### Market Elements

<table>
<thead>
<tr>
<th>Date</th>
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<tbody>
<tr>
<td>July 11, 2012</td>
<td>NEW Market Elements</td>
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### Relative Strength Filter

<table>
<thead>
<tr>
<th>Date</th>
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<tbody>
<tr>
<td>July 12, 2012</td>
<td>NEW Dealing With Down</td>
<td>9</td>
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<td>July 11, 2012</td>
<td>Fingerprint of Capitalism / Semi Softness</td>
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<tr>
<td>July 10, 2012</td>
<td>Natural Gas Stocks Turning the Corner</td>
<td>11</td>
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<td>July 9, 2012</td>
<td>Technology Momentum Sells</td>
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</tr>
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<td>July 6, 2012</td>
<td>The Calm Is About to Break</td>
<td>13</td>
</tr>
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<td>July 5, 2012</td>
<td>Stimulus – Ask Why</td>
<td>14</td>
</tr>
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<td>July 4, 2012</td>
<td>Energy - &quot;What Was Bad&quot; Trading Rally</td>
<td>15</td>
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<tr>
<td>July 3, 2012</td>
<td>Technology Slipping Into Negative Territory</td>
<td>16</td>
</tr>
<tr>
<td>July 2, 2012</td>
<td>Time to Start Bottom Fishing in Thermal Coal</td>
<td>17</td>
</tr>
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<td>June 29, 2012</td>
<td>The Runs</td>
<td>18</td>
</tr>
<tr>
<td>June 28, 2012</td>
<td>Market Sells the Trending Winners</td>
<td>19</td>
</tr>
<tr>
<td>June 27, 2012</td>
<td>Broken Parts</td>
<td>20</td>
</tr>
<tr>
<td>June 26, 2012</td>
<td>Pay Dirt</td>
<td>21</td>
</tr>
<tr>
<td>June 25, 2012</td>
<td>U.S. Industrials – Under the Big Top</td>
<td>22</td>
</tr>
<tr>
<td>June 22, 2012</td>
<td>Through Asian Eyes</td>
<td>23</td>
</tr>
<tr>
<td>June 21, 2012</td>
<td>Correlation Breakdowns – Good and Bad</td>
<td>24</td>
</tr>
<tr>
<td>June 20, 2012</td>
<td>Italy Could Trump Ben</td>
<td>25</td>
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<tr>
<td>June 19, 2012</td>
<td>Diversified Mining - Expect a Pulse</td>
<td>26</td>
</tr>
<tr>
<td>June 18, 2012</td>
<td>It's Complicated</td>
<td>27</td>
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<tr>
<td>June 15, 2012</td>
<td>Airline Bottoming Patterns</td>
<td>28</td>
</tr>
<tr>
<td>June 14, 2012</td>
<td>Buy Golds, Sell S&amp;P 500</td>
<td>29</td>
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<td>June 13, 2012</td>
<td>Through Swiss Eyes</td>
<td>30</td>
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<td>June 12, 2012</td>
<td>Italy Shunned</td>
<td>31</td>
</tr>
<tr>
<td>June 11, 2012</td>
<td>The FROB Gets Fed</td>
<td>32</td>
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### Focal Points

<table>
<thead>
<tr>
<th>Date</th>
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<th>Page</th>
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<tbody>
<tr>
<td>June 22, 2012</td>
<td>Focus Shifts (Back) to Asia</td>
<td>33</td>
</tr>
<tr>
<td>May 16, 2012</td>
<td>Major Double Top for Global Real Estate</td>
<td>34</td>
</tr>
<tr>
<td>April 11, 2012</td>
<td>SIFI Creditworthiness Breakdown</td>
<td>35</td>
</tr>
<tr>
<td>December 13, 2011</td>
<td>Liquified Gold; Kinross</td>
<td>37</td>
</tr>
<tr>
<td>December 12, 2011</td>
<td>How Long the Famine for China Feeders?</td>
<td>38</td>
</tr>
<tr>
<td>November 7, 2011</td>
<td>The Storm, the Calm, and the Cheshire Cat</td>
<td>39</td>
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</table>

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Market Elements

- Equities flattened out after five days of losses; the FOMC minutes stirred but did not shake markets; Industrials and Technology lost, Financials and Energy gained.
- U.S. treasury yields neared the June spike low post a strong 10yr auction; Spanish and Italian yields fell towards the midpoints of the past 2–3 weeks; German 2yr yields closed at a new low of -1.6bps.
- Commodity currencies rebounded, while the Euro remained well grounded against the USD.
- Energy led most commodity baskets to gains; agricultural commodities rallied but then fell back on the U.S. crop report.

Levels*

<table>
<thead>
<tr>
<th>Currencies (USD per)</th>
<th>Commodities</th>
<th>Government 10-Yr Benchmark</th>
<th>Equity Indices &amp; Sentiment</th>
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</thead>
<tbody>
<tr>
<td>Symbol</td>
<td>H/L Level</td>
<td>%Chg</td>
<td>Symbol</td>
</tr>
<tr>
<td>DXY</td>
<td>H 83.46</td>
<td>0.1%</td>
<td>S&amp;P 1200</td>
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<tr>
<td>EUR</td>
<td>L 1.2298</td>
<td>-0.1%</td>
<td>S&amp;P/TSX</td>
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<tr>
<td>CHF</td>
<td>L 1.0192</td>
<td>-0.1%</td>
<td>Euro STOXX</td>
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<tr>
<td>GBP</td>
<td>* 1.5504</td>
<td>-0.1%</td>
<td>FTSE 100</td>
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<tr>
<td>CAD</td>
<td>* 0.9806</td>
<td>0.3%</td>
<td>Hang Seng</td>
</tr>
<tr>
<td>AUD</td>
<td>* 1.0245</td>
<td>0.5%</td>
<td>Topix</td>
</tr>
<tr>
<td>NZD</td>
<td>* 0.7970</td>
<td>0.4%</td>
<td>S&amp;P/ASX</td>
</tr>
<tr>
<td>BRL</td>
<td>* 0.4916</td>
<td>0.0%</td>
<td>Shang/Shen</td>
</tr>
<tr>
<td>MEXN</td>
<td>* 0.7508</td>
<td>0.5%</td>
<td>Sensex30</td>
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<tr>
<td>ZAR</td>
<td>* 0.1212</td>
<td>-0.4%</td>
<td>CDX IG 5Yr</td>
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<td>NZD</td>
<td>* 0.7914</td>
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<td>TRIN</td>
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<tr>
<td>SGD</td>
<td>* 0.8764</td>
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<td>VIX</td>
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Moves

