## Wednesday, June 4, 2014

### Market Elements

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### Relative Strength Filter

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<td>June 4, 2014</td>
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<td>U.S. Small Cap Growth Energy</td>
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<td>May 30, 2014</td>
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<td>Stronger Bonds = Weaker Capital Markets Stocks</td>
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<td>May 29, 2014</td>
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<td>Long Duration Assets vs. Liabilities</td>
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<td>May 28, 2014</td>
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<td>Key Positive Reversals: SBUX, CELG, F, NA</td>
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<td>May 27, 2014</td>
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<td>CDN SmallCaps – Buying the Dip</td>
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<td>May 26, 2014</td>
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<td>Switch Into Diversified Miners</td>
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<td>May 23, 2014</td>
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<td>When Gold Wakes Up</td>
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<td>May 22, 2014</td>
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<td>Small Cap Energy; The Pause That Refreshed</td>
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<td>European Credit Breakdowns</td>
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<td>The Time for EM</td>
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<td>May 16, 2014</td>
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<td>European Greed-Fear Axis – Sell Italy</td>
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<td>May 15, 2014</td>
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<td>Rethinking Utilities</td>
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<td>May 14, 2014</td>
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<td>The Violent Shift in Strength &amp; Momentum</td>
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<td>May 13, 2014</td>
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<td>Delivery – UPS, CP</td>
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<td>May 12, 2014</td>
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<td>Canadian Small Caps to Prune &amp; to Buy</td>
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<td>May 9, 2014</td>
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<td>Shift Back to Canadian Financials</td>
<td>27</td>
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<td>May 8, 2014</td>
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<td>Momentum Trade? Try REITs</td>
<td>28</td>
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<td>May 7, 2014</td>
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<td>Stress but Little Contagion = Rotation; Buy Mexico</td>
<td>29</td>
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<td>May 5, 2014</td>
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<td>Internet Software Punished to 10th Decile</td>
<td>31</td>
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<td>May 2, 2014</td>
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### Focal Points

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<tr>
<td>June 24, 2013</td>
<td>Tighten Up</td>
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</table>
Market Elements

- Equity indices were mixed to lower; the Russell retreated to its 200d MA; the TOPIX was the exception, rising for the 9th day.
- Treasuries continued to lead a retreat in global bonds (moved from 240bps to 260bps in the past 4 days); the US 2yr yield rose back above its 50d MA (40bps); corporate default risk indices narrowed.
- The USD was mixed against the majors; the yen continued to fall, and closed at a 2m low; the euro continued to tread water near a 4m low.
- Grains added to losses; base metals pivoted to losses; oil contracts were mixed; lumber continued to slide; gold traded in a narrow range.

Levels*

<table>
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<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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<td>LME Al 3m</td>
<td>Japan</td>
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Moves

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Sectors

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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; *// = 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

- While Treasuries are leading the sell-off in bonds, Bunds are reversing the positive trend, and Italian bonds are balking at the yield lows, pre-Draghi.
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

Euro

Gold (Spot)

U.S. 5Yr 5Yr Forward Breakeven

S&P 500

Yen

Crude Oil (WTI)

Japanese 10-Yr Bond

S&P/TSX Composite

MSCI EM Currency Index

Natural Gas (NMX)

Canadian 10-Yr Bond

CDX North American Inv. Grade Index

Canadian Dollar

Copper (CMX)

German 10-Yr Bund

VIX

Australian Dollar

Nickel (LME 3Mo)

Italian 10-Yr Bond

Ave. Prime Broker 5yr CDS
Daily Sector Charts
3-Month View with 26-Day Bollinger Bands and 150-, 200- and 50-Day Moving Averages

- Canada – at a 52-week high: Industrials, Consumer Discretionary, Financials.

S&P 500

S&P/TSX Composite

S&P Europe 350
Market Movers – Largest Daily Percentage Moves

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

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<th>Symbol</th>
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<td>Caern Energy PLC</td>
<td>CNE LN</td>
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<td>CNOOC Ltd</td>
<td>883 HK</td>
<td>2.6%</td>
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<td>JX Holdings Inc</td>
<td>5020 JT</td>
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<td>Petrofac Ltd</td>
<td>PFC LN</td>
<td>-1.3%</td>
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<tr>
<td>AMEC PLC</td>
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<tr>
<td>WorleyParsons Ltd</td>
<td>WOR AT</td>
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<td>Gerdau SA</td>
<td>GGB UN</td>
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<tr>
<td>Formosa Plastics Corp</td>
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<td>Itochu Resources Ltd</td>
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<td>Anglo American PLC</td>
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<td>K+S AG</td>
<td>SDF GY</td>
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<td>Dia SQ</td>
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<td>Rohm Co Ltd</td>
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<td>Nokia Oyj</td>
<td>NOKIY FH</td>
<td>-1.4%</td>
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<td>ALU FP</td>
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<td>Empresa Nacional de Electricidad</td>
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<tr>
<td>Kansai Electric Power Co Inc</td>
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### S&P 500

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### S&P/TSX Composite

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

**Energy**

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**Industrials**

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<tr>
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<tr>
<td>SLG</td>
<td>SLG</td>
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<tr>
<td>SLG</td>
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**Consumer Discretionary**

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**Consumer Staples**

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**Technology**

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**Utilities**

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**Healthcare**

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**Financials**

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**Market Elements**

- **U.S.**
  - FRX: 39.70 -2.0%
  - DGX: 121.54 -0.2%
  - ESRX: 133.68 -0.3%
  - M: 69.59 -0.6%
  - STJ: 201.72 -1.3%
  - BDX: 68.87 -0.6%
  - TYC: 61.64 0.0%
  - UNP: 100.24 0.4%
  - ITW: 33.67 0.6%
  - BA: 31.42 0.5%
  - BBBY: 57.22 0.5%
  - AZO: 169.61 -1.5%
  - TIF: 59.35 -0.2%
  - BBY: 28.06 2.2%
  - GAS: 65.09 0.3%
  - V: 211.32 -1.0%

- **U.K.**
  - JEP: 25.00 -1.9%

- **Others**
  - CMME: 70.99 -1.3%
  - MHFI: 81.52 -1.0%
  - ICE: 194.80 3.3%
  - MCD: 85.17 -0.7%
  - AXP: 91.73 -2.1%
  - UPS: 78.78 -1.1%
  - DFS: 59.52 0.0%
  - SLR: 8.90 -1.0%
  - BYD: 34.59 0.0%
  - BBY: 151.23 -0.1%
  - JPM: 55.60 0.4%
  - C: 48.31 0.0%
  - DVX: 70.41 -0.7%

**Notes**

- **+** move of more than 5%
- **= within 10% of the 52-wk High/Low;**
- **= close to the S&P 500's close;**
- **= close to the Dow Jones Industrial Average's close;**
- **= close to the Nasdaq Composite's close;**
- **= close to the small-cap Russell 2000's close;**
- **= close to the large-cap Russell 3000's close;**
<table>
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<td>SJS</td>
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<td>PAA</td>
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<tr>
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<tr>
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<td>NBD</td>
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<td>-2.2%</td>
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**Health Care**
- Symbol H/L Last %Chg
- Percentage changes may vary.

