## Thursday, October 24, 2013

### Market Elements

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<td>October 23, 2013</td>
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### Relative Strength Filter

<table>
<thead>
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<td>October 24, 2013</td>
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<td>Severed Trends Among Yield Stocks</td>
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<td>Yield Part II - REITs</td>
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<td>Small Cap Leaders</td>
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<td>Construction Materials Bottoming – HOLN, HEI</td>
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<td>October 18, 2013</td>
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<td>Yield Again – VZ, CAR-U, VLO</td>
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<td>October 17, 2013</td>
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<td>Energy E&amp;P – Continued Improvement</td>
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<td>October 16, 2013</td>
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<td>Debt Concerns Waning … in EM</td>
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<td>October 15, 2013</td>
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<td>Steel Now 3rd Decile – NUE, SCHN, VALE</td>
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<td>October 11, 2013</td>
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<td>Gold Shorts – SSL, DGC</td>
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<td>October 10, 2013</td>
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<td>European Banks Part II – Breaking Out</td>
<td>18</td>
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<td>October 9, 2013</td>
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<td>You Know You Are in Trouble When</td>
<td>19</td>
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<td>Debt Woe Waining – Not U.S., but European Banks</td>
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<td>Take It Out on Materials</td>
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<td>Industrial Internals &amp; Transportation Infrastructure</td>
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<td>Aerospace &amp; Defense – Too Close to the Sun</td>
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### Focal Points

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<tbody>
<tr>
<td>June 24, 2013</td>
<td>Tighten Up</td>
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Major equity indices reversed yesterday’s gains. Energy and financials led all global sectors lower. MSCI Europe Banks plunged 2% on ECB’s stress tests plans.

Global 10y yields added to Tuesday’s declines; CDN 10y yield reached a 3m low after the BoC lessened its tightening bias. China 5yr CDS jumped to a 10d high amid liquidity concerns.

The JPY rallied to its 200d MA. Commodity currencies fell between 0.6% and 1.5% against the U.S. dollar. The Canadian dollar lost the most in 4m.

Brent oil dropped 2.2% to the low of the month; WTI declined for a third straight day. Cu led all metals lower. Au held at a 3wk high.

Levels*

<table>
<thead>
<tr>
<th>Currencies (USD per)</th>
<th>Government 10- Yr Benchmark</th>
<th>Equity Indices &amp; Sentiment</th>
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<tbody>
<tr>
<td>Symbol</td>
<td>H/L Level %Chg</td>
<td>Symbol</td>
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<tr>
<td>DJ UBS</td>
<td>127.11 -0.8%</td>
<td>S&amp;P 1200</td>
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<tr>
<td>WTI Oil</td>
<td>97.07 -0.7%</td>
<td>S&amp;P/TSX</td>
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<tr>
<td>NMX Gas</td>
<td>3.62 1.1%</td>
<td>U.S.</td>
</tr>
<tr>
<td>Gold</td>
<td>1,333.5 -0.5%</td>
<td>U.K.</td>
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<tr>
<td>Silver</td>
<td>22.57 -0.6%</td>
<td>Germany</td>
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<tr>
<td>Palladium</td>
<td>4.35 1.0%</td>
<td>Italy</td>
</tr>
<tr>
<td>LME Al 3m</td>
<td>0.84 -1.9%</td>
<td>Spain</td>
</tr>
<tr>
<td>LME Ni 3m</td>
<td>6.60 -2.0%</td>
<td>Portugal</td>
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<tr>
<td>LME Zn 3m</td>
<td>0.88 -1.5%</td>
<td>Greece</td>
</tr>
<tr>
<td>LME Au 3m</td>
<td>13.8 -2.1%</td>
<td>Australia</td>
</tr>
<tr>
<td>LME Cu</td>
<td>326.60 3.9%</td>
<td>Hong Kong</td>
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<tr>
<td>Com</td>
<td>442.75 1.0%</td>
<td>India</td>
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<tr>
<td>Corn</td>
<td>350.00 -1.8%</td>
<td>Japan</td>
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<tr>
<td>DJ UBS</td>
<td>127.11 -0.8%</td>
<td>China</td>
</tr>
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<td>Mexico</td>
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<td>Corn</td>
<td>350.00 -1.8%</td>
<td>Japan</td>
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</tbody>
</table>

Moves

Currencies (spot)

Commodities

Government 10- Yr Benchmarks

Equity Indices

Sectors

S&P Global 1200

S&P Europe 350

S&P 500

S&P/TSX Composite

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

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

Currencies
- U.S. Dollar Index

Commodities
- D.J.-UBS Commodity Price Index
- Gold (Spot)
- Crude Oil (WTI)
- Natural Gas (NMX)
- Copper (CMX)
- Nickel (LME 3Mo)

Bonds
- U.S. 10-Yr Bond
- U.S. 5Yr 5Yr Forward Breakeven
- Japanese 10-Yr Bond
- Canadian 10-Yr Bond
- Italian 10-Yr Bond

Equities
- MSCI World Index
- S&P 500
- S&P/TSX Composite
- CDX North American Inv. Grade Index
- VIX
- DOOM: 1M Yen IV (AUD,EUR,USD)
Intra Day Charts
2-Day 1-Minute View

Currencies
U.S. Dollar Index

Commodities
D.J.-UBS Commodity Price Index

Bonds
U.S. 10-Yr Bond

Equities
MSCI World Index

Yen

Gold (Spot)

U.S. 5Yr 5Yr Forward Breakeven

S&P 500

Euro

Crude Oil (WTI)

Japanese 10-Yr Bond

S&P/TSX Composite

Asia Dollar Index

Natural Gas (NMX)