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<th>Currencies (spot)</th>
<th>Commodities</th>
<th>Government 10- Year Benchmarks</th>
<th>Equity Indices</th>
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<tbody>
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<td>Symbol</td>
<td>Level</td>
<td>%Chg</td>
<td>Symbol</td>
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<tr>
<td>AUD</td>
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<td>S&amp;P Global 1200</td>
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<td>S&amp;P Europe 350</td>
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<td>BRL</td>
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<td>S&amp;P 500</td>
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<tr>
<td>CAD</td>
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<td>0.0%</td>
<td>S&amp;P/TSX Composite</td>
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Source for all data and graphics in this publication: BMO Capital Markets, Bloomberg, Thomson

* H/L = at a new closing 52- wk High/Low; */o = 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

- Equity uptrends and Investment grade default risk remain in positive trends as Italian yields continue to churn.
- Treasuries acting way too positively for our liking.

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Currencies

U.S. Dollar Index

Commodities

D.J.-UBS Commodity Price Index

Bonds

U.S. 10-Yr Bond

Equities

MSCI World Index

- Euro
- Gold (Spot)
- Crude Oil (WTI)
- Canadian 10-Yr Bond
- S&P 500
- Asia Dollar Index
- Natural Gas (NMX)
- German 10-Yr Bund
- S&P/TSX Composite
- Latin America Dollar Index
- Copper (CMX)
- Spanish 10-Yr Bond
- CDX North American Inv. Grade Index
- Canadian Dollar
- Nickel (LME 3Mo)
- Italian 10-Yr Bond
- VIX
- Australian Dollar
- TRIN
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

[Graphs of various financial instruments and markets are shown, including Currencies, Commodities, Bonds, and Equities.]
Daily Sector Charts
3-Month View with 26-Day Bollinger Bands and 150-, 200- and 50-Day Moving Averages

- Europe – at a 52-week high: Health Care.
### Market Movers – Largest Daily Percentage Moves

<table>
<thead>
<tr>
<th>Name</th>
<th>Symbol</th>
<th>% Chg</th>
</tr>
</thead>
<tbody>
<tr>
<td>China Petroleum &amp; Chemical Corp</td>
<td>386 HK</td>
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</tr>
<tr>
<td>Repsol YPF SA</td>
<td>REP SQ</td>
<td>1.4%</td>
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<tr>
<td>CNOC Ltd</td>
<td>883 HK</td>
<td>1.3%</td>
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<tr>
<td>WorleyParsons Ltd</td>
<td>WOR AT</td>
<td>-1.7%</td>
</tr>
<tr>
<td>OMV AG</td>
<td>OMV AV</td>
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</tr>
<tr>
<td>Inexp Corp</td>
<td>1605 TO</td>
<td>-2.2%</td>
</tr>
<tr>
<td>Nan Ya Plastics Corp</td>
<td>1303 TT</td>
<td>5.2%</td>
</tr>
<tr>
<td>ThyssenKrupp AG</td>
<td>TKA GY</td>
<td>2.5%</td>
</tr>
<tr>
<td>Societé Quimica y Miner de C</td>
<td>SQM UN</td>
<td>2.4%</td>
</tr>
<tr>
<td>Mitsui Chemicals Inc</td>
<td>4183 JT</td>
<td>-3.0%</td>
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<tr>
<td>Nippon Paper Group Inc</td>
<td>3801 JT</td>
<td>-3.4%</td>
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<tr>
<td>Alumina Ltd</td>
<td>AWG AT</td>
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<td>Jardine Matheson Holdings Ltd</td>
<td>JM SP</td>
<td>2.7%</td>
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<td>Daikin Industries Inc</td>
<td>6367 JT</td>
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<td>Grupo Televisa SAB</td>
<td>COPEC CC</td>
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<tr>
<td>Panasonic Corp</td>
<td>6752 JT</td>
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<tr>
<td>OPAP SA</td>
<td>OPAP GA</td>
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<tr>
<td>Embraer SA</td>
<td>ERJ UN</td>
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<td>Hyundai Mobis</td>
<td>012330 KP</td>
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<tr>
<td>Li &amp; Fung Ltd</td>
<td>494 HK</td>
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<td>Empresas COPEC SA</td>
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<td>Fiat Industrial SpA</td>
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<td>European Aeronautic Defence</td>
<td>EAD FP</td>
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<td>Commercial Bank of Mexico SAB</td>
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<td>Kerry Group PLC</td>
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<td>Japan Tobacco Inc</td>
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<tr>
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<tr>
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<td>Elan Corp PLC</td>
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<td>Federal Standard National Corp</td>
<td>FSN</td>
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<tr>
<td>Tenet Healthcare Corp</td>
<td>TBC GY</td>
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<td>Cerberus Medical Inc</td>
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<td>ACE Ltd</td>
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<td>Cia Paranaense de Energia</td>
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<tr>
<td>New NS Energy Corp</td>
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<tr>
<td>Semi Group</td>
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<td>-1.7%</td>
</tr>
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</table>

