99 | 1.0%
BAX  | 66.00 | 0.1%
COV  | 63.14 | 1.6%
VRTX | 20.87 | 1.8%
IRX | 97.32 | 0.7%

### Utilities
- **Symbol**  | **Last** | **% Chg**
--- | --- | ---
SO  | 61.49 | 2.2%
EX  | 33.23 | 1.1%
SE  | 58.97 | 0.8%
SRE | 50.84 | 1.0%

### Financials
- **Symbol**  | **Last** | **% Chg**
--- | --- | ---
WFC  | 41.43 | -0.0%
USB  | 37.56 | 0.0%
CMA  | 40.63 | 0.8%
JPM  | 72.96 | 0.2%
BBT  | 33.73 | 1.3%
STI  | 33.50 | -1.8%
FITB  | 18.20 | 0.3%

### Market Elements
- **Symbol**  | **Last** | **% Chg**
--- | --- | ---
V  | 192.20 | -1.6%
MA  | 684.18 | -0.8%
HCA  | 48.11 | -0.7%
AMT  | 74.11 | 1.7%
NYCHB | 15.63 | 0.0%
HCBK | 9.34 | 0.7%
PBRCT | 14.78 | -0.5%
BAC  | 14.19 | -0.2%
JPM  | 52.51 | -0.0%
C  | 49.92 | -0.1%

---

**HighLow**: **High Low**; **High**: is within 10% of the **52-wk Low**; **HighLow**: move of more than 5%
### Canadian Market Movers

#### Energy
- **Symbol**: WRG, NVA, IAE, KOG US, EFX, PSI
- **Last Chg**: 7.75, 6.88, 13.90, 0.2%, -1.1%, -0.4%

#### Materials
- **Symbol**: GEI, BNE, IOC US, LUN, RC, BDI
- **Last Chg**: 25.40, 7.28, 67.17, 4.47, -0.8%, -1.1%

#### Industrials
- **Symbol**: TBH, WPT, RUS, FTT, NTL US, RBA, DCL, DFI
- **Last Chg**: 22.26, 25.75, 26.23, 23.57, -1.0%, -1.5%

#### Consumer Discretionary
- **Symbol**: MG, UN, MRE, DOO, GC, AYA, GC
- **Last Chg**: 88.03, 34.43, 10.88, -1.6%, -0.6%

#### Technology
- **Symbol**: OTC, GDC, MEQ, MDZ/A, RCI/B, GLU, IAC/V
- **Last Chg**: 4.12, 19.25, 0.5%, 7.18, -0.2%

#### Financials
- **Symbol**: XIT, XRC, BCA, RJH, CD/A, WJX, AMG
- **Last Chg**: 18.61, 13.80, 1.0%, 17.81, -0.2%

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#### Market Elements

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### Utilities
- **Symbol**: SMF, CG, HBC, MDZ/A, MDI, NDM
- **Last Chg**: 2.35, 4.37, 1.4%, 3.95, 3.9%, -5.0%

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### Telecom Services
- **Symbol**: BXX, BAC, RJH, WJX, MDZ/A
- **Last Chg**: 20.14, 8.74, 18.71, 0.5%, 3.95

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### Health Care
- **Symbol**: NVDQ U, IM, DR, ACC, LW, RCL, EAM
- **Last Chg**: 18.32, 15.90, 8.74, 10.64, 7.80, 46.95

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### Consumer Staples
- **Symbol**: SC, PJC/A, GO, APE, MB, GL
- **Last Chg**: 60.01, 18.30, 4.56, 5.99, 20.20, 46.32

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### Other Market Movements
- **Symbol**: MIX, CPG, L, BKF, ATDD/B, EMPA
- **Last Chg**: 56.55, 4.56, 4.56, -0.6%, -0.6%, -0.6%
Steel Now 3rd Decile – NUE, SCHN, VALE

TOOLKIT

- we wrote on the steel industry last almost a month ago, the industry had improved to a neutral reading, which was the time to consider bottom fishing.
- On Monday, that score rose to 3rd decile – Figure 1. At this point, we believe you should have steel as a consideration in the generalist portfolio, and if you are a resource specialist suffering with 10th decile golds, and 8th decile diversified metals and miners, you should be overweight the steel group.

Nucor is a large cap, low volatility outperformer. Shares broke out of a head and shoulders bottom early this year, and are now trending higher at a rate of 30%/year – Figure 1. This leads to outperformance of 16% against ACWI, and 25% against the materials sector. The CDS trend is narrowing, and 50, 150, and 200d MAs are all positive.