**Technology**
- Symbol H/L Last %Chg
- Percentage changes may vary.

**Utilities**
- Symbol H/L Last %Chg
- Percentage changes may vary.

**Consumer Staples**
- Symbol H/L Last %Chg
- Percentage changes may vary.

**Commodities**
- Symbol H/L Last %Chg
- Percentage changes may vary.

**Market Elements**
- Symbol H/L Last %Chg
- Percentage changes may vary.

**Industrials**
- Symbol H/L Last %Chg
- Percentage changes may vary.

**Financials**
- Symbol H/L Last %Chg
- Percentage changes may vary.

**Market Capitalizations**
- Symbol H/L Last %Chg
- Percentage changes may vary.
U.S. Small Cap Growth Energy

- Energy strength is global, market cap agnostic, and continues to look very positive in our breadth analysis – Figure 1.
- We are specifically targeting U.S. Small Cap Growth energy names as a small (only 4% by weight) place to hide for managers benchmarked off of the Russell 2000 Growth index, which is being battered by technology weakness (see yesterday’s RSF) – Figure 2.

We carved out energy stocks with consistent price uptrends that are in outperforming trends against the Russell 2000 Growth index and sector – Figure 3. A broader list of Russell 2000 (including value) energy outperformers is found at this link.

Shown below is a list of Russell 2000 Growth Energy Outperformers in Consistent Uptrends.

<table>
<thead>
<tr>
<th>Symbol</th>
<th>Name</th>
<th>Sub Industry</th>
<th>Grp RS</th>
<th>1-Day Equity Chg (%)</th>
<th>5-Day Equity Chg (%)</th>
<th>MktCap (US$)</th>
<th>Price Trend</th>
<th>Trend Slope</th>
<th>Hi (No)</th>
<th>Low (No)</th>
<th>%Chg wrt 50d MA</th>
<th>Chg wrt 50 Day MA Trend</th>
<th>RSI Dty</th>
</tr>
</thead>
<tbody>
<tr>
<td>TRGP</td>
<td>Targa Resources Corp</td>
<td>OG Str</td>
<td>1</td>
<td>1.1%</td>
<td>1.5%</td>
<td>4,941</td>
<td>—</td>
<td>103%</td>
<td>42.0</td>
<td>9.0</td>
<td>9.0%</td>
<td>Above Rising</td>
<td>76</td>
</tr>
<tr>
<td>PHX</td>
<td>Panhandle Oil and Gas Inc</td>
<td>OG E&amp;P</td>
<td>3</td>
<td>-0.1%</td>
<td>-4.9%</td>
<td>430</td>
<td>—</td>
<td>174%</td>
<td>12.0%</td>
<td>12.0%</td>
<td>12.0%</td>
<td>Above Rising</td>
<td>57</td>
</tr>
<tr>
<td>REX</td>
<td>REX American Resources Corp</td>
<td>OG RMkt</td>
<td>4</td>
<td>2.0%</td>
<td>10.0%</td>
<td>602</td>
<td>—</td>
<td>255%</td>
<td>48.0%</td>
<td>20.0%</td>
<td>20.0%</td>
<td>Above Rising</td>
<td>73</td>
</tr>
<tr>
<td>PQ</td>
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<td>OG E&amp;P</td>
<td>3</td>
<td>0.8%</td>
<td>0.3%</td>
<td>397</td>
<td>—</td>
<td>208%</td>
<td>3.0%</td>
<td>3.0%</td>
<td>3.0%</td>
<td>Above Rising</td>
<td>52</td>
</tr>
<tr>
<td>CRZO</td>
<td>Carrizo Oil &amp; Gas Inc</td>
<td>OG E&amp;P</td>
<td>3</td>
<td>5.1%</td>
<td>4.3%</td>
<td>2,747</td>
<td>—</td>
<td>120%</td>
<td>48.0%</td>
<td>10.0%</td>
<td>10.0%</td>
<td>Above Rising</td>
<td>67</td>
</tr>
<tr>
<td>EPL</td>
<td>EPL Oil &amp; Gas Inc</td>
<td>OG E&amp;P</td>
<td>3</td>
<td>0.7%</td>
<td>-1.4%</td>
<td>1,480</td>
<td>—</td>
<td>170%</td>
<td>-1.0%</td>
<td>-1.0%</td>
<td>-1.0%</td>
<td>Below Falling</td>
<td>48</td>
</tr>
<tr>
<td>ATHL</td>
<td>Athlon Energy Inc</td>
<td>OG E&amp;P</td>
<td>3</td>
<td>1.3%</td>
<td>2.1%</td>
<td>4,215</td>
<td>—</td>
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<td>9.0%</td>
<td>9.0%</td>
<td>9.0%</td>
<td>Above Rising</td>
<td>63</td>
</tr>
<tr>
<td>FANG</td>
<td>Diamondback Energy Inc</td>
<td>OG E&amp;P</td>
<td>3</td>
<td>2.9%</td>
<td>9.6%</td>
<td>3,977</td>
<td>—</td>
<td>119%</td>
<td>19.5%</td>
<td>10.0%</td>
<td>10.0%</td>
<td>Below Rising</td>
<td>66</td>
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<td>SYRG</td>
<td>Synergy Resources Corp</td>
<td>OG E&amp;P</td>
<td>3</td>
<td>-0.4%</td>
<td>0.5%</td>
<td>871</td>
<td>—</td>
<td>80%</td>
<td>3.0%</td>
<td>3.0%</td>
<td>3.0%</td>
<td>Above Rising</td>
<td>51</td>
</tr>
<tr>
<td>IO</td>
<td>ION Geophysical Corporation</td>
<td>OG Equl</td>
<td>3</td>
<td>0.0%</td>
<td>-4.5%</td>
<td>661</td>
<td>—</td>
<td>117%</td>
<td>-4.0%</td>
<td>-4.0%</td>
<td>-4.0%</td>
<td>Below Falling</td>
<td>48</td>
</tr>
<tr>
<td>CRR</td>
<td>CARBO Ceramics Inc</td>
<td>OG Equl</td>
<td>3</td>
<td>-0.3%</td>
<td>2.4%</td>
<td>3,143</td>
<td>—</td>
<td>61%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>Above Rising</td>
<td>53</td>
</tr>
<tr>
<td>KOG</td>
<td>Kodak Oil &amp; Gas</td>
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<td>3</td>
<td>1.3%</td>
<td>1.4%</td>
<td>3,382</td>
<td>—</td>
<td>50%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>Above Rising</td>
<td>53</td>
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<td>AXAS</td>
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<td>OG E&amp;P</td>
<td>3</td>
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<td>-6.0%</td>
<td>455</td>
<td>—</td>
<td>108%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>1.0%</td>
<td>Above Rising</td>
<td>48</td>
</tr>
<tr>
<td>SN</td>
<td>Sanchez Energy Corp</td>
<td>OG E&amp;P</td>
<td>3</td>
<td>0.3%</td>
<td>1.0%</td>
<td>1,727</td>
<td>—</td>
<td>42%</td>
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<td>13.0%</td>
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<td>Above Rising</td>
<td>63</td>
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<td>MHR</td>
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<td>OG E&amp;P</td>
<td>3</td>
<td>4.0%</td>
<td>9.8%</td>
<td>1,600</td>
<td>—</td>
<td>25%</td>
<td>1.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>Below Rising</td>
<td>58</td>
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<td>GST</td>
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<td>OG E&amp;P</td>
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<td>-5.7%</td>
<td>451</td>
<td>—</td>
<td>35%</td>
<td>12.0%</td>
<td>12.0%</td>
<td>12.0%</td>
<td>Above Rising</td>
<td>57</td>
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</table>

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Small Cap Technology Shorts

- Our breadth reading on technology continues to weaken away from neutral and toward negative – Fig 1.
- The key driver here is U.S. small cap software stocks, which, after stabilizing for a few weeks, have started to weaken once again.