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

#### Energy
- Symbol: H, Last: $123.24, %Chg: -3.5%
- Symbol: NE, Last: $33.34, %Chg: -2.7%
- Symbol: DSK, Last: $61.39, %Chg: -7.3%
- Symbol: NBR, Last: $13.24, %Chg: -1.7%

#### Industrials
- Symbol: ECL, Last: $39.72, %Chg: 0.2%
- Symbol: LXG, Last: $19.45, %Chg: 0.2%
- Symbol: XOM, Last: $84.38, %Chg: 1.5%
- Symbol: CVX, Last: $104.85, %Chg: 0.9%
- Symbol: COP, Last: $54.36, %Chg: 1.6%
- Symbol: OXY, Last: $84.57, %Chg: 1.5%

#### Materials
- Symbol: BAS, Last: $9.34, %Chg: -0.9%
- Symbol: MTRX, Last: $11.52, %Chg: -0.6%
- Symbol: GPP, Last: $4.00, %Chg: -0.8%
- Symbol: DOW, Last: $30.29, %Chg: -0.9%
- Symbol: PPG, Last: $100.82, %Chg: -1.2%
- Symbol: EMN, Last: $92.40, %Chg: -0.3%

#### Health Care
- Symbol: Symbol: Health Care, Last: $179.02, %Chg: -1.9%
- Symbol: Symbol: Health Care, Last: $179.02, %Chg: -1.9%
- Symbol: Symbol: Health Care, Last: $179.02, %Chg: -1.9%

### Consumer Staples
- Symbol: CVS, Last: $46.90, %Chg: -0.1%
- Symbol: HAG, Last: $29.46, %Chg: -0.7%
- Symbol: SY, Last: $21.78, %Chg: -1.0%

### Technology
- Symbol: YHOO, Last: $15.80, %Chg: -0.1%
- Symbol: AKAM, Last: $23.71, %Chg: -0.3%
- Symbol: VRX, Last: $24.62, %Chg: -0.3%
- Symbol: AGC, Last: $57.73, %Chg: 0.3%
- Symbol: CTSH, Last: $56.12, %Chg: -0.5%
- Symbol: SAI, Last: $11.61, %Chg: 0.6%

### Financials
- Symbol: WFC, Last: $33.27, %Chg: 0.9%
- Symbol: WAG, Last: $41.99, %Chg: 0.8%
- Symbol: CMCA, Last: $37.97, %Chg: -0.1%
- Symbol: HUM, Last: $74.50, %Chg: -1.7%
- Symbol: DG, Last: $107.36, %Chg: -0.3%
- Symbol: ESRX, Last: $82.77, %Chg: 1.1%

### Consumer Discretionary
- Symbol: GM, Last: $19.90, %Chg: -0.5%
- Symbol: LG, Last: $7.22, %Chg: -0.2%
- Symbol: MGM, Last: $19.90, %Chg: -0.5%
- Symbol: WMT, Last: $17.72, %Chg: -1.6%
- Symbol: COST, Last: $14.49, %Chg: -0.4%
- Symbol: FYX, Last: $12.70, %Chg: -2.5%

### Utilities
- Symbol: GOOG, Last: $571.19, %Chg: -1.8%
- Symbol: AIG, Last: $62.41, %Chg: -1.5%
- Symbol: COO, Last: $53.00, %Chg: -0.7%
- Symbol: BHP, Last: $49.55, %Chg: -0.7%
- Symbol: PNL, Last: $47.53, %Chg: -0.7%
- Symbol: LS, Last: $18.99, %Chg: -1.7%

### Market Elements
- Symbol: Market Elements, Last: $179.02, %Chg: -1.9%
- Symbol: Market Elements, Last: $179.02, %Chg: -1.9%
- Symbol: Market Elements, Last: $179.02, %Chg: -1.9%

### Tech Sector
- Symbol: Market Elements, Last: $179.02, %Chg: -1.9%
- Symbol: Market Elements, Last: $179.02, %Chg: -1.9%
- Symbol: Market Elements, Last: $179.02, %Chg: -1.9%

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**Footnote:**
- "High" indicates a new closing 52-week high.
- "Low" indicates within 10% of the 52-week high.
- **Bold** indicates move of more than 5%.
## Canadian Market Movers

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</table>

Note: The %Chg values are calculated based on the closing values as follows: %Chg = \( \frac{\text{Last } - \text{Previous Close}}{\text{Previous Close}} \times 100 \). The table includes the symbol, high, low, and last prices, along with the percentage change for each entry.
Dealing With Down

- It took some time, and indeed it took the breakdown in the relative performance uptrend of Technology to do so, but our “best fit” trend for the S&P 500 now sports a negative (if just ever so slightly) slope – Figure 1.
  - The slope is expected to tilt more toward the negative.
  - This would be in the direction of the trends on most major global equity indices, which are already trending lower – see link.

- Global growth expectations, using the Asia Dollar index as a proxy, are trending lower, and the counter-trend rally is fading sharply this morning – Figure 2.
  - This is how to deal with down – you buy the stuff where down (trend of yields) looks green on the screen.

- Eventually, and with enough pressure, the outperforming trends of U.S. stocks versus U.S. bonds will break. We have seen signs of this before, and there are some short-term moving averages on stock/bond ratios that are rolling over.

- If you look at an equity market like Canada, where the equity weights are tilted toward global growth, stocks are underperforming bonds at double-digit rates – Figure 4. North of the 49th, we have been dealing with down for some time.

