## Monday, July 16, 2012

### Market Elements

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### Relative Strength Filter

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<td>Time to Start Bottom Fishing in Thermal Coal</td>
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<td>Broken Parts</td>
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<td>U.S. Industrials – Under the Big Top</td>
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<td>Through Asian Eyes</td>
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<td>Italy Could Trump Ben</td>
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<td>It's Complicated</td>
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<td>Buy Golds, Sell S&amp;P 500</td>
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### Focal Points

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<td>June 22, 2012</td>
<td>Focus Shifts (Back) to Asia</td>
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<td>May 16, 2012</td>
<td>Major Double Top for Global Real Estate</td>
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<td>SIFI Creditworthiness Breakdown</td>
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<td>The Storm, the Calm, and the Cheshire Cat</td>
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The MSCI World Index broke a seven-session losing streak. All 10 global sectors rose at least 1%; US banks, led by JPM, posted the largest gain in four months.

Yields on Spanish and Italian 10-yr government bonds rose. The German 2-yr bond minted a lower low for a third straight session.

The USD pulled back from a 2-yr high, with most major crosses gaining vs. the greenback. The euro rose for the first time in 4 sessions.

Base metals rebounded to lead commodities higher. Copper and gold recouped this week’s losses. Brent Oil closed at a 1.5 month high, rising above its 50dma.

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**Levels***

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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
Intra Day Charts
2-Day 1-Minute View

Currencies
- U.S. Dollar Index
- Euro
- Asia Dollar Index
- Latin America Dollar Index
- Canadian Dollar
- Australian Dollar

Commodities
- DJ-U.S. Commodity Price Index
- Gold (Spot)
- Crude Oil (WTI)
- Natural Gas (NMX)
- Copper (CMX)
- Nickel (LME 3Mo)

Bonds
- U.S. 10-Yr Bond
- Canadian 10-Yr Bond
- German 10-Yr Bund
- Spanish 10-Yr Bond

Equities
- MSCI World Index
- S&P 500
- S&P/TSX Composite
- CDX North American Inv. Grade Index
- VIX
- TRIN
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: Consumer Staples, Utilities.
- Canada – at a 52-week low: Information Technology.
- Europe – at a 52-week high: Health Care.

S&P 500

S&P/TSX Composite

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

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<th>% Chg</th>
<th>Name</th>
<th>Symbol</th>
<th>% Chg</th>
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<td>-0.3%</td>
<td>Sunoco Inc</td>
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<td>FMC</td>
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<td>Bemis Co Inc</td>
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<td>RR Donnelly &amp; Sons Co</td>
<td>RRD</td>
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<td>VK</td>
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<td>Nippon Yusen KK</td>
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<td>Deere &amp; Co</td>
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<td>Celgene Corp</td>
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<td>Cigna Corp</td>
<td>CI</td>
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<td>DGX</td>
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<td>Medtronic Inc</td>
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<td>National Bank of Greece SA</td>
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<td>Citigroup Inc</td>
<td>C</td>
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<td>Banca Monte dei Paschi di Sien</td>
<td></td>
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<td>ET TRADE Financial Corp</td>
<td>ETFC</td>
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<td>NGK Holdings Inc</td>
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<td>Kimco Realty Corp</td>
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<td>XL Group PLC</td>
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<td>Alastate Corp/The</td>
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<td>Samsung Electronics Co Ltd</td>
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<td>Red Hat Inc</td>
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<td>SAP AG</td>
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<td>Cognizant Technology Solutions</td>
<td>CSTH</td>
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<td>Infineon Technologies AG</td>
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<td>Computer Sciences Corp</td>
<td>CSC</td>
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<td>Hewlett-Packard Co</td>
<td>HPQ</td>
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<tr>
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<td>F5 Networks Inc</td>
<td>FFV</td>
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<td>Ricoh Co Lt</td>
<td>7752JT</td>
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<td>S</td>
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<td>Crown Castle International</td>
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<td>CenturyLink Inc</td>
<td>CTL</td>
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<td>NTT DOCOMO INC</td>
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<td>SEPV</td>
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<td>CMS Energy Corp</td>
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<tr>
<td>Kyushu Electric Power Co Inc</td>
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<td>PCG</td>
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</tr>
</tbody>
</table>

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

### Energy
- Symbol: HLC
- Last %Chg: 7.85
- 1-day High: 66.47
- 52-wk High: 99.30
- 52-wk Low: 56.10

### Industrials
- Symbol: ASH
- Last %Chg: 3.75
- 1-day High: 52.20
- 52-wk High: 97.60
- 52-wk Low: 41.50

### Consumer Discretionary
- Symbol: CVX
- Last %Chg: 2.20
- 1-day High: 34.80
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Consumer Staples
- Symbol: GM
- Last %Chg: 1.50
- 1-day High: 18.00
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Technology
- Symbol: WMT
- Last %Chg: 9.50
- 1-day High: 17.80
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Financials
- Symbol: C
- Last %Chg: 1.48
- 1-day High: 19.20
- 52-wk High: 97.00
- 52-wk Low: 40.50