Schnitzer Steel is our small cap pick, trending higher at the same rate as Nucor, yet its shares are still in the bottoming pattern – Figure 3. This company ranks 1st decile on our dividend screen due to an indicated yield of 2.6% and positive dividend growth record.

Vale is the largest steel stock by market cap, its 5yr CDS broke below a widening trend last week (Figure 4), and shares broke above a downtrend yesterday. This is the trigger to cover shorts and consider the potential for a V-bottom.

Figure 1: Steel Relative Strength Decile

Figure 2: Nucor (NUE US) DVD Adj Price Trend

Figure 3: Schnitzer Steel (SCHN US) DVD Adj Price Trend

Figure 4: Vale (VALE US) 5Yr CDS Trend (see Price Trend Here)
Gold Shorts – SSL, DGC

- This week has been heavy on highlighting the fruits of the last crisis, or going long European banks (see here and here), and also reading the tea leaves of the manufactured U.S. debt crisis, which is a focus on the hot potato nature of U.S. T-bills. All the while, we are looking at the head and shoulders top on gold, which measures down to $1,130, and waiting for it to come to fruition. We think it will soon – Figure 1. It’s harvest time. Happy Canadian Thanksgiving!
- The key feature of this next leg down will be the fact that credit will become a much larger part of the discussion – Figure 2.

- One-third of the gold stocks we cover are momentum sells, so the exercise of finding gold shorts is not a difficult one.
  - If we narrow the list down to top 20 by market cap, pick stocks above $5 and look at those whose Bollinger bands are narrow relative to history (consolidating losses) we can find the stocks that can pick-up downside volatility as gold falls.
  - Sandstorm Gold is in a very consistent downtrend, falling at a rate of just over 60%/year, and has been consolidating losses for six weeks. Shares are just breaking down from this consolidation now. Our downside target is $3.25 – Figure 3.
  - Detour Gold sports the highest implied volatility of the majors. It failed to form a head and shoulders bottom, will try to form a double bottom, and failing that, downside risk is to $5 – Figure 4.
- Our one-stop shopping gold link is titled Aurum.

Figure 1: Spot Gold

Figure 2: Gold Basket (AU, NEM, ABX) 5-Yr CDS

Figure 3: Sandstorm Gold (SSL CN) Price Trend

Figure 4: Detour (DGC CN) Gold Price Trend

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Relative Strength Filter

European Banks Part II – Breaking Out

- Why the media and market is going on about U.S. politics & the potential for debt default (and T-bill yields coast, yet do not retreat this morning), across the pond European banks are breaking out (Figure 1), as the cost to protect their debt against default is breaking down – Figure 2. Two days ago we highlighted the momentum buys and a risky and derisking Portuguese bank, all in Euro terms; today we look at European banks in USD terms for those that do not hedge.

- A link to USD price trends on European Banks is found here.
  - Amongst large caps, Banco Santander is breaking out of a 2-year bottoming pattern, which measures to $12.50 – Figure 3. The CDS trend that defines the “risky and derisking” driver is found here.
  - Amongst small caps, a momentum buy, whose stock has been sleeping for past six weeks while the CDS has been narrowing sharply, is Bank of Ireland – Figure 4.

Figure 1: MSCI European Bank Index – Breaking Out Today

Figure 2: 5-yr CDS Index on European Banks

Figure 3: Banco Santander SA (SAN US) Dvd Adj Price Trend

- 1Y Target $12.50

Figure 4: Bank of Ireland (IRE US) USD Price Trend

A link to USD price trends on European Banks is found here.

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
You Know You Are in Trouble When

- You know you are in trouble when stocks become highly correlated – Figure 1, and are being driven off of T-bill yields – Figure 2. That trouble is for quant models and program traders.

- You know you will find opportunities when stocks become highly correlated – Figure 1, and are being driven off of T-Bill yields – Figure 2. That opportunity is for investors that know that T-bill yields are not the long-term determinant of equity performance.

- The signalling at how long we will be in this U.S. default mess is found by looking at how high and how far out US T-Bill yields will be stressed during the “Brinkmanship”. This is the same statement we made Monday; the only difference is that is now “sells” are targeting both the stocks that are not liked (Monday’s list) and the stocks that are liked – Figure 1.

- We figure it is in between what you want to sell (pretty much everything is being sold now) and what you want to buy (the market is doing what markets do best, speak loudly such that politicians get it right in the end), so now is the time to put together shopping lists.

