**Market Elements**

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<thead>
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<th>Date</th>
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<tr>
<td>June 6, 2012</td>
<td>Market Elements</td>
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**Relative Strength Filter**

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<tr>
<td>June 7, 2012</td>
<td>Feeding the FROB</td>
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<td>June 6, 2012</td>
<td>Zero Yield Trumping Negative - Gold</td>
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<td>June 5, 2012</td>
<td>Buying the Sell-Off</td>
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<td>June 4, 2012</td>
<td>5% Off With Volume Spike</td>
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<td>Fire</td>
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<td>May 31, 2012</td>
<td>Dive and Pre-Dive</td>
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<td>May 30, 2012</td>
<td>EU (German) Aid?</td>
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<td>May 29, 2012</td>
<td>Spanish Banks Hit New Lows</td>
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<td>Flattening the Canadian Book</td>
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<td>Oversold 1 – Wide Bands</td>
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<td>May 8, 2012</td>
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**Focal Points**

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<td>May 16, 2012</td>
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<td>SIFI Creditworthiness Breakdown</td>
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Market Elements

- The MSCI World index posted the best one-day showing for the year with a rally of 2.2%; Financials and Resources led the upside.
- Spanish 10-year bonds rallied for the fifth consecutive session amid speculation that the EU could inject funds into the Spanish FROB; North American safe haven yields surged for the third day.
- Commodity currencies led solid gains against the USD; the Euro rose to a seven-session high; the Asia dollar index rose 0.5%, its best showing of the year.
- Gold surged to a two-month high, and then retreated to close flat in late-afternoon trade; oil tracked equity gains; base metals were mixed.

Levels*

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<tr>
<th>Currencies (USD per)</th>
<th>Commodity</th>
<th>Government 10- Yr Benchmark</th>
<th>Equity Indices &amp; Sentiment</th>
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<tbody>
<tr>
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<td>High/Low</td>
<td>Level</td>
<td>%Chg</td>
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Moves

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<td>Lumber</td>
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<td>S&amp;P 1200</td>
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<td>Platinum</td>
<td>Italy</td>
<td>S&amp;P 500</td>
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<td>S&amp;P&amp;TSX</td>
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<td>WTI Oil</td>
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<td>LME Al 3m</td>
<td>Hong Kong</td>
<td>S&amp;P&amp;ASX</td>
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<td>Gold</td>
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<td>U.S.</td>
<td>S&amp;P&amp;ASX</td>
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<tr>
<td>JPY</td>
<td>LME Zn 3m</td>
<td>Germany</td>
<td>S&amp;P&amp;ASX</td>
</tr>
<tr>
<td>JPY</td>
<td>NMX Gas</td>
<td>UK</td>
<td>S&amp;P&amp;ASX</td>
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<td>Lumber</td>
<td>China</td>
<td>S&amp;P&amp;ASX</td>
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<td>Germany</td>
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Sectors

- S&P Global 1200
- S&P Europe 350
- S&P 500
- S&P/TSX Composite

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

- Europe weighs up limited Spanish rescue (injecting directly into the FROB) – FT.
- Spain comes to the bond market (with some small issues) on Thursday.
Intra Day Charts
2-Day 1-Minute View
Daily Sector Charts
3-Month View with 26-Day Bollinger Bands and 150-, 200- and 50-Day Moving Averages

- U.S. – at a 52-week high: Telecommunications Services.
## Market Movers – Largest Daily Percentage Moves

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

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<thead>
<tr>
<th>Name</th>
<th>Symbol</th>
<th>% Chg</th>
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<tr>
<td>Tullow Oil PLC</td>
<td>TLL LN</td>
<td>6.4%</td>
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<tr>
<td>Cairn Energy PLC</td>
<td>CNR LN</td>
<td>5.0%</td>
</tr>
<tr>
<td>AMEC PLC</td>
<td>AMEC LN</td>
<td>4.8%</td>
</tr>
<tr>
<td>WorleyParsons Ltd</td>
<td>WOR AT</td>
<td>0.1%</td>
</tr>
<tr>
<td>SK Innovation Co Ltd</td>
<td>066707 KP</td>
<td>0.0%</td>
</tr>
<tr>
<td>Origin Energy Ltd</td>
<td>ORG AT</td>
<td>-0.8%</td>
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### Materials

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<th>Symbol</th>
<th>% Chg</th>
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<tr>
<td>Lominn PLC</td>
<td>LMI LN</td>
<td>9.5%</td>
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<td>Randgold Resources Ltd</td>
<td>RRS LN</td>
<td>7.7%</td>
</tr>
<tr>
<td>CRH PLC</td>
<td>CRH ID</td>
<td>7.2%</td>
</tr>
<tr>
<td>Iuka Resources Ltd</td>
<td>IUL AT</td>
<td>-1.5%</td>
</tr>
<tr>
<td>Nippon Paper Group Inc</td>
<td>3893 JT</td>
<td>-2.2%</td>
</tr>
<tr>
<td>Incitec Pivot Ltd</td>
<td>IPL AT</td>
<td>-3.6%</td>
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### Industrials

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<tr>
<td>Finmeccanica SpA</td>
<td>FNC IM</td>
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<tr>
<td>Alstom S</td>
<td>ALO FP</td>
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<tr>
<td>Dai Nippon Printing Co Ltd</td>
<td>7912 JT</td>
<td>6.4%</td>
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<tr>
<td>Qantas Air</td>
<td>QAN AT</td>
<td>-2.6%</td>
</tr>
<tr>
<td>Vestas Wind Systems AV</td>
<td>VWS DC</td>
<td>-2.7%</td>
</tr>
<tr>
<td>QR National</td>
<td>QRNT AT</td>
<td>-2.9%</td>
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### Cons Disc

<table>
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<tr>
<td>Sharp Corp/Japan</td>
<td>6753 JT</td>
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<tr>
<td>UBM PLC</td>
<td>UBM LN</td>
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<tr>
<td>WPP PLC</td>
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<tr>
<td>InterContinental Hotel Group</td>
<td>IHG LN</td>
<td>-0.8%</td>
</tr>
<tr>
<td>British Sky Broadcasting Group</td>
<td>BSY LN</td>
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</tr>
<tr>
<td>Home Retail Group PLC</td>
<td>HOME LN</td>
<td>-2.7%</td>
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### Cons Stap

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<tr>
<td>Kirin Holding</td>
<td>CARLB DC</td>
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<td>SABMiller PLC</td>
<td>SAB LN</td>
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<tr>
<td>Diaego PLC</td>
<td>DGE LN</td>
<td>4.3%</td>
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<tr>
<td>Kao Corp</td>
<td>4452 JT</td>
<td>-1.5%</td>
</tr>
<tr>
<td>Tata &amp; Lyle PLC</td>
<td>TATE LN</td>
<td>-1.6%</td>
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<tr>
<td>Koninklijke Ahold NV</td>
<td>AH NA</td>
<td>-4.2%</td>
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### Health Care

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<td>Shire PLC</td>
<td>SHP LN</td>
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<tr>
<td>Novo Nordisk A/S</td>
<td>NOVOB DC</td>
<td>3.4%</td>
</tr>
<tr>
<td>Merck KGaA</td>
<td>MRK GY</td>
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</tr>
<tr>
<td>Eisai Co Ltd</td>
<td>4523 JT</td>
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</tr>
<tr>
<td>Daiichi Sankyo Co Ltd</td>
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<td>Ono Pharmaceutical Co Ltd</td>
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### Financials

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<td>Man Group PLC</td>
<td>ENM LN</td>
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</tr>
<tr>
<td>AXA SA</td>
<td>CS FP</td>
<td>7.0%</td>
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<tr>
<td>National Australia Bank Ltd</td>
<td>NAB AT</td>
<td>-1.3%</td>
</tr>
<tr>
<td>Bankinter SA</td>
<td>BKT SX</td>
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<tr>
<td>Banco Comercial Portuguesa SA</td>
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### Technology

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<td>Cap Gemini SA</td>
<td>CAP FP</td>
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<tr>
<td>TDK Corp</td>
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<tr>
<td>Advantest Corp</td>
<td>6857 JT</td>
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<tr>
<td>Taiwan Semiconductor</td>
<td>2330 TT</td>
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<tr>
<td>Logica PLC</td>
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### Telecom

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<tr>
<th>Name</th>
<th>Symbol</th>
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<tbody>
<tr>
<td>Telecom Italia SpA</td>
<td>TIT IM</td>
<td>6.6%</td>
</tr>
<tr>
<td>Cable &amp; Wireless Communication</td>
<td>CWC LN</td>
<td>3.4%</td>
</tr>
<tr>
<td>Telefonica SA</td>
<td>TEF SQ</td>
<td>3.2%</td>
</tr>
<tr>
<td>Microm International Cellular</td>
<td>MICS SS</td>
<td>-0.0%</td>
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<tr>
<td>NTN DoCoMo Inc</td>
<td>9437 JT</td>
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### Utilities