---

### Energy
- Symbol: NE
- Last %Chg: 3.48
- 1-day High: 73.59
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Industrials
- Symbol: DOW
- Last %Chg: 3.20
- 1-day High: 18.00
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Consumer Discretionary
- Symbol: JCI
- Last %Chg: 2.70
- 1-day High: 19.20
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Consumer Staples
- Symbol: CVS
- Last %Chg: 2.00
- 1-day High: 34.80
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Technology
- Symbol: GOOG
- Last %Chg: 1.50
- 1-day High: 18.00
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Financials
- Symbol: WFC
- Last %Chg: 1.48
- 1-day High: 19.20
- 52-wk High: 97.00
- 52-wk Low: 40.50

---

### Energy
- Symbol: DSV
- Last %Chg: 3.48
- 1-day High: 73.59
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Industrials
- Symbol: MD
- Last %Chg: 3.20
- 1-day High: 18.00
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Consumer Discretionary
- Symbol: JCP
- Last %Chg: 2.70
- 1-day High: 19.20
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Consumer Staples
- Symbol: MCD
- Last %Chg: 2.00
- 1-day High: 34.80
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Technology
- Symbol: YHOO
- Last %Chg: 1.50
- 1-day High: 18.00
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Financials
- Symbol: CMA
- Last %Chg: 3.48
- 1-day High: 73.59
- 52-wk High: 97.00
- 52-wk Low: 40.50

---

### Energy
- Symbol: HRC
- Last %Chg: 3.20
- 1-day High: 18.00
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Industrials
- Symbol: EMR
- Last %Chg: 2.70
- 1-day High: 19.20
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Consumer Discretionary
- Symbol: UTX
- Last %Chg: 2.00
- 1-day High: 34.80
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Consumer Staples
- Symbol: CSK
- Last %Chg: 2.00
- 1-day High: 19.20
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Technology
- Symbol: GOOG
- Last %Chg: 1.50
- 1-day High: 18.00
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Financials
- Symbol: CMA
- Last %Chg: 3.48
- 1-day High: 73.59
- 52-wk High: 97.00
- 52-wk Low: 40.50

---

### Energy
- Symbol: DRI
- Last %Chg: 3.20
- 1-day High: 18.00
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Industrials
- Symbol: MLL
- Last %Chg: 2.70
- 1-day High: 19.20
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Consumer Discretionary
- Symbol: ITT
- Last %Chg: 2.00
- 1-day High: 34.80
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Consumer Staples
- Symbol: PCLN
- Last %Chg: 2.00
- 1-day High: 19.20
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Technology
- Symbol: ADP
- Last %Chg: 2.00
- 1-day High: 19.20
- 52-wk High: 97.00
- 52-wk Low: 40.50

### Financials
- Symbol: CMA
- Last %Chg: 3.48
- 1-day High: 73.59
- 52-wk High: 97.00
- 52-wk Low: 40.50
### Canadian Market Movers

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<thead>
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### Industry Movers

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<tr>
<td>Utilities</td>
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### Consumer Discretionary Movers

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<tr>
<td>LNR</td>
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<td>1.3%</td>
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<tr>
<td>MRE</td>
<td>1.00</td>
<td>14.59</td>
<td>1.3%</td>
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<tr>
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### Technology Movers

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### Financials

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</table>

### Market Elements

- **Energy**
  - Symbol H/L: 1.68
  - Last: 14.59
  - %Chg: 1.3%

- **Materials**
  - Symbol H/L: 1.68
  - Last: 14.59
  - %Chg: 1.3%

- **Industrials**
  - Symbol H/L: 1.68
  - Last: 14.59
  - %Chg: 1.3%

- **Consumer Discretionary**
  - Symbol H/L: 1.68
  - Last: 14.59
  - %Chg: 1.3%

- **Technology**
  - Symbol H/L: 1.68
  - Last: 14.59
  - %Chg: 1.3%

- **Financials**
  - Symbol H/L: 1.68
  - Last: 14.59
  - %Chg: 1.3%

---

**Note:** This data is a snapshot from July 13, 2012, and represents the market movements as of that date.
U.S. Short Rates Signalling Weakness

- Throughout the first half of this year, we could point toward the trend on the U.S. 2-year bond, and remark that the trend is higher, which represents that stability of the U.S. economy.
  - Short rates trending higher = bond holders expect the FED to increase rates as the economy stabilizes.
  - We can no longer make such a claim.
    - U.S. short rates have broken the uptrend – Figure 1.
- Demand for safe-haven assets (Figure 1) is very impressive, and disconcerting for those holding non-save-haven assets.
Eating & Drinking Close to Home

- **Eighteen of 29 Hotel & Resort stocks** are underperforming the market, so the breakdowns in two of the best stocks, Wyndham and Marriott, are signals to reduce / sell.
  - Wyndham has a very good track record, and assuming that the corporate profile has not changed, our call would be to move back to market weight while the industry corrects - Figure 1.
  - Marriott has a much more checkered history. If you are not selling now (on a lowered forecast), you are just waiting for a bounce to do so - Figure 2.

- **Ten of 15 Brewers** are outperforming the market, so the relative strength (only) positive reversal in the worst draw in the keg, Molson Coors, raises the question is there value here - Figure 3?

- The restaurant group is more diversified in relative performance, but the largest member, McDonald's has been a spectacular underperformer over the past 6 months. McDonald's has spent the bulk of the past four years outperforming. This is the inflection point to buy back in - Figure 4.
  - Wendy's has more of a Molson Coors (poor) pattern, but it too is trying to reverse the underperforming trend - see link.