Canadian 10-Yr Bond

CDX North American Inv. Grade Index

Canadian Dollar

Copper (CMX)

German 10-Yr Bund

VIX

Australian Dollar

Nickel (LME 3Mo)

Italian 10-Yr Bond

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

- **U.S.** – at a 52-week high: **Industrials.**
- **Canada** – at a 52-week high: **Industrials, Consumer Discretionary, Health Care.**
### Market Movers – Largest Daily Percentage Moves

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

<table>
<thead>
<tr>
<th>NAME</th>
<th>Symbol</th>
<th>% Chg</th>
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<td>Empresas COPEC SA</td>
<td>COPEC</td>
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<tr>
<td>Origin Energy Ltd</td>
<td>ORG</td>
<td>1.5%</td>
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<tr>
<td>AMEC PLC</td>
<td>AMEC</td>
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<tr>
<td>Tenaris SA</td>
<td>TEN</td>
<td>-2.1%</td>
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<tr>
<td>Petrobras Brasilheiro SA</td>
<td>PBR/A</td>
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<tr>
<td>CNOCO Ltd</td>
<td>883 HK</td>
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<tr>
<td>Newcrest Mining Ltd</td>
<td>NCMT</td>
<td>3.5%</td>
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<tr>
<td>Norsk Hydro ASA</td>
<td>NHY</td>
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<tr>
<td>Koninklijke DSM NV</td>
<td>DSMNA</td>
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<tr>
<td>Anglo-American PLC</td>
<td>AAL</td>
<td>-3.9%</td>
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<tr>
<td>Antazetgasta PLC</td>
<td>ANTO</td>
<td>-3.8%</td>
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<td>Nitto Denko Corp</td>
<td>6988 JT</td>
<td>-7.5%</td>
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<tr>
<td>Peugeot SA</td>
<td>UG</td>
<td>3.3%</td>
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<tr>
<td>Persimmon PLC</td>
<td>PSN</td>
<td>2.4%</td>
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<tr>
<td>ITV PLC</td>
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<tr>
<td>Segam Sammy Holdings Inc</td>
<td>6460 JT</td>
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<tr>
<td>Qantas Airways Ltd</td>
<td>QAN</td>
<td>-4.6%</td>
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<tr>
<td>Peugeot SA</td>
<td>UG</td>
<td>3.3%</td>
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<td>Cons Disc</td>
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<td>Cia de Bebedas das Americas</td>
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<td>Heineken NV</td>
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<td>BMPS</td>
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<tr>
<td>Algonquin Power &amp; Utilities Co</td>
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<tr>
<td>Canadian Utilities Ltd</td>
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<tr>
<td>Emera Inc</td>
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<tr>
<td>Just Energy Group Inc</td>
<td>JE</td>
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**Bold** = move of more than 5%
<table>
<thead>
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<th>U.S. Market Movers</th>
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</table>

### Energy
- Symbol: Symbol
- Last %Chg: %
- %Chg: %

### Industrials
- Symbol: Symbol
- Last %Chg: %
- %Chg: %

### Consumer Discretionary
- Symbol: Symbol
- Last %Chg: %
- %Chg: %

### Consumer Staples
- Symbol: Symbol
- Last %Chg: %
- %Chg: %

### Technology
- Symbol: Symbol
- Last %Chg: %
- %Chg: %

### Financials
- Symbol: Symbol
- Last %Chg: %
- %Chg: %

### Materials
- Symbol: Symbol
- Last %Chg: %
- %Chg: %

### Health Care
- Symbol: Symbol
- Last %Chg: %
- %Chg: %

### Utilities
- Symbol: Symbol
- Last %Chg: %
- %Chg: %

### Utilities
- Symbol: Symbol
- Last %Chg: %
- %Chg: %

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## Canadian Market Movers

<table>
<thead>
<tr>
<th>Symbol</th>
<th>Last</th>
<th>High/Low</th>
<th>NASDAQ</th>
<th>S&amp;P</th>
<th>TSX 60</th>
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<tbody>
<tr>
<td>TXG</td>
<td>12.34</td>
<td>-2.1%</td>
<td>-2.1%</td>
<td>-2.1%</td>
<td>-2.1%</td>
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<tr>
<td>TXG</td>
<td>11.24</td>
<td>-1.7%</td>
<td>-1.7%</td>
<td>-1.7%</td>
<td>-1.7%</td>
</tr>
<tr>
<td>TXG</td>
<td>10.97</td>
<td>-1.4%</td>
<td>-1.4%</td>
<td>-1.4%</td>
<td>-1.4%</td>
</tr>
<tr>
<td>TXG</td>
<td>10.55</td>
<td>-1.1%</td>
<td>-1.1%</td>
<td>-1.1%</td>
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</tr>
<tr>
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<td>-1.0%</td>
<td>-1.0%</td>
<td>-1.0%</td>
<td>-1.0%</td>
</tr>
</tbody>
</table>