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<td>VIE SF</td>
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<td>Red Electrica Corp S A</td>
<td>REE SQ</td>
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<tr>
<td>Suzue Environment Co</td>
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<td>Kansai Electric Power Co Inc</td>
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<tr>
<td>Chubu Electric Power Co Inc</td>
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### S&P 500

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<td>Anadarko Petroleum Corp</td>
<td>APC</td>
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<tr>
<td>Pioneer Natural Resources Co</td>
<td>PXD</td>
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<tr>
<td>Kinder Morgan Inc/Delaware</td>
<td>KMI</td>
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<tr>
<td>Haliburton Co</td>
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<td>Alpha Natural Resources Inc</td>
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<tr>
<td>International Paper Co</td>
<td>IP</td>
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<td>Vulcan Materials Co</td>
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<td>Newmont Mining Corp</td>
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<tr>
<td>Sherwin-Williams Co/T</td>
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<table>
<thead>
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<th>Symbol</th>
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<td>Pitney Bowes Inc</td>
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### S&P/TSX Composite

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

### Energy
- **Symbol**: SPN  
- **Last Close**: 46.71  
- **% Change**: 1.2%

### Industrials
- **Symbol**: ATW  
- **Last Close**: 36.49  
- **% Change**: 1.6%

### Consumer Discretionary
- **Symbol**: HED  
- **Last Close**: 46.99  
- **% Change**: 1.6%

### Technology
- **Symbol**: GOOG  
- **Last Close**: 580.17  
- **% Change**: 1.8%

### Financials
- **Symbol**: WFC  
- **Last Close**: 57.59  
- **% Change**: 1.7%
### Canadian Market Movers

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Feeding the FROB

- This morning European senior financial default risk breaks the uptrend from the March low – Figure 1.
- The MSCI World index, in turn, breaks the steep downtrend from the low – Figure 2.
  - This follows the enthusiasm that world markets have enjoyed over the past 24 hours as the story about injecting EU funds into the Spanish FROB gains legs.
  - Whether this bailout avenue is legal or not remains an open question.
- For risk markets (and us) to get truly enthused, we would like to see
  - Counterparty risk break the uptrend from the late March low – Figure 3.
  - The Spanish 5-year CDS break the uptrend from the early March low – Figure 4.
    - The root of global market weakness is Spanish.
  - The Spanish 5-year CDS is the key trend to watch.

Figure 1: European Senior Financial Default Risk
Figure 2: MSCI World Index
Figure 3: U.S. 2-Year Swap Spread (Counterparty Risk)
Figure 4: Spanish 5-Year CDS

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

Zero Yield Trumping Negative - Gold

This morning gold, when domiciled in Swiss franc, a currency that you are punished to own (2-year yield is currently -28bps), reverses a downtrend – Figure 1.
  - Mind the inflection point.
  - Gold shares, which started reversing underperforming trends in late May, are showing up in our group selection report in the best position of the year at 7th decile – Figure 2.

- Amongst large caps, shown in terms of relative strength against the majors, the best gold company (by far) is Yamana Gold – Figure 3.
- On a price basis, the most consistent uptrend (in the S&P/TSX composite) is held by Argonaut Gold – Figure 4.
- Price Trends on indexed gold shares are shown at these links:
  - S&P/TSX Composite
  - Russell 2000
  - MSCI World

Figure 1: Spot Gold in Swiss Franc

Figure 2: Gold Relative Strength Decile

Figure 3: Yamana Gold (AUY) vs. Gold Miners (GDX)

Figure 4: Argonaut Gold

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Buying the Sell-Off

• Yesterday, there was a rare counter-trend move where safe-haven bonds sold off – Figure 1.
  o We advise clients to buy into this sell-off.
  o The trends of global safe-haven bond yields are solidly in place.
    ▪ All show yields that are trending lower.
    ▪ All show yields below falling 50-day moving averages.
    ▪ All show yields below falling 200-day moving averages.
• The money to buy bonds should come from equities.
  o The relative strength of U.S. equities to U.S. bonds is breaking down – Figure 2.
    ▪ Mind the 2-year head and shoulders top on this pattern.
  o The relative strength of Canadian equities to Canadian bonds has been punished below the bottom of the channel.
    ▪ At this point one asks if stocks are oversold, or if the trend can accelerate.
    ▪ Given the break out in the cost to protect China against default, we anticipate that the trend can and will accelerate.

Figure 1: Trends on Global (safe-Haven) Long Bonds

<table>
<thead>
<tr>
<th>Name</th>
<th>Symbol</th>
<th>1-Day Chg (%)</th>
<th>5-Day Chg (%)</th>
<th>Reward /Risk</th>
<th>Trend Slope</th>
<th>Hi (Mn.)</th>
<th>Low (Mn.)</th>
<th>%Chg wrt 50 Day MA</th>
<th>Chg wrt 200 Day MA Trend</th>
<th>%Chg wrt 200 Day MA Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>USGG10YR</td>
<td>5.0%</td>
<td>-12.3%</td>
<td>Down</td>
<td>-12%</td>
<td>-20.1%</td>
<td>Below Falling</td>
<td>-23.3%</td>
<td>Below Falling</td>
<td></td>
</tr>
<tr>
<td>Swiss</td>
<td>GS10YSS10</td>
<td>3.1%</td>
<td>18.1%</td>
<td>Down</td>
<td>-44%</td>
<td>-24.9%</td>
<td>Below Falling</td>
<td>-34.9%</td>
<td>Below Falling</td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>GDBR10</td>
<td>3.1%</td>
<td>-13.4%</td>
<td>Down</td>
<td>-57%</td>
<td>-24.1%</td>
<td>Below Falling</td>
<td>-34.5%</td>
<td>Below Falling</td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td>GCAN10YR</td>
<td>3.1%</td>
<td>-6.7%</td>
<td>Down</td>
<td>-10%</td>
<td>-15.5%</td>
<td>Below Falling</td>
<td>-19.2%</td>
<td>Below Falling</td>
<td></td>
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<tr>
<td>France</td>
<td>GFRN110</td>
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<td>-9.7%</td>
<td>Down</td>
<td>-3.5%</td>
<td>-13.5%</td>
<td>Below Falling</td>
<td>-23.3%</td>
<td>Below Falling</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>GG10YGB10</td>
<td>0.7%</td>
<td>-6.9%</td>
<td>Down</td>
<td>-10.1%</td>
<td>-15.6%</td>
<td>Below Falling</td>
<td>-30.1%</td>
<td>Below Falling</td>
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<tr>
<td>U.K.</td>
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<td>Down</td>
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<td>-29.5%</td>
<td>Below Falling</td>
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<td>Australia</td>
<td>GACGB10</td>
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<td>-12.9%</td>
<td>Down</td>
<td>-22.9%</td>
<td>-22.9%</td>
<td>Below Falling</td>
<td>-30.5%</td>
<td>Below Falling</td>
<td></td>
</tr>
</tbody>
</table>

Monday's Back-up in Yield

Figure 3: Rel. Performance US Stocks vs Bonds (SPY vs. IEF)  Figure 4: Rel. Performance CDN Stocks vs Bonds (XIC vs XBB)

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
5% Off With Volume Spike

Because of the strong downdraft on Friday, our **Capitulation Filters** filled up quite nicely. We highlight a simple one below:

- Stocks in Figure 1 below are:
  - in the top 3 group deciles (a key for us);
  - where price has been trending higher;
  - where shares are off at least 5% in the last week; and
  - where there is a spike in volume on Friday.

As for the overall market, we do not expect that equity markets have bottomed yet. On the tape this morning we see:
  - Swiss 2yr yields hovering at -30 bps.
  - Spanish 5-year Sovereign CDS trading in a very narrow range, but not budging from a high level of 603 bps. The same is true of the Italian 5-year CDS, where the level is 570 bps.
  - The Asia dollar index rebounding to a 3-session high.
  - Reports of, then denials of, any EU/ECB “master plan”.