- You can take these signals as evidence that the world is taking vacation days in the back yard. Enjoy the BBQ.

---

**Figure 1:** Wyndham Worldwide vs. S&P 500

**Figure 2:** Marriott International vs. S&P 500

**Figure 3:** Molson Coors Brewing vs. S&P 500

**Figure 4:** McDonald's vs. S&P 500

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Dealing With Down

- It took some time, and indeed it took the breakdown in the relative performance uptrend of Technology to do so, but our “best fit” trend for the S&P 500 now sports a negative (if just ever so slightly) slope – Figure 1.
  - The slope is expected to tilt more toward the negative.
  - This would be in the direction of the trends on most major global equity indices, which are already trending lower – see link.
- Global growth expectations, using the Asia Dollar index as a proxy, are trending lower, and the counter-trend rally is fading sharply this morning – Figure 2.
- Global growth expectations, using trends on safe-haven bonds, are trending lower, and the trends are solid – Figure 3.
  - This is how to deal with down – you buy the stuff where down (trend of yields) looks green on the screen.
- Eventually, and with enough pressure, the outperforming trends of U.S. stocks versus U.S. bonds will break. We have seen signs of this before, and there are some short-term moving averages on stock/bond ratios that are rolling over.
- If you look at an equity market like Canada, where the equity weights are tilted toward global growth, stocks are underperforming bonds at double-digit rates – Figure 4. North of the 49th, we have been dealing with down for some time.

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

Figure 2: Asia Dollar Index

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

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

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

Fingerprint of Capitalism / Semi Softness

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

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

Figure 1: The Fingerprint of Capitalism Working in Spain

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

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

Figure 4: U.S. Semiconductor Price Trend

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

Natural Gas Stocks Turning the Corner

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

Figure 1: NMX Natural Gas

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

<table>
<thead>
<tr>
<th>Name / Link to Charts</th>
<th>Symbol &amp; Links</th>
<th>1-day Chg (%)</th>
<th>5-day Chg (%)</th>
<th>MktCap US$m</th>
<th>Chg Last Day</th>
<th>Reward /Risk</th>
<th>Trend Slope</th>
<th>Hi (Mo)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farlboro Energy Ltd</td>
<td>EL, CN</td>
<td>-7.5%</td>
<td>-19.5%</td>
<td>172</td>
<td>↑</td>
<td>↑</td>
<td>↓</td>
<td>-145</td>
</tr>
<tr>
<td>Anadarko Petroleum Corp</td>
<td>APC, US</td>
<td>1.3%</td>
<td>6.2%</td>
<td>33,130</td>
<td>↑</td>
<td>↑</td>
<td>↓</td>
<td>-74%</td>
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<tr>
<td>Bill Barrett Corp</td>
<td>BBI, US</td>
<td>-2.2%</td>
<td>-1.6%</td>
<td>1014</td>
<td>↑</td>
<td>↑</td>
<td>↓</td>
<td>-151%</td>
</tr>
<tr>
<td>Anadarko Energy Corp</td>
<td>APC, CA</td>
<td>1.2%</td>
<td>13.3%</td>
<td>956</td>
<td>↑</td>
<td>↑</td>
<td>↑</td>
<td>-108%</td>
</tr>
<tr>
<td>Tulsa Energy Corp</td>
<td>EGE, CN</td>
<td>0.8%</td>
<td>3.9%</td>
<td>172</td>
<td>↑</td>
<td>↑</td>
<td>↑</td>
<td>-122%</td>
</tr>
<tr>
<td>Chesapeake Energy Corp</td>
<td>CHK, US</td>
<td>0.3%</td>
<td>7.4%</td>
<td>13,234</td>
<td>↑</td>
<td>↑</td>
<td>↑</td>
<td>-97%</td>
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<td>Corrada Resources</td>
<td>CRD, CN</td>
<td>-5.1%</td>
<td>20.6%</td>
<td>64</td>
<td>↑</td>
<td>↑</td>
<td>↑</td>
<td>-126%</td>
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<tr>
<td>EVCO Resources Inc</td>
<td>EVC, US</td>
<td>-2.2%</td>
<td>-3.7%</td>
<td>1,584</td>
<td>↑</td>
<td>↑</td>
<td>↑</td>
<td>-100%</td>
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<tr>
<td>NuVista Energy Ltd</td>
<td>NVA, CN</td>
<td>3.6%</td>
<td>27.9%</td>
<td>440</td>
<td>↑</td>
<td>↑</td>
<td>↑</td>
<td>-122%</td>
</tr>
<tr>
<td>Southwestern Energy Co</td>
<td>SWN, US</td>
<td>0.3%</td>
<td>0.2%</td>
<td>11,106</td>
<td>↑</td>
<td>↑</td>
<td>↑</td>
<td>-96%</td>
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<tr>
<td>Open Field Energy Corp</td>
<td>OFE, CN</td>
<td>0.8%</td>
<td>34.3%</td>
<td>100</td>
<td>↑</td>
<td>↑</td>
<td>↑</td>
<td>-66%</td>
</tr>
</tbody>
</table>

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Technology Momentum Sells

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

Most U.S. technology industries are in underperforming trends against the S&P 500, and the propensity is to fall below their channels – Figure 3.