**Healthcare**

- **Symbol**
- **High/Low**
- **NASDAQ**
- **S&P**
- **TSX 60**

**NQDO U H** | 18.72 | 15.7% | 15.7% | 15.7% | 15.7% |

**Biotech**

- **Symbol**
- **High/Low**
- **NASDAQ**
- **S&P**
- **TSX 60**

**NQDO U H** | 61.10 | 0.1% | 0.1% | 0.1% | 0.1% |

**Technology**

- **Symbol**
- **High/Low**
- **NASDAQ**
- **S&P**
- **TSX 60**

**NQDO U H** | 20.33 | 0.0% | 0.0% | 0.0% | 0.0% |

**Financials**

- **Symbol**
- **High/Low**
- **NASDAQ**
- **S&P**
- **TSX 60**

**NQDO U H** | 19.15 | 0.0% | 0.0% | 0.0% | 0.0% |

**Market Elements**

- **Symbol**
- **High/Low**
- **NASDAQ**
- **S&P**
- **TSX 60**

**NQDO U H** | 30.64 | 0.0% | 0.0% | 0.0% | 0.0% |

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**Note:** High/Low = High/Low of the past month; NASDAQ = NASDAQ Market; S&P = S&P/TSX 60 Index; TSX 60 = Toronto Stock Exchange Market.
Relative Strength Filter

October 24, 2013
Research Comment
Quantitative/Technical Research Website

Mark Steele
(416) 359-4641
mark.steele@bmo.com
Assoc: Tiberiu Stoichita/Jin Li

Severed Trends Among Yield Stocks

- With bond yields breaking to the downside, we continue to apply a yield filter when looking at stocks. This narrows down our universe to stocks yielding more than 2% with good dividend growth records.
- The key tables we look at every day are our “severed trends lists” (outperforming trends breaking down, and underperforming trends breaking to the upside) and when we screen them for the largest 20 MSCI World members that have yield greater than 2% and good dividend growth, we glean the stocks in Figure 1.

- Suncor has been a stellar outperformer since it was buffeted by Buffet. With the oil price breaking an uptrend, Suncor is breaking an outperforming trend.
- Microchip Technology and STMicroelectronics are the large cap leaders in a wave of semi stocks, which broke down yesterday, many of which did so on high volume.
- The MSCI World Staples index broke above an underperforming trend yesterday; the largest stock contributing to this reversal is Colgate-Palmolive.
- The weakest stocks breaking above underperforming trends are utilities. In Canada, on a relative basis, utilities have suffered more than in other geographies, underperforming at a rate of 35%/year. Fortis and Canadian Utilities are now breaking above these underperforming trends.

---

Figure 1: Largest 20 Yield (Above 2% and Good Dividend Growth) MSCI World Members Severing Trends Yesterday