Figure 1: S&P 500 (Price Trend) Is Rolling Over

Figure 2: Asia Dollar Index

Figure 3: Trends of Global Safe-Haven Bonds (Sea of GREEN)

Figure 4: S&P/TSX Versus Canadian Bonds (XIC / XBB)

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

Fingerprint of Capitalism / Semi Softness

- We will have to watch this one closely, but this morning it looks like capitalism is prevailing in Spain and much to the benefit of the country, if only just for a few hours – Figure 1.
  - The “event” is the Spanish banking bailout blueprint, which forces losses on subordinate debt holders, which in the case of Spain are unfortunately depositors.
  - The benefit is that Spanish sovereign debt is gaining (yields falling), and as such the stress (via contagion) on the Italian bond market (which is the ultimate “we care about”) is reduced.
- The “watch this one closely” will be the potential for bank runs in Spain, which could be destabilizing.

Elsewhere in capital markets.
  - We note the 5-year CDS on AMD broke an improving trend yesterday – Figure 2.
  - On a broader scale, semiconductors are in a consistently underperforming trend – Figure 3 …
  - …which is turning into a price downtrend – Figure 4.
- We continue to see evidence to support our short technology stance.

Figure 1: The Fingerprint of Capitalism Working in Spain

Figure 2: AMD 5-Year CDS Breaking the Wrong Way

Figure 3: U.S. Semiconductors vs. S&P 500

Figure 4: U.S. Semiconductor Price Trend

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

Natural Gas Stocks Turning the Corner

- As natural gas holds just below the $3 mark – Figure 1, one quarter of gassy stocks are reversing underperforming trends against the S&P 500 and S&P/TSX – Figure 2.
- It just took a while for North America’s largest gassy stock to break above an underperforming trend as Anadarko is doing now – Figure 3.
  - This reversal in the market cap leader provides cover for the juniors (the bulk of Figure 2).
- As a resource specialist, the turn in Encana occurred 6 months ago.
  - Encana is in an outperforming trend versus a global resource basket – Figure 2.
  - ECA is also basing versus the S&P 500, outperforming U.S. energy, and outperforming Canadian benchmarks.

Figure 1: NMX Natural Gas

Figure 2: Positive Reversals of Gassy Stocks vs. S&P 500

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<tr>
<th>Name / Link to Charts</th>
<th>Symbol &amp; Links</th>
<th>1-day Chg (%)</th>
<th>5-day Chg (%)</th>
<th>MktCap US$m</th>
<th>Chg Last Day</th>
<th>Reward /Risk</th>
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Source: BMO Capital Markets, Bloomberg, Thomson, Markit

Figure 3: Anadarko Petroleum Versus S&P 500

Figure 4: Encana Versus MSCI World Energy & Materials
Technology Momentum Sells

- Last week, we highlighted technology slipping from “neutral to negative.”
  - The slip has turned into a dive – Figure 1.
    - It is time to look at shorting tech stocks.
  - Recent weakness is due to another batch of technology stocks breaking below outperforming trends, including Citrix Systems – Figure 2.

- Most U.S. technology industries are in underperforming trends against the S&P 500, and the propensity is to fall below their channels – Figure 3.
- We highlight a list of technology momentum sells with the weakest earnings estimate revisions in Figure 4.

Figure 1: Relative Weakest Position in 1.5 Years

Figure 2: Citrix Systems vs. S&P 500

Figure 3: U.S. Technology Sub-Industries Versus S&P 500

Figure 4: Technology Momentum Sells with Worst Earnings Estimate Revision Deciles (Market Cap Floor $1.5bn)

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Source: BMO Capital Markets, Bloomberg, Thomson, 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.
This morning the cost to protect Italian bonds from default breaks back into the ½ Mille High Club (514 bps as we hit send), and German 2-year yields fall back into negative yield territory for the second time.

- Italian – European AAA spreads are reversing the downtrend from the Berlusconi era high as Spanish – European AAA spreads near the June peak – Figure 1.

- It is a good time to:
  - Short Santander stock, which leapfrogged over fellow SIFIs UniCredit and Morgan Stanley to sport the CDS curve, which is closest to inversion – Figure 2.
  - Buy protection on Morgan Stanley, as it approaches the limit of its counter-trend contraction – Figure 3.
  - Buy volatility, as the VIX starts to base – Figure 4.

Figure 1: Spreads of Italian & Spanish 10yrs vs. European AAA Figure 2: Santander (SAN US) Price Trend

Figure 3: Morgan Stanley 5-Year CDS Figure 4: CBOE Volatility Index (VIX)

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Stimulus – Ask Why

• Today:
  o Spanish and Italian 10-year bond yields continue to pivot off of a string of higher lows – Figure 1.

• Also today:
  o China pairs up with the BOE (again) ‘surprising’ with a second rate cut while the BOE gives us more QE.
  o The ECB cuts rates too.

China, the BOE and the ECB are doing their best to ease the pressure on the run on Europe (Figure 1), which has led to:
  o The euro falling at a rate of 11%/year – Figure 2.
  o Safe haven yields falling at rates of 20–50%/year – Figure 3.

• It is the ‘why’ (Figure 1) that leads to the central bank measures.
• When the trends of the ‘why’ change, then we would consider stimulus measures to be something more than a lift to sell into.
  o The trends have not changed.
    ▪ The MSCI ACWI xUSA Index hits resistance and the downtrend soon – Figure 4.