We highlight a list of technology momentum sells with the weakest earnings estimate revisions in Figure 4.

Figure 1: Relaxed Position In 1.5 Years

Figure 2: Citrix Systems vs. S&P 500

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

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

<table>
<thead>
<tr>
<th>Company</th>
<th>Decile Rank</th>
<th>Symbol</th>
<th>Pricing</th>
<th>Price Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Network</td>
<td>10th</td>
<td>0.10</td>
<td>3.78</td>
<td>-5%</td>
</tr>
<tr>
<td>Apple Inc.</td>
<td>10th</td>
<td>0.10</td>
<td>3.78</td>
<td>-5%</td>
</tr>
<tr>
<td>Microsoft</td>
<td>10th</td>
<td>0.10</td>
<td>3.78</td>
<td>-5%</td>
</tr>
<tr>
<td>Tesla</td>
<td>10th</td>
<td>0.10</td>
<td>3.78</td>
<td>-5%</td>
</tr>
</tbody>
</table>

Source: BMO Capital Markets, Bloomberg, Thomson, Markit

This report was prepared in part by an analyst(s) employed by BMO Nesbitt Burns Inc., and who is (are) not registered as a research analyst(s) under FINRA rules. For disclosure statements, including the Analyst's Certification, please refer to pages 2 to 3.
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Relative Strength Filter

The Calm Is About to Break

- This morning the cost to protect Italian bonds from default breaks back into the ½ Mille High Club (514 bps as we hit send), and German 2-year yields fall back into negative yield territory for the second time.
- Italian – European AAA spreads are reversing the downtrend from the Berlusconi era high as Spanish – European AAA spreads near the June peak – Figure 1.
- It is a good time to:
  - Short Santander stock, which leapfrogged over fellow SIFIs UniCredit and Morgan Stanley to sport the CDS curve, which is closest to inversion – Figure 2.
  - Buy protection on Morgan Stanley, as it approaches the limit of its counter-trend contraction – Figure 3.
  - Buy volatility, as the VIX starts to base – Figure 4.

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

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

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

- Today:
  - Spanish and Italian 10-year bond yields continue to pivot off of a string of higher lows – Figure 1.
- Also today:
  - China pairs up with the BOE (again) 'surprising' with a second rate cut while the BOE gives us more QE.
  - The ECB cuts rates too.

- China, the BOE and the ECB are doing their best to ease the pressure on the run on Europe (Figure 1), which has led to:
  - The euro falling at a rate of 11%/year – Figure 2.
  - Safe haven yields falling at rates of 20–50%/year – Figure 3.
- It is the 'why' (Figure 1) that leads to the central bank measures.
- When the trends of the 'why' change, then we would consider stimulus measures to be something more than a lift to sell into.
  - The trends have not changed.
    - The MSCI ACWI xUSA Index hits resistance and the downtrend soon – Figure 4.

Figure 1: Spanish and Italian Bond Yields

Figure 2: Euro Falling at a Rate of 11%/Year

Figure 3: Trends on Global Safe-Haven Yields

Figure 4: MSCI ACWI xUSA

Source: BMO Capital Markets, Bloomberg, Thomson, Markit

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Energy – "What Was Bad" Trading Rally

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

**Figure 1: Asia Dollar Index**
- Trend / Width: -3% / 4%
- Trend Length: 15 mo
- Nearing Resistance

**Figure 2: U.S. 10-Year Treasury Yield**
- Trend / Width: -19% / 41%
- Trend Length: 11 mo
- Yield Firmly Grounded

**Figure 3: Brent Oil**
- Trend / Width: -5% / 26%
- Trend Length: 10 mo
- Distribution Top Target $80

**Figure 4: MSCI Oil, Gas & Consumable Fuels vs. ACWI**
- Trend / Width: -9% / 4%
- Trend Length: 6 mo
- What Was Bad is Now Good Rally (To Be Sold Into)

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

- **Technology** is slipping from a neutral to a negative reading in our group selection report – Figure 1.
  - Importantly, this reading is not market capitalization (AAPL) weighted.
- 12 of 16 sub-industries measure up in negative deciles.

12 of 16 sub-industries measure up in negative deciles.

12 of 16 sub-industries measure up in negative deciles.

- **Computer Hardware** in particular has slipped to an 8th decile reading – Figure 2.
  - The group now has more underperformers than outperformers, and one-third of the outperforming stocks have broken their uptrends – Figure 3.

### Figure 1: Information Technology Relative Strength Z-Score
- Slipping from Neutral Towards Negative
- Group RS: 1.09
- 5-Day MA: 1.10
- 20-Day MA: 1.23