- We know what we like: earnings growth (earnings estimates being revised higher, positive earnings, long-term expected earnings growth exceeding 10%) is working in many segments of the market, our top 3 SubIndustry deciles will narrow this list down, and if you can get yield and dividend growth, why not. This narrow list is shown in Figure 3.

Figure 1: CBOE S&P 500 Implied Correlation (JCJ)

Quantifying “Group Think” When Stocks Become Highly Correlated For a Brief Time

Figure 2: S&P 500 and US 1m T-Bill Yield Yesterday

Figure 3: Stocks in Top 3 SubIndustry Deciles That Meet Both Our Earnings Growth Filter and Dividend Yield/Growth Filter

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Debt Woe Waining – Not U.S., but European Banks

- OK, U.S. debt woe is not waning yet, and U.S. political theatre is pushing both the VIX and implied correlation among U.S. stocks higher, but…
- …if you look across the pond at Europe (where indices are outperforming), the cost to protect European banks against default is forming another leg down – Figure 1.
  - And, yes, it’s the same picture for peripheral European Banks.

- If we scan European banks within MSCI Europe, we find:
  - High credit risk Banco Espirito Santo SA is forming both a major double bottom and a H&L bottom against MSCI Europe – Figure 2.
  - We classify one-fifth of European Banks as “momentum buys” due to consistent outperformance, positioning above rising moving averages, and the fact that they are not overbought – Figure 3.
  - The one bank that remains a momentum sell is Emerging Market-leveraged Standard Chartered. This makes sense given the credit picture we see in EM (see page 10 of this overview).
  - The reason you may not want to play European banks via an ETF is due to the underperformance of heavyweight HSBC.

Figure 1: 5-yr CDS Basket of European Banks

Figure 2: Banco Espirito Santo SA vs. MSCI Europe

Figure 3: European Bank Momentum Buys Against MSCI Europe

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Take It Out on Materials

- On the possibility of a U.S. debt default on U.S. Government “Brinkmanship,” there is lots of political noise out there and then there is signal. The signal comes from looking at the short end of the U.S. T-bill curve, and watching how elevated yields go, and how far out in time the “hot potato” pricing gets – Figure 1. On Friday, concern moved from late October to mid-November.

- Between our four weakest sectors, we expect that the market will treat the threat of U.S. default as a threat on the global economy and take it out on the Materials sector. This sector has recovered from horrid pricing of July, but remains negative, and has lost upside momentum. Otherwise put, there is a bid to sell into.

- We highlight USD price trends on the largest material momentum sells in the weakest five sub-industries in Figure 3 below. Charts are found at this link. We know there are many gold stocks in there, and many see a US default as a bonanza for gold, but we still see gold trending down – see link.

Figure 1: U.S. T-Bill Pricing at 6:50am This Morning (BBT)

Figure 2: Materials Relative Strength Z-Score

Figure 3: USD Price Trends on Largest 20 Developed Market Material Momentum Sells in The Weakest SubIndustries

Source: BMO Capital Markets, Bloomberg, Thomson, Markit

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Relative Strength Filter

Industrial Internals & Transportation Infrastructure

- The weakest sector momentum this week was found in **Industrials** – Figure 1. This sector has undoubtedly received flows that did not want to go into resources, as typically industrial and resource strength is paired, but that was not the case this time around.

- Digging into the internals (Figure 2), the most material casualty has been government spending related **Aerospace** (which we covered yesterday). There has also been strength, however, notably in **Airlines**, which are making a comeback, and **transportation infrastructure**.

- Airlines are a great recovery story. They have had a great 2H 2012-13, but stepping back, they are just now breaking out of a bottoming formation, and are still recovering from a three-year decline – Figure 3.

- Transportation Infrastructure is coming up to a key inflection point – Figure 4. It was a former stellar outperformer that has spent the last six years market/underperforming and is close to taking out this key downtrend. In a portfolio, benchmarked against a **Global Infrastructure Index**, transportation makes up one-third of the momentum buy list – Figure 5.

