The Barmac *Journal*

The art of Finance Bartles & McCarthy

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EQUITY MARKET SUMMARY

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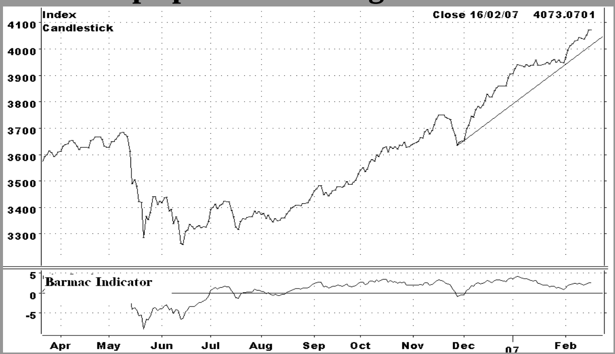
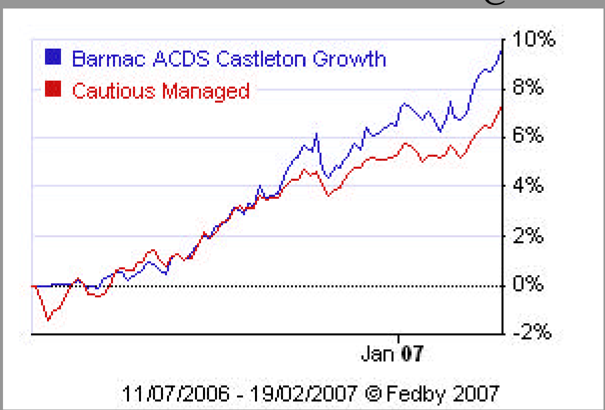
GLOBAL EQUITIES SURGE TO NEW HIGHS WHILST VOLATILITY PLUNGES - SO WHAT HAPPENS NEXT?

BARMAC MARKET DIRECTIONAL INDICATOR:-
BUY SIGNAL - issued on 28th August
Small-Cap up 17% since signal.



As can be seen from above the Barmac indicator remains in "buy" despite a temporary "wobble" in late November as the market continues its advance. Stops have been raised to 6200 on Ftse.

The Barmac Castleton OEIC has advanced steadily and has outperformed Ftse 100 since launch on 11/07/2006
CASTLETON GROWTH TRUST @109.62



The first six weeks of the year have followed the familiar pattern of the previous two with a strong advance through Jan and Feb. This so far follows our own expected roadmap of a strong rise into spring and then a long overdue summer correction, potentially in excess of 10%. As regular readers are aware we here at Barmac are extremely concerned by the complete lack of a meaningful correction in the advance witnessed since the end of 2002. Indeed the VIX index of implied market volatility is trading at multi-year record lows a sure fire indication of a confident and worry free market.

Well, why not? What's to worry about in a bull market that began in 2002, and in almost five years still hasn't had even a normal 10% correction, something that historically happens on average of every 1.4 years, whether in a bull or bear market. It happened even in the rip-roaring seemingly one-direction 1990s bull market. Historically the market has had a 15% decline on average of every 2.2 years, and a decline of more than 20% (a bear market) on average of every 3.8 years.

And here's this hummer making no waves at all in almost five years. Over the last year or two it hasn't even produced a ripple.

How unusual has the lack of volatility been? So unusual that investors and the media are astonished when the Dow occasionally closes up or down 100 points in a day. If it's to the upside it creates excitement. If it's to the downside it creates alarm. And why not. Over the last three years there have been only 24 days when the Dow closed up or down 150 points or more. That's an average of 8 times per year. Is that unusual? During the five years from 1998 through 2002, which included roughly 2.5 years of bull market, and 2.5 years of bear market, there were 245 such days. That's an average of one day out of every five trading days that investors had to contend with the Dow closing up or down more than 150 points.

And even that was nothing. During those same five years (from 1998 through 2002), there were 122 days when the Dow closed up or down more than 200 points, 56 days when it closed up or down more than 250 points, 30 days when it closed up or down more than 300 points, and 8 days when it closed up or down more than 400 points.