**Figure 1: Stocks in Top Decile Groups That Sold Off at Least 5% Last Week**

<table>
<thead>
<tr>
<th>Company</th>
<th>Symbol &amp; Links</th>
<th>Sub Industry</th>
<th>Group</th>
<th>pricing</th>
<th>Price Trend</th>
<th>Technical Attributes</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Rentals Inc, UK/US</td>
<td>ToolOut</td>
<td>BICS</td>
<td>8</td>
<td>11.11</td>
<td>-4.5%</td>
<td>5-day Chg (%)</td>
</tr>
<tr>
<td>Huddle Inc, REST/US</td>
<td>SigmaFit</td>
<td>BICS</td>
<td>21</td>
<td>7.24</td>
<td>-4.3%</td>
<td>1-day Chg (%)</td>
</tr>
<tr>
<td>Level 3 Communications, UST/US</td>
<td>Apariz</td>
<td>BICS</td>
<td>11</td>
<td>12.32</td>
<td>-3.5%</td>
<td>5-day Chg (%)</td>
</tr>
<tr>
<td>Popular Inc, BOP/US</td>
<td>ResMed</td>
<td>BICS</td>
<td>2</td>
<td>14.27</td>
<td>-4.0%</td>
<td>1-day Chg (%)</td>
</tr>
<tr>
<td>Sunlight Translations, #6/FT/US</td>
<td>Telsa</td>
<td>BICS</td>
<td>2</td>
<td>8.20</td>
<td>-3.7%</td>
<td>5-day Chg (%)</td>
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<tr>
<td>SyntexPharma, SNV/US</td>
<td>ResMed</td>
<td>BICS</td>
<td>1</td>
<td>1.74</td>
<td>-0.5%</td>
<td>5-day Chg (%)</td>
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<tr>
<td>Formula Informatica, FTT/US</td>
<td>Telsa</td>
<td>BICS</td>
<td>2</td>
<td>16.56</td>
<td>-3.9%</td>
<td>5-day Chg (%)</td>
</tr>
<tr>
<td>Brookdata Services, BMO/US</td>
<td>HSBCity</td>
<td>BICS</td>
<td>9</td>
<td>35.45</td>
<td>-2.3%</td>
<td>5-day Chg (%)</td>
</tr>
<tr>
<td>ViSalis Inc, US/US</td>
<td>Reliant</td>
<td>BICS</td>
<td>1</td>
<td>24.77</td>
<td>-0.8%</td>
<td>5-day Chg (%)</td>
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<tr>
<td>SFB Financial, SIV/US</td>
<td>ResMed</td>
<td>BICS</td>
<td>1</td>
<td>27.50</td>
<td>-3.1%</td>
<td>5-day Chg (%)</td>
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<tr>
<td>U.S. Thalidomide, PRU/US</td>
<td>ResMed</td>
<td>BICS</td>
<td>2</td>
<td>12.56</td>
<td>-4.2%</td>
<td>5-day Chg (%)</td>
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<tr>
<td>Brunswick Corp, BC/US</td>
<td>Laspa</td>
<td>BICS</td>
<td>3</td>
<td>22.41</td>
<td>-6.8%</td>
<td>5-day Chg (%)</td>
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<tr>
<td>Ambula Automatics, MDI/US</td>
<td>AutoFit</td>
<td>BICS</td>
<td>3</td>
<td>25.25</td>
<td>-4.0%</td>
<td>5-day Chg (%)</td>
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<tr>
<td>FirstMedWest Corp, PM/LUS</td>
<td>ResMed</td>
<td>BICS</td>
<td>2</td>
<td>3.55</td>
<td>-5.3%</td>
<td>5-day Chg (%)</td>
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<tr>
<td>Hospitality Trusts, HFT/US</td>
<td>AnceBET</td>
<td>BICS</td>
<td>1</td>
<td>35.50</td>
<td>-4.1%</td>
<td>5-day Chg (%)</td>
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<tr>
<td>Prospera Bancs, PHL/US</td>
<td>ResMed</td>
<td>BICS</td>
<td>2</td>
<td>4.44</td>
<td>-5.3%</td>
<td>5-day Chg (%)</td>
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<tr>
<td>Prodigy Financial, OFS/US</td>
<td>FirstMCI</td>
<td>BICS</td>
<td>9</td>
<td>13.40</td>
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<td>5-day Chg (%)</td>
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<tr>
<td>Platform Auto, PAS/US</td>
<td>AutoFit</td>
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<td>3</td>
<td>24.86</td>
<td>-4.4%</td>
<td>5-day Chg (%)</td>
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<td>BBM Corp, BEM/US</td>
<td>Reliant</td>
<td>BICS</td>
<td>8</td>
<td>23.85</td>
<td>-6.2%</td>
<td>5-day Chg (%)</td>
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<td>Baxalta Innovations, BAX/US</td>
<td>ResMed</td>
<td>BICS</td>
<td>2</td>
<td>7.31</td>
<td>-5.6%</td>
<td>5-day Chg (%)</td>
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<td>LastGroup Pharma, COP/US</td>
<td>ResMed</td>
<td>BICS</td>
<td>1</td>
<td>5.80</td>
<td>-4.8%</td>
<td>5-day Chg (%)</td>
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<tr>
<td>Delphi Investments, COS/US</td>
<td>ResMed</td>
<td>BICS</td>
<td>1</td>
<td>5.50</td>
<td>-2.8%</td>
<td>5-day Chg (%)</td>
</tr>
<tr>
<td>Hemi Global Holdings, HTH/US</td>
<td>Tecra</td>
<td>BICS</td>
<td>2</td>
<td>12.43</td>
<td>-3.6%</td>
<td>5-day Chg (%)</td>
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<tr>
<td>Mannatech Co, MNT/US</td>
<td>ResMed</td>
<td>BICS</td>
<td>3</td>
<td>55.30</td>
<td>-2.9%</td>
<td>5-day Chg (%)</td>
</tr>
</tbody>
</table>

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Fire

- It is rather noteworthy when the World Bank chief says it is time to “break the glass” on the emergency fire alarm (FT, Spiegel).
  - In listening to both Mario Monti and Mario Draghi yesterday, we sure do not get the sense that there is an emergency plan for Europe.
  - We are still in the finger pointing stage.

- You can still move relatively calmly toward the exits.
  - This calm will not last for long.
  - Counterparty risk, as judged by the U.S. 2-year swap spread is just breaking out – Figure 1.
  - Mind the inflection point.

Figure 1: U.S. 2-Year Swap Spread; a Gauge of Counterparty Risk
Dive and Pre-Dive

- The cost of a good Swiss mattress to stuff your cash into is soaring.
  - This is panic.
  - We love panic, because it typically provides the grease to get the job done.
  - But that happens only when there is panic selling, not panic buying like we see with Swiss bonds.
- Global stock markets are just hovering about.
  - No panic here.
  - So we are still just at the stage where leaders just point fingers.
  - You don’t buy into this.
  - But you can still sell.

Figure 1: MSCI World Index and Swiss 2-Year Bond Yield

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
EU (German) Aid?

- It is credit that counts.
- This morning, European Senior Financial default risk threatens to break to the upside – Figure 1, top.
- Counterparty risk is about to wake up – Figure 1, middle.
- S&P 500 is about to pay attention – Figure 1, bottom.
- This as:
  - The Negative: Spanish Prime Minister Rajoy’s plan to strap Spain to Bankia is (apparently) rejected by the ECB (yesterday’s news).
  - The Positive: The headline of “EU willing to ‘envisage’ direct ESM bank recapitalization” (7:00 a.m. this morning).
    - Will the Germans (tax payers) turn “envisage” into “action”?
      - If so, then markets cool, and U.S. equity investors can (once again) ignore European woe.
      - If not, then the stress indications (top and middle) break to the upside, and equities break to the downside.
  - We await the market call (USSP2 is the ticker) on this.

Figure 1: European Senior Financial Default Risk; U.S. 2-Year Swap Spread (Gauge of Counterparty Risk); S&P 500

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Spanish Banks Hit New Lows

- Apparently, and this is the market talking, the Bankia bailout did very little to inspire confidence. Quite the opposite is true.
  - All but one Spanish bank has broken down to a new low – Figure 1.
  - The shape of the European Repo market curve shows a notable distrust amongst banks.
  - The European Bank Index is a few ticks away from breaking down – Figure 2.

- We expect that counterparty risk will once again start to pivot higher – Figure 3.
  - And with this pivot, we expect that U.S. equities will resume their descent.

Figure 1: Spanish Bank Shares (Largest Market Cap on Top)
Figure 2: MSCI European Banks
Figure 3: U.S. 2-Year Swap Spread (Counterparty Risk)

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

May 28, 2012
Research Comment
Quantitative/Technical Research Website

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Flattening the Canadian Book

- Canadian Financials like Banks, LifeCos and Asset Managers are breaking below outperforming trends.
- Canadian Gold shares are breaking above underperforming trends.
- We think it is prudent to flatten the book, lighting up on what should have been an overweighed position in Financials, and moving back toward a more neutral position on golds.
  - A flat portfolio should not be an underperforming portfolio.
- State side”
  - U.S. financials is also breaking below an outperforming trend.
  - U.S. golds, also known as NEM, is also breaking above an underperforming trend.
- The question that will certainly arise is should one go long gold shares?
  - Bullion itself is trending lower, but has managed to break above 50-day MAs in a few currencies. This is recent slight improvement.
    - To go long gold bullion at this point is to go long a counter-trend rally.
  - There are seven gold stocks in outperforming trends (not very consistently outperforming mind you). These are the ones to focus on from the standpoint of being long, instead of just flat: AR, PVG, BTO, FNY, TXG, AGI, BAA.

Figure 1: Index Members vs. S&P/TSX Composite (10bn Market Cap Floor - Full List Shown at This Link) vs. SPTSX (Minimum Weight 0.6%)
Relative Strength Filter

Technology Slipping

- After meandering in neutral territory for a number of weeks, Technology is slipping into the negative in our group selection report – Figure 1.
- The two largest indices breaking below the bottom ends of relative strength channels are Semiconductors and Communication equipment – Figures 2, 3.
- At the micro level, there are 20% of IT stocks in the Russell 3000 Growth index are breaking below their Relative Strength Trend channels – Figure 4.
- On an intra-sector basis, the best U.S. sub industries are:
  - Hardware (best stocks are DDD, SSYS and AAPL), and
  - Data Processing (see link for members).