---

**Figure 1: Industrial Relative Strength Z-Score**

**Figure 2: MSCI World Industrial Industries vs. MSCI World**

**Figure 3: Airlines vs. MSCI World**

**Figure 4: Transportation Infrastructure vs. MSCI World**

**Figure 5: Transportation Infrastructure Momentum Buys vs Macquarie Global Infrastructure Index**

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Relative Strength Filter

Aerospace & Defense – Too Close to the Sun

- It is day 3 of the U.S. government shutdown, and there will be problems for some companies that rely on the government.
- Lockheed Martin, Northrop Grumman and Rockwell Collins have broken below outperforming trends. Raytheon has also broken down against a global benchmark.
- If you missed Aerospace & Defense this year, you missed a great party. After marketperforming for four years, the relative performance spiked like it has not done in over a decade – Figure 1. A pullback after such a fantastic run would be significant in scale.
- This subindustry is typically a heterogeneous mixture of stocks, which shows up in our breadth work as a group that would look more like noise than signal. That was until this year, when the reading coalesced at the first decile position. That coalescence is starting to break down again – Figure 2.

- Lockheed Martin is the largest stock to have broken both its outperformance and steep dividend-adjusted price trend. It is just starting to enter a support zone now, but if it breaks below $120, there is an air pocket until $108 – Figure 3.
- Raytheon (Figure 4) and Northrop Grumman have similar patterns.
Sell Small Cap Value Traps to Buy Earnings Growth

- Why small caps? More upside torque, and while large caps are pulling back, small caps are hitting new highs – see this link.
- Last week we highlighted the fact that positive earnings growth is working for small caps, while a value focus is actually harnessing negative results. Today we will focus on both, suggesting some value traps to dispose of (or short) while harnessing some earnings growth-focused stocks as replacement alternatives.
- Value traps (sells/shorts) are on the left: Sherritt, CVR Partners, and Erie Indemnity. They are all from weak subindustries, and are not oversold. Earnings growth (buys/overweights) stocks are on the right: Mullen Group, On Assignment and 8x8. They are from strong subindustries, and are not overbought. All of our screens and charts came from this link.

Value Traps to Sell
Figure 1: Sherritt Intl (S CN) Dividend Adjusted Price Trend

Earnings Growth to Buy
Figure 2: Mullen Group (MTL CN) Dvd Adjusted Price Trend

Figure 3: CVR Partners LP (UAN US) Dvd Adj Price Trend

Figure 4: On Assignment Inc. (ASGN) Price Trend

Figure 5: Erie Indemnity (ERIE US) Dvd Adjusted Price Trend

Figure 6: 8x8 Inc. (EGHT US) Price Trend

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Relative Strength Filter

Wireless Breaking Out of Decade-Long Base

- Wireless telecom just hit 1st decile – Figure 1.
- It is the new staple.
- Looking longer term, the relative performance of the global wireless group is breaking out of a decade-long base – Figure 2.
- Softbank is the current very buyable large cap momentum buy, just breaking out of a consolidation pattern – Figure 3.
- Cellcom Israel is closer to the bottom, yet has still established itself as a momentum buy, and has also just started to break out of a consolidation pattern on volume yesterday – Figure 4.
- SBA Communications has very low volatility, is reversing an underperforming trend against the S&P 500, and is breaking out on an absolute price basis – Figure 5.
- SK Telecom is a large, liquid, emerging market stock with moderately low volatility, good upside torque, and shares are also breaking out of a 5mo consolidation pattern – Figure 6.

Figure 1: Wireless Telecom Relative Strength Decile

Figure 2: World Wireless Telecom vs. MSCI World

Figure 3: Softbank Corp DVD Adjusted Price Trend in USD

Figure 4: Cellcom Israel Dividend Adjusted Price Trend in USD

Figure 5: SBA Communications Dividend Adjusted Price Trend

Figure 6: SK Telecom Dividend Adjusted Price Trend in USD

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Cashing Up With Staples – GIS, CPB, SAFM

- If anything, we expect our clients will treat current equity weakness as a buy, but perhaps not quite yet. The strength we see is in Industrials, Technology and segments of the Consumer Discretionary sector. We will focus on what can be sold to make room for such purchases.
- While U.S. indices hit new highs in September, four sectors did not: Financials, Staples, and interest rate sensitive Telecom and Utilities. Given the improvement in bond pricing and volatility, we focused heavily last week on the downside risks in Financials and Staples stocks.
- The staples sector has slid rather dramatically in our Group Selection Report – Figure 1.
- Below, we highlight three stocks that have broken outperforming trends, show topping patterns where RSI and MACD did not confirm the highs, and are priced quite a far distance from major support: General Mills, Campbell Soup, and Sanderson Farms – Figures 2-4.