How many times in the last three years has the Dow closed up or down 200 points in a day? Just five. How many times in the last three years has it closed up or down more than 250 points? None. 300 points? None. 400 points? None.

It's even been quite some time since the market has had that kind of move in a week, let alone a day. The last time the Dow gained more than 200 points *in a week* was mid-November when it closed up 234 points for the week. Prior to that you have to go back to August 18 of last year, when the Dow gained 293 points in a week. And you have to go back to June 14 of last year for the last time the Dow declined more than 200 points in a week, when it declined 351 points.

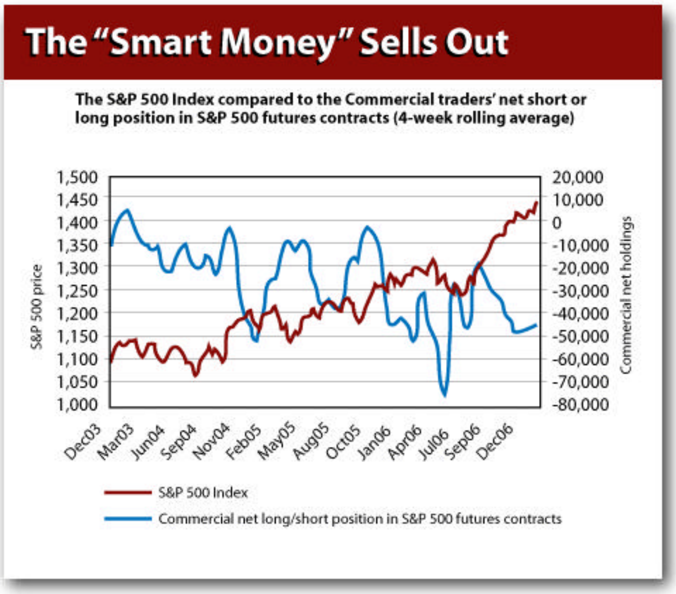
Perhaps the final statistic on volatility will seal the case! Since the June 06 lows the S&P 500 has not seen a correction in excess of 3% as it has quietly and harmoniously worked steadily higher. This steady ascent has been matched by major indices across Europe and represents the single longest ultra low volatility sequence since 1928!
Something has got to give as night always follows day.

WE PREDICT;

A volatility storm at some time in 2007
- so watch out and run tight stops until it has passed.

COT report also implies S&P weakness

The latest report from the CFTC's Commitment of Traders Report provides additional evidence that the stock market might soon retreat from its highs. The "smart money" Commercial traders have been increasing their net-short position in S&P 500 futures contracts for several weeks



The Commercials, often called the "smart money," have amassed their largest net-short position since just before the stock market sell-off of last May and June. Not surprisingly, the small speculators – a.ka., the "dumb money" - are taking the other side of this trade. This usually-wrong crowd has amassed its largest net-long position in several months.
The smart money isn't always smart, of course…and the dumb money isn't always dumb. But when the dumb-money begins to exhibit extreme confidence and complacency, the smart money usually begins to look quite smart indeed.

7th YEAR OF THE DECADE & THE "PRESIDENTIAL CYCLE"

by Bob Prechter

The Decennial Pattern, postulated by Edgar Lawrence Smith in 1939, has been remarkably useful in anticipating intra-decade trends. Amazingly his observations have held true in the ensuing decades since 1939.