### Figure 2: Computer Hardware Relative Strength Z-Score
- Group RS: 1.20
- 5-Day MA: 1.23
- 20-Day MA: 1.26

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

<table>
<thead>
<tr>
<th>Company</th>
<th>Decile</th>
<th>Pricing</th>
<th>Relative Strength vs S&amp;P 500</th>
<th>Technical Attributes</th>
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<td></td>
<td></td>
<td></td>
<td>Chg Last Day</td>
<td>%Chg wrt 50 Day MA</td>
</tr>
<tr>
<td>1. Xerox Corp</td>
<td>1</td>
<td>75.68</td>
<td>-5.3% 13.0% 46.5%</td>
<td>10% Below Falling</td>
</tr>
<tr>
<td>2. Apple Inc</td>
<td>3</td>
<td>454.043</td>
<td>-7.1% 4.5% 17%</td>
<td>1% Below Falling</td>
</tr>
<tr>
<td>3. NCR Corp</td>
<td>6</td>
<td>3.624</td>
<td>1.5% 4% 16%</td>
<td>6% Below Falling</td>
</tr>
<tr>
<td>4. Dell Inc</td>
<td>8</td>
<td>21.862</td>
<td>0% 4% 16%</td>
<td>10% Below Falling</td>
</tr>
<tr>
<td>5. Intel Corp</td>
<td>12</td>
<td>6.572</td>
<td>-1.4% 4% 16%</td>
<td>6% Below Falling</td>
</tr>
<tr>
<td>6. Microsoft Corp</td>
<td>14</td>
<td>26.26</td>
<td>-1.5% 18% 60%</td>
<td>11% Below Falling</td>
</tr>
<tr>
<td>7. Advanced Micros</td>
<td>16</td>
<td>2.794</td>
<td>-3% 16% 7%</td>
<td>3% Below Falling</td>
</tr>
<tr>
<td>8. Yocto Technology</td>
<td>18</td>
<td>2.8546</td>
<td>-0.5% 16% 8%</td>
<td>1% Below Falling</td>
</tr>
<tr>
<td>9. RIM Corp</td>
<td>20</td>
<td>3.624</td>
<td>-7.1% 4% 16%</td>
<td>8% Below Falling</td>
</tr>
</tbody>
</table>

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

Time to Start Bottom Fishing in Thermal Coal

- **Central Appalachian coal**, which had been trending lower at a rate of 43%/year for the past year, reversed this trend on Friday - Figure 1.
  - This move follows **Natural gas**, which has been basing/bottoming since April.
- Shares are just starting to react, but it is very early days.
  - **Arch Coal**, which had been underperforming in spectacular fashion, has reversed this downtrend - Figure 2.
  - **Cloud Peak** has more defined basing pattern. The downtrend was also reversed, and a first set of higher highs and lows has developed - Figure 3.
- The largest thermal coal stocks show more nuanced signs of strength.
  - **Consol Energy** hit a 1-month relative strength high, which is a pre-cursor to reversing its underperforming trend - Figure 4.
  - **Peabody Energy** gapped higher on Friday. It rose from below the bottom end of its underperforming pattern (-90%/year).

**Figure 1: Positive Reversal for Central Appalachian Coal**

**Figure 2: Arch Coal vs. S&P 500**

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

**Figure 4: Consol Energy vs. S&P 500**

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

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

Figure 1: Swiss 5-Year Bond Yield

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

Figure 3: Technology vs. S&P 500

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

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Market Sells the Trending Winners

- The market continues to move toward a more bearish leaning. Importantly, it is not there yet, and we are not ready to buy yet.
- The U.S. Consumer Discretionary index broke below an outperforming trend yesterday.
  - This U.S. Sector had been the most consistently outperforming of the 10.
  - Mind the turn, where the market starts to sell the long-term winners.
  - Along those lines, U.S. Technology just edged below its outperforming trend as well.
- Consumer Discretionary is a basket of apples and oranges, so you have to dig into the details of where the pressure came from.
- At the stock level, the S&P 500 consumer discretionary stocks that have been punished below the bottom end of trend channels, which fell yesterday, are highlighted in Figure 2.
- Both Starbucks (Figure 3) and Chipotle Mexican Grill have been fantastic outperformers. They both broke these outperforming trends yesterday. Yum! Brands broke a steep outperforming trend a few weeks back; it is falling below a less well-defined uptrend now.
- Auto retail (AZO, ORLY, KMX), another big winner, was coloured the brightest red yesterday, making it a trio of woe as retail joins Autos and Auto Parts.
- Macy’s continues to break below its outperforming trend, while its CDS breaks above a narrowing trend (Figure 4). JCP continues to slide, as its CDS nears 800 bps. Nordstrom is trending lower.

---

**Figure 1: U.S. Consumer Discretionary Index vs. S&P 500**

**Figure 2: S&P 500 Consumer Disc Below Channels & Fell Yesterday**

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

**Figure 4: Macy’s 5-Year CDS**
Broken Parts

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

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

Figure 2: Global Auto Parts Relative Strength Decile

Figure 3: BorgWarner vs. S&P 500 Index

Figure 4: Auto Parts Momentum Sell List

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
In a market, where most commodities are very red, grains are a refreshing colour of green.

- As a basket, grains, which had been moving sideways/higher, shot materially higher yesterday - Figure 1.
- The creditworthiness of a basket of Fertilizer CDS, which had been trending tighter (bullish), just broke to a lower low (bullish) - Figure 2.
- U.S. Fertilizers & Ag. Chemicals broke above an underperforming trend against the S&P 1500 yesterday.
- Canadian Fertilizers are breaking above a neutral trend against the S&P/TSX Composite.
  - Against the materials group, grains have formed a multi-year basing pattern and are trending higher.

At a global level, there is a blend of outperformers and underperformers, but the underperformers are reversing downtrends - Figure 3.