Our breadth indication is a function of both stocks breaking outperforming trends and stocks in underperforming trends.

- The wave of Russell 2000 growth technology (and biotechnology) stocks breaking outperforming trends yesterday is shown in Figure 2.
- As this deterioration has been going on for three months now (Figure 1), there is now a solid book of momentum sells, or stocks trending lower, below falling MAs and not oversold from which to pick short sale candidates – Figure 3.

Figure 1: Technology Relative Strength Z-Score

Figure 2: Technology (& Biotech) Breaking Outperforming Trends vs. Russell 2000 Growth Yesterday

Figure 3: Russell 2000 Growth Technology (& Biotechnology) Momentum Sells (Dv Adj Price Trends)
All Cap Material Weakness

- Last Friday, both global large cap and small cap materials sectors broke down from slightly outperforming trends. Bases that have been in a holding pattern for the past year started to give way – Figures 1, 2.
- From an equal-weighted breadth perspective, the materials sector has been neutral to negative for years. Portfolios should be underweight, or transitioning in that direction.

- At the global industry level, it was the miners that broke a flat trend on Friday. The key hiding place to allocate materials funds continues to be chemicals.
- Specifically targeting the miners, we highlight the largest 20 stocks at the inflection point where they are breaking outperforming trends vs ACWI – Figure 3. The market is rotating away from these names.

**Figure 1: Materials vs MSCI World**

**Figure 2: Small Cap Materials vs MSCI World**

**Figure 3: Miners Breaking Outperforming Trends vs ACWI**

<table>
<thead>
<tr>
<th>Symbol</th>
<th>Name</th>
<th>Domicile</th>
<th>Sub Industry</th>
<th>GPR</th>
<th>RS</th>
<th>LT</th>
<th>RS</th>
<th>Close</th>
<th>50-May</th>
<th>Trend</th>
<th>Chg Last Day</th>
<th>ACWI</th>
<th>Chg 50 MA Trend</th>
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<td>ACX SM</td>
<td>Acerinox SA</td>
<td>Spain</td>
<td>Steel</td>
<td>10</td>
<td>6</td>
<td>1</td>
<td>12.59</td>
<td>-0.3%</td>
<td>-0.1%</td>
<td>4,414</td>
<td>▼</td>
<td>76%</td>
<td>2%</td>
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<td>SBLG US</td>
<td>Sibanye Gold Ltd</td>
<td>South Africa</td>
<td>Gold</td>
<td>9</td>
<td>1</td>
<td>1</td>
<td>9.82</td>
<td>0.6%</td>
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<td>2,205</td>
<td>▼</td>
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<td>Constellium NV</td>
<td>Netherlands</td>
<td>Alum</td>
<td>3</td>
<td>1</td>
<td>1</td>
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<td>-0.2%</td>
<td>0.3%</td>
<td>3,032</td>
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<td>7</td>
<td>1</td>
<td>13.65</td>
<td>-0.9%</td>
<td>-2.2%</td>
<td>1,212</td>
<td>▼</td>
<td>79%</td>
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</tr>
<tr>
<td>PDL LN</td>
<td>Petra Diamonds Limited</td>
<td>Jersey</td>
<td>PrecMet</td>
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<td>4</td>
<td>2</td>
<td>155.70</td>
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<td>79%</td>
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<tr>
<td>AMS SJ</td>
<td>Anglo Platinum Ltd</td>
<td>South Africa</td>
<td>PrecMet</td>
<td>8</td>
<td>10</td>
<td>1</td>
<td>45,100.00</td>
<td>-2.8%</td>
<td>-5.3%</td>
<td>11,495</td>
<td>▼</td>
<td>51%</td>
<td>2.5%</td>
</tr>
<tr>
<td>AUUKY US</td>
<td>Anglo American Plc</td>
<td>U.K.</td>
<td>DownMet</td>
<td>5</td>
<td>9</td>
<td>1</td>
<td>12.20</td>
<td>-5.6%</td>
<td>-5.6%</td>
<td>34,077</td>
<td>▼</td>
<td>46%</td>
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</tr>
<tr>
<td>BSL AU</td>
<td>Bluescope Steel Ltd</td>
<td>Australia</td>
<td>Steel</td>
<td>10</td>
<td>9</td>
<td>2</td>
<td>5.84</td>
<td>-3.9%</td>
<td>-1.4%</td>
<td>3,038</td>
<td>▼</td>
<td>27%</td>
<td>-6%</td>
</tr>
<tr>
<td>SMF CN</td>
<td>SEMAFOD</td>
<td>Canada</td>
<td>Steel</td>
<td>9</td>
<td>30</td>
<td>2</td>
<td>3.57</td>
<td>1.1%</td>
<td>-4.8%</td>
<td>919</td>
<td>▼</td>
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<td>-9%</td>
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<tr>
<td>SSL CN</td>
<td>Sandstorm Gold Ltd</td>
<td>Canada</td>
<td>Gold</td>
<td>9</td>
<td>7</td>
<td>2</td>
<td>5.71</td>
<td>-0.2%</td>
<td>-5.6%</td>
<td>586</td>
<td>▼</td>
<td>57%</td>
<td>-5%</td>
</tr>
<tr>
<td>BTO CN</td>
<td>B2Gold Corp</td>
<td>Canada</td>
<td>Gold</td>
<td>9</td>
<td>7</td>
<td>2</td>
<td>2.63</td>
<td>-1.1%</td>
<td>-10.8%</td>
<td>1,640</td>
<td>▼</td>
<td>58%</td>
<td>4.5%</td>
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<td>NCMGY US</td>
<td>Newcrest Mining Ltd</td>
<td>Australia</td>
<td>Steel</td>
<td>9</td>
<td>9</td>
<td>2</td>
<td>9.01</td>
<td>-1.4%</td>
<td>-4.4%</td>
<td>6,906</td>
<td>▼</td>
<td>63%</td>
<td>-5%</td>
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<tr>
<td>NG CN</td>
<td>Novagold Resources Inc</td>
<td>Canada</td>
<td>Gold</td>
<td>9</td>
<td>10</td>
<td>2</td>
<td>3.24</td>
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<td>648</td>
<td>▼</td>
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<td>-15%</td>
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<td>ABG LN</td>
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<td>U.K.</td>
<td>Steel</td>
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<td>9</td>
<td>2</td>
<td>217.00</td>
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<td>1,492</td>
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<td>PAA CN</td>
<td>Pan American Silver Co</td>
<td>Canada</td>
<td>Silver</td>
<td>10</td>
<td>9</td>
<td>3</td>
<td>15.35</td>
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<td>1,665</td>
<td>▼</td>
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<tr>
<td>GFI US</td>
<td>Gold Fields Ltd</td>
<td>South Africa</td>
<td>Gold</td>
<td>9</td>
<td>10</td>
<td>3</td>
<td>3.54</td>
<td>0.9%</td>
<td>-9.2%</td>
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<td>▼</td>
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<td>-11%</td>
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<td>Australia</td>
<td>DownMet</td>
<td>5</td>
<td>7</td>
<td>4</td>
<td>57.88</td>
<td>-2.9%</td>
<td>-2.7%</td>
<td>109,005</td>
<td>▼</td>
<td>9%</td>
<td>2.5%</td>
</tr>
<tr>
<td>HMY US</td>
<td>Harmony Gold Mining Co</td>
<td>South Africa</td>
<td>Gold</td>
<td>9</td>
<td>10</td>
<td>4</td>
<td>2.65</td>
<td>1.1%</td>
<td>-11.7%</td>
<td>1,155</td>
<td>▼</td>
<td>32%</td>
<td>-15%</td>
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<td>U.K.</td>
<td>DownMet</td>
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<td>5</td>
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<td>▼</td>
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<td>U.S.</td>
<td>Steel</td>
<td>10</td>
<td>5</td>
<td>4</td>
<td>17.27</td>
<td>-1.6%</td>
<td>-1.2%</td>
<td>3,659</td>
<td>▼</td>
<td>5%</td>
<td>10.5</td>
</tr>
</tbody>
</table>