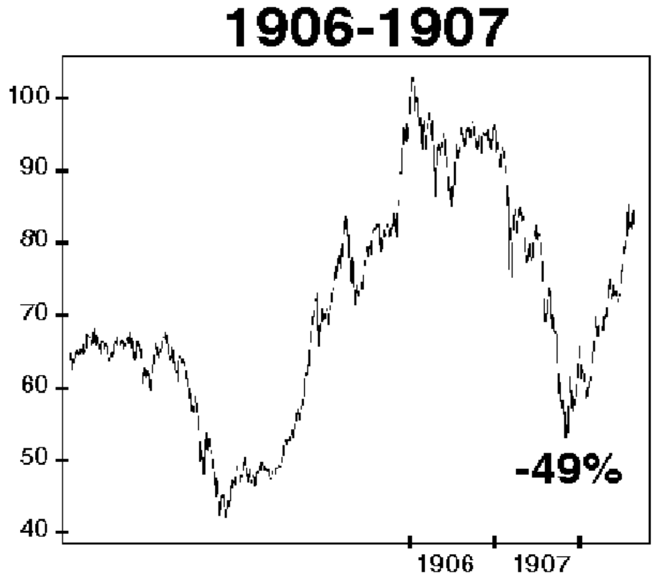
One of the interesting aspects of the theory is that there is a “significant” drop in the seventh year of the decade (this has occurred in 7 out of the past 10 decades). “Significant” in this case means that it is the largest decline of any duration for at least an 6-year span time span bracketing the decline. In two cases (1937/8 and 1987), the drop was the largest for 41 and 33 years, respectively.

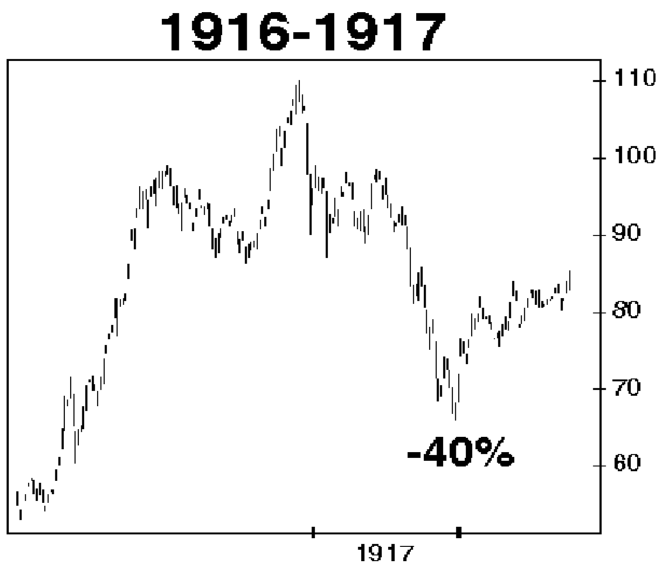
Interestingly, during the 19th Century a similar pattern emerges with 5 out of 10 decades witnessing a major fall in year 7 and one that didn’t (1897) was preceded by a major decline in the 6th year. In fact the two biggest declines in the entire century occurred in 1807 and 1857. The probability of the two biggest declines in a century should in the year 7 is only one percent. So the mysterious tendency appears real and long standing (200 years).

The following pages show graphs of the declines in the 6th or 7th years of the past ten decades, to provide a perspective of what has gone on before. Had a drop in the range of 15 to 25%+ like the setbacks of 1926, 1946 and 1966 occurred last year, the odds of a bullish or neutral 2007 would have risen. But the continued rally has played into the potential for a serious (20%+) decline, as exemplified by the action in 1907, 1917, 1937, 1957, 1977, 1987 and to a lesser extent 1997. Each of these years followed a 6th year with only a mild correction, and that is all we saw once again in 2006.

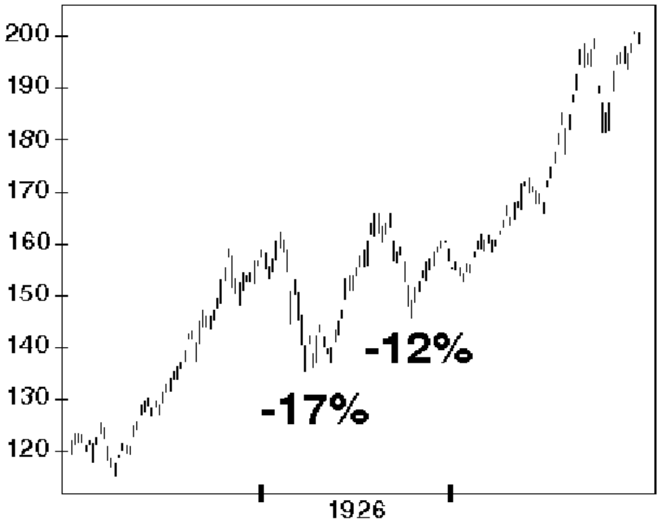
The “Presidential cycle” normally implies that the third year of a US president’s term tends to be an up year in stocks. What happens when that year is also the 7th year of a decade, as happened in 1907, 1927, 1947, 1967 and 1987?