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Looking for Trouble, Financials Again

- Fourth note in a row from us with a negative tone? Yes.
- Something smelly out there? Well, we have to admit that when see a head and shoulders top on the world’s 3rd largest financial, JPMorgan, we start looking for trouble. Bonds are also too well bid lately.
- On the whole, the credit market is trending in the right direction, yet over the past five days 18 out of 20 of the world’s too interconnected to fail financials have widened more than 5% – Figure 1.
- We will centre on financials – Figure 1. We will use our relative strength work to focus in on the weakest three industries in our group selection report. Then looking at the price trends in these 406 stocks, we are going to look for trouble.
- There are 11 stocks with broken price trends, we covered JPM and Citi a few days ago, but now just breaking down yesterday is CI Financial, which has been trending higher at a very impressive rate of 47%/year. We advocate trimming a position here. Shoot first we suppose – Figure 2.
- There are 34 stocks in our Momentum Sell list. The one Underperform rated by our REIT team is Hudson Pacific Properties – Figure 3.
- Finally, a credit situation where the CDS uptrend matches the equity downtrend – Standard Chartered PLC – Figure 4.

Figure 1: CDS Trends on Global Too Interconnected to Fails
Figure 2: CI Financial Dividend Adjusted Price Trend
Figure 3: Hudson Pacific Properties Dividend Adjusted Price
Figure 4: Standard Chartered PLC Dividend Adjusted Price

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Staples for Sale

- Not liking staples kind of feels like not liking a puppy, but according to our global breadth work, the sector is shifting out of neutral and toward more of a negative reading – Figure 1.
- From a market cap weighed relative strength standpoint, the trend is clearly negative, and consistently so –

Figure 1: Consumer Staples Relative Strength Z-Score

Stocks with weak technicals (breaking down, or momentum sells):
- Monster Beverage is a momentum stock on the verge of losing momentum, which can be a difficult time – Figure 3.
- Kellogg broke below support and we don’t see another level of safety for quite a few dollars lower – Figure 4.
- On our momentum sell list with high torque is Suedzucker AG, and with low torque, is Rogers Sugar – Figures 5, 6.

Figure 2: Consumer Staples vs. MSCI World

Figure 3: Monster Beverage (MNST) Price Trend

Figure 4: Kellogg Dividend Adjusted Price Trend

Figure 5: Suedzucker AG Dividend Adjusted Price Trend

Figure 6: Rogers Sugar Dividend Adjusted Price Trend

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Weakening U.S. Financials are making a notable mark on the U.S. equity market, which is sinking relative to the ACWI – Figure 1.

The four major Financial sub-industries: Other Diversified Financials (JPM, BAC, C), Diversified Banks (WFC, CMA, USB), Regional Banks, and Asset Managers have all broken below 50d MAs.

Half of the stocks in the 500 that have broken below outperforming trends are financials – Figure 2.

- JPM sports a “textbook” distribution top and has downside risk to $44 – Figure 3.
- Citigroup just broke a consolidation pattern to the downside yesterday. Support and downside risk is to the $38-42 zone – Figure 4.
- And yes, treasuries continue to be very well bid this morning.
TOOLKIT

- The shellacking that bonds have taken since ‘taper’ hit the financial lexicon is starting to wane, with US and Canadian bond yields breaking below steep uptrends – Figure 1.
- At the same time, U.S. Financials are breaking below outperforming trends. You see this at the index level – Figure 2. You see it with the large bellwethers: WFC, JPM, BAC, C, PNC, …

With the rate relief, we suggest shifting some U.S. financials (which are breaking down) into some utilities, but a very specific group: the few that are in outperforming (if but only marginally) trends against the market, and also in outperforming trends against the sector – Figure 3.
- NextEra (NEE) is at the bottom end of the channel, which is rising at a rate of 27%/year – Figure 4.
- NiSource (NI) has spent six months consolidating gains. We expect shares to break to the upside – Figure 5.
Tighten Up

- In May and June, markets started a new dance called the Tighten Up.
  - 1st tighten up on the long end of the U.S. treasury curve – Figure 1.
  - 2nd tighten up the Chinese interbank lending curve – Figure 2.
  - 3rd tighten up on the short end of the U.S. treasury curve – Figure 3.