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

May 30, 2014
Research Comment
Quantitative/Technical Research Website

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Stronger Bonds = Weaker Capital Markets Stocks

- Following on yesterday’s statement (REITs are the only global financial industry in an outperforming trend); we delve into the most consistently underperforming financial group - capital markets – Figure 1.
- The pattern of relative performance is perhaps less tightly tied to long rates now as when the group was joined at the hip during 2011-2012, but the relationship is still a formidable force: lower long rates = capital market underperformance – Figure 2.
- The spectrum of capital markets stocks vs MSCI World shows stocks continuing to break and shift toward underperformance – Figure 3.

Figure 1: Capital Markets vs MSCI World

Figure 2: Capital Markets vs MSCI World & US 30Y Bond

Figure 3: Capital Markets Stocks vs MSCI World

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Surprised that the U.S. 10y yield broke below 2.5% yesterday? Don’t be. The trend for global 10y rates is lower, and it is even more pronounced at the longer, 30y end of the curve – Figure 1.

Note that that the U.S. 30y just broke the uptrend from the 2012 recovery low – Figure 2.

This is all pre-Draghi, and notice inflation expectations in Germany & France continue to trend lower, suggesting ECB-induced pressure on rates will be with us for some time.

Amongst global financial industries, REITs are the only group in an outperforming trend against the market, and that trend started when rates peaked – Figures 3, 4.

Amongst global industrial industries, Transportation Infrastructure is the most consistent outperformer, and that trend also started when rates peaked. Widening out to a Global Infrastructure index, which includes utilities & pipelines, and you see the similarly timed and structured outperformance – Figure 5.

Relative Strength Filter

Key Positive Reversals: SBUX, CELG, F, NA

- They have been out of favour, lagging, in some cases falling, then along comes the inflection point where the trends are broken to the upside, and you need to rethink your position.
- Starbucks broke above both the relative strength and absolute price downtrend yesterday. This as the price of coffee, which has been trending higher at over 300%/year, broke down – Figure 1.
- Celgene also saw positive reversals in both relative strength and price downtrends. The volume yesterday, as it broke back above its 200d MA, was the best in a month – Figure 2.
- Ford has been meandering out of its underperforming trend, while its CDS continues to narrow. We expect this sleeper will start tilting toward outperformance – Figure 3.
- National Bank has been digesting gains since November. It is just breaking out of that holding pattern, and reversing a relative strength downtrend – Figure 4.

Figure 1: Starbucks vs S&P 500

Figure 2: Celgene vs S&P 500

Figure 3: Ford vs S&P 500 (see CDS Trend Here)

Figure 4: National Bank vs S&P/TSX Composite

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

May 27, 2014
Research Comment
Quantitative/Technical Research Website

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CDN SmallCaps – Buying the Dip

- Canadian small caps have suffered their 2nd setback since stabilizing against the large cap driven composite just over a year ago. We recommend buying this pullback – Figure 1.
  - For source of funds, we highlight the stocks in the S&P/TSX 60, which are in underperforming trends against the market and sector – Figure 2.
- Our momentum buy list of what the market is valuing is highlighted in Figure 3.
  - Half of this list consists of energy companies, and our breadth reading on energy continues to be positive.
  - The balance of this list contains some industrials, and interest sensitives (bond yields continue to trend lower), and very little in other sectors.
- Our severed market underperformers list highlights companies vying to dust off their underperforming trends – Figure 4;
  - REITs are add-ons to a positively developing theme.
  - We highlighted HudBay (Restricted) as a new emerging positive within diversified miners yesterday.
- Gold stocks, which are the 2nd largest subindustry, do not show up on either list. They should also be considered source of funds, in a tilted Canadian small cap portfolio.

Figure 1: S&P/TSX SmallCaps vs Composite

Figure 2: S&P/TSX 60 Underperformers

Figure 3: S&P/TSX SmallCap Momentum Buys

Figure 4: Severed Market Underperformers

CDN Small Cap Momentum Buys (Half are Energy)

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
*BMO Capital Markets is restricted on HudBay Minerals and Torstar Corp.
Switch Into Diversified Miners

- Following our “When Gold Wakes Up” piece on Friday, where we expect it to wake up to the downside, we highlight the strength in diversified miners, which is our “switch into group” in the materials sector. Using our breadth gauge, diversified miners have broken out of a negative reading, which has persisted for years – Fig 1.

- At this early stage, where our strength reading is just at the upper end of neutral, we will highlight the group winners;
  - For the Canadian perspective, we highlight these miners against the Canadian SubIndustry where it becomes readily apparent that there are three key outperformers: Lundin, First Quantum, and HudBay (Restricted) – Fig 3.
  - A global perspective can be found using the ACWI Metals & Mining ex Gold & Silver as a benchmark. We circled two groups here, the most consistent outperformers and the stocks breaking out above marginally outperforming trends – Figure 3.

Figure 1: Diversified Minerals Relative Strength Z-Score

Figure 2: CDN Miners vs. S&P/TSX Diversified Minerals Index

Figure 3: Global Miners vs ACWI Metals & Mining ex Gold & Silver

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

When Gold Wakes Up

- Gold volatility, like volatility metrics on other commodities, FX, equity and debt markets, is trending towards all-time lows. The chart of bullion is that of a narrowing wedge, approaching the apex. When it does wake up, or break the wedge, we expect it does to the downside.
- Holdings of the gold (GLD) ETF have fallen to a 5y low after a rebound earlier this year – Figure 1.
- The dollar is strengthening against the euro, which is bullion unfriendly. More properly emphasized, the euro is breaking its uptrend and 200d MA this morning, two weeks before the ECB announces its suite of tools, which will be used to “address” euro strength.
  - No one is betting against Draghi – Figure 2.

- This week, gold stocks made it back to a neutral or 5th decile reading for the first time in over a year. We expect that the strength ends there, and recommend using it to sell into – Figure 3.
- Part of the reason that the euro is breaking down, is the recent market push back in owning European peripheral debt, and for that we can see some clients wanting to own protection. Gold stocks, however, are in an underperforming trend against bullion, and the stocks to sell are those in underperforming trends against the metal – Fig 4.

Figure 1: Gold Bullion vs Gold ETF Holdings (GLD/SPDR)

Figure 2: Euro Breaking Down This Morning

Figure 3: Gold Relative Strength Decile

Figure 4: Gold Shares in Underperforming Trends vs Bullion

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Note: BMO Capital Markets is restricted on Yamana Gold

May 23, 2014
Research Comment
Quantitative/Technical Research Website

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Small Cap Energy; The Pause That Refreshed

- Our breadth reading for the Energy sector, which had paused for a few weeks, broke out to a new high yesterday – Figure 1.
  - As an aside, the strongest sectors, measured by our global breadth heat map are Utilities, Energy, and Telecom.
  - The strength, which is universal across market cap and regional regimes, on a 1d or 5d basis, is amplified in small cap sectors – Figure 2.