The answer is that the Presidential cycle tends to win. In three out of those five years – 1927, 1947, and 1967 –the market rose. However, if the Presidential Cycle is working, the market is usually weak in the second year of a term, which is the 6th year of the decade. All three of the bullish 7th years followed sharp market declines in the preceding 6th year. The two exceptions to the Presidential Cycle tendency – 1907 and 1987 – were whoppers: The first contained the famous “panic of ‘07” and the latter saw the biggest crash since 1929. These events share a trait: Both of them followed 6th years with only mild corrections. Likewise 2006 was a year with only a mild correction. So with RESPECT TO THE Presidential Cycle, 2007 is setting up like 1907 and 1987, two glaring exceptions to the overall tendency within the past 100 years.

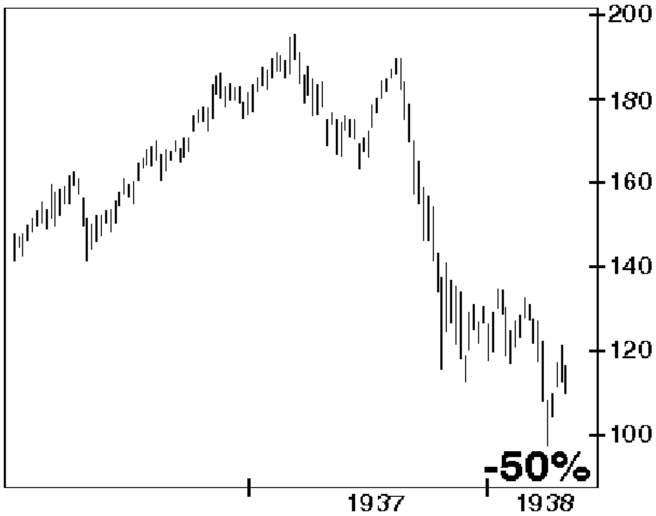




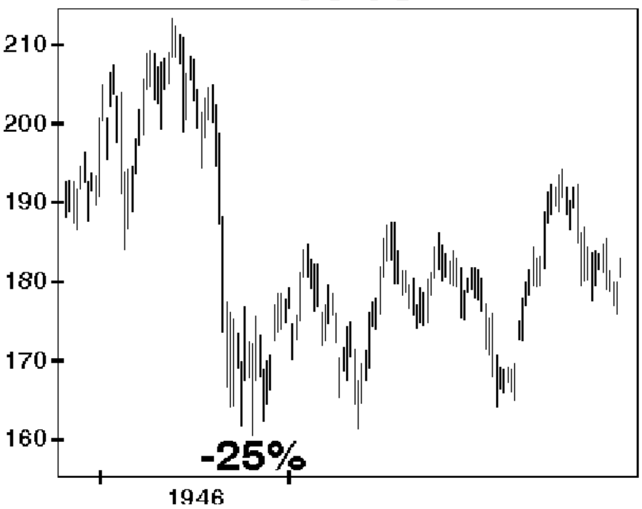
1926



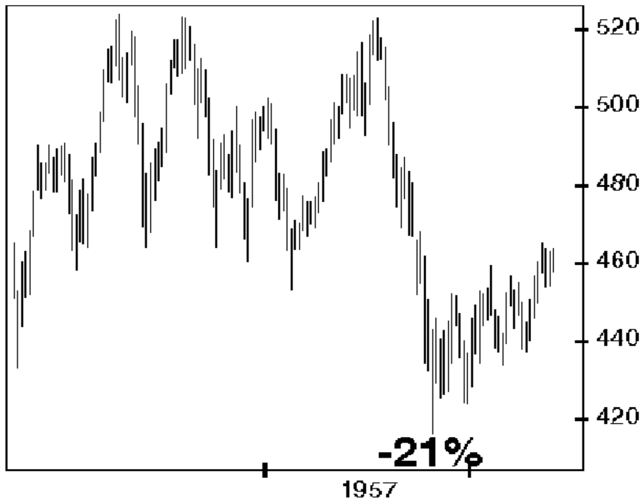
1937-8



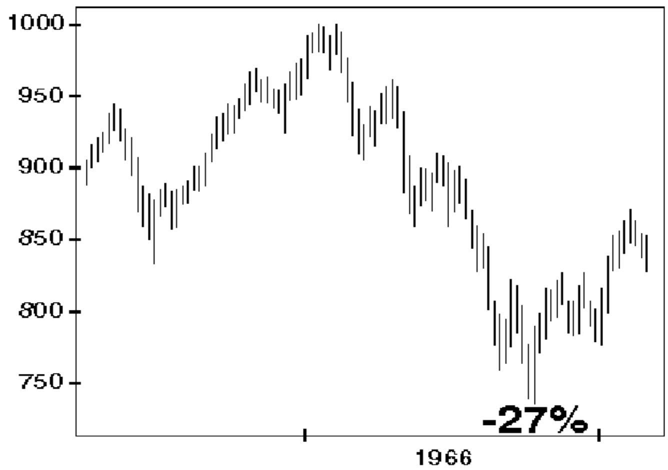
1946



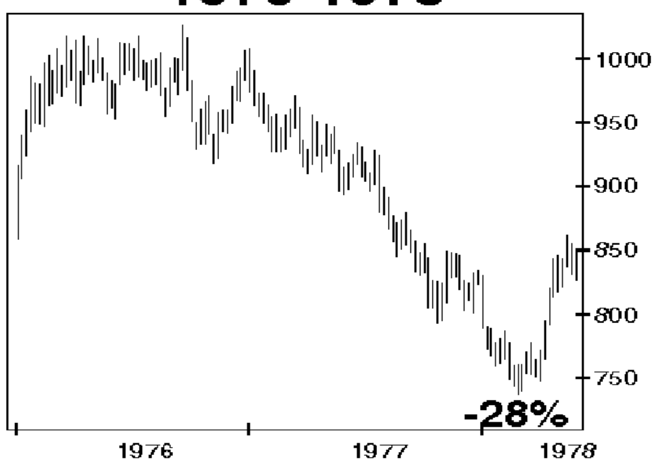
1957

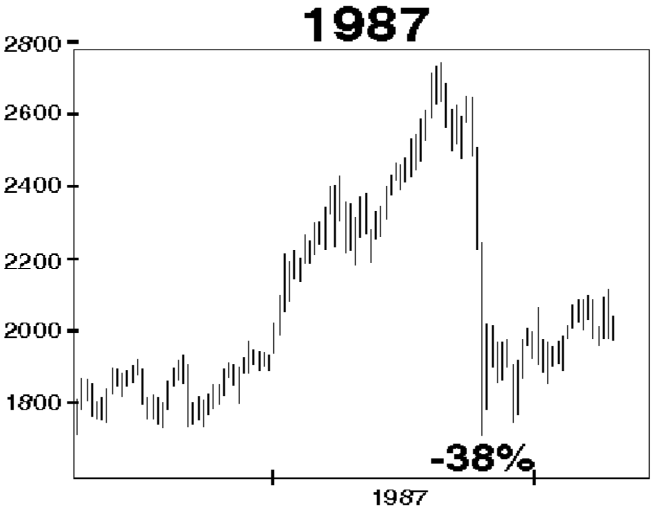


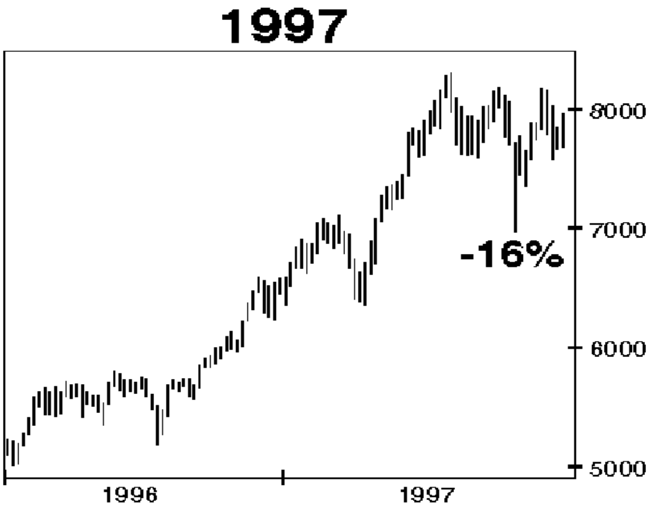
1966



1976-1978







History has a nasty habit of repeating itself so all investors should enjoy the current rally but be prepared for the volatility storm that is building in ferocity.