<table>
<thead>
<tr>
<th>Symbol</th>
<th>Name</th>
<th>Industry</th>
<th>Gp</th>
<th>RS</th>
<th>DVD</th>
<th>1-day Equity Chg (%)</th>
<th>5-day Equity Chg (%)</th>
<th>MidCap [US$]</th>
<th>Chg Last Day</th>
<th>MSCI World Ln N</th>
<th>Trend Slope</th>
<th>RS Hi (Mo)</th>
<th>RS Low (Mo)</th>
<th>%Chg wrt S&amp;O MA</th>
<th>Chg wrt 50 Day MA</th>
<th>Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>SU CN</td>
<td>Suncor Energy Inc</td>
<td>Int.Oil&amp;G</td>
<td>9</td>
<td>1</td>
<td>-2.3%</td>
<td>-2.1%</td>
<td>52,851</td>
<td>↓</td>
<td>36%</td>
<td>2.5</td>
<td>1%</td>
<td>Above Rising</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MCP US</td>
<td>Microchip Technology Inc</td>
<td>Semi</td>
<td>7</td>
<td>2</td>
<td>-3.9%</td>
<td>-2.4%</td>
<td>7,683</td>
<td>↑</td>
<td>14%</td>
<td>4.5</td>
<td>-2%</td>
<td>Below Falling</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>STM US</td>
<td>STMicroelectronics NV</td>
<td>Semi</td>
<td>7</td>
<td>1</td>
<td>-8.6%</td>
<td>-9.9%</td>
<td>7,220</td>
<td>↓</td>
<td>10%</td>
<td>6.0</td>
<td>-10%</td>
<td>Below Falling</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>OKE US</td>
<td>Oneok Inc</td>
<td>GasUtil</td>
<td>6</td>
<td>1</td>
<td>0.5%</td>
<td>3.3%</td>
<td>11,558</td>
<td>↑</td>
<td>-5%</td>
<td>2.0</td>
<td>6%</td>
<td>Above Rising</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FIE GR</td>
<td>Fimmann AG</td>
<td>SpecStk</td>
<td>3</td>
<td>3</td>
<td>0.7%</td>
<td>3.6%</td>
<td>4,677</td>
<td>↑</td>
<td>-4%</td>
<td>1.5</td>
<td>3%</td>
<td>Above Rising</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BAS GR</td>
<td>BASF SE</td>
<td>DiversChem</td>
<td>1</td>
<td>1</td>
<td>-0.1%</td>
<td>1.6%</td>
<td>93,588</td>
<td>↑</td>
<td>-11%</td>
<td>4.0</td>
<td>5%</td>
<td>Above Rising</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CL US</td>
<td>Colgate-Palmolive Co</td>
<td>HoldInd</td>
<td>4</td>
<td>2</td>
<td>0.0%</td>
<td>2.5%</td>
<td>38,880</td>
<td>↑</td>
<td>-5%</td>
<td>2.5</td>
<td>7%</td>
<td>Above Rising</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>NSC US</td>
<td>Norfolk Southern Corp</td>
<td>Railroads</td>
<td>6</td>
<td>2</td>
<td>6.8%</td>
<td>7.7%</td>
<td>26,847</td>
<td>↑</td>
<td>-7%</td>
<td>13.5</td>
<td>13%</td>
<td>Above Rising</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GLW US</td>
<td>Corning Inc</td>
<td>ElecComp</td>
<td>8</td>
<td>2</td>
<td>14.1%</td>
<td>21.5%</td>
<td>25,386</td>
<td>↑</td>
<td>-12%</td>
<td>21.0</td>
<td>20%</td>
<td>Above Rising</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RVI US</td>
<td>Raffinex Bank Intl AG</td>
<td>DiversBnk</td>
<td>6</td>
<td>2</td>
<td>-4.2%</td>
<td>7.7%</td>
<td>7,070</td>
<td>↑</td>
<td>-63%</td>
<td>1.5</td>
<td>4%</td>
<td>Above Rising</td>
<td></td>
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<tr>
<td>SAB LN</td>
<td>SABMiller PLC</td>
<td>Brewers</td>
<td>8</td>
<td>2</td>
<td>1.0%</td>
<td>5.9%</td>
<td>33,481</td>
<td>↑</td>
<td>-23%</td>
<td>1.0</td>
<td>3%</td>
<td>Above Rising</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PCL US</td>
<td>Plum Creek Timber Co Inc (REIT)</td>
<td>SpecREIT</td>
<td>7</td>
<td>2</td>
<td>-0.2%</td>
<td>1.5%</td>
<td>8,051</td>
<td>↑</td>
<td>-28%</td>
<td>2.5</td>
<td>6%</td>
<td>Above Rising</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>VZ US</td>
<td>Verizon Communications Inc</td>
<td>InteTelSrv</td>
<td>5</td>
<td>1</td>
<td>-0.6%</td>
<td>7.6%</td>
<td>145,447</td>
<td>↑</td>
<td>-29%</td>
<td>2.0</td>
<td>8%</td>
<td>Above Rising</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FCR CN</td>
<td>First Capital Realty Inc</td>
<td>ReitOpCo</td>
<td>8</td>
<td>1</td>
<td>0.3%</td>
<td>4.8%</td>
<td>3,391</td>
<td>↑</td>
<td>-31%</td>
<td>2.0</td>
<td>6%</td>
<td>Above Rising</td>
<td></td>
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</tr>
<tr>
<td>2503 JP</td>
<td>Kin Hldings Co Ltd</td>
<td>Brewhrs</td>
<td>8</td>
<td>2</td>
<td>-1.0%</td>
<td>2.9%</td>
<td>14,659</td>
<td>↑</td>
<td>-50%</td>
<td>1.5</td>
<td>4%</td>
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<td></td>
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<td></td>
</tr>
<tr>
<td>AEP US</td>
<td>American Electric Power Co Inc</td>
<td>ElecUtil</td>
<td>6</td>
<td>1</td>
<td>2.4%</td>
<td>6.3%</td>
<td>22,645</td>
<td>↑</td>
<td>-34%</td>
<td>2.0</td>
<td>7%</td>
<td>Above Rising</td>
<td></td>
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<tr>
<td>CU CN</td>
<td>Canadian Utilities Ltd</td>
<td>MultiUtil</td>
<td>5</td>
<td>2</td>
<td>0.6%</td>
<td>3.3%</td>
<td>6,626</td>
<td>↑</td>
<td>-36%</td>
<td>2.5</td>
<td>6%</td>
<td>Above Rising</td>
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<td></td>
</tr>
<tr>
<td>HCP US</td>
<td>HCP Inc</td>
<td>SpecREIT</td>
<td>7</td>
<td>3</td>
<td>0.1%</td>
<td>1.2%</td>
<td>19,352</td>
<td>↑</td>
<td>-63%</td>
<td>3%</td>
<td>Above Rising</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FTS CN</td>
<td>Fortis Inc</td>
<td>ElecUtil</td>
<td>6</td>
<td>1</td>
<td>1.0%</td>
<td>3.1%</td>
<td>6,646</td>
<td>↑</td>
<td>-30%</td>
<td>5%</td>
<td>Above Rising</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MTS AU</td>
<td>Metcash Ltd</td>
<td>FDDistr</td>
<td>2</td>
<td>1</td>
<td>0.3%</td>
<td>1.9%</td>
<td>2,736</td>
<td>↑</td>
<td>-72%</td>
<td>2%</td>
<td>Below Falling</td>
<td></td>
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<td></td>
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Source: BMO Capital Markets, Bloomberg, Thomson, Markit

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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>
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<td>Buy Outperform</td>
<td>35.8%</td>
<td>20.3%</td>
<td>47.8%</td>
<td>36.7%</td>
<td>48.3%</td>
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<td>Hold Market Perform</td>
<td>59.4%</td>
<td>13.1%</td>
<td>51.1%</td>
<td>56.9%</td>
<td>50.2%</td>
<td>41.1%</td>
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<tr>
<td>Sell Underperform</td>
<td>4.9%</td>
<td>3.4%</td>
<td>1.1%</td>
<td>6.4%</td>
<td>1.5%</td>
<td>5.6%</td>
</tr>
</tbody>
</table>

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Yield Part II - REITs

- It’s not just that long and short rates are breaking yield uptrends, it’s that bonds, whether corporate or treasuries, are where concern is falling the fastest – Figure 1. It’s the focus on the fear of rising rates, and the reversal of this fear, which drives our focus on yield (see link), emerging markets (see link), and now a more in-depth focus on REITs as the MSCI REIT index mints its first higher high – Figure 2.

- For the REIT specialist, a link to REIT stocks shown against the ACWI REIT index is found here.

- For the generalist, we highlight dividend-adjusted price trends of REITs in the MSCI World index, where the yield is above 2% and the REITs have good record of dividend growth – Figure 3.
  - Most stocks are either trending higher, or are reversing downtrends, they are not overbought; and the largest on the list, SPG, is just reversing a six-month downtrend.