Sock it to me now
Tighten it up
*Archie Bell & The Drells*

- A tipping point has been reached. The central bankers’ bank (BIS) now deems that (1) there has been enough stimulus provided to the global economy, (2) more cannot be done without compounding risks that central banks have already created, and (3) easing has led to the delay of structural reforms (*BIS Annual Report June 23, 2013*).
- After a period of unprecedented central bank easing, and ultra low interest rate volatility, markets are adjusting to now rather rapid tightening and escalating volatility.
  - The known unknown is that when interest rates move from low and highly certain, to high and highly uncertain, that carry trades blow up. This was Long-Term Capital Management, this was Carlyle Capital Corporation, and this is the known unknown that markets are routing out now.
- Our goal over the next few pages is to detail these stresses, which we believe are still at very early stages. We expect global equity weakness to persist over the near term.

---

**Figure 1: U.S., German, and Japanese 10-Year Bond Yields (Top) and Implied Volatility (Bottom)**

**Figure 2: Chinese Interbank Lending Rates**

**Figure 3: Odds of a '14 Fed Rate Hike From Fed Funds Futures**

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
FOMC: Early Withdrawal? Really?

- There has been a change in the calculus of the FED this year. In BIS terms, “Delivering further extraordinary monetary stimulus is becoming increasingly perilous”.
  - U.S. inflation expectations just started to ease leading into the FOMC minutes release in February.
  - On February 20 we learned that the FED was concerned about its open ended QE policy.
    - This was also the start of the market's fascination with the term “tapering” which has been written about 150 times per day, on average, in the month of June (“NT Tapering” on Bloomberg).
  - Inflation expectations really started falling after Cypriot debt resolution uncertainty came to bear on March 18.
    - One month later, inflation expectations were breaking down globally.
  - While inflation expectations were falling, asset price inflation was picking up. This is obviously not the inflation that the fed targets, but it was the destination that the market was targeting for QE related flows.
  - Would outgoing Bernanke go down as the FED who stoked asset price inflation? – Figure 4.
    - On May 22 Bernanke and the FOMC told the market that QE could be stepped down as early as June.
    - On June 19 Bernanke delivered the withdrawal schedule verbally.
    - Asset price inflation is no longer a problem.
  - Asset price deflation in our clients’ portfolios is our key interest now.

Figure 4: US Inflation Expectations (10-Year Breakeven Rate) Top; FTSE Global REIT Index (TENHGU) Bottom
PBOC: Money Not in the Right Places

- While it may seem to be a stretch to jump from looking at inflation expectations at the long end of the U.S. curve, to the stresses at the ultra short end of the Chinese credit curve, it is not.
  - The combination of low U.S. interest rates, and interest rate volatility encouraged flows into emerging markets with higher-yielding assets.
  - The FOMC, whose policy underpins the world’s largest and most liquid bond market becomes the central banker to the world via the carry trade.
    - $3.9 trillion had flowed into emerging markets over the past four years.
- It is a mistake to apply market western policy thinking to policy action of the new People's Republic of China government, and the PBOC.
  - Rather than releasing stimulus in response to weak economic figures, which was the point where the Chinese sovereign CDS broke to the upside (Figure 5), China has done the opposite, has withheld stimulus, and has allowed banking stress to build – Figure 2.
  - China is getting its plumbing in order by reigning in the shadow banking system, which it needs to get under control such that it can have a handle on its financial system. During this plumbing exercise,
    - Chinese bank CDS levels are soaring – Figure 6.
    - Chinese Real Estate CDS levels are soaring – Figure 7.
- We are sure that the Minsky Moment for many shadowy players in the Chinese financial system is upon them now, but to call this the Lehman moment for China as a whole is premature. Possible, but premature – Figure 8.
  - China has breathing room to tighten up, and so it is.
  - Global growth oriented resource countries such as Canada should continue to be underweighted.

Figure 5: Chinese Sovereign CDS

Figure 6: Chinese Bank 5Yr CDS

Figure 7: Chinese Real Estate CDS

Figure 8: Chinese Sovereign CDS Levels and Curve
BIS: Borrowed Time

- The tone of the BIS annual report released Sunday shows central banking thinking turning from carrot to stick:

  *What central bank accommodation has done during the recovery is to borrow time...But the time has not been well used*

- The short end of the U.S. curve is tightening up.
  - The FED’s assessment, disclosed last Wednesday, was to bring the time of a rate hike forward by two months.
  - Fed funds futures on Friday signaled a greater than 50% probability of a FED rate hike next year – Figure 3.