Figure 1: Technology Relative Strength Z-Score

Figure 2: U.S. Semiconductors vs. S&P 1500

Figure 3: U.S. Communication Equipment vs. S&P 1500

Figure 4: Russell 3000 Growth IT Breaking Below RS Channels

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Patience

- We would have thought as the cost to protect Italy against default threatened to break to the upside, as it has today (Figure 1), that equities would be falling.
  - They are not.
    - We could dream up an argument that would support this morning’s leaning. The argument would be something along the lines of, “sure the world’s 3rd largest bond market is being threatened, but so what?”
    - Or we could be patient and wait for equities to follow the concern.
      - We will be patient.
      - Make no mistake: up, in this case, is bad – Figure 1.

Figure 1: Italian 5-Yr CDS

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Sentiment toward Asia and thus Asian-led global growth is very nicely summed up using the Asian dollar index (ADXY, a basket of Asian currencies).

This morning’s breakdown of the ADXY was the subject our note on Monday. It is a good barometer for the breakdowns in copper and crude oil – Figures 1, 2.

- Our downside target for copper is $2.60.
- Our downside target for crude is $80.

The context around the stress impacting Asian shores this morning:

- The Italian 5-year CDS jumps back to the 500 bps mark.
- The Swiss 2-year yield is priced at -10 bps, which would be a new closing low if we finish here (the intraday low was a negative 11.4 bps on August 18).
- Germany issues 2-year bonds with a zero coupon, and declares that it will not issue bonds with a negative coupon.
- Commodity currencies are all diving.

Is it any wonder that resource heavy Canadian and Australian markets are the most consistent global underperformers? Is it any wonder that we are pushing the theme of capital preservation?
Still Standing – Momentum Buy List

- Make no mistake:
  - Equity indices are either trending lower, or are breaking below uptrends.
  - Safe-haven bond yields are trending lower.
  - Fear gauges are elevated, but are not at panic buy levels.

- Yet, if your job is to run an equity portfolio (if you are running a balanced fund, you should note these changes), then it is worth noting the stocks that are still standing.
  - We highlight our large cap momentum buy list (full list at this link), based on price (as opposed to relative strength) trends below.
  - These shares are trending higher, are above rising 50- and 200-day MAs, and are not overbought.

Figure 1: Large Cap Momentum Buy List – [Click Here for Full List]

<table>
<thead>
<tr>
<th>Company</th>
<th>Decile</th>
<th>Pricing</th>
<th>Price Trend</th>
<th>Technical Attributes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Name / Link to Charts</td>
<td>Symbol &amp; Links</td>
<td>Ctry</td>
<td>Sub Industry</td>
<td>Group RS</td>
</tr>
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<td>L'Heureux Inc</td>
<td>ORD LP</td>
<td>France</td>
<td>Defence</td>
<td>3</td>
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<td>Standard Bank Gr.</td>
<td>SAI SI</td>
<td>South Africa</td>
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<td>NVUS-U</td>
<td>Dan.</td>
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<td>Can.</td>
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<td>Colgate Palmolive</td>
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<td>HHP</td>
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<td>TRV-US</td>
<td>U.S.</td>
<td>S&amp;P 500</td>
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<td>U.S.</td>
<td>Electric</td>
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<td>National Grid Inc</td>
<td>NGO-US</td>
<td>U.K.</td>
<td>Multi</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Asia Watch

- With our compass of stress pointed at Europe, we have spent little on Asia, the growth engine of the world.
- In the currency market:
  - The Asia dollar index, after stabilizing for 8-months, breaks to the downside again. Our target is 110 - Figure 1.
    - Capital outflows in China is causing a "mega dash for the dollar".
- In the credit market:
  - Chinese sovereign CDS is breaking to the upside - Figure 2.
  - Chinese bank CDS is also breaking to the upside, and bank equities are following - Figure 3.
- In the commodity market:
  - Dr. Copper, after stabilizing for 8-months, breaks to the downside again. Our target is $2.60 - Figure 4.
    - Demand, or the lack thereof, is causing Chinese consumers to default on raw materials contracts.

Figure 1: Asia Dollar Index

Figure 2: China 5Yr Sovereign CDS

Figure 3: Bank of China Equity/CDS Overlay

Figure 4: Dr. Copper

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

Defensive Stocks vs. Bonds

- Defensive and/or yield-oriented equity ETFs in the U.S. and Canada are breaking below outperforming trends versus their respective bond markets - Figures 1-4.
  - Our system raises the question: “should one sell defensive stocks to buy even more defensive bonds?”
    - We advise selling defensive stocks to buy even more defensive bonds.

- The market is just now starting to price in a Grexit, Drachmageddon, or any other new fangled term.
  - This will take some time.
  - These breakdowns have just started.
  - It can be far less painful (potentially even painless) if your portfolio is oriented appropriately.

Figure 1: U.S. Real Estate vs. U.S. Bonds (ICF vs. IEF)
Figure 2: U.S. Pharma vs. U.S. Bonds (XPH vs. IEF)
Figure 3: CDN Real Estate vs. CDN Bonds (XRE vs. XBB)
Figure 4: CDN Income Trusts vs. CDN Bonds (XTR vs. XBB)

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Capital Preservation Is Job 1

- Equity investors run after depositors run on Bankia (B&W version here) – Figure 1.
- Credit market takes a run on HSBC – Figure 2.
  - CDS trends on your favourite SIFI found are found here.
- Morgan Stanley’s credit curve is quickly motoring toward inversion – Figure 3.
  - Morgan Stanley now has the flattest curve of the SIFI list, leapfrogging over UniCredit yesterday.
- Capital markets not liking banks choose bunds instead – Figure 4.
  - At this rate, the German 10-year bund yield will hit 1% by mid-summer.
- This is the environment where even safe-haven-like equities like water utilities and real estate start to sell off.
- This is the market where capital preservation is job 1.
Relative Strength Filter

Shorting U.S. Real Estate

- When the UltraShort Real Estate ETF breaks above a downtrend, the question is “can you make money shorting U.S. Real Estate?”
- We think so.
  - See Focal Points – “Major Double Top for Global Real Estate”

Figure 1: UltraShort U.S. Real Estate ETF (SRS) vs. S&P 500 Financials

Begs Question - Can You Make Money Shorting Real Estate vs. Going Long U.S. Financials?

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Wake-Up Zone, Not Buy-In Zone

- Most global equity markets have now broken uptrends from the 2011 lows - Figure 1.
  - Six weeks ago, it was just Spain and Brazil that were the early leaders breaking uptrends as the credit market went hostile on Spain.
- Most implied volatility (panic) gauges have broken uptrends from the 2011 highs - Figure 2.
  - The first reversals came just over a month ago.
  - The current level of concern is still in the wake-up zone - not the buy-in zone (Figure 2).
- Our U.S. CDS index of too-interconnected to fail financials is reversing the trend of credit improvement - Figure 3. This is why the S&P should break the uptrend from the low. Credit leads.
  - The first breaks came a month ago.
- If we trace back the point in time where there was an inkling of concern for the S&P 500 (which has still not quite broken our uptrend from the low) it was on March 22, “Markets Revisit the European Debt Crisis.” Revisiting those original points of concern:
  - The Spanish sovereign CDS shows no sign of topping.
  - The Spanish - AAA spread is definitely in panic territory. Now comes the very tricky point of attempting to find what will undoubtedly be a spike top.
  - The Italian - AAA spread has retracted half of the Monti honeymoon improvement, and follows the woe in Spain.