Figure 1: Where Fear (Implied Volatility) Is Receding Fastest

<table>
<thead>
<tr>
<th>Name</th>
<th>Symbol</th>
<th>1-Day Chg (%)</th>
<th>5-Day Chg (%)</th>
<th>Chg Last Day</th>
<th>Reward / Risk</th>
<th>Trend Slope</th>
<th>30 Day MA</th>
<th>%Chg w/r 50d MA</th>
<th>Chg w/r 200d MA</th>
<th>Chg w/r 50d MA</th>
<th>Trend</th>
<th>Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>US 10yr IV</td>
<td>TYIY</td>
<td>-10.5%</td>
<td>-18.1%</td>
<td>-14%</td>
<td>2.5</td>
<td>-27%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>4%</td>
</tr>
<tr>
<td>Treasury</td>
<td>NOTE</td>
<td>-11.8%</td>
<td>-18.8%</td>
<td>-10%</td>
<td>5.6</td>
<td>-28%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>4%</td>
</tr>
<tr>
<td>10 Corp IV</td>
<td>LOOOV</td>
<td>-8.9%</td>
<td>-13.3%</td>
<td>-14%</td>
<td>5.6</td>
<td>-30%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>4%</td>
</tr>
<tr>
<td>Gold VIX</td>
<td>GLV</td>
<td>-3.5%</td>
<td>-20.4%</td>
<td>-3%</td>
<td>5.2</td>
<td>-13%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>4%</td>
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<tr>
<td>Van Camry Trade</td>
<td>DDOOM</td>
<td>-3.3%</td>
<td>-12.8%</td>
<td>-23%</td>
<td>10.6</td>
<td>-21%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>4%</td>
</tr>
<tr>
<td>EM PX</td>
<td>INPVEN</td>
<td>-2.8%</td>
<td>-7.3%</td>
<td>-39%</td>
<td>5.5</td>
<td>-19%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>4%</td>
</tr>
<tr>
<td>STOXX 50 VIX</td>
<td>VAX</td>
<td>-2.5%</td>
<td>-16.2%</td>
<td>-11%</td>
<td>18%</td>
<td>-18%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>4%</td>
</tr>
<tr>
<td>MT Corp IV</td>
<td>MHSV</td>
<td>-2.1%</td>
<td>-13.4%</td>
<td>-3%</td>
<td>19%</td>
<td>-21%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>-12%</td>
<td>Below Rising</td>
<td>4%</td>
</tr>
</tbody>
</table>

Where is Fear Receding At The Fastest Pace? Bonds

Figure 2: MSCI World Real Estate Trusts Index

1st Higher High to Go With the Higher Low, and Back Above a Rising 50d MA

Figure 3: Dividend Adjusted Price Trends on MSCI World REITs With Yield > 2% and Good Yield/Dividend Growth Factors

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>LI FP</td>
<td>Klepierre</td>
<td>6.6%</td>
<td>4.6%</td>
<td>3%</td>
<td>Above Falling</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
</tr>
<tr>
<td>8933 JP</td>
<td>Japan Retail Fund Investments</td>
<td>6.5%</td>
<td>4.6%</td>
<td>3%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
</tr>
<tr>
<td>PSA US</td>
<td>Public Storage Inc.</td>
<td>6.3%</td>
<td>4.6%</td>
<td>3%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
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<tr>
<td>CPX AU</td>
<td>CPS Retail Property Trust</td>
<td>6.3%</td>
<td>4.6%</td>
<td>3%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
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<tr>
<td>HCN US</td>
<td>Health Care REIT</td>
<td>6.7%</td>
<td>4.6%</td>
<td>3%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
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<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
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<tr>
<td>O US</td>
<td>Realty Income Corp</td>
<td>6.3%</td>
<td>4.6%</td>
<td>3%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
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<td>Above Rising</td>
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<td>Above Rising</td>
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<tr>
<td>VTR US</td>
<td>Ventas Inc</td>
<td>6.7%</td>
<td>4.6%</td>
<td>3%</td>
<td>Above Rising</td>
<td>4%</td>
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<td>HCP US</td>
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<td>4.6%</td>
<td>3%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
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<td>Above Rising</td>
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<td>Above Rising</td>
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<tr>
<td>VNO US</td>
<td>Vornado Realty Trust</td>
<td>6.3%</td>
<td>4.6%</td>
<td>3%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
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<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
</tr>
<tr>
<td>FRT US</td>
<td>Federal Realty Investment</td>
<td>6.3%</td>
<td>4.6%</td>
<td>3%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
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<td>Above Rising</td>
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<td>Above Rising</td>
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<tr>
<td>RLV US</td>
<td>Rayonier Inc</td>
<td>6.3%</td>
<td>4.6%</td>
<td>3%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
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<td>AVE US</td>
<td>AvalonBay Communities Inc</td>
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<td>4.6%</td>
<td>3%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
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<td>REIT-CN</td>
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<td>3%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
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<td>4%</td>
<td>Above Rising</td>
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<td>Above Rising</td>
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<tr>
<td>PLC US</td>
<td>Plum Creek Timber Co Inc</td>
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<td>4.6%</td>
<td>3%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
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<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
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<td>823 HK</td>
<td>Link REIT</td>
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<td>4.6%</td>
<td>3%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
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<td>Above Rising</td>
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<td>DLR US</td>
<td>Digital Realty Trust Inc</td>
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<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
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<tr>
<td>SPG US</td>
<td>Simon Property Group Inc</td>
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<td>4.6%</td>
<td>3%</td>
<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
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<td>Above Rising</td>
<td>4%</td>
<td>Above Rising</td>
<td>4%</td>
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</table>

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

October 22, 2013
Research Comment
Quantitative/Technical Research Website

Mark Steele
(416) 359-4641
mark.steele@bmo.com
Assoc: Tiberiu Stoichita/Jin Li

Small Cap Leaders

- You see it in the U.S., and you see it looking at world ex U.S., small cap indices have a little more upside torque than large cap indices. This is also where our systems ferret out new ideas for the portfolio. We highlight a “best of” list of ACWI Small Cap index members below which are Momentum buys in a 1st decile subindustry. We further filtered the list by putting on an earnings growth-focused filter, as we see this working in many segments of the market.