- While the indices are dominated by large caps, our equal-weighted breadth reading would tilt toward small caps (70% of the energy stocks we follow have a market cap less than $5bn). The energy sector rally really only started taking off this year, so it is important to look both at the momentum buy leaders and the “severed market underperformers” (laggards picking up) lists – Figure 3, 4.
  - Relative strength momentum buys are found at these links for the following benchmarks: MSCI World SMID, TSX Small Cap, Russell 2000.
  - Relative strength severed underperformers are found at these links for the following benchmarks: MSCI World SMID, TSX Small Cap, Russell 2000.

Figure 1: Energy Relative Strength Z-Score

Figure 2: Energy Sector Relative Strength vs Local Markets

Figure 3: Energy Mo Buys vs MSCI World SMID (Full List Here)

Figure 4: Energy Severed Underperformers vs MSCI World SMID

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
European Credit Breakdowns

- Credit is always the highest on our radar screen, as when conditions turn sour, correlations tend toward one and pricing becomes fear-driven.
- Our key “first look” is on 5yr CDS trends on the interconnected-to-fail list of financials. It is in quite good shape, but there are some recent kinks that bear monitoring closely.
- We will go back to last week’s GDP report, which broke the calm, and the positive credit trend for Portugal (see European Greed-Fear Axis – Sell Italy). Yesterday, the Italian 5y CDS followed suit by breaking a narrowing trend – Figure 1, 2.
- On Monday, the 5y CDS on BNP Paribas broke above a positive credit trend. This was followed by Credit Agricole SA yesterday – Figures 3, 4.
- We highlight the list of European moderate to high risk (CDS deciles 4-10) interest-sensitive (Financials, Utilities, Telecom) companies that sport broken CDS trends. The list is small and not enough to break trends on our custom CDS indices, but early in a downturn, you focus on the detail and granularity – Figure 5.

![Figure 1: Italian 5y CDS](image1)

![Figure 2: Portugal 5y CDS](image2)

![Figure 3: BNP Paribas 5y CDS](image3)

![Figure 4: Credit Agricole SA 5y CDS](image4)

![Figure 5: Positive (Narowing) Trends on Moderate to High Risk EU Interest-Sensitive That Have Broken to the Widening Side](image5)

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Best of Nasdaq 100

- With peripheral Europe very recently on a weak footing (which continues this morning), our note yesterday focused on looking for new leadership, which we find in Emerging Markets. You can only put so much capital into EM, so what else is catching a bid? The Nasdaq. The recent European weakness/Nasdaq strength is best seen by looking at markets in outperforming trends vs the S&P 500 – Figure 1.

- The Nasdaq 100 broke a steep outperforming trend against the S&P 500 in March. It has been wavering or moving sideways for a month now, and yesterday it rose to a 1.5mo high against both the S&P 500 and the MSCI World index – Figure 2.

- While the Nasdaq is wavering, we will highlight the shares that are not. Established, or in some cases reestablished, leadership can be found in our momentum buy list, where we used the MSCI World as a denominator to provide a “best of” grouping – Figure 3.
  - For completeness, our Nasdaq 100 momentum sell list, which is half the size (vs MSCI World), is found at this link.

Figure 1: Outperforming Markets (Some Broken) vs S&P 500

Figure 2: Nasdaq 100 vs S&P 500

Figure 3: Momentum Buy List of Nasdaq 100 Index Members vs MSCI World (see this 2nd link for Mo Buys vs S&P 500)

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

The Time for EM

- To set the stage there is targeted weakness in some US and European markets;
  - the NASDAQ and Russell 2000 have broken uptrends, and show no signs of firming yet (technology breadth is still weak, as is our reading on biotech).
  - Peripheral European indices are breaking outperforming trends (see last Friday’s note on Italy).

- New sources of strength will be sought – Figure 1.

- Major EM crosses (ex the Chinese Renminbi) are firming above rising 50d MAs and trend channels (green arrows) - Figure 2. EM currency volatility is falling back to the pre-taper tantrum (Apr 2013) low.

- EM bonds are trending higher at a rate of 15%/year, bettered and only the US long bond (which itself is outperforming the S&P 500) – Figure 3. EM debt volatility just broke to a 12m low last Friday.

- The MSCI EM index is breaking above an underperforming trend vs MSCI World (and close to the same point against the 500) – Fig 4.

Fig 1: ETFs Breaking Above Underperforming Trends vs ACWI

<table>
<thead>
<tr>
<th>Name</th>
<th>Symbol</th>
<th>I2 RS Chg (%</th>
<th>I2 RS Chg (%)</th>
<th>Chg Last Day</th>
<th>Reward /Risk</th>
<th>Trend Slope</th>
<th>RS Hi (Mo)</th>
<th>%Chg w/50 MA</th>
<th>Chg w/ 50 Day MA</th>
<th>Trend</th>
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<td>EMAR US</td>
<td>VMAS TR</td>
<td>1.4%</td>
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<td>↑↑↑↑</td>
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<td>Above 50</td>
<td>Trend</td>
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<td>1%</td>
<td>Above 50</td>
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<td>1.0</td>
<td>3%</td>
<td>Above 50</td>
<td>Trend</td>
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<td>↑↑↑↑</td>
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<td>3.5</td>
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<td></td>
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<td>Above 50</td>
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<td>1%</td>
<td>1%</td>
<td>Above 50</td>
<td>Trend</td>
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<td>-1.1%</td>
<td>↑↑↑↑</td>
<td>-16%</td>
<td>2%</td>
<td>Above 50</td>
<td>Trend</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Russia</td>
<td>RURUSD</td>
<td>0.2%</td>
<td>1.5%</td>
<td>↑↑↑↑</td>
<td>-11%</td>
<td>3%</td>
<td>Above 50</td>
<td>Trend</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chilean Peso</td>
<td>CLPUSD</td>
<td>0.1%</td>
<td>0.3%</td>
<td>↑↑↑↑</td>
<td>-14%</td>
<td>1%</td>
<td>Above 50</td>
<td>Trend</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taiwanese Dollar</td>
<td>TWUSD</td>
<td>0.1%</td>
<td>0.0%</td>
<td>↑↑↑↑</td>
<td>-6%</td>
<td>0%</td>
<td>Above 50</td>
<td>Trend</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Fig 2: Major EM Currency Crosses vs USD

Fig 3: Major Bond ETFs (AUM > $4bn)

- TLT US: US Long Term Bond ETF
- EMB US: Emerging Markets Bond ETF
- LQD US: US iBoxx Corporate Bond Fund
- SPDR: High Yield Bond ETF
- HYG US: High Yield Corp Bond Fund
- TIP US: US TIPS Bond ETF
- AGG US: US Corp Bond ETF
- BND US: Vanguard Total Bond Market ETF
- ESM US: US 7-10 Yr Bond ETF
- MBG US: Barclays HIBOND Bond ETF
- SHY US: US Short Term Bond ETF

Fig 4: MSCI EM vs MSCI World

Source: BMO Capital Markets, Bloomberg, Thomson, Market
European Greed-Fear Axis – Sell Italy

Yesterday, on the European GDP report, there was a decided shift in sentiment in peripheral European credit from one of greed (economic optimism and/or front running Draghi QE), to fear (Italian, Spanish and Portuguese 5yr CDS widening at least 10% apiece, from multi-year lows). Of the three peripheral nations, Portugal was the only CDS to break its narrowing trend – Figure 1.