- In the group:
  - There is just one momentum buy (outperforming market and sector, above rising moving averages and not overbought) - American Vanguard (AVD).
  - There are 10 stocks outperforming the market and the sector, including Syngenta, Terra Nitrogen, and Agrium.
  - Both Potash and Mosaic reversed underperforming trends yesterday.

Relative strength trend on all fertilizer and agricultural chemical stocks is found at this link.

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

Figure 2: Fertilizer Group 5-Year CDS Basket

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

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
U.S. Industrials – Under the Big Top

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

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

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

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

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

Through Asian Eyes

- In today’s Focal Points: Focus Shifts (Back) to Asia, we highlight,
  - “China caught the Spanish flu in March, broke away thanks to a surprise rate cut on June 7, and has started to deteriorate again as of this Wednesday”
  - It has been Asian currency and credit, which have been giving the world the strongest signals over the past two days.

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

Figure 1: Asian Sovereign CDS and Counterparty Risk

Figure 2: Energy vs. MSCI ACWI

Figure 3: Materials vs. MSCI ACWI

Figure 4: Industrials vs. MSCI ACWI

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

- We have the luxury of looking at intraday charts as they develop with the news flow. The importance here is that we have a good understanding at what moves, and does not move, markets. From these movements, we eventually see correlations build up and break down.
- The breakdown in the fit between European senior financial default risk and counterparty risk (Figure 1) is responsible for the pivot in the S&P 500 – Figure 2. This is a large positive to be stressed.
- The positive (inverted) fit between the copper cost to protect Australia, China and now Italy (Figure 3) from default is the reason we expect to see a short-covering rally, albeit in a bear market, for mining shares (Figure 4).
  - The tape was not compliant to this thesis yesterday (Figure 3 top right).
  - We suppose the fundamental reason driving the CDS matters here.
    - If Italian CDS is narrowing because of fundamental change, we expect copper would be reacting better.
    - If, however, the risk reduction is due to yet another can kicking exercise (sans Bundesbank support), then we expect that all we would get out of this is a counter trend rebound. The U.S. equity market would continue to act as a safe-haven asset against other equity markets.

Source: BMO Capital Markets, Bloomberg, Thomson, Markit

Figure 1: European Sr Fin Default Risk and Counterparty Risk

Figure 2: S&P 500 Index

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

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

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

Figure 1: Italian 5-Year CDS

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

Figure 3: Liquid Diversified Miners (BMO Outperform / Market Perform / Market Perform Speculative)

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Diversified Mining - Expect a Pulse

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

It’s Complicated

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

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

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

Airline Bottoming Patterns

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

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

Figure 1: Southwest Airlines vs. S&P 500

Figure 2: Southwest Airlines Price Trend

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

Figure 4: Air Canada Price Trend

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

Buy Golds, Sell S&P 500

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

**Figure 1**: Gold Miners vs S&P 500 ETF (Mind The Inflection Pt)  **Figure 2**: **Gold vs Oil** (Sell Oil or Energy Shares to Fund)

**Figure 3**: **Goro Resource vs. ACWI** (one of a few outperformers)  **Figure 4**: **Kinross vs. Gold Miners** (Don’t Dumpster Dive)

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

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

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

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Major Double Top for Global Real Estate

- Those that do not like banks (and we do not like banks) hide out in insurance.
  - Insurance just broke the uptrend from the 2011 low, like most major equity markets, including the S&P 500.

- Those that do not like insurance hide out in real estate, which has given the most consistent positive performance.

- Real estate just broke the uptrend from the 2011 low – Figure 1.

- Now there are breakdowns, and there are breakdowns.
  - The context behind this one is that money (and you know who you are) has flowed into Real Estate as a yield-oriented safe haven.
  - This has pushed global real estate back to the 2011 high, which forms a major double top. Major support is 16% below current levels, which is when the double top would seem more obvious. Double top downside risk is 33% below the current level.

- The wider context is that a bank run on Greece is a “great fear,” and the ECB is apparently cutting and running.
  - In this environment, risk assets will cut and run.
  - The breakdown shows that this attitude has just started for Global Real Estate.

Figure 1: MSCI ACWI Real Estate

...Raising Concern of a Double Top...

... Which Most Would Ask Only After Major Support (16% Below The Current Level) is Breached...

... Which is Far Too Late When One Gets Paid for AUM as the Downside Double Top Target is 160, or 33% Below Current Levels

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

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

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

Figure 1: Credit Default Swap Trends for Eight Global SIFIs – Trends of Credit Improvement (↓) are Being Reversed (↑)
Source: BMO Capital Markets, Bloomberg, Thomson, Markit
Liquified Gold; Kinross

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

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

Figure 1: Gold Bullion

Figure 2: Gold and European Banks; Correlation of Returns

Figure 3: Gold Relative Strength Decile

Figure 4: Kinross vs. NYSE Arca Gold Miners Index

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

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

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

- Until these trends of counterparty uncertainty (Figures 2) and equity underperformance (Figures 3, 4) break, asset allocators should continue to hold a defensive hand. For how long? Until the bond vigilantes are satisfied. We watch, and wait.