- FleetCor is the largest stock in the list, and is also in data processors, where we see broad strength and have for some time. Shares are trending higher at a rate of 150%/year – Figure 2.

- ASOS PLC is a leader within Internet retail where we believe you should be placing some of your consumer discretionary weight. Shares that are trending higher at 164%/year just pulled back and held at the 50d MA – Figure 3.

Figure 1: ACWI Small Cap Momentum Buys, in 1st Decile SubIndustries, With an Earnings-Focused Filter

<table>
<thead>
<tr>
<th>Symbol</th>
<th>Name</th>
<th>Sub Industry</th>
<th>Grp Rank</th>
<th>FE</th>
<th>1-day Equity Chg (%)</th>
<th>5-day Equity Chg (%)</th>
<th>MicCap (USD)</th>
<th>ACWI Smll</th>
<th>Trend Slope</th>
<th>Rs Hi (Mo)</th>
<th>Rs Low (Mo)</th>
<th>%Chg wrt 50d MA</th>
<th>Chg wrt 50 Day MA Trend</th>
<th>%Chg wrt 200d MA</th>
<th>Chg wrt 200 Day MA Trend</th>
<th>RSI Dvy</th>
<th>EY</th>
<th>OBV</th>
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<tr>
<td>ASC LN</td>
<td>ASOS PLC</td>
<td>Industi</td>
<td>1</td>
<td>2</td>
<td>0.4%</td>
<td>6.5%</td>
<td>7,182</td>
<td>91%</td>
<td>1.0</td>
<td>7%</td>
<td>Above Rising</td>
<td>38%</td>
<td>Above Rising</td>
<td>61</td>
<td>0.01</td>
<td>21%</td>
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<td>WAGE US</td>
<td>WageWorks Inc.</td>
<td>HREmpl</td>
<td>1</td>
<td>1</td>
<td>0.5%</td>
<td>1.7%</td>
<td>1,792</td>
<td>113%</td>
<td>1.0</td>
<td>11%</td>
<td>Above Rising</td>
<td>64%</td>
<td>Above Rising</td>
<td>62</td>
<td>0.80</td>
<td>15%</td>
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<tr>
<td>RL TUS</td>
<td>FleetCor Technologies</td>
<td>DataProc</td>
<td>1</td>
<td>2</td>
<td>-0.2%</td>
<td>5.9%</td>
<td>9,178</td>
<td>67%</td>
<td>1.0</td>
<td>6%</td>
<td>Above Rising</td>
<td>34%</td>
<td>Above Rising</td>
<td>60</td>
<td>2.71</td>
<td>16%</td>
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<td>2371 JP</td>
<td>Kakaku.com Inc.</td>
<td>IndustriGrv</td>
<td>1</td>
<td>1</td>
<td>-2.0%</td>
<td>-0.4%</td>
<td>5,085</td>
<td>167%</td>
<td>1.0</td>
<td>8%</td>
<td>Above Rising</td>
<td>56%</td>
<td>Above Rising</td>
<td>55</td>
<td>1.55</td>
<td>24%</td>
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<td>GMCL US</td>
<td>Omnicell Inc.</td>
<td>HiData Tec.</td>
<td>1</td>
<td>3</td>
<td>1.4%</td>
<td>-1.4%</td>
<td>839</td>
<td>52%</td>
<td>1.0</td>
<td>2%</td>
<td>Above Rising</td>
<td>22%</td>
<td>Above Rising</td>
<td>53</td>
<td>3.03</td>
<td>16%</td>
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<td>ACON US</td>
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<td>HREmpd</td>
<td>1</td>
<td>1</td>
<td>-0.6%</td>
<td>3.7%</td>
<td>1,651</td>
<td>52%</td>
<td>1.0</td>
<td>7%</td>
<td>Above Rising</td>
<td>27%</td>
<td>Above Rising</td>
<td>64</td>
<td>3.13</td>
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<td>PKW US</td>
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<td>Cash&amp;Garn</td>
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<td>-0.2%</td>
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<td>Above Rising</td>
<td>48</td>
<td>2.93</td>
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<td>Interneti</td>
<td>1</td>
<td>2</td>
<td>2.6%</td>
<td>-3.4%</td>
<td>2,570</td>
<td>67%</td>
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<td>19%</td>
<td>Above Rising</td>
<td>56%</td>
<td>Above Rising</td>
<td>64</td>
<td>2.11</td>
<td>21%</td>
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<td>1,729</td>
<td>31%</td>
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<td>5%</td>
<td>Above Rising</td>
<td>28%</td>
<td>Above Rising</td>
<td>61</td>
<td>3.04</td>
<td>15%</td>
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</tbody>
</table>

Figure 2: FleetCor Technologies Price Trend

Figure 3: ASOS PLC (ASC LN) Price Trend

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

Construction Materials Bottoming – HOLN, HEI

- The global construction materials index, which is heavily weighted towards European stocks, is just about to reverse a three-year underperforming trend, and is breaking out of a head-and-shoulders bottom – Figure 1.
  - We are seeing signs of a thaw in EM credit weakness, which is key to this group.
  - We are also seeing a retreat of the threat of higher U.S. long and short rates, which has been the driver of EM outflows.