Figure 1: Spanish and Italian Bond Yields
Figure 2: Euro Falling at a Rate of 11%/Year
Figure 3: Trends on Global Safe-Haven Yields
Figure 4: MSCI ACWI xUSA

Source: BMO Capital Markets, Bloomberg, Thomson, Markit

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Energy – "What Was Bad" Trading Rally

- The Asia dollar index, our proxy for global growth, sports a series of lower highs and lows. It is trending lower. The pivot off of the low came as China cut rates, and the recent rally is nearing resistance – Figure 1.
- Brent oil, which has formed a distribution top, has just entered the resistance zone.
  - Our downside target remains $80 – Figure 3.
- When global growth is feared, treasury yields rise.
  - Treasury yields are not rising – Figure 2.
- The MSCI Oil, Gas & Consumable Fuels Index has reversed a steep downtrend versus ACWI yesterday – Figure 4.
  - Previous reversals have led to good periods of outperformance.
  - Previous reversals have also seen the treasury market awaken (line up Figures 2 and 4), yet treasuries are not awakening.
  - This appears to be a "what was bad is now good" rally.
  - Good for traders, but not so much for investors.

---

Figure 1: Asia Dollar Index

Figure 2: U.S. 10-Year Treasury Yield

Figure 3: Brent Oil

Figure 4: MSCI Oil, Gas & Consumable Fuels vs. ACWI

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Technology Slipping Into Negative Territory

- **Technology** is slipping from a neutral to a negative reading in our group selection report – Figure 1.
  - Importantly, this reading is not market capitalization (AAPL) weighted.
- 12 of 16 sub-industries measure up in negative deciles.
- **Computer Hardware** in particular has slipped to an 8th decile reading – Figure 2.
  - The group now has more underperformers than outperformers, and one-third of the outperforming stocks have broken their uptrends – Figure 3.

---

**Figure 1: Information Technology Relative Strength Z-Score**

Slipping from Neutral Towards Negative

**Figure 2: Computer Hardware Relative Strength z-Score**

**Figure 3: Relative Strength Trends on Global Computer Hardware Stocks**

---

1/3 of Outperformers Breaking Down

More Underperformers Than Outperformers

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

Time to Start Bottom Fishing in Thermal Coal

- Central Appalachian coal, which had been trending lower at a rate of 43%/year for the past year, reversed this trend on Friday - Figure 1.
  - This move follows Natural gas, which has been basing/bottoming since April.
- Shares are just starting to react, but it is very early days.
  - Arch Coal, which had been underperforming in spectacular fashion, has reversed this downtrend - Figure 2.
  - Cloud Peak has more defined basing pattern. The downtrend was also reversed, and a first set of higher highs and lows has developed - Figure 3.

- The largest thermal coal stocks show more nuanced signs of strength.
  - Consol Energy hit a 1-month relative strength high, which is a pre-cursor to reversing its underperforming trend - Figure 4.
  - Peabody Energy gapped higher on Friday. It rose from below the bottom end of its underperforming pattern (-90%/year).

Figure 1: Positive Reversal for Central Appalachian Coal

Figure 2: Arch Coal vs. S&P 500

Figure 3: Cloud Peak Energy vs. S&P 500

Figure 4: Consol Energy vs. S&P 500

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
The Runs

- This morning markets react positively to the concessions that Monti wrangled out of Merkel, although there seems to be a bit of confusion over exactly what was decided, and of course Germany can’t decide on anything of importance without the Bundestag, Merkel’s next stop.
- For the question of “will this halt the bank run out of Europe?” we defer to the Swiss 5-year bond yield – Figure 1.
  - Swiss yields continue to sport a trend of lower lows and highs, albeit the torque has been diminished somewhat. The bank run continues, albeit diminished somewhat.
  - Spanish banks, which gapped on the EU news, are currently trading near the lows of the session.
- For the question of does this make the euro a favoured currency, we highlight the trend – Figure 2. Can you spot today’s decision? Enough said.
- Moving to equities, the run out winning sectors continues. U.S. technology has been outperforming the S&P 500 at a rate of 8%/year. It eased slightly below this uptrend on Wednesday, a move that accelerated yesterday (relative performance was a negative 0.7%) – Figure 3.
- Large cap technology shares falling yesterday, which are below the bottom ends of their channels, are highlighted in Figure 4.

---

**Figure 1: Swiss 5-Year Bond Yield**

Somewhat Diminished Intensity On The Run On The European Banking System

**Figure 2: Euro Trending Lower at a Rate of 12%/Year**

**Figure 3: Technology vs. S&P 500**

Breaking an Outperforming Trend

**Figure 4: Large Cap S&P 1500 Technology Below Trend Which Fell Yesterday and Are Below Trend Channels**

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
The market continues to move toward a more bearish leaning. Importantly, it is not there yet, and we are not ready to buy yet.

The U.S. Consumer Discretionary index broke below an outperforming trend yesterday.

- This U.S. Sector had been the most consistently outperforming of the 10.
  - Mind the turn, where the market starts to sell the long-term winners.
  - Along those lines, U.S. Technology just edged below its outperforming trend as well.

Consumer Discretionary is a basket of apples and oranges, so you have to dig into the details of where the pressure came from.

At the stock level, the S&P 500 consumer discretionary stocks that have been punished below the bottom end of trend channels, which fell yesterday, are highlighted in Figure 2.

Both Starbucks (Figure 3) and Chipotle Mexican Grill have been fantastic outperformers. They both broke these outperforming trends yesterday. Yum! Brands broke a steep outperforming trend a few weeks back; it is falling below a less well-defined uptrend now.

Auto retail (AZO, ORLY, KMX), another big winner, was coloured the brightest red yesterday, making it a trio of woe as retail joins Autos and Auto Parts.

Macy's continues to break below its outperforming trend, while is CDS breaks above a narrowing trend (Figure 4). JCP continues to slide, as its CDS nears 800 bps. Nordstrom is trending lower.