Figure 1: Most Major Equity Benchmarks Have Now Broken Uptrends

<table>
<thead>
<tr>
<th>Name</th>
<th>1-Day Chg (%)</th>
<th>5-Day Chg (%)</th>
<th>Reward /Risk</th>
<th>Trend Slope</th>
<th>Hi (Mo.)</th>
<th>Low (Mo.)</th>
<th>% Chg S055Day MA</th>
<th>Chg wtr 50 Day MA Tread</th>
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<tr>
<td>Mexican IPC</td>
<td>-1.4%</td>
<td>-4.2%</td>
<td>↑</td>
<td>19%</td>
<td>1.5</td>
<td>-1.4%</td>
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<td>Below Falling</td>
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<td>-2.7%</td>
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<td>-3.0%</td>
<td>←</td>
<td>33%</td>
<td>3.0</td>
<td>-4.1%</td>
<td>Below Falling</td>
<td>Below Falling</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>-1.1%</td>
<td>-2.3%</td>
<td>↓</td>
<td>29%</td>
<td>3.5</td>
<td>-3.4%</td>
<td>Below Falling</td>
<td>Below Falling</td>
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<td>German DAX</td>
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<td>-1.8%</td>
<td>↓</td>
<td>37%</td>
<td>4.5</td>
<td>-5.1%</td>
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<td>Below Falling</td>
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<td>Swiss SMI</td>
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<td>-2.7%</td>
<td>↓</td>
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<td>4.5</td>
<td>-4.6%</td>
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<td>Below Falling</td>
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<tr>
<td>MSCI EMI Cap</td>
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<td>-3.8%</td>
<td>↓</td>
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<td>4.0</td>
<td>-4.8%</td>
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<td>Below Falling</td>
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<tr>
<td>Russell 2000</td>
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<td>-1.5%</td>
<td>↓</td>
<td>31%</td>
<td>4.0</td>
<td>-4.2%</td>
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<td>Below Falling</td>
</tr>
<tr>
<td>Hong Kong HS1</td>
<td>-1.2%</td>
<td>-3.5%</td>
<td>↓</td>
<td>27%</td>
<td>4.9</td>
<td>-4.8%</td>
<td>Below Falling</td>
<td>Below Falling</td>
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<tr>
<td>ACWI</td>
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<td>-3.2%</td>
<td>↓</td>
<td>22%</td>
<td>4.9</td>
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<td>Korean KOSPI</td>
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<td>-1.9%</td>
<td>↓</td>
<td>18%</td>
<td>4.0</td>
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<td>↓</td>
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<td>Brazil Bovespa</td>
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<td>-0.6%</td>
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<td>-3.7%</td>
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<tr>
<td>MSCI BH</td>
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<td>↓</td>
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<td>Below Falling</td>
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<tr>
<td>UK FTSE 100</td>
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<td>-3.4%</td>
<td>↓</td>
<td>17%</td>
<td>4.5</td>
<td>-5.1%</td>
<td>Below Falling</td>
<td>Below Falling</td>
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<tr>
<td>Aussie S&amp;P/ASX</td>
<td>-0.3%</td>
<td>-0.1%</td>
<td>←</td>
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<td>-0.3%</td>
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<tr>
<td>ACBS AUSX</td>
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<td>↓</td>
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<td>4.0</td>
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<td>Japanese TPX</td>
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<tr>
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<td>-4.2%</td>
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<td>Below Falling</td>
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<td>S&amp;P/TSX</td>
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<td>-3.1%</td>
<td>↓</td>
<td>3%</td>
<td>5.5</td>
<td>-5.8%</td>
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<td>Below Falling</td>
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<td>Italian MIB</td>
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<td>-4.3%</td>
<td>↓</td>
<td>4%</td>
<td>7.5</td>
<td>-10.8%</td>
<td>Below Falling</td>
<td>Below Falling</td>
</tr>
<tr>
<td>Russian MICEX</td>
<td>-3.1%</td>
<td>-2.0%</td>
<td>↓</td>
<td>15%</td>
<td>5.0</td>
<td>-7.5%</td>
<td>Below Falling</td>
<td>Below Falling</td>
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<tr>
<td>Indian SENSEX</td>
<td>-0.5%</td>
<td>-1.6%</td>
<td>↓</td>
<td>13%</td>
<td>4.0</td>
<td>-3.4%</td>
<td>Below Falling</td>
<td>Below Falling</td>
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<tr>
<td>S&amp;P/TSX Smi</td>
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<td>-4.5%</td>
<td>↓</td>
<td>17%</td>
<td>7.5</td>
<td>-5.3%</td>
<td>Below Falling</td>
<td>Below Falling</td>
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<td>Chinese CSI</td>
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<td>-2.8%</td>
<td>↓</td>
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<td>1.0%</td>
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<td>Spanish IBEX</td>
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<td>-3.6%</td>
<td>↓</td>
<td>25%</td>
<td>49.0</td>
<td>-10.6%</td>
<td>Below Falling</td>
<td>Below Falling</td>
</tr>
</tbody>
</table>

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Counterparty Risk Surging

- When the stability of the banking system is in question, risk assets sell off.
  - The stability of the banking system is in question.
    - You see this using the U.S. 2-year swap spread, which rose to a 4-year high this morning (shows as a 4-month low, on the inverted scale below).
  - More familiar measures of heightened risk tension this morning include:
    - European senior financial default risk, which is at a 4-month high of 480bps this morning.
    - The Italian 5-year CDS, which, at 482bps, is at a 3.5-month high.
    - The Spanish 5-year CDS, which, at 541bps, is at an all-time high.
  - Risk assets, such as the S&P 500, are expected to continue to sell off – Figure 1.

Figure 1: S&P 500 and Counterparty Risk (U.S. 2-year Swap Spread, Inverted Scale)

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

**Uptrends on the Edge**

- The MSCI World index has been trending higher at a rate of 23%/year since the Q4 low. It is just testing the lower limit of this channel – Figure 1.
  - The FTSE 100 has broken the trend – Figure 2, as has the Swiss SMI, the Brazil Bovespa and the MSCI Emerging Markets Index.
  - We expect that more equity indices will break their uptrends from the Q4 low.

- Copper has been trending higher at a rate of 25%/year since the Q4 low. It is just testing the lower limit of the channel – Figure 3. Zinc is also testing this limit, and nickel is trending lower.
  - We expect copper to break to the downside, in a similar fashion to what we see for crude oil – Figure 4.

- These breakdowns, and near breakdowns, stem from a credit environment which is becoming more unfriendly.
  - When both credit and equity markets are at the point of maximum distress, there will be a bottom.
  - Obviously, this is difficult to ascertain in real time, but we are far from this point now.

---

**Figure 1: MSCI ACWI**

**Figure 2: FTSE 100 Index**

**Figure 3: LME 3Mo Copper**

**Figure 4: Crude Oil - OPEC Basket**

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Oversold 1 – Wide Bands

- Yes, the European debt crisis part 2 is upon us.
- Yes, the Spanish 5-year CDS is at a record wide this morning (520 bps).
- And, yes, the market is paying attention. So much so that our oversold buckets are filling up rapidly.
  - When corporate fundamentals do not matter to equity pricing is when you need to know the fundamentals.
    - That job is yours.
- Our job is to quantify the most oversold stocks.
- One of our favourite oversold lists is shown below – stocks that are oversold based on a short-term (26-day) Bollinger band, where the bandwidth is very wide – Figure 1.
  - Happy hunting.

Figure 1: Oversold Stocks – Below Bottom End of 26-day Bollinger Band, Where Band Width is Very Wide (see link for full list)

<table>
<thead>
<tr>
<th>Company</th>
<th>Pricing</th>
<th>Relative Strong</th>
<th>Technical Attributes</th>
</tr>
</thead>
<tbody>
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<td>Name / Link to Charts</td>
<td>Symbol &amp; Links</td>
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<td>CTCH US</td>
<td>ETelecom</td>
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<td>Prudential</td>
<td>BAC US</td>
<td>Int Us</td>
</tr>
<tr>
<td>3</td>
<td>Principal Financial</td>
<td>PBUS US</td>
<td>Lifetite Inc.</td>
</tr>
<tr>
<td>4</td>
<td>Newmont Mining</td>
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<td>Gold</td>
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<td>Credit Suisse Group</td>
<td>CS US</td>
<td>DeGaMu</td>
</tr>
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<td>Fido All</td>
<td>TELL US</td>
<td>IntetChix</td>
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<tr>
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<td>ImmunoGen Inc</td>
<td>TGX US</td>
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<tr>
<td>8</td>
<td>STD Financial</td>
<td>BM CN</td>
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<td>JSC US</td>
<td>BoldPath</td>
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<td>BMO SE</td>
<td>BMO US</td>
<td>DocPath</td>
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<td>Steel Mfg Co</td>
<td>FMP US</td>
<td>Action</td>
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<td>CAT US</td>
<td>Illustri</td>
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<td>LOF US</td>
<td>ElecComp</td>
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<td>COD US</td>
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<td>KHS US</td>
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<tr>
<td>31</td>
<td>Power Financial</td>
<td>PWR US</td>
<td>Lifetite Inc.</td>
</tr>
</tbody>
</table>

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

When it Rains

- As the cost to protect Spain from default rises back above 500 bps for the first time in two weeks,
  - Italy’s only Systemically Important Financial Institution (SIFI) is back trending toward failure – Figure 1.
  - The cost for European financials to obtain USD is back to being squeezed – Figure 2
    • Which brings back that unwelcome POSITIVE correlation between gold and European banks.
  - You can see the funding pressure/gold fit in the intraday moves this morning – Figure 3.
- This is the rain.
  - The pour is watching Asian sovereign CDS reverse trends of credit improvement – Figure 4.

Figure 1: UniCredit 5-Year CDS

Figure 2: Cost to Obtain USD From EUR in the Swap Market

Figure 3: Gold and USD Funding Stress (Intraday)

Figure 4: China 5-year CDS

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Positive Stock & Credit Trends Are Breaking

- Positive share price trends are breaking down:
  - 20% of S&P 500 members, which had been trending higher (dividend adjusted price series), have broken below their uptrends – Figure 1.
  - The same 20% breakdown percentage is seen for MSCI Ex USA members.
  - In Canada, 17% of S&P/TSX composite stocks are breaking below uptrends (over 60% of CDN stocks are trending lower).
- Positive corporate credit trends are breaking down. Stocks and credit go hand in hand:
  - Yesterday, there were 20 liquid CDS that broke their trends toward credit improvement.
  - The EU Main corporate CDS index, which had been improving at a rate of 130%/year, just broke that trend.