Last week, the Italian MIB index broke an outperforming trend against MSCI World – Figure 2. Yesterday, the price trend followed suit – see link. MSCI Ireland and Portugal have also broken outperforming trends, and Austria has been punished below the bottom end of its underperforming trend.

Since the relative strength of Italian stocks (Figure 2) broke before the “news”, we see this market as the key short candidate of Europe. Delving into the breadth, one sees an overwhelming tilt toward outperformance, and those outperforming trends were breaking en masse yesterday, and on heavy volume (“v” subscripts below) we may add – Figure 3.

Italian Stocks Overwhelmingly Tilted Towards Outperformance; Those Outperforming Trends Are Being Broken Large Volume ("v" Subscripts)

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Rethinking Utilities

- After our citing yesterday of technology weakness (during yesterday’s session, even the “defensive” U.S. technology, semi and data processor groups broke below outperforming trends), we move to the new leadership of, and you are not going to like it, utilities. Every day our system defines what the “longest most consistent trend” is on a time series. Yesterday, for U.S. utilities, it switched from showing a sloppy underperforming trend to that of a consistent (second only to chemicals-dominated materials) outperforming trend, and one with a buyable pullback, we may add – Figure 1.
  - Since interest rates peaked at the start of the year, U.S. utilities broke out of a 7mo consolidation pattern and are currently trending higher at a rate of 38%/year (S&P 500 trending higher at 22%/y).
  - Global 10y yields, we reiterate, are trending lower, and many are currently lauded below the bottom ends of their channels – Figure 2.

- We highlight the many local utility indices vs. their home markets to show that in most cases they have pivoted toward outperformance – Figure 3. The granularity of how utilities are performing relative to various benchmarks can be sought out using our “index constituents link.”
- For the global manager, we offer up the short list of Utility momentum buys where we further filter the list to show stocks with yield >2% and good dividend growth profiles – Figure 4.

**Figure 1: Utilities vs. S&P 500 ; see Price Trend Here**

**Figure 2: Trends on Global 10y Bond Yields – Sea of Green**

**Figure 3: Local Utilities Sectors vs. Their Markets**

**Figure 4: Utility Momentum Buys With Good Dvd Yield & Growth**

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
The Violent Shift in Strength & Momentum

- With most broad equity indices trending higher, violent shifts that are taking place under the hood are masked. A stark example of the shift going on is found by looking at the relative performance of the Russell 2000 Value vs. Growth indices – Figure 1.

- The shift away from growth toward value has been violent, which you see from looking at your portfolio – Figure 2.

- The shift away from growth shows no sign of easing, which we see from our strength & momentum sector heat map – Figure 2.

- We tuned the “momentum” indication in our Group Selection Report to be very dynamic so as to catch shifts quickly. Capturing the turning point early, but not prematurely is where the real value comes in:
  - It already captures value oriented energy momentum as just ever so slightly negative, when (profit taking) weakness has only been observed since last Thursday. Our energy breadth strength score continues to be very much on the positive side of the ledger.
  - It sees technology, which due to equal weighting is more a reflection of growth, as still losing strength and momentum. Otherwise put, the “v” bottom for technology is still in the “\" phase – Figure 3.
  - Discretionary is our new weakest sector. Since this grouping is so broad, covering everything from auto parts to restaurants, for clarity we highlighted the top underperformers in the weakest sub-industry deciles to best define the weakness– Figure 4.

Figure 1: Russell 2000 Value vs Russell 2000 Growth

Figure 2: Global Sector Heat Map

Figure 3: Technology Relative Strength Z-Score

Figure 4: Discretionary Underperformers vs MSCI World
One place to look for bottom fishing opportunities is in the global industries breaking above underperforming trends – Figure 1.

Many times our system tracks a consolidation pattern or mere “time out” period; we believe that to be the case in a few transport groups.

Under the most consistently underperforming category, Air Freight is breaking to the upside – Figure 2. Therein you will see UPS coming out of a consolidation pattern – Figure 3.

In the global and Canadian groups, you see rails breaking above a flat, slightlyunderperforming trend – Figure 4. CP is the Canadian favourite, with a consolidation pattern trending with a steep slope all of its own – Figure 5.
Canadian Small Caps to Prune & to Buy

- **Canadian small caps** have been rising at almost twice the slope as the TSX Composite index. The index just broke that steep uptrend last Friday – Figure 1.
- While we expect that this pullback is the sort that refreshes, noting,
  - positive momentum trumps negative momentum by a 7:1 margin, and
  - less than 2% of index members are overbought after the pullback.
- We would also note that the strong uptrend for Canadian small caps would have whisked most stocks along with it, and that last Friday’s severed uptrend serves as a good notice to prune weaker members out of your portfolio.
- Given the pullback in CDN small caps was slanted toward resources, we highlight the resources with poor long-term history, which are breaking below price uptrends. This is our “consider pruning” list – Figure 2.
- Our favoured list is the subset of our momentum buy list of Small Cap index stocks which are amongst the best (top 3 deciles) subindustries - Figure 3.

**Figure 1: S&P/TSX Canadian Small Cap Index**

**Figure 2: Small Caps With Weak LTerm History Breaking Uptrends**

**Figure 3: Momentum Buy List (Price Trends) of S&P/TSX SmallCaps Within Top 3 Subindustry Deciles**

**Topics Covered:**
- Canadian Small Caps
- TSX Composite Index
- Uptrend Break
- Positive Momentum
- Negative Momentum
- Overbought Indicators
- Resource Pullback
- Consider Pruning List
- Top 3 Deciles Subindustries

**Source:** BMO Capital Markets, Bloomberg, Thomson, Markit. BMO Capital Markets is Restricted on Superior Plus Corporation (SPB)
Shift Back to Canadian Financials

- **Canadian Financials** broke above an underperforming trend yesterday – Figure 1.
  - We see the underperformance as just a “time out” period, and that the time out is over.
  - The key heavy weight sector losing strength was *energy* where some profit taking *finally emerged* – Figure 2.
- **CDN Financials** are slanted towards underperformance, yet those underperforming trends are breaking to the upside – Figure 3. *Yesterday*, we highlighted some *positive reversals* in CDN REITs, and you can add *Boardwalk* to that list now too.
- The key index mover that added its weight to the list of positive reversals is *Royal Bank*, where the *current positive trend slope of 14%* understates its potential – Figure 4. A similar pattern, yet more advanced, is *CI Financial* – Figure 5.

**Figure 1: Canadian Financials vs S&P/TSX Composite**

**Figure 2: CDN Sectors vs S&P/TSX Composite**

**Figure 3: S&P/TSX Composite Financials vs S&P/TSX Composite**

**Figure 4: Royal Bank Dvd Adj Price Trend**

**Figure 5: CI Financial Dvd Adj Price Trend**

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Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Momentum Trade? Try REITs

- Despite the breakdown in the Nasdaq and Russell 2000, the momentum trade is not dead; it has just shifted:
  - The Nasdaq was trending higher at a rate of 31%/year and has broken this trend.
  - U.S. REITs are trending higher at a rate of 33%/year and are heading for new highs.
- In late January, after interest rates peaked and started to break below 50d MAs; REITs formed a V-bottom against the market, which was the “return of REITs” period – Figure 1. Now with global rates trending lower (universally we may add, Figure 2), REITs have started to trend higher against the market. Welcome to the momentum trade. Global REITs are about to break out to new highs, being just 1% below last May’s peak.