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

Broken Parts

- The cost to protect a basket of Auto Parts stocks against default is breaking to the upside (a negative) – up 3% yesterday, 7% over the past five days – Figure 1.
- Yesterday, Auto Parts retreated back to 10th (worst) decile in our Group Selection report – Figure 2.
- The Global Auto Parts index is just hanging on to a skinny (and shaky) 2% outperformance trend,
  - is a very poor place to be (alongside autos) within the consumer discretionary sector, and
  - appears to be just behind autos, which broke its price uptrend yesterday (parts link).
- BorgWarner was the key credit mover of the group yesterday (CDS moves & charts found at this link), with its 5-year CDS widening 11%. Its relative strength (and price pattern) is a 2-year distribution top – Figure 3. BorgWarner's 2012 price high was not confirmed by either relative strength (Figure 3) or credit.
- We rank 9 of the list of 41 Auto Parts stocks as momentum sells – Figure 4.
- Continental, was a key large cap (4th largest stock in the group) relative strength breakdown yesterday (CDS widened 3%)
- For Canadians, Linamar has been a stellar outperformer. It broke that outperformance trend yesterday.

Figure 1: CDS Trend on a Basket of Auto Parts Companies (CON AG, TRW US, GKN LN, FR FP, JCI US, BWA US)

Figure 2: Global Auto Parts Relative Strength Decile

Figure 3: BorgWarner vs. S&P 500 Index

Figure 4: Auto Parts Momentum Sell List

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Pay Dirt

- In a market, where most commodities are very red, grains are a refreshing colour of green.
  - As a basket, grains, which had been moving sideways/higher, shot materially higher yesterday - Figure 1.
- The creditworthiness of a basket of Fertilizer CDS, which had been trending tighter (bullish), just broke to a lower low (bullish) - Figure 2.
- U.S. Fertilizers & Ag. Chemicals broke above an underperforming trend against the S&P 1500 yesterday.
- Canadian Fertilizers are breaking above a neutral trend against the S&P/TSX Composite.
  - Against the materials group, grains have formed a multi-year basing pattern and are trending higher.
- At a global level, there is a blend of outperformers and underperformers, but the underperformers are reversing downtrends - Figure 3.
- In the group:
  - There is just one momentum buy (outperforming market and sector, above rising moving averages and not overbought) - American Vanguard (AVD).
  - There are 10 stocks outperforming the market and the sector, including Syngenta, Terra Nitrogen, and Agrium.
  - Both Potash and Mosaic reversed underperforming trends yesterday.
- Relative strength trend on all fertilizer and agricultural chemical stocks is found at this link.

**Figure 1: DJ UBS Grains ETN (JUG US) Price Trend**

**Figure 2: Fertilizer Group 5-Year CDS Basket**

**Figure 3: MSCI ACWI Fertilizer Shares vs. MSCI All Country World Index**

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

U.S. Industrials – Under the Big Top

- **U.S. Industrials** ranks just behind **Energy** as the most consistently underperforming U.S. sector – Figure 1.
- Now the **price pattern** is starting to turn down as well, starting with just a mildly sloping (-3%) trend, but behind this turn is a large distribution top pattern – Figure 2.
  - Investors should be eying the major support level (17% lower), and ultimately the distribution top target (35% lower).
- Looking under the big top, the most consistently underperforming large-cap industrials against the S&P 500 are shown in Figure 3.
- We now have 46% of S&P 500 industrials in downward sloping price trends. Small caps are slightly worse, with 52% of Russell 2000 industrials in negative price trends.

**Figure 1: U.S. Industrials vs. S&P 500**

**Figure 2: U.S. Industrials**

**Figure 3: Most Consistently Underperforming S&P 500 Industrials ($5bn Market Cap Cutoff)**

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

Through Asian Eyes

- In today’s Focal Points: Focus Shifts (Back) to Asia, we highlight,
  - “China caught the Spanish flu in March, broke away thanks to a surprise rate cut on June 7, and has started to deteriorate again as of this Wednesday”

- It has been Asian currency and credit, which have been giving the world the strongest signals over the past two days.

- If you overlay counterparty risk (which itself has a great fit to the S&P 500) with a basket of Asian Sovereign CDS, you see a very good fit – Figure 1.
  - One can argue that China’s rate cut on June 7 was a key driver of risk reduction.
  - The question over the last two days (three if you include today, as the Asian Sovereign CDS basket continues to rise) is “has that driver run out of gas?”
  - Looking at the relative strength picture, those with portfolios oriented toward global growth know that the gas ran out quite some time ago – Figures 2-4.

Figure 1: Asian Sovereign CDS and Counterparty Risk

Figure 2: Energy vs. MSCI ACWI

Figure 3: Materials vs. MSCI ACWI

Figure 4: Industrials vs. MSCI ACWI

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Correlation Breakdowns – Good and Bad

TOOLKIT

- We have the luxury of looking at intraday charts as they develop with the news flow. The importance here is that we have a good understanding at what moves, and does not move, markets. From these movements, we eventually see correlations build up and break down.

- The breakdown in the fit between European senior financial default risk and counterparty risk (Figure 1) is responsible for the pivot in the S&P 500 – Figure 2. This is a large positive to be stressed.

- The positive (inverted) fit between the copper cost to protect Australia, China and now Italy (Figure 3) from default is the reason we expect to see a short-covering rally, albeit in a bear market, for mining shares (Figure 4).
  - The tape was not compliant to this thesis yesterday (Figure 3 top right).
  - We suppose the fundamental reason driving the CDS matters here.
    - If Italian CDS is narrowing because of fundamental change, we expect copper would be reacting better.
    - If, however, the risk reduction is due to yet another can kicking exercise (sans Bundesbank support), then we expect that all we would get out of this is a counter trend rebound. The U.S. equity market would continue to act as a safe-haven asset against other equity markets.