EQUITY MARKET REVIEW

We will undertake to review (below) the key support levels to watch as equities continue to advance on a market-by-market basis. All investors obviously wish to remain on board a rising trend but the risks of a 15 to 25 per cent decline are building as each day passes without incident

The Ftse 100 chart (below) highlights the fairly steady advance since June with a supporting trend currently lying at 6250. A breach of this level would indicate a serious loss of upside momentum and a possible failed upside break of the 6330 upper line of the previous trading range. A decline below 6200 would confirm the break and possibly open the way to more serious declines.

Ftse100 daily

Ftse mid 250

The Mid 250 (above) sports a similar strong advance from the summer lows with major supporting trend currently resting at 11330 just 2% below the recent high.

The warning bells would begin to ring on breach of the rising trend and much more serious declines would look likely on any decline below recent trading support at around 11050.

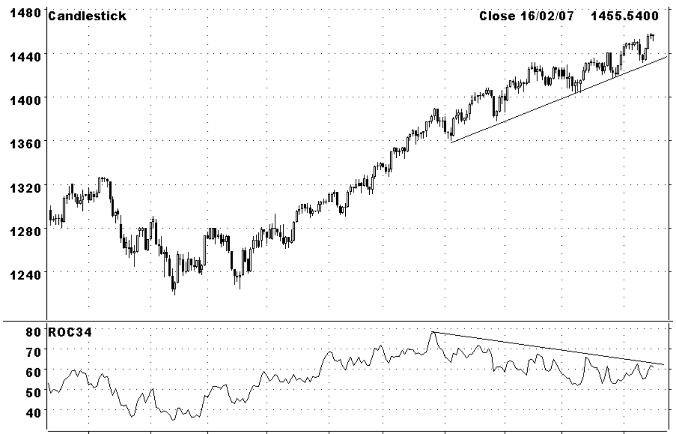
The US markets have witnessed an unprecedented spell of extremely low volatility as highlighted by the chart for **the Dow (below**).

The advance since November has occurred against a backdrop of waning momentum (see lower panel) and this non-confirmation implies a reversal of some degree is becoming increasingly likely. The key area to watch is 12500 where the current supporting trend currently sits. A test of the 12,000 levels looks a real possibility if the supporting trend is broken.

Dow Jones

The S&P 500 looks almost identical to the Dow and the world's largest market cap index also has non-confirmed momentum since late October. A decline below 1430 (our reco stop) would break trend line support and open the possibility of falls toward 1360.

S&P 500



JAPAN

One market that does look very positive is Japan thanks to a potential halt in the decline of its currency is Japan.

The two charts below show the recent stellar performance of the Nikkei over the past few months as well as the Sterling converted return on the Ishare Japan ETF.

As can be clearly seen until a few days ago UK investors in Japan would have been frustrated by a double digit Yen decline since the summer consequently eroding any meaningful returns. Happily the Yen appears to be steadying of late and this has led to a dramatic break-out by the Sterling quoted Ishare Japan ETF. Whilst this share holds above £7.35 then Tokyo should remain a positive investment for sterling investors.

Nikkei

IShare MSCI Japan

REGARDS

And good hunting

AndyMc and AndyB