- The largest stock, Holcim, has not reacted to the recent narrowing of CDS; if it did, the underperforming and price downtrends would likely reverse to the upside. Mind the gap – Figure 2.
- Higher on the risk scale, which is where you want to be when credit markets are as blissful as they are, is Heidelberg Cement, whose 5Yr CDS just minted a lower low (positive) after receding from EM shock threats earlier this year – Figure 3.
  - Relative strength and price trends here are pausing, or consolidating gains.
  - We expect upside breakouts in both, and a move back towards the 50%/yr trends, which is what you get when a risky stock starts to de-risk once again – Figures 3, 4.

Figure 1: Construction Materials vs. MSCI World

Figure 3: Heidelberg Cement 5y CDS (see Equity/CDS Overlay)

Figure 2: Holcim Equity/ CDS Overlay (see CDS, Equity Trends)

Figure 4: Heidelberg Cement (HEI GR) Dvd Adj Price Trend

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

Yield Again – VZ, CAR-U, VLO

- It starts with the signaling in…
  - Industrial, which are breaking below an outperforming trend in the market cap weighted global benchmark, and our equal-weighted breadth indication is also receding back to neutral.
  - Bonds, which are breaking below 50d MAs, and in some cases are breaking yield uptrends.
- …then if you look at recent economic signaling from the U.S., it has rolled over, giving cover for bond yields to mint a lower low (Figure 1), which happened this morning on both the long and short end of the curve.

- Reaching into our yield-focused filter, looking for positive turns amongst stocks with yield > 2% with a positive dividend growth record:
  - Verizon Communications (VZ US) with a 4.3% yield and consistent 3% dividend growth gapped higher and broke above an underperforming trend against the S&P 500 yesterday. Our trend channel just measures the six-month consolidation, which is ending. Our upside technical target is $60 – Figure 2.
  - CDN Apartment Properties REIT (CAR-U CN) with an indicated yield of 5.4%, and accelerating dividend growth broke above an underperforming trend against the S&P/TSX composite this week. Volume is building at the lows. We expect it will soon get back to the highs – Figure 3.
  - Valero Energy (VLO US), with an indicated yield of 2.3% and double digit 1y and 3y dividend growth, broke above relative strength and price downtrends this week. Its 5y CDS narrowed 10% over the past five days (TSO narrowed 11%, and broke below a widening trend) and refiners have moved off the bottom in our breadth work. Our upside technical target is $55 – Figure 4.

Figure 1: Citi US Economic Surprise Index and US 10Y Yield

Figure 2: Verizon Communication (VZ US) Dvd Adj Stock Price

Figure 3: CDN Apartment REIT (CAR-U) Dvd Adj Price Trend

Figure 4: Valero Energy (VLO US) Dvd Adj Price Trend

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Energy E&P – Continued Improvement

- We cover 230 E&P stocks, and collectively, on a non-market cap weighted basis, they were, to be polite, to be avoided, showing up as generally underperforming the market and the energy sector. This month, they improved to a neutral reading, and yesterday, they reached 4th decile, one step below the top 3 - Figure 1.

- On a market cap weighted basis, a global index looks a little dear (see link), and almost a quarter of E&P stocks currently look overbought, so we assume that when we tell you that we see strength, the response will be “yes we know.”

- Going stock picking from an earnings growth focused screen, a dividend yield/growth driven screen, and a value screen, we highlight the following three:
  - Raging River Exploration hits both our earnings-focused screen and our momentum buy list. It has had consolidated gains for five weeks now, yet is still in an uptrend, rising at over 100%/year – Figure 2.
  - Baytex Energy hits our yield-focused screen with an indicated yield of 6.15% and a flat dividend growth profile. Shares had a leg up in June/July, which was enough to reverse the downtrend. Shares have been consolidating gains since. Our target on the next leg up is $50 – Figure 3.
  - Anadarko Petroleum is on both our earnings growth and value-focused screens. Its stock uptrend follows the credit improvement trend we see in its CDS. Shares are trending higher at a rate of 26%/yr (Figure 4), which beats ACWI, is in line with S&P 500, and beats S&P 500 Energy.

Figure 1: E&P Relative Strength Decile

Figure 2: Raging River Exploration (RRX CN) Price Trend

Figure 3: Baytex Energy (BTE CN) Dvd Adj Price Trend

Figure 4: Anadarko Petroleum (APC US) Dvd Adj Price Trend

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Debt Concerns Waning … in EM

- In the U.S., the current credit focus of the world, T-Bills maturing in October hover at yield highs. A world away, emerging market concern, sparked by a taper tantrum in May, is receding:
  - Implied volatility on EM bonds minted a 3rd lower low yesterday – Figure 1.
  - While large risky developed market CDS trends are trending favorably (why we like European banks for example), credit trends on EM have been trending wider (negative). Over the past week, these negative CDS trends in EM companies have been experiencing positive reversals – Figure 2.
  - We highlighted this with Vale SA yesterday.

- Oi SA (OIBR US) is a Brazilian Telecom company whose CDS risk, while high at 150 bps, is topping, and whose stock is forming a double bottom. Shares closed at $2.07. Our double bottom target is $3.25 – Figure 3.