- For the global generalist, we highlight the momentum buy list of MSCI World members in Figure 3.
- For the specialist, there are 44 momentum buys against the ACWI REIT index (not your benchmark? Please inquire).
- Close to half of REITs in the S&P 1500 are outperforming the market and financial sector.
- The Russell 2000 has a mo buy list with 17 REITs.
- There are fewer CDN REITs in outperforming trends, but three just broke above underperforming trends yesterday (AP, CUF, CWT).

Figure 1: REITs vs MSCI World

Figure 2: Trends on Major Global 10-Year Bond Yields

Figure 3: Momentum Buy List of REITs vs MSCI World Index

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

Stress but Little Contagion = Rotation; Buy Mexico

- Weakness in technology (and biotechnology), and certain indices heavily weighted in these groups, continues. That is the “stress”.
- “Contagion” refers to the credit market, which when stressed is the ultimate tie that binds. Credit is NOT stressed:
  - the cost to protect the banking system from default is poised at multi-year lows, and
  - corporate CDS indices continue to trend lower.
- Our “little” qualifier to contagion refers to implied correlation amongst S&P 500 members, which is closer to a 1-year high, than a 1-year low – Figure 1.
  - So, yes, stocks are “swarming” together more now than they were at the start of the year, but we are nowhere near highly correlated levels that are typically brought on by stress to the credit market.
- If you look at the “severed trends” amongst global indices vs the MSCI World (outperformers breaking to the downside, underperformers breaking to the upside), you see the more technology-weighted indices breaking down, and the markets breaking to the upside have high concentrations of energy, yield, or staples – Figure 2.
- The latest market to break to the upside is the Mexican IPC, which we recommend buying against the S&P 500. The underperforming trend is breaking to the upside, and there is good breadth behind the move – Figures 3, 4.

Figure 1: CBOE S&P 500 Implied Correlation

Stocks were all “doing their own thing”...

Figure 2: “Severed Trends” of Markets vs MSCI World

Markets Weighted Towards Yield, Energy and Staples Breaking to the Upside

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
U.S. Small Caps - Troubled vs. Non-Troubled

To begin, we define the troubled and note that it is not universal across all sectors. The Russell 2000 continues to break a steep uptrend with its correction in both time and price as producer durables (industrials), health care, and technology break below price uptrends. The strongest sectors, trending higher and above rising 50d MAs are staples and energy – Figure 1.

Moving to the relative, 50d MAs on the relative strength trends of the sectors against the 2000 shows the recent stance of “anything but health care and technology” (the only two sectors below falling 50d MAs) – Figure 2.

For the generalist who needs to keep a balanced weighting across sectors, we highlight the momentum buys within the troubled sectors of health care and technology. Two-thirds of the list comprises health care names, and the most prominent subindustry is pharmaceuticals, which garners a 2nd decile rating in our breadth work – Figure 3.

We show the same momentum buy list for the current favourite sectors, energy and staples. The combined list is heavily tilted toward energy (16 of the 19 stocks in the list), which continues to show positive strength and momentum – Figure 4.

**Figure 1: Price Trends on Russell 2000 & Sectors**

<table>
<thead>
<tr>
<th>Name</th>
<th>Chg Last Day</th>
<th>Reward /Risk</th>
<th>Trend Slope</th>
<th>1-day Price Chg(%)</th>
<th>5-day Price Chg(%)</th>
<th>%Chg wrt 50d MA</th>
<th>Chg wrt 50-d Price MA Trend</th>
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**Figure 2: Sector Relative Strength Trends vs Russell 2000**

<table>
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<th>Name</th>
<th>Reward /Risk</th>
<th>Trend Slope</th>
<th>RS Hi (%)</th>
<th>RS Low (%)</th>
<th>%Chg wrt 50d MA</th>
<th>Chg wrt 50-d RS MA Trend</th>
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<td>5.4% Above Rising</td>
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<td>Technology vs. Russell 2000</td>
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<td>-1%</td>
<td>-3.0% Below Rising</td>
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<td></td>
<td></td>
<td>-8%</td>
<td>0.9% Above Rising</td>
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</table>

**Figure 3:** Russell 2000 Health Care and Technology Mo Buys

**Figure 4:** Russell 2000 Staples and Energy Momentum Buys

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Internet Software Punished to 10th Decile

- Our breadth indication for the technology sector (and biotechnology group for that matter) recorded the worst reading of the year, a move that was driven off the weakness in internet technology stocks, which were punished to 10th decile last Friday – Fig. 1, 2.

- The NASDAQ itself has broken its steep uptrend just by going sideways as the twin weaknesses in still highly correlated technology and biotechnology (rolling 20-day fit of returns of the NASDAQ biotech and internet index is still a high 80%) segments have fallen in tandem.

- We highlight price trends on the largest 20 internet technology stocks below – Figure 3. Half of the group has broken below the bottom ends of their price channels, yet our oversold lists are still very skinny both in terms of number of stocks and market cap. In our opinion, it’s too early to bottom fish here.

- We would continue to prune technology positions (or move into defensive tech), and consider the Energy sector as the key “rotate into” candidate.

Figure 1: Technology Relative Strength Z-Score

Figure 2: Internet Technology Relative Strength Decile

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Today we highlight the other enhancement to our Sector Report: the addition of the price trends of our benchmark indices, the denominators in the relative strength ratios. As a reminder, you can view the Sector Report by either clicking the button on the top left of this note, or accessing our web page.

You can see these price trends in two ways – Figure 1:

- By selecting the “Price Trends” view from the “Sectors” page, which displays the price trends of the sectors and benchmark(s) in the selected region(s); within the MSCI World space, Healthcare and Technology are still ahead of the benchmark while Energy, Utilities and Telecom broke above positive trends - Figure 2;
- By clicking on the newly added “Benchmarks” button, which shows only the price trends of the main benchmarks – Figure 3; this view shows developed markets sporting positive trends, with S&P/TSX in the lead at 27%/yr, Russell 2000 indices severing their trends and Emerging and Asian markets in slightly negative trends.

Figure 1: Sectors Page – Price Trends View

Figure 2: MSCI World Index and Sectors Price Trends

Figure 3: Price Trends of Benchmarks

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

Sector Report Upgrade I

- We have upgraded our Sector Report by broadening the depth of coverage with the inclusion of more Global and U.S. economic sector indices. Our initial view shows only two of these new indices, but you can increase/decrease their number by rolling over either the World or U.S. button and change the selection – Figure 1.
  - The best and worst sectors are migrating toward neutral, with Technology, Health Care and Industrials reducing their outperformance or even reversing it (Russell 2000, MSCI Europe) and Energy, Staples and Utilities breaking above underperforming or flat trends in most markets.