- Nowhere does time seem to be more borrowed than in the European periphery where bonds received a massive ECB (Draghi) induced grace period. It seems that European policy makers could use the stick to un-jam the process that calm has created.
  - The stick is coming:
    - The Spanish sovereign CDS, like many others, has broken to the upside – Figure 9.
    - A peripheral European banks CDS basket is basing and should soon mint a higher high– Figure 10.
    - Italian-German and Spanish-German stress and spreads are just now starting to turn up again – Figure 11.
    - The Italian bank UniCredit remains the SIFI with the most inverted curve – Figures 12, 13.
SIFI: Stresses Rising

- The cost to protect systemically important financial institutions (SIFI) is rising – Figure 13.
  - Where the trends were showing improvement in creditworthiness (green wedges), the trends have broken (red arrows).
  - Our systems’ best fit for most European SIFI CDS trends is towards widening (red wedges).
- Debt protection costs at the short end of the curve (1yr) debt is rising faster than the long end of the curve (5yr).
  - Our SIFI CDS trend list below is sorted by this ratio (CDS Curve 1/5Yr).
  - No curve is even close to being over 100% (LEH-like), but it is interesting (and unflattering) to see Asia-centric HSBC line up close to UniCredit (top two lines in Figure 13).

Figure 13: CDS Trends on Too-Interconnected to Fail Banks

<table>
<thead>
<tr>
<th>Name</th>
<th>1-day Equity Chg (%)</th>
<th>5-day Equity Chg (%)</th>
<th>MktCap (US$)</th>
<th>Chg Last Day</th>
<th>CDS Trend Slope</th>
<th>CDS Hi (Mo)</th>
<th>CDS Low (Mo)</th>
<th>CDS Curve 1/5yr</th>
<th>CDS %Chg wrt 50 DMA</th>
<th>Chg wrt 50 Day MA Trend</th>
</tr>
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<tr>
<td>UniCredit SpA</td>
<td>-4.1%</td>
<td>-7.2%</td>
<td>27,666</td>
<td>↑</td>
<td>-13%</td>
<td>2.5</td>
<td>0.58</td>
<td>22%</td>
<td>Above Rising</td>
<td></td>
</tr>
<tr>
<td>HSBC Holdings PLC</td>
<td>-0.1%</td>
<td>-3.6%</td>
<td>191,403</td>
<td>↑</td>
<td>-30%</td>
<td>7.5</td>
<td>0.51</td>
<td>32%</td>
<td>Above Rising</td>
<td></td>
</tr>
<tr>
<td>ING Groep NV</td>
<td>-2.1%</td>
<td>-3.1%</td>
<td>33,509</td>
<td>↑</td>
<td>-45%</td>
<td>2.0</td>
<td>0.49</td>
<td>9%</td>
<td>Above Felling</td>
<td></td>
</tr>
<tr>
<td>Banco Santander SA</td>
<td>-1.2%</td>
<td>-6.9%</td>
<td>69,239</td>
<td>↑</td>
<td>-42%</td>
<td>2.5</td>
<td>0.47</td>
<td>24%</td>
<td>Above Rising</td>
<td></td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>-1.0%</td>
<td>-3.6%</td>
<td>48,825</td>
<td>↑</td>
<td>-60%</td>
<td>5.5</td>
<td>0.46</td>
<td>35%</td>
<td>Above Rising</td>
<td></td>
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<tr>
<td>Royal Bank of Scotland Group PLC</td>
<td>-5.1%</td>
<td>-10.3%</td>
<td>27,112</td>
<td>↑</td>
<td>-10%</td>
<td>9.5</td>
<td>0.46</td>
<td>43%</td>
<td>Above Rising</td>
<td></td>
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<td>Barclays PLC</td>
<td>-0.8%</td>
<td>-5.3%</td>
<td>56,350</td>
<td>↑</td>
<td>3%</td>
<td>7.0</td>
<td>0.44</td>
<td>22%</td>
<td>Above Rising</td>
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<td>Goldman Sachs Group Inc</td>
<td>-0.7%</td>
<td>-5.3%</td>
<td>70,724</td>
<td>↑</td>
<td>-49%</td>
<td>6.5</td>
<td>0.42</td>
<td>39%</td>
<td>Above Rising</td>
<td></td>
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<tr>
<td>Credit Suisse Group</td>
<td>-1.2%</td>
<td>-5.3%</td>
<td>42,253</td>
<td>↑</td>
<td>50%</td>
<td>7.0</td>
<td>0.38</td>
<td>20%</td>
<td>Above Rising</td>
<td></td>
</tr>
<tr>
<td>Bank of America Corp</td>
<td>-1.6%</td>
<td>-2.9%</td>
<td>136,803</td>
<td>↑</td>
<td>-47%</td>
<td>6.5</td>
<td>0.36</td>
<td>28%</td>
<td>Above Rising</td>
<td></td>
</tr>
<tr>
<td>Commerzbank AG</td>
<td>-2.3%</td>
<td>-1.8%</td>
<td>10,873</td>
<td>↑</td>
<td>35%</td>
<td>3.0</td>
<td>0.36</td>
<td>14%</td>
<td>Above Rising</td>
<td></td>
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<tr>
<td>Credit Agricole SA</td>
<td>-2.3%</td>
<td>-6.0%</td>
<td>21,255</td>
<td>↑</td>
<td>6%</td>
<td>2.0</td>
<td>0.35</td>
<td>15%</td>
<td>Above Rising</td>
<td></td>
</tr>
<tr>
<td>UBS AG</td>
<td>-1.5%</td>
<td>-4.7%</td>
<td>64,921</td>
<td>↑</td>
<td>11%</td>
<td>6.5</td>
<td>0.35</td>
<td>23%</td>
<td>Above Rising</td>
<td></td>
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<tr>
<td>Deutsche Bank AG</td>
<td>0.6%</td>
<td>-4.2%</td>
<td>44,674</td>
<td>↑</td>
<td>27%</td>
<td>2.5</td>
<td>0.35</td>
<td>19%</td>
<td>Above Rising</td>
<td></td>
</tr>
<tr>
<td>BNP Paribas</td>
<td>-2.6%</td>
<td>-5.9%</td>
<td>66,362</td>
<td>↑</td>
<td>-25%</td>
<td>2.5</td>
<td>0.35</td>
<td>10%</td>
<td>Above Rising</td>
<td></td>
</tr>
<tr>
<td>JPMorgan Chase &amp; Co</td>
<td>-1.0%</td>
<td>-2.2%</td>
<td>196,392</td>
<td>↑</td>
<td>-2%</td>
<td>6.5</td>
<td>0.34</td>
<td>18%</td>
<td>Above Rising</td>
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<td>Citigroup Inc</td>
<td>-2.2%</td>
<td>-4.8%</td>
<td>142,620</td>
<td>↑</td>
<td>-55%</td>
<td>5.5</td>
<td>0.33</td>
<td>31%</td>
<td>Above Rising</td>
<td></td>
</tr>
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<td>Societe Generale</td>
<td>-2.1%</td>
<td>-5.6%</td>
<td>27,619</td>
<td>↑</td>
<td>-16%</td>
<td>2.0</td>
<td>0.32</td>
<td>13%</td>
<td>Above Rising</td>
<td></td>
</tr>
<tr>
<td>Wells Fargo &amp; Co</td>
<td>2.2%</td>
<td>2.0%</td>
<td>216,940</td>
<td>↑</td>
<td>-29%</td>
<td>0.29</td>
<td>12%</td>
<td>Above Rising</td>
<td></td>
<td></td>
</tr>
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</table>
US Equities: Last Dot Finally Connected, Picture Now Emerging

