



Occasional Paper No. 3

How the Bear is running its course

March 2008

Summary

This paper updates the Occasional Paper No. 2 and investigates recent movements in major share markets.

It sets out data which represents the underlying trends in eight share markets (USA, New Zealand, Japan, Europe, Australia, China, Hong Kong and India)

Using quantitative analysis and applying a set of transformational algorithms it develops a data series for each market called the “**S&L TREND REVERSAL**” line which identifies the date at which each market moves from a Bull phase to a Bear market.

The **S&L TREND REVERSAL** indicates that NZ, Australia, USA, Europe, Japan, and the Chinese share markets have moved, or are moving, into a Bear market. India remains in a Bull market at this point (13 March 2008).

S&L suggests investment managers consider utilising an indicator such as the S&L TREND REVERSAL as an important tool in managing client investment funds.

Cheny Chen

Investment Analyst
cheny@savingsandloans.co.nz
09 820 1857

Maurizio Piglia

Director Research and
Investments
maurizio@savingsandloans.co.nz
09 820 1854

Contents

1. Introduction	2
2. Data	2
3. S&L Trend Reversal	2
3.1 U.S.A.....	2
3.2 New Zealand NZX 50 Capital Index	3
3.3 Japan NIKKEI 225	4
3.4 Europe STOXX 600	4
3.5 Australia ASX 200.....	5
3.6 China SHANGHAI	6
3.7 Hong Kong HENG SENG.....	6
3.8 India BSE 100.....	7
4. Conclusion	8

List of Figures

Figure 1 United States	3
Figure 2 New Zealand	3
Figure 3 Japan.....	4
Figure 4 Europe.....	5
Figure 5 Australia.....	5
Figure 6 China	6
Figure 7 Hong Kong.....	7
Figure 8 India.....	7



1. Introduction

The recent market mayhem in financial markets is characteristic of every financial market turning point. These typically come along every 4-6 years.

The spill over effects into "Main Street" including the material impacts on household budgets of interest rate hikes, declines in home prices and increased prices for fuel and other staples are of concern to observe.

However, after having adjusted client asset allocations to be insulated from the bear market conditions, the key task for funds managers now is to take a disciplined approach to closely monitoring the development of this bear phase. Eventually this monitoring will identify a change in the market trends.

The objective of this No. 3 Occasional Paper is to indicate the manner in which this regular monitoring can proceed on a quantitative basis. It relies on close analysis of movements in the prices within markets.

Our endeavour is to detect the Primary Trend, whatever this Primary Trend is and more importantly turning points at the earliest stage –without reacting to false signals.

It is a (relatively) simple model, but is intelligent enough to guide fund managers through what can be an emotional time and it enables an approach which cuts through the market noise in periods of extreme market volatility to distil the underlying market trend.

2. Data

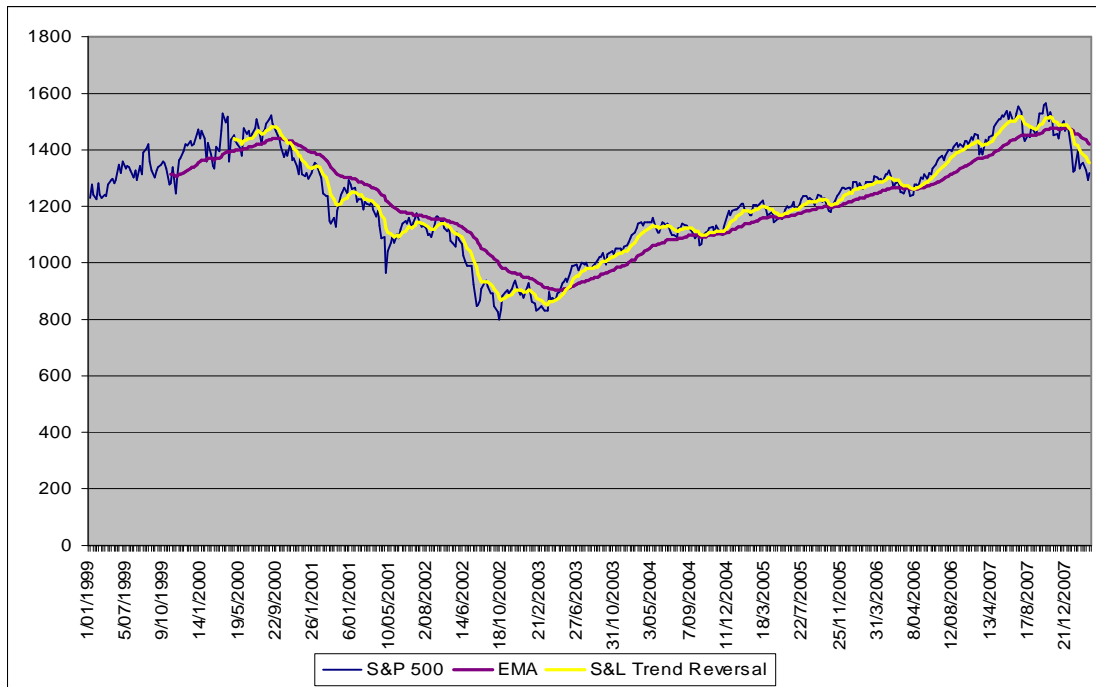
S&L has studied some major indices including emerging markets to provide a clearer view of the global share markets. These countries include USA, New Zealand, Japan, Europe, Australia, China, Hong Kong and India. The analysis considered S&P 500, Nikkei 225, DJ Stoxx 600, ASX 200, Shanghai, Heng Seng and India BSE 100 from 1 January 1999 to 13 March 2008 with data derived from Datastream.