Figure 1: Italian and Chinese 5-Year Sovereign CDS

Figure 2: U.S. 2-Year Swap Spread (Gauge of Counterparty Risk)

Figure 3: S&P/TSX Composite vs. Scotia CDN Bond Index Fund

Figure 4: S&P/ASX 200 vs. S&P/ASX Government Bond Index

Source: BMO Capital Markets, Bloomberg, Markit

This report was prepared in part by an analyst(s) employed by BMO Nesbitt Burns Inc., and who is (are) not registered as a research analyst(s) under FINRA rules. For disclosure statements, including the Analyst's Certification, please refer to pages 2 to 3.
The Storm, the Calm, and the Cheshire Cat

- A solid equity market needs a solid banking system. In Europe one would presume, this needs a solid market for sovereign, and especially, Italian debt. This presumption is not the way the market is currently priced. Italian too-interconnected-to-fail UniCredit Group’s 5-year CDS is priced close to 100bps more creditworthy than Italian government CDS – Figure 1.
  - The stability of bank creditworthiness is the key support, and reason we are seeing defensives break below outperforming trends, and more “risk-on” stocks break above underperforming trends.
  - Whether this spread is driven off of a need to hedge Italian sovereign risk, potential for bank capital injections, or government guaranteed bank bond offerings (or other market elements), the key for risk markets is that bank risk moves are not as dire as sovereign risk moves.
- Italian – European AAA 10yr debt spreads have widened materially in the past few weeks. They have come within 20bps of the level at which LCH.Clearnet may raise margin requirements. The rolling 30d correlation of moves between Italian 10yr debt and an AAA basket is currently about -30%, way off of the worst “sell Italy, buy AAA” mentality seen in July - Figure 2.
- The creditworthiness of global systematically important financial institutions (SIFI) has been relatively stable (page 2).
  - The ECB signaled an abandonment of attempts to keep a lid on Italian debt the day that outgoing ECB President Trichet left office. The incoming ECB President Draghi takes a very different approach, asking “What makes you think that to become the lender of last resort for governments is actually the thing that you need to keep the euro area together?”. He left his first ECB press conference smiling like a Cheshire Cat. Mind the change in stance!
- The message of Draghi is shaping up to be, we will not cap your rates, so you had better do what you need to do to make your bonds palatable. This is capitalism. This is what markets need. When a carrot does not work, use a stick.
  - There were thousands of sticks demonstrating in Rome against Berlusconi this weekend.
  - Markets reacted positively to talk of Berlusconi leaving his post, as he is seen as either unwilling or unable to bring forward tough austerity measures.
- With recent political turmoil, the demand for EFSF bonds has soured. The AAA German to still AAA French 10-year bond spread has tracked this concern (page 4). Still, EFSF bonds were priced and sold today. Capitalism marches on.
  - The ECB SMPS program doubled its purchases of debt in Draghi’s 1st week, it clearly was done in a manner that allowed yields to rise, and thus inflict political pressure on Berlusconi.
  - This political pressure will likely be translated into more financial corporate failures. This clearing of the decks, while turbulent, is exactly what capitalism is based upon.
- Investors should watch the politics through the lens of bank default risk. This is how to best interpret the inflection points we are seeing in our Relative Strength trends.