- AmBev (AMB US) finds its widening CDS trend breaking, its 10-month underperforming trend being reversed, and its stock reversing a downtrend – Figure 4. The short-term double bottom measures to $45. Longer term, this company has a good history of trending higher and outperforming the ACWI.
Steel Now 3rd Decile – NUE, SCHN, VALE

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

- Nucor is a large cap, low volatility outperformer. Shares broke out of a head and shoulders bottom early this year, and are now trending higher at a rate of 30%/year – Figure 1. This leads to outperformance of 16% against ACWI, and 25% against the materials sector. The CDS trend is narrowing, and 50, 150, and 200d MAs are all positive.
- Schnitzer Steel is our small cap pick, trending higher at the same rate as Nucor, yet its shares are still in the bottoming pattern – Figure 3. This company ranks 1st decile on our dividend screen due to an indicated yield of 2.6% and positive dividend growth record.
- Vale is the largest steel stock by market cap, its 5yr CDS broke below a widening trend last week (Figure 4), and shares broke above a downtrend yesterday. This is the trigger to cover shorts and consider the potential for a V-bottom.

Figure 1: Steel Relative Strength Decile

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

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

Figure 4: Vale (VALE US) 5Yr CDS Trend (see Price Trend Here)

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

Gold Shorts – SSL, DGC

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

- The key feature of this next leg down will be the fact that credit will become a much larger part of the discussion – Figure 2.

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

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

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

Figure 1: MSCI European Bank Index – Breaking Out Today

Figure 2: 5-yr CDS Index on European Banks

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

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

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

- You know you are in trouble when stocks become highly correlated – Figure 1, and are being driven off of T-bill yields – Figure 2. That trouble is for quant models and program traders.
- You know you will find opportunities when stocks become highly correlated – Figure 1, and are being driven off of T-Bill yields – Figure 2. That opportunity is for investors that know that T-bill yields are not the long-term determinant of equity performance.
- The signalling at how long we will be in this U.S. default mess is found by looking at how high and how far out US T-Bill yields will be stressed during the “Brinkmanship”. This is the same statement we made Monday; the only difference is that is now “sells” are targeting both the stocks that are not liked (Monday’s list) and the stocks that are liked – Figure 1.
- We figure it is in between what you want to sell (pretty much everything is being sold now) and what you want to buy (the market is doing what markets do best, speak loudly such that politicians get it right in the end), so now is the time to put together shopping lists.
- We know what we like: earnings growth (earnings estimates being revised higher, positive earnings, long-term expected earnings growth exceeding 10%) is working in many segments of the market, our top 3 SubIndustry deciles will narrow this list down, and if you can get yield and dividend growth, why not. This narrow list is shown in Figure 3.

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

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

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

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

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

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

Figure 1: 5-yr CDS Basket of European Banks

Figure 2: Banco Espirito Santo SA vs. MSCI Europe

Figure 3: European Bank Momentum Buys Against MSCI Europe

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

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

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

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

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

Figure 2: Materials Relative Strength Z-Score

Figure 3: USD Price Trends on Largest 20 Developed Market Material Momentum Sells in The Weakest SubIndustries
Industrial Internals & Transportation Infrastructure

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

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

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

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

Figure 1: Industrial Relative Strength Z-Score

Figure 2: MSCI World Industrial Industries vs. MSCI World

Figure 3: Airlines vs. MSCI World

Figure 4: Transportation Infrastructure vs. MSCI World

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

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

Aerospace & Defense – Too Close to the Sun

- It is day 3 of the U.S. government shutdown, and there will be problems for some companies that rely on the government.
- Lockheed Martin, Northrop Grumman and Rockwell Collins have broken below outperforming trends. Raytheon has also broken down against a global benchmark.
- If you missed Aerospace & Defense this year, you missed a great party. After marketperforming for four years, the relative performance spiked like it has not done in over a decade – Figure 1. A pullback after such a fantastic run would be significant in scale.
- This subindustry is typically a heterogeneous mixture of stocks, which shows up in our breadth work as a group that would look more like noise than signal. That was until this year, when the reading coalesced at the first decile position. That coalescence is starting to break down again – Figure 2.
- Lockheed Martin is the largest stock to have broken both its outperformance and steep dividend-adjusted price trend. It is just starting to enter a support zone now, but if it breaks below $120, there is an air pocket until $108 – Figure 3.
- Raytheon (Figure 4) and Northrop Grumman have similar patterns.

Figure 1: Global Aerospace vs. MSCI World

Figure 2: Aerospace & Defense Relative Strength Z-Score

Figure 3: Lockheed Martin Dividend-Adjusted Price Trend

Figure 4: Raytheon Co. Dividend-Adjusted Price Trend

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.

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

Figure 2: Chinese Interbank Lending Rates

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

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

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

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

- While it may seem to be a stretch to jump from looking at inflation expectations at the long end of the U.S. curve, to the stresses at the ultra short end of the Chinese credit curve, it is not.
  - The combination of low U.S. interest rates, and interest rate volatility encouraged flows into emerging markets with higher-yielding assets.
  - The FOMC, whose policy underpins the world’s largest and most liquid bond market becomes the central banker to the world via the carry trade.
    - $3.9 trillion had flowed into emerging markets over the past four years.
- It is a mistake to apply market western policy thinking to policy action of the new People's Republic of China government, and the PBOC.
  - Rather than releasing stimulus in response to weak economic figures, which was the point where the Chinese sovereign CDS broke to the upside (Figure 5), China has done the opposite, has withheld stimulus, and has allowed banking stress to build – Figure 2.
  - China is getting it’s 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](image1)

![Figure 6: Chinese Bank 5Yr CDS](image2)

![Figure 7: Chinese Real Estate CDS](image3)

![Figure 8: Chinese Sovereign CDS Levels and Curve](image4)
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.

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](image-url)
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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