- The stress in the banking system is just starting to be felt in the U.S. equity market – Figure 14.
  - The breakout in the cost to protect the US Banks against default last Thursday coincided with the breakdown in the S&P 500.
- The U.S. 2-year swap spread, a gauge of counterparty risk, has just started to get in the game – Figure 15.
  - It is still incredibly low – Figure 16, but will move higher with continued stress in the banking system.
  - When stresses are high enough, one can watch this counterparty risk move with S&P futures tick for tick.
  - We have not seen this yet, but are expecting it. When we see it, we will be closer to an equity bottom.
- The known unknown is that when interest rates move from low and highly certain to high and highly uncertain that carry trades blow up.
  - This is the precursor to LTCM, to CCC, and to the known unknown of 2013.
  - When this unknown is known, we believe equities will be lining up for a bottom.

Figure 14: US Bank CDS and the S&P 500
Figure 15: U.S. 2-year Swap Spread
Figure 16: U.S. 2-year Swap Spread – Long Term Perspective
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<th>Rating Category</th>
<th>BMOCM US Universe*</th>
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<td>Buy</td>
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<td>Sell</td>
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<td>1.5%</td>
<td>5.6%</td>
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* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.
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Mkt = Market Perform - Forecast to perform roughly in line with the analyst’s coverage universe on a total return basis;
Und = Underperform - Forecast to underperform the analyst’s coverage universe on a total return basis;
(S) = Speculative investment;
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