Figure 1: Sector & Industry Report – Initial View

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

Investment & Trading Ideas

Tighten Up

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

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

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

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

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

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

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

Figure 5: Chinese Sovereign CDS

Figure 6: Chinese Bank 5Yr CDS

Figure 7: Chinese Real Estate CDS

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

- The tone of the BIS annual report released Sunday shows central banking thinking turning from carrot to stick:
  
  *What central bank accommodation has done during the recovery is to borrow time...But the time has not been well used*

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

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

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**Figure 9: Spanish Sovereign CDS**

**Figure 10: Average Peripheral Bank CDS**

**Figure 11: Italian and Spanish Spreads off of German Bunds**

**Figure 12: UniCredit SpA 5Yr CDS**
SIFI: Stresses Rising

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

---

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

<table>
<thead>
<tr>
<th>Name</th>
<th>1-day Equity Chg (%)</th>
<th>5-day Equity Chg (%)</th>
<th>MktCap (US$)</th>
<th>Chg Last Day</th>
<th>CDS % Chg 1/5Yr</th>
<th>CDS % Chg 50 DMA</th>
<th>Chg wrt 50 Day MA</th>
<th>Trend Slope</th>
</tr>
</thead>
<tbody>
<tr>
<td>UniCredit SpA</td>
<td>-4.1%</td>
<td>-7.2%</td>
<td>27,666</td>
<td>↑</td>
<td>-13%</td>
<td>2.5</td>
<td>0.58</td>
<td>22%</td>
</tr>
<tr>
<td>HSBC Holdings PLC</td>
<td>-0.1%</td>
<td>-3.6%</td>
<td>191,403</td>
<td>↑</td>
<td>-30%</td>
<td>7.5</td>
<td>0.51</td>
<td>32%</td>
</tr>
<tr>
<td>ING Groep NV</td>
<td>-2.1%</td>
<td>-3.1%</td>
<td>33,909</td>
<td>↑</td>
<td>-45%</td>
<td>2.0</td>
<td>0.49</td>
<td>9%</td>
</tr>
<tr>
<td>Banco Santander SA</td>
<td>-1.2%</td>
<td>-6.9%</td>
<td>69,239</td>
<td>↑</td>
<td>-42%</td>
<td>2.5</td>
<td>0.47</td>
<td>24%</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>-1.0%</td>
<td>-3.6%</td>
<td>48,825</td>
<td>↑</td>
<td>-60%</td>
<td>5.5</td>
<td>0.46</td>
<td>35%</td>
</tr>
<tr>
<td>Royal Bank of Scotland Group Plc</td>
<td>-5.1%</td>
<td>-10.3%</td>
<td>27,112</td>
<td>↑</td>
<td>-10%</td>
<td>9.5</td>
<td>0.46</td>
<td>43%</td>
</tr>
<tr>
<td>Barclays PLC</td>
<td>-0.8%</td>
<td>-5.3%</td>
<td>56,350</td>
<td>↑</td>
<td>8%</td>
<td>7.0</td>
<td>0.44</td>
<td>22%</td>
</tr>
<tr>
<td>Goldman Sachs Group Inc</td>
<td>-0.7%</td>
<td>-5.3%</td>
<td>70,724</td>
<td>↑</td>
<td>-49%</td>
<td>6.5</td>
<td>0.42</td>
<td>39%</td>
</tr>
<tr>
<td>Credit Suisse Group</td>
<td>-1.2%</td>
<td>-5.3%</td>
<td>42,253</td>
<td>↑</td>
<td>50%</td>
<td>7.0</td>
<td>0.38</td>
<td>20%</td>
</tr>
<tr>
<td>Bank of America Corp</td>
<td>-1.6%</td>
<td>-2.9%</td>
<td>136,803</td>
<td>↑</td>
<td>-47%</td>
<td>6.5</td>
<td>0.36</td>
<td>28%</td>
</tr>
<tr>
<td>Commerzbank AG</td>
<td>-2.3%</td>
<td>-1.8%</td>
<td>10,873</td>
<td>↑</td>
<td>35%</td>
<td>3.0</td>
<td>0.36</td>
<td>14%</td>
</tr>
<tr>
<td>Credit Agricole SA</td>
<td>-2.3%</td>
<td>-6.0%</td>
<td>21,255</td>
<td>↑</td>
<td>6%</td>
<td>2.0</td>
<td>0.35</td>
<td>15%</td>
</tr>
<tr>
<td>UBS AG</td>
<td>-1.5%</td>
<td>-4.7%</td>
<td>64,921</td>
<td>↑</td>
<td>11%</td>
<td>6.5</td>
<td>0.35</td>
<td>23%</td>
</tr>
<tr>
<td>Deutsche Bank AG</td>
<td>0.6%</td>
<td>-4.2%</td>
<td>44,674</td>
<td>↑</td>
<td>27%</td>
<td>2.5</td>
<td>0.35</td>
<td>19%</td>
</tr>
<tr>
<td>BNP Paribas</td>
<td>-2.6%</td>
<td>-5.9%</td>
<td>66,362</td>
<td>↑</td>
<td>-26%</td>
<td>2.5</td>
<td>0.35</td>
<td>18%</td>
</tr>
<tr>
<td>JPMorgan Chase &amp; Co</td>
<td>-1.0%</td>
<td>-2.2%</td>
<td>196,392</td>
<td>↑</td>
<td>-2%</td>
<td>6.5</td>
<td>0.34</td>
<td>18%</td>
</tr>
<tr>
<td>Citigroup Inc</td>
<td>-2.2%</td>
<td>-4.8%</td>
<td>142,620</td>
<td>↑</td>
<td>-55%</td>
<td>5.5</td>
<td>0.33</td>
<td>31%</td>
</tr>
<tr>
<td>Societe Generale</td>
<td>-2.1%</td>
<td>-5.6%</td>
<td>27,619</td>
<td>↑</td>
<td>-16%</td>
<td>2.0</td>
<td>0.32</td>
<td>13%</td>
</tr>
<tr>
<td>Wells Fargo &amp; Co</td>
<td>2.2%</td>
<td>-2.8%</td>
<td>216,940</td>
<td>↑</td>
<td>-29%</td>
<td>0.29</td>
<td>12%</td>
<td>Above Rising</td>
</tr>
</tbody>
</table>
US Equities: Last Dot Finally Connected, Picture Now Emerging

- The stress in the banking system is just starting to be felt in the U.S. equity market – Figure 14.
  - The breakout in the cost to protect the US Banks against default last Thursday coincided with the breakdown in the S&P 500.
- The U.S. 2-year swap spread, a gauge of counterparty risk, has just started to get in the game – Figure 15.
  - It is still incredibly low – Figure 16, but will move higher with continued stress in the banking system.
  - When stresses are high enough, one can watch this counterparty risk move with S&P futures tick for tick.
  - We have not seen this yet, but are expecting it. When we see it, we will be closer to an equity bottom.
- The known unknown is that when interest rates move from low and highly certain to high and highly uncertain that carry trades blow up.
  - This is the precursor to LTCM, to CCC, and to the known unknown of 2013.
  - When this unknown is known, we believe equities will be lining up for a bottom.
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<th>BMO Rating</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>42.0%</td>
<td>21.5%</td>
<td>60.7%</td>
<td>40.8%</td>
<td>53.6%</td>
<td>53.6%</td>
</tr>
<tr>
<td>Hold</td>
<td>Market Perform</td>
<td>52.8%</td>
<td>10.8%</td>
<td>38.2%</td>
<td>52.8%</td>
<td>43.8%</td>
<td>40.8%</td>
</tr>
<tr>
<td>Sell</td>
<td>Underperform</td>
<td>5.2%</td>
<td>3.2%</td>
<td>1.1%</td>
<td>6.3%</td>
<td>2.7%</td>
<td>5.6%</td>
</tr>
</tbody>
</table>

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.
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