Figure 1: UniCredit - Italian Government 5-year CDS Spread

Figure 2: Italian Debt Margin Call Watch

Source: BMO Capital Markets, Bloomberg, Thomson, Markit
The Calm amongst Banks

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

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

<table>
<thead>
<tr>
<th>Name</th>
<th>Ticker</th>
<th>Country</th>
<th>Mkt Cap ($bn)</th>
<th>1Yr/5yr (%)</th>
<th>1y CDS</th>
<th>5Yr CDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Morgan Stanley</td>
<td>MS US</td>
<td>U.S.</td>
<td>32</td>
<td>112%</td>
<td>439</td>
<td>393</td>
</tr>
<tr>
<td>Bank of America Corp</td>
<td>BAC US</td>
<td>U.S.</td>
<td>66</td>
<td>111%</td>
<td>401</td>
<td>361</td>
</tr>
<tr>
<td>Goldman Sachs Group Inc</td>
<td>GS US</td>
<td>U.S.</td>
<td>53</td>
<td>107%</td>
<td>338</td>
<td>317</td>
</tr>
<tr>
<td>UniCredit SpA</td>
<td>UCG IM</td>
<td>Italy</td>
<td>21</td>
<td>95%</td>
<td>379</td>
<td>398</td>
</tr>
<tr>
<td>Societe Generale</td>
<td>GLE FP</td>
<td>France</td>
<td>19</td>
<td>88%</td>
<td>280</td>
<td>317</td>
</tr>
<tr>
<td>Banco Santander SA</td>
<td>STD US</td>
<td>Spain</td>
<td>69</td>
<td>84%</td>
<td>253</td>
<td>302</td>
</tr>
<tr>
<td>Lloyds TSB Group PLC</td>
<td>LYG U.K.</td>
<td>U.K.</td>
<td>31</td>
<td>80%</td>
<td>238</td>
<td>298</td>
</tr>
<tr>
<td>Credit Agricole SA</td>
<td>ACA FP</td>
<td>France</td>
<td>18</td>
<td>80%</td>
<td>209</td>
<td>263</td>
</tr>
<tr>
<td>RBS Group Plc</td>
<td>RBS U.K.</td>
<td>U.K.</td>
<td>22</td>
<td>79%</td>
<td>255</td>
<td>321</td>
</tr>
<tr>
<td>Citigroup Inc</td>
<td>CUS U.S.</td>
<td>U.S.</td>
<td>89</td>
<td>79%</td>
<td>191</td>
<td>242</td>
</tr>
<tr>
<td>Commerzbank AG</td>
<td>CKB GERM.</td>
<td>Germany</td>
<td>12</td>
<td>78%</td>
<td>188</td>
<td>241</td>
</tr>
<tr>
<td>BNP Paribas</td>
<td>BNP FRANCE</td>
<td>France</td>
<td>51</td>
<td>75%</td>
<td>176</td>
<td>234</td>
</tr>
<tr>
<td>ING Groep NV</td>
<td>ING NL</td>
<td>Netherlands</td>
<td>32</td>
<td>71%</td>
<td>136</td>
<td>191</td>
</tr>
<tr>
<td>UBS AG</td>
<td>UBS CH</td>
<td>Switzerland</td>
<td>48</td>
<td>71%</td>
<td>131</td>
<td>185</td>
</tr>
<tr>
<td>Barclays PLC</td>
<td>BCS UK</td>
<td>U.K.</td>
<td>36</td>
<td>71%</td>
<td>145</td>
<td>205</td>
</tr>
<tr>
<td>Nordea Bank AB</td>
<td>NDA SWE</td>
<td>Sweden</td>
<td>36</td>
<td>70%</td>
<td>112</td>
<td>159</td>
</tr>
<tr>
<td>HSBC Holdings PLC</td>
<td>HBC UK</td>
<td>U.K.</td>
<td>155</td>
<td>69%</td>
<td>96</td>
<td>138</td>
</tr>
<tr>
<td>Wells Fargo &amp; Co</td>
<td>WFC US</td>
<td>U.S.</td>
<td>134</td>
<td>69%</td>
<td>105</td>
<td>152</td>
</tr>
<tr>
<td>Deutsche Bank AG</td>
<td>DB DE</td>
<td>Germany</td>
<td>36</td>
<td>67%</td>
<td>133</td>
<td>199</td>
</tr>
<tr>
<td>Credit Suisse Group</td>
<td>CS CH</td>
<td>Switzerland</td>
<td>32</td>
<td>67%</td>
<td>107</td>
<td>160</td>
</tr>
<tr>
<td>Bank of China Ltd</td>
<td>3988 HK</td>
<td>China</td>
<td>30</td>
<td>64%</td>
<td>166</td>
<td>261</td>
</tr>
<tr>
<td>JPMorgan Chase &amp; Co</td>
<td>JPM US</td>
<td>U.S.</td>
<td>132</td>
<td>63%</td>
<td>93</td>
<td>147</td>
</tr>
<tr>
<td>Mizuho Financial</td>
<td>8316 JP</td>
<td>Japan</td>
<td>39</td>
<td>54%</td>
<td>86</td>
<td>159</td>
</tr>
<tr>
<td>Sumitomo Mitsui</td>
<td>MTU JAP</td>
<td>Japan</td>
<td>60</td>
<td>51%</td>
<td>71</td>
<td>140</td>
</tr>
<tr>
<td>Mitsubishi UFJ</td>
<td>STT US</td>
<td>U.S.</td>
<td>20</td>
<td>23%</td>
<td>35</td>
<td>153</td>
</tr>
</tbody>
</table>

Figure 4: Morgan Stanley Equity and CDS Curve

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

- The Greek Referendum on/off saga of last week took a toll on the “disorderly default” pricing (disorderly being over the short-term, i.e. 1-year CDS, as opposed to long-term, i.e. 5-year CDS) of Greece – Figures 7, 8.
- Italian and Spanish curves did not react negatively to this panic – Figure 8, 10.
- The sovereign curves of Ireland and Portugal have not been impacted by last’s week’s new Greek stress – Figure 9.

**Figure 7: European CDS Curves**

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

**Figure 8: Greek and Italian Sovereign CDS Curves**

**Figure 9: Irish and Portuguese Sovereign CDS Curves**

**Figure 10: Greek and Spanish Sovereign CDS Curves**
Appetite for EFSF and French Bonds; Stability in French and French Bank CDS

- European bailouts by the European Financial Stability Facility (EFSF) are supported by bonds. This allows a window to observe the appetite that investors have for the bailout fund – Figures 11, 12.
  - When the first EFSF bond was sold in January the demand was “sky-high”.
  - Last week’s EFSF bond auction, to raise €3bn for Ireland, had to be postponed due to lack of demand.
    - This is understandable, given the massive political turmoil.
  - Today, the EFSF bond went ahead despite weakening demand.
    - This forward push, despite being priced under hostile market terms, is important.

- The EFSF – EU bond spread can be viewed as an indication of the markets’ level of concern about the EFSF’s ability to handle the European debt crisis. Moves in this spread have set the tone for which AAA rated German and French bonds (where keeping the AAA rating is a concern) are priced – Figure 12.
  - This is the storm.
- Using CDS pricing, the cost to protect France against default moves sideways, as does the cost to protect French banks – Figure 13.
  - This is the calm.

Figure 11: EFSF and Equivalent EU Bonds

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

Figure 13: French Government and BNP Paribas 5-Year CDS
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<th>Rating Category</th>
<th>BMOCM US Universe*</th>
<th>BMOCM US IB Clients**</th>
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<th>BMOCM Universe****</th>
<th>BMOCM IB Clients*****</th>
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