**Figure 1: S&P 500 Index Members Breaking Below Their Price Trend Channels**

<table>
<thead>
<tr>
<th>Stock</th>
<th>Trend</th>
<th>Stock</th>
<th>Trend</th>
<th>Stock</th>
<th>Trend</th>
<th>Stock</th>
<th>Trend</th>
<th>Stock</th>
<th>Trend</th>
</tr>
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<td>HD US</td>
<td>78%</td>
<td>CSCC US</td>
<td>29%</td>
<td>DOV US</td>
<td>36%</td>
<td>SWY US</td>
<td>18%</td>
<td>R US</td>
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<td>IP US</td>
<td>55%</td>
<td>JEC US</td>
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<td>GNW US</td>
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<td>NVIDIA US</td>
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<td>52%</td>
<td>AES US</td>
<td>38%</td>
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<td>PLL US</td>
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<td>MCHP US</td>
<td>8%</td>
<td>HP US</td>
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<tr>
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<td>DNB US</td>
<td>51%</td>
<td>COP US</td>
<td>25%</td>
<td>ALTR US</td>
<td>12%</td>
<td></td>
<td></td>
</tr>
<tr>
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<td>46%</td>
<td>PRU US</td>
<td>51%</td>
<td>VAR US</td>
<td>-1%</td>
<td>APA US</td>
<td>8%</td>
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<td></td>
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<tr>
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<td>VMC US</td>
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<td>PCAR US</td>
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<td>SAI US</td>
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<tr>
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<td>ADSK US</td>
<td>62%</td>
<td>CAT US</td>
<td>38%</td>
<td>EXPD US</td>
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<td>48%</td>
<td>JBL US</td>
<td>61%</td>
<td>NOV US</td>
<td>38%</td>
<td>NDAQ US</td>
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<td>7%</td>
<td>MYL US</td>
<td>48%</td>
<td>ETN US</td>
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<td>SNDK US</td>
<td>5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IVZ US</td>
<td>73%</td>
<td>ADT US</td>
<td>34%</td>
<td>DCP US</td>
<td>57%</td>
<td>HES US</td>
<td>3%</td>
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</tr>
<tr>
<td>AMD US</td>
<td>96%</td>
<td>AKAM US</td>
<td>64%</td>
<td>AIZ US</td>
<td>26%</td>
<td></td>
<td></td>
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<tr>
<td>MCO US</td>
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<td>XLNX US</td>
<td>35%</td>
<td>HRB US</td>
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<td>GD US</td>
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<tr>
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<td>UNM US</td>
<td>27%</td>
<td>KMX US</td>
<td>25%</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>BMS US</td>
<td>31%</td>
<td>WPO US</td>
<td>29%</td>
<td>RRO US</td>
<td>45%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>WM US</td>
<td>35%</td>
<td>JDSU US</td>
<td>48%</td>
<td>DYN US</td>
<td>26%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PHN US</td>
<td>85%</td>
<td>MCO US</td>
<td>28%</td>
<td>MU US</td>
<td>51%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BON US</td>
<td>69%</td>
<td>XYL US</td>
<td>35%</td>
<td>KR US</td>
<td>12%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NVI US</td>
<td>92%</td>
<td>NVL US</td>
<td>15%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LNC US</td>
<td>71%</td>
<td>SBE US</td>
<td>23%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BAC US</td>
<td>122%</td>
<td>NFLX US</td>
<td>75%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BWA US</td>
<td>63%</td>
<td>F US</td>
<td>25%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
More Breakdowns in U.S. Banks

- First we will point the finger at the culprit, then we will highlight why the finger needs to be pointed.
  - The improvement in U.S. commercial mortgage-backed securities pricing was halted in February.
  - The slide in pricing started in late March/early April, which coincided with the S&P 500 breaking below its 50-day moving average for the first time this year (U.S. Investment Grade default risk was also surging, and Italian bonds were selling off) – Figure 1.
  - The late April rebound in CMBS was arrested in May (Figure 1 top).

- During this last selloff in U.S. CMBS (when the European credit situation was calm / improving):
  - Last Thursday, we saw Citigroup break below an outperforming trend.
  - On Friday, JPMorgan Chase & Co. and Bank of America followed suit – Figures 3, 4.
  - On Friday, the creditworthiness of Wells Fargo, which is the most consistently outperforming U.S. large cap bank, broke its trend of improvement in creditworthiness – Figure 4.

- A weakening banking system is a weakening bull market.
  - We continue to expect a 10-15% correction in U.S. banks (BKX).

Figure 1: U.S. CMBX vs. S&P 500

Figure 2: JPMorgan Chase & Co. vs. S&P 500

Figure 3: Bank of America vs. S&P 500

Figure 4: Wells Fargo 5-Year CDS

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
The U.S. equity market has been stellar. When you look at any other major market against the S&P 500, you realize how much diversification into other global markets has hurt.

So, it is notable when we just start to see breakdowns in some of the price trends of the U.S. sub industries – Figure 1.

- If the U.S. equity market started to weaken, it would be joining the crowd.

Computer Hardware, A.K.A. AAPL and others is taking a well-deserved pause/correction after a stellar ride – Figure 2.

Managed Health Care (Figure 3) is seeing many of its members break price trends, including UNH, AET and HUM.

Auto Manufacturers, a.k.a. Ford and a few (THO), is breaking below a 9-month uptrend – Figure 4.

Hypermarkets & Super Centers, a.k.a. WMT and COST, is also part of the groups struggling to maintain the uptrend.

Figure 1: U.S. Industries Breaking Below Uptrends
Figure 2: S&P Computer Hardware Price Trend
Figure 3: U.S. Managed Health Care Price Trend
Figure 4: U.S. Auto Manufacturers Price Trend

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Focal Points

Investment & Trading Ideas

Major Double Top for Global Real Estate

- Those that do not like banks (and we do not like banks) hide out in insurance.
  - Insurance just broke the uptrend from the 2011 low, like most major equity markets, including the S&P 500.
- Those that do not like insurance hide out in real estate, which has given the most consistent positive performance.
- Real estate just broke the uptrend from the 2011 low – Figure 1.

- Now there are breakdowns, and there are breakdowns.
  - The context behind this one is that money (and you know who you are) has flowed into Real Estate as a yield-oriented safe haven.
  - This has pushed global real estate back to the 2011 high, which forms a major double top. Major support is 16% below current levels, which is when the double top would seem more obvious. Double top downside risk is 33% below the current level.
- The wider context is that a bank run on Greece is a “great fear,” and the ECB is apparently cutting and running.
  - In this environment, risk assets will cut and run.
  - The breakdown shows that this attitude has just started for Global Real Estate.

Figure 1: MSCI ACWI Real Estate

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
SIFI Creditworthiness Breakdown

- The creditworthiness of the global banking system is at the breakdown point – Figure 1.
  - Trends of credit improvement for eight systematically important financial institutions (SIFI) are breaking down (CDS trends of credit improvement are being reversed) – Figures 2-9. All of these breakdowns occurred yesterday.

- We know the culprit is Spain.
  - If you think that Spain will be able to turn itself around and come to the market at a reasonable price, or perhaps that Italy will stop being dragged down with Spain, you are buying into this panic.
  - If not, you are selling, or moving to defensive havens.
    - We advocate selling or moving to defensive havens.