Figure 1: European Sr Fin Default Risk and Counterparty Risk

Figure 2: S&P 500 Index

Figure 3: Italian 5yr CDS (Inverted Scale Shown) and Copper

Figure 4: Metals & Mining vs. MSCI ACWI
Italy Could Trump Ben

- Excuse us for suggesting that the positive impact of Italy could beat out what the FED might announce/not announce this afternoon but, this morning, the cost to protect Italy against default has just broken the 3-month trend of credit deterioration - Figure 1.
- This means that we will again be talking about Canada, since the European debt crisis has placed the Resource-heavy Canadian equities in a very undesirable position relative to world markets.
- This morning’s move in Italian credit is a positive in the fight against the two-year topping pattern for global growth-oriented mining shares. Yesterday, the S&P/TSX Diversified Mining index broke above an underperforming trend – Figure 2.
- In the spirit of credit trumps all, and given that diversified miners are still in underperforming trends, we highlight the miners where our fundamental analysts suggest that underperformance is not warranted. Many are close to and are breaking above 50d MAs. At the very least, cover your shorts.

Figure 1: Italian 5-Year CDS

Figure 2: Canadian Diversified Metals & Minerals vs. S&P/TSX

Figure 3: Liquid Diversified Miners (BMO Outperform / Market Perform / Market Perform Speculative)
Diversified Mining - Expect a Pulse

- First off, the world has dumped on diversified miners. The group is suffering at a 10th decile position in our Group Selection Report, and there has been absolutely no pulse in this stance for a month – Figure 1.
- Typically, the group, and the copper price for that matter, swing with the creditworthiness of Asia (China and Australia) – Figure 2.
  - Australian creditworthiness has been improving for a month, and China’s CDS pivoted from bad to good at the start of June.
  - Copper and miners have lagged this improvement.
- The speculative net position in copper is the shortest it has been since the 2008-9 spike low. There is potential for a decent short covering rally.
- First Quantum, the second largest Canadian diversified miner reversed an underperforming trend yesterday. Clearly it is not enough to move the group – but it is the first sign of strength we have seen being translated in the equity world.

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

June 18, 2012
Research Comment
Quantitative/Technical Research Website

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It’s Complicated

- Reading the weekend headlines: Greece, Greece, Greece, Greece, Greece...Spanish 10-year yields hit a euro record high of 7.14%.
- For a North American equity investor, Greece, Spain, or Italy do not matter too much. It is how they affect the banking system that is of concern.
- A key measure of counterparty risk (the banking system) is the U.S. 2-year swap spread. Moves in the U.S. 2-year swap spread have had a correlation to moves in the S&P 500 of 60–70% over the past two months.
  - Counterparty risk is dramatically receding.
    - This is bullish – Figure 1 top.
- Another less stable, but slightly better current fit with the S&P 500 is simply U.S. 10-year treasury yields.
  - Yields continue to edge lower, a non-confirmation of the Thursday/Friday rally in the S&P 500.
    - This is bearish – Figure 1 bottom.
- We pay heed to both signals, realizing that with reduced concerns on the banking system, the S&P 500 can rally back toward major resistance starting at 1360, but without the support of higher treasury yields, the rally can fizzle, like it did in April, when the treasury market remained firm (the “Unconfirmed” signal in Figure 1).
  - It is a complicated, but important, message.
    - It is very impressive that counterparty risk is receding at a time when stress on the Spanish bond market is reaching new highs (5-year CDS just broke out to a new high of 620 bps this morning). One cannot ignore this bull statement.
    - One cannot ignore the treasury market either, where 10-year yields have dropped to a six-session low this morning.

Figure 1: S&P 500 vs. Counterparty Risk (top) and Treasuries (bottom)

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

Airline Bottoming Patterns

- Southwest Airlines is breaking above an underperforming trend against the S&P 500, and the price trend is basing (double bottom pattern) – Figures 1, 2.
- Air Canada is reversing an underperforming trend and a price downtrend – Figures 3, 4.

Those looking for the best airline patterns that are not bottoming should consider:
  - US Airways Group outperforming the S&P 500 at 140%/year and trending higher at a rate of over 160%.
  - WestJet Airlines outperforming the S&P/TSX at a rate of 75%/year and trending higher at a rate of 68%/year.

Figure 1: Southwest Airlines vs. S&P 500

Figure 2: Southwest Airlines Price Trend

Figure 3: Air Canada vs. S&P/TSX Composite

Figure 4: Air Canada Price Trend

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

**Buy Golds, Sell S&P 500**

- **Gold shares** are reversing a 10-month downtrend against the S&P 500 – Figure 1.
- **Gold is now trending slightly higher in Aussie dollars**, a currency whose interest rate advantage has slipped dramatically.
- Those looking for sources of funds to buy golds should consider **energy** – Figure 2.
- There are a few gold shares that are already consistent outperformers versus broad equity markets, like **Goro Resources** – Figure 3.
- We advise against bottom fishing amongst the **laggards** – Figure 4.
- Price trends on gold shares are **found at this link**.
- Relative strength trends of gold shares in the MSCI World index are **found here**.
- Relative strength trends of **gold shares in the S&P/TSX Composite Index are found here**.