Figure 1: Credit Default Swap Trends for Eight Global SIFIs – Trends of Credit Improvement (↑) are Being Reversed (↑)

<table>
<thead>
<tr>
<th>Name / Link to Charts</th>
<th>Symbol &amp; Links</th>
<th>MktCap US$mm</th>
<th>Chg Last Day</th>
<th>Reward Risk</th>
<th>Trend Slope</th>
<th>CDS Curve 1/5yrs</th>
<th>CDS 1-day chg (%)</th>
<th>CDS 5-day chg (%)</th>
<th>% Chg wrt 50 Day MA</th>
<th>Chg wrt 50 Day MA Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Morgan Stanley</td>
<td>MS US</td>
<td>34,250</td>
<td>↑</td>
<td>↑</td>
<td>-94%</td>
<td>84%</td>
<td>6%</td>
<td>24%</td>
<td>25%</td>
<td>Above Rising</td>
</tr>
<tr>
<td>Goldman Sachs Group Inc</td>
<td>GS US</td>
<td>56,698</td>
<td>↑</td>
<td>↑</td>
<td>-93%</td>
<td>74%</td>
<td>3%</td>
<td>24%</td>
<td>23%</td>
<td>Above Rising</td>
</tr>
<tr>
<td>Lloyds Banking Group plc</td>
<td>LYG US</td>
<td>31,938</td>
<td>↑</td>
<td>↑</td>
<td>-46%</td>
<td>70%</td>
<td>8%</td>
<td>15%</td>
<td>21%</td>
<td>Above Rising</td>
</tr>
<tr>
<td>Royal Bank of Scotland Group Plc</td>
<td>RBS US</td>
<td>22,825</td>
<td>↑</td>
<td>↑</td>
<td>-57%</td>
<td>59%</td>
<td>8%</td>
<td>20%</td>
<td>20%</td>
<td>Above Rising</td>
</tr>
<tr>
<td>UBS AG</td>
<td>UBS US</td>
<td>47,327</td>
<td>↑</td>
<td>↑</td>
<td>-41%</td>
<td>62%</td>
<td>5%</td>
<td>17%</td>
<td>17%</td>
<td>Above Rising</td>
</tr>
<tr>
<td>Credit Suisse Group</td>
<td>CS US</td>
<td>31,318</td>
<td>↑</td>
<td>↑</td>
<td>-46%</td>
<td>59%</td>
<td>7%</td>
<td>17%</td>
<td>21%</td>
<td>Above Rising</td>
</tr>
<tr>
<td>Citigroup Inc</td>
<td>C US</td>
<td>96,236</td>
<td>↑</td>
<td>↑</td>
<td>-57%</td>
<td>59%</td>
<td>10%</td>
<td>34%</td>
<td>28%</td>
<td>Above Rising</td>
</tr>
<tr>
<td>Barclays PLC</td>
<td>BCS US</td>
<td>39,686</td>
<td>↑</td>
<td>↑</td>
<td>-95%</td>
<td>54%</td>
<td>3%</td>
<td>22%</td>
<td>23%</td>
<td>Above Rising</td>
</tr>
</tbody>
</table>

Figure 2: Morgan Stanley 5-Year CDS

Figure 3: Goldman Sachs 5-Year CDS
Figure 4: **Lloyds TSB 5-Year CDS**

Figure 5: **Royal Bank of Scotland 5-Year CDS**

Figure 6: **UBS AG 5-Year CDS**

Figure 7: **Credit Suisse Group 5-Year CDS**

Figure 8: **Citigroup 5-Year CDS**

Figure 9: **Barclays PLC 5-Year CDS**

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Liquified Gold; Kinross

- Gold has been trending higher, at a rate of 28%/year for the past two years. It just broke that trend Monday – Figure 1.
  - The USD funding squeeze for European financials (EuroDoom) started up again last Friday, and continued in the Monday session (see chart).
  - Those expecting gold to act as a safeguard against European turmoil need to consider that moves in gold are now, and not insignificantly, positively correlated with European bank stocks – Figure 2.
  - The fit between gold and the cost to obtain USD in the swap market started in September.

- In the heyday for gold, when bullion was through $1,900, there was good utility in owning bullion. There was a negative correlation between bank stress and gold (Figure 2). In those days, gold shares garnered a 3rd decile reading, as opposed to the poor 8th decile showing that they currently exhibit - Figure 3.
  - Now European stress leads to liquefied gold.
- The large cap gold share with the weakest relative strength profile vs. the NYSE Arca Gold Miners index (GDM) is Kinross – Figure 4.
- If you want safety, do not buy Canadian or Australian gold stocks, instead, buy their government bonds. See Focal Points: How Long the Famine for China Feeders?

Figure 1: Gold Bullion

Figure 2: Gold and European Banks; Correlation of Returns

Figure 3: Gold Relative Strength Decile

Figure 4: Kinross vs. NYSE Arca Gold Miners Index

Source: BMO Capital Markets, Bloomberg
How Long the Famine for China Feeders?

- Italian bonds are the epicentre of the European debt crisis. Last week, the 5-day volatility (G&K) for the Italian 10-year bond yield exceeded 100%.
- The massive, early-week downdraft in yields was caused by both the “Save Italy” decree (Italian austerity package) and the market’s misread of Super Mario Draghi’s intentions.
- Yields shot up dramatically after the ECB chairman told his world audience that “the ECB is not an IMF member” (8:58 a.m., Dec. 8), dashing hopes that the ECB might be a conduit to the IMF funding of European sovereigns.

- The simple and connected points are that if the bond vigilantes decide to continue to pressure Italy, then:
  - the Italian 5-year CDS, currently priced at 566 bps, will take out the November high of 602 bps. This stress is causing assets to be repatriated from Emerging (growth) Markets, which is causing related uncertainty – Figure 1;
  - measures of counterparty risk should continue to trend higher, given Italy is the third-largest bond market in the world – Figure 2; and
  - the equity markets of China feeding nations, like Canada and Australia, should continue to underperform their respective bond markets. The current rate of underperformance is in excess of 30%/year – Figures 3, 4.
- Until these trends of counterparty uncertainty (Figures 2) and equity underperformance (Figures 3, 4) break, asset allocators should continue to hold a defensive hand. For how long? Until the bond vigilantes are satisfied. We watch, and wait.

Source: BMO Capital Markets, Bloomberg, Markit

This report was prepared in part 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 2 to 3.
The Storm, the Calm, and the Cheshire Cat

- A solid equity market needs a solid banking system. In Europe one would presume, this needs a solid market for sovereign, and especially, Italian debt. This presumption is not the way the market is currently priced. Italian too-interconnected-to-fail UniCredit Group’s 5-year CDS is priced close to 100bps more creditworthy than Italian government CDS – Figure 1.
  - The stability of bank creditworthiness is the key support, and reason we are seeing defensives break below outperforming trends, and more “risk-on” stocks break above underperforming trends.
  - Whether this spread is driven off of a need to hedge Italian sovereign risk, potential for bank capital injections, or government guaranteed bank bond offerings (or other market elements), the key for risk markets is that bank risk moves are not as dire as sovereign risk moves.

- Italian – European AAA 10yr debt spreads have widened materially in the past few weeks. They have come within 20bps of the level at which LCH.Clearnet may raise margin requirements. The rolling 30d correlation of moves between Italian 10yr debt and an AAA basket is currently about -30%, way off of the worst “sell Italy, buy AAA” mentality seen in July - Figure 2.

- The creditworthiness of global systematically important financial institutions (SIFI) has been relatively stable (page 2). The European debt crisis has seen two victims, Dexia and MF Global, and a “shoot-first” approach has been taken towards Jefferies Group. On the whole, however, calm prevails.

- Italian and Spanish sovereign CDS curves have not joined the inverted club of Greece, Portugal, or Ireland (page 3).

- The ECB signaled an abandonment of attempts to keep a lid on Italian debt the day that outgoing ECB President Trichet left office.

- Incoming ECB President Draghi takes a very different approach, asking "What makes you think that to become the lender of last resort for governments is actually the thing that you need to keep the euro area together?". He left his first ECB press conference smiling like a Cheshire Cat. Mind the change in stance!

- The message of Draghi is shaping up to be, we will not cap your rates, so you had better do what you need to do to make your bonds palatable. This is capitalism. This is what markets need. When a carrot does not work, use a stick.
  - There were thousands of sticks demonstrating in Rome against Berlusconi this weekend.
  - Markets reacted positively to talk of Berlusconi leaving his post, as he is seen as either unwilling or unable to bring forward tough austerity measures.

- With recent political turmoil, the demand for EFSF bonds has soured. The AAA German to still AAA French 10-year bond spread has tracked this concern (page 4). Still, EFSF bonds were priced and sold today. Capitalism marches on.

- While the ECB SMP program doubled its purchases of debt in Draghi’s 1st week, it clearly was done in a manner that allowed yields to rise, and thus inflict political pressure on Berlusconi.
  - This political pressure will likely be translated into more financial corporate failures. This clearing of the decks, while turbulent, is exactly what capitalism is based upon.

- Investors should watch the politics through the lens of bank default risk. This is how to best interpret the inflection points we are seeing in our Relative Strength trends.
The Calm amongst Banks

- The table of Too-Interconnected-To-Fail, or more formally, Global Systemically Important Financial Institutions (SIFI), ranked by CDS curve has not changed too much over the past two months – Figure 3.
- U.S. bank/brokers are on top with inverted curves. The level of inversion of these curves has improved over the past month, as we detail with Morgan Stanley – Figure 4.
- Major European bank CDS curves have not inverted. For many, one-year CDS levels have remained about 80-90% of the 5-year levels.