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**Figure 1: Gold Miners vs S&P 500 ETF (Mind The Inflection Pt)**

[Graph showing Gold Miners vs S&P 500 ETF]

**Figure 2: Gold vs Oil** (Sell Oil or Energy Shares to Fund)

[Graph showing Gold vs Oil]

**Figure 3: Goro Resource vs. ACWI** (one of a few outperformers)

[Graph showing Goro Resource vs. ACWI]

**Figure 4: Kinross vs. Gold Miners** (Don’t Dumpster Dive)

[Graph showing Kinross vs. Gold Miners]

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Through Swiss Eyes

- Yesterday, for the first time, the Swiss 5-year bond yield was bid into negative yield. The Swiss safety deposit box grows in duration – Figure 1.
- Importantly, other “safe-haven” bonds, such as German bunds and U.S. Treasuries are not following suit.
  - German bund yields are actually soaring.
  - Rising treasury yields are very near and dear to our hearts. The fit of the moves between the S&P 500 and U.S. 10-year Treasuries is now an impressive (or not really if your job is to argue why equity fundamentals matter) 77% - Figure 2.
  - Rising Yields = Rising Equities
- Back to bonds:
  - The sell-off in German bunds coincides with a deterioration of creditworthiness of Germany versus Switzerland – Figure 3.
  - One is a Target 2 creditor, which could get paid back in a euro-lite currency. The other is not.
- The sell-off in Treasuries contains no such fuse, and thus one should expect no such fire behind the move. This is a key point (back to Figure 2).
- You can’t go to Switzerland without mentioning gold – Figure 4.

Figure 1: Swiss Bond Yields: 2 to 20-year Bonds

Figure 2: Fit of S&P 500 Moves to U.S. 10-Year Treasuries

Figure 3: Bond Yields and Default Risk vs. Swiss CDS

Figure 4: Gold vs. German 5-10Yr Bond ETF (RXPSEX GY)
Italy Shunned

- In the aftermath of the failed European Bazooka, the world’s 3rd largest bond market is shunned.
- The fit of equities to the Italian job is not hand in glove, but it is strong enough to support the string of lower highs and lower lows.

Figure 1: The Italian Job

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Today the market enters day 3 of the FROB feeding frenzy, but this time there is a bit of hard news around the bailout.

- We have a headline-friendly EUR 100 billion amount.
- We have the German finance minister on the tape saying the funds will likely come via the ESM, whereby Spanish government bonds will find themselves subordinated to the ESM.

Most important to us is the reaction in the bond market, which is the driver of what happens to equities (because if credit is not happy, equities are not happy).

- Starting with the destination of those concerned about a GRExit (or SpExit), the Swiss 2-year bond yield drops to a new low of -33.9 bps.
- The Spanish 10-year yield erased an early morning rally, and is now up 8 bps on the day – Figure 1.
- The Italian 10-year bond yield rises to a 5-session high – Figure 2. The breakout point is 6% (key watch this week).

The hostile credit environment remains hostile. We do not expect change.

- Resources should continue to underperform (Figure 3) and trend lower (Figure 4).
- Defensive sectors should continue to strengthen, at least in relative strength terms.
Focus Shifts (Back) to Asia

- Yesterday, the Asia dollar index suffered the worst day of the past three weeks. Its sharp decline led oil and other industrial commodities lower – Figure 1.
- The day before, it was Asian CDS that widened the most among fellow sovereigns. While we lamented how copper was not following the recent European credit improvement, it was Asia that the market was focusing on.
- China caught the Spanish flu in March, broke away thanks to a surprise rate cut on June 7, and has started to deteriorate again as of this Wednesday – Figure 2.
- Yesterday, equity markets broke to the downside in concert with the Asian currency basket. Downside risk is 5% lower for the resource heavy S&P/TSX – Figure 3.
- The U.S. equity market is also influenced by moves in the Asia Dollar Index. It has been this way for years. The influence is still not as great as that of counterparty risk (which rose for the first day in six yesterday), but it is still substantial, growing and has the potential to hit the 90s as it did last year – Figure 4.

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 (↑)}
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?
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.
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 Systematically 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.

- 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.

### Figure 3: Credit Profiles of Global Systematically 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 1Yr</th>
<th>5Yr 5Yr</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>399</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>39</td>
<td>88%</td>
<td>280</td>
<td>317</td>
</tr>
<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>
</tr>
<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>
</tr>
<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>
</tr>
<tr>
<td>Commerzbank AG</td>
<td>CBK GR</td>
<td>Germany</td>
<td>12</td>
<td>78%</td>
<td>188</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>
</tr>
<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>
</tr>
<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>
</tr>
<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>
</tr>
<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>
</tr>
<tr>
<td>Credit Suisse Group</td>
<td>CS US</td>
<td>Switzerland</td>
<td>32</td>
<td>67%</td>
<td>107</td>
<td>160</td>
</tr>
<tr>
<td>Bank of China Ltd</td>
<td>3988 HK</td>
<td>China</td>
<td>30</td>
<td>64%</td>
<td>166</td>
<td>261</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>50%</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
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.

Figure 11: EFSF and Equivalent EU Bonds

Figure 12: EFSF-EU Spread and German-French Bond Spread

Figure 13: French Government and BNP Paribas 5-Year CDS
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<table>
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<th>Rating Category</th>
<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>
</tr>
</thead>
<tbody>
<tr>
<td>Buy</td>
<td>Outperform</td>
<td>37.7%</td>
<td>12.1%</td>
<td>52.1%</td>
<td>39.2%</td>
<td>48.3%</td>
</tr>
<tr>
<td>Hold</td>
<td>Market Perform</td>
<td>60.0%</td>
<td>7.0%</td>
<td>47.9%</td>
<td>57.6%</td>
<td>51.0%</td>
</tr>
<tr>
<td>Sell</td>
<td>Underperform</td>
<td>2.4%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>3.2%</td>
<td>0.7%</td>
</tr>
</tbody>
</table>

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** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage within ratings category.
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