### Figure 3: Credit Profiles of Global Systemically Important Financial Institutions – Ranked by CDS Curve (1/5 year)

<table>
<thead>
<tr>
<th>Name</th>
<th>Ticker</th>
<th>Country</th>
<th>MktCap ($bn)</th>
<th>1Yr/5yr (%)</th>
<th>1Yr CDS</th>
<th>5Yr CDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Morgan Stanley</td>
<td>MS US</td>
<td>U.S.</td>
<td>32</td>
<td>112%</td>
<td>439</td>
<td>393</td>
</tr>
<tr>
<td>Bank of America Corp</td>
<td>BAC US</td>
<td>U.S.</td>
<td>66</td>
<td>111%</td>
<td>401</td>
<td>361</td>
</tr>
<tr>
<td>Goldman Sachs Group Inc</td>
<td>GS US</td>
<td>U.S.</td>
<td>53</td>
<td>107%</td>
<td>338</td>
<td>317</td>
</tr>
<tr>
<td>UniCredit SpA</td>
<td>UCG IM</td>
<td>Italy</td>
<td>21</td>
<td>95%</td>
<td>379</td>
<td>398</td>
</tr>
<tr>
<td>Societe Generale</td>
<td>GLE FP</td>
<td>France</td>
<td>19</td>
<td>88%</td>
<td>280</td>
<td>317</td>
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<tr>
<td>Banco Santander SA</td>
<td>STD US</td>
<td>Spain</td>
<td>69</td>
<td>84%</td>
<td>253</td>
<td>302</td>
</tr>
<tr>
<td>Lloyds TSB Group PLC</td>
<td>LYG US</td>
<td>U.K.</td>
<td>31</td>
<td>80%</td>
<td>238</td>
<td>298</td>
</tr>
<tr>
<td>Credit Agricole SA</td>
<td>ACA FP</td>
<td>France</td>
<td>18</td>
<td>80%</td>
<td>209</td>
<td>263</td>
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<tr>
<td>RBS Group Plc</td>
<td>RBS US</td>
<td>U.K.</td>
<td>22</td>
<td>79%</td>
<td>255</td>
<td>321</td>
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<tr>
<td>Citigroup Inc</td>
<td>C US</td>
<td>U.S.</td>
<td>89</td>
<td>79%</td>
<td>191</td>
<td>242</td>
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<tr>
<td>Commerzbank AG</td>
<td>CBK GR</td>
<td>Germany</td>
<td>12</td>
<td>78%</td>
<td>168</td>
<td>241</td>
</tr>
<tr>
<td>BNP Paribas</td>
<td>BNP FP</td>
<td>France</td>
<td>51</td>
<td>75%</td>
<td>176</td>
<td>234</td>
</tr>
<tr>
<td>ING Groep NV</td>
<td>ING US</td>
<td>Netherlands</td>
<td>32</td>
<td>71%</td>
<td>136</td>
<td>191</td>
</tr>
<tr>
<td>UBS AG</td>
<td>UBS US</td>
<td>Switzerland</td>
<td>48</td>
<td>71%</td>
<td>131</td>
<td>185</td>
</tr>
<tr>
<td>Barclays PLC</td>
<td>BCS US</td>
<td>U.K.</td>
<td>36</td>
<td>71%</td>
<td>145</td>
<td>205</td>
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<tr>
<td>Nordea Bank AB</td>
<td>NDA SS</td>
<td>Sweden</td>
<td>36</td>
<td>70%</td>
<td>112</td>
<td>159</td>
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<tr>
<td>HSBC Holdings PLC</td>
<td>HBC US</td>
<td>U.K.</td>
<td>155</td>
<td>69%</td>
<td>96</td>
<td>138</td>
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<tr>
<td>Wells Fargo &amp; Co</td>
<td>WFC US</td>
<td>U.S.</td>
<td>134</td>
<td>69%</td>
<td>105</td>
<td>152</td>
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<tr>
<td>Deutsche Bank AG</td>
<td>DB US</td>
<td>Germany</td>
<td>36</td>
<td>67%</td>
<td>133</td>
<td>199</td>
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<td>Credit Suisse Group</td>
<td>CS US</td>
<td>Switzerland</td>
<td>32</td>
<td>67%</td>
<td>107</td>
<td>160</td>
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<tr>
<td>Bank of China Ltd</td>
<td>3988 HK</td>
<td>China</td>
<td>30</td>
<td>64%</td>
<td>166</td>
<td>281</td>
</tr>
<tr>
<td>JPMorgan Chase &amp; Co</td>
<td>JPM US</td>
<td>U.S.</td>
<td>132</td>
<td>63%</td>
<td>93</td>
<td>147</td>
</tr>
<tr>
<td>Mizuho Financial</td>
<td>MFG US</td>
<td>Japan</td>
<td>33</td>
<td>70%</td>
<td>88</td>
<td>160</td>
</tr>
<tr>
<td>Sumitomo Mitsui</td>
<td>8316 JP</td>
<td>Japan</td>
<td>39</td>
<td>54%</td>
<td>86</td>
<td>159</td>
</tr>
<tr>
<td>Mitsubishi UFJ</td>
<td>MTU US</td>
<td>Japan</td>
<td>60</td>
<td>51%</td>
<td>71</td>
<td>140</td>
</tr>
<tr>
<td>State Street Corp</td>
<td>STT US</td>
<td>U.S.</td>
<td>20</td>
<td>23%</td>
<td>35</td>
<td>153</td>
</tr>
</tbody>
</table>

### Figure 4: Morgan Stanley Equity and CDS Curve

- UniCredit (UCG), which is the only Italian financial that the Financial Stability Board considers a SIFI, has seen its creditworthiness tread water for the past few months - Figure 5. The Italian sovereign - UCG CDS spread has widened (in the favour of UCG) close to 100bps, a new high (Figure 1).
- The creditworthiness of French Banks like SocGen (Figure 6) and BNP (Figure 13) has also moved sideways despite the stresses on their sovereign debt holdings. These holdings, mind you, have been reduced.
The Calm amongst Sovereigns

- The Greek Referendum on / off saga of last week took a toll on the “disorderly default” pricing (disorderly being over the short-term, i.e. 1-year CDS, as opposed to long-term, i.e. 5-year CDS) of Greece – Figures 7, 8.

- Italian and Spanish curves did not react negatively to this panic – Figure 8, 10.

- The sovereign curves of Ireland and Portugal have not been impacted by last’s week’s new Greek stress – Figure 9.

<table>
<thead>
<tr>
<th>Name</th>
<th>1Yr/5yr (%)</th>
<th>1yr CDS</th>
<th>5Yr CDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>207%</td>
<td>10,538</td>
<td>5,084</td>
</tr>
<tr>
<td>Portugal</td>
<td>126%</td>
<td>1,400</td>
<td>1,111</td>
</tr>
<tr>
<td>Ireland</td>
<td>118%</td>
<td>879</td>
<td>747</td>
</tr>
<tr>
<td>Ukraine</td>
<td>91%</td>
<td>686</td>
<td>754</td>
</tr>
<tr>
<td>Italy</td>
<td>90%</td>
<td>437</td>
<td>488</td>
</tr>
<tr>
<td>Spain</td>
<td>86%</td>
<td>332</td>
<td>385</td>
</tr>
<tr>
<td>Vietnam</td>
<td>79%</td>
<td>311</td>
<td>395</td>
</tr>
<tr>
<td>Bahrain</td>
<td>76%</td>
<td>268</td>
<td>352</td>
</tr>
<tr>
<td>Hungary</td>
<td>75%</td>
<td>400</td>
<td>530</td>
</tr>
<tr>
<td>Belgium</td>
<td>75%</td>
<td>211</td>
<td>280</td>
</tr>
</tbody>
</table>
Appetite for EFSF and French Bonds; Stability in French and French Bank CDS

- European bailouts by the European Financial Stability Facility (EFSF) are supported by bonds. This allows a window to observe the appetite that investors have for the bailout fund – Figures 11, 12.
  - When the first EFSF bond was sold in January the demand was “sky-high”.
  - Last weeks EFSF bond auction, to raise €3bn for Ireland, had to be postponed due to lack of demand.
    - This is understandable, given the massive political turmoil.
  - Today, the EFSF bond went ahead despite weakening demand.
    - This forward push, despite being priced under hostile market terms, is important.
- The EFSF – EU bond spread can be viewed as an indication of the markets’ level of concern about the EFSF’s ability to handle the European debt crisis. Moves in this spread have set the tone for which AAA rated German and French bonds (where keeping the AAA rating is a concern) are priced – Figure 12.
  - This is the storm.
- Using CDS pricing, the cost to protect France against default moves sideways, as does the cost to protect French banks – Figure 13.
  - This is the calm.
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<th>BMOCM US Universe*</th>
<th>BMOCM US IB Clients**</th>
<th>BMOCM US IB Clients***</th>
<th>BMOCM Universe****</th>
<th>BMOCM IB Clients*****</th>
<th>Starmine Universe</th>
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<tr>
<td>Buy</td>
<td>Outperform</td>
<td>37.7%</td>
<td>60.0%</td>
<td>47.9%</td>
<td>57.6%</td>
<td>51.0%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>12.1%</td>
<td>7.0%</td>
<td>0.0%</td>
<td>3.2%</td>
<td>0.7%</td>
</tr>
<tr>
<td>Hold</td>
<td>Market Perform</td>
<td>52.1%</td>
<td>47.9%</td>
<td>57.6%</td>
<td>51.0%</td>
<td>40.1%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>0.0%</td>
<td>0.0%</td>
<td>3.2%</td>
<td>0.7%</td>
<td>5.3%</td>
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