3. S&L Trend Reversal

The following graphs compare the indices interpolated with particular algorithms of "**S&L TREND REVERSAL**" in yellow and the Moving Average (MA) in purple.

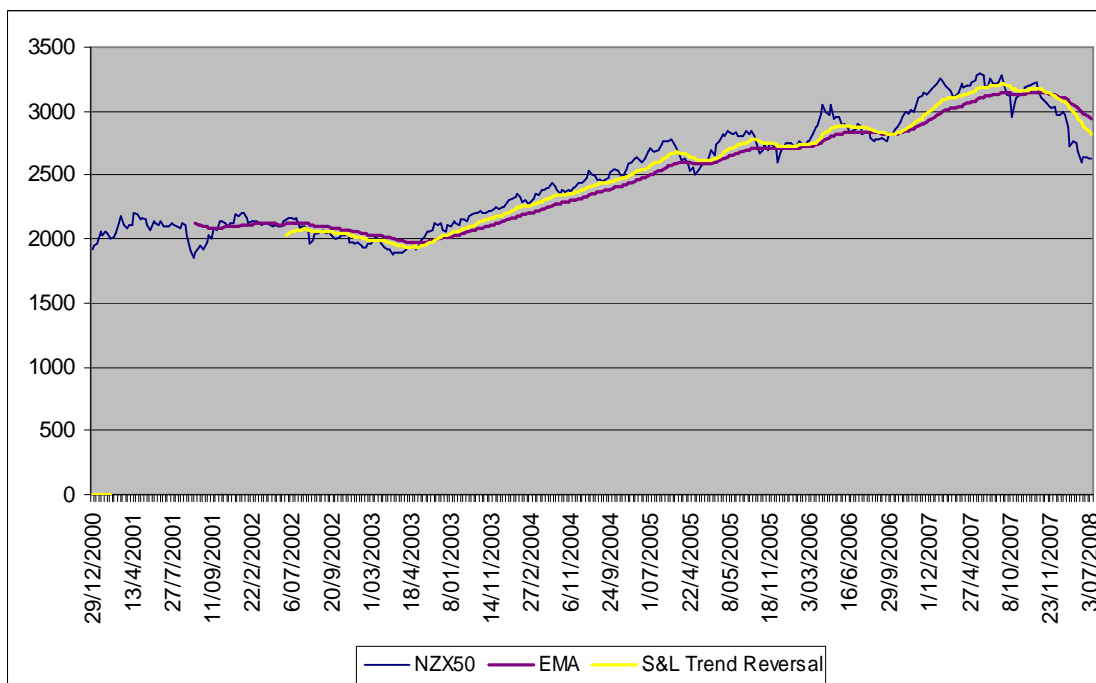
3.1 U.S.A

The market is well into a bear phase with no indication at this point of a turning. Based upon past market behaviour it seems that the USA is at the beginning of that bear phase.

Figure 1 United States


3.2 New Zealand NZX 50 Capital Index

In the case of the NZX 50. In Figure 2, the **S&L TREND REVERSAL** indicates New Zealand remains in the Bear phase which commenced in late November 2007 with no inclination at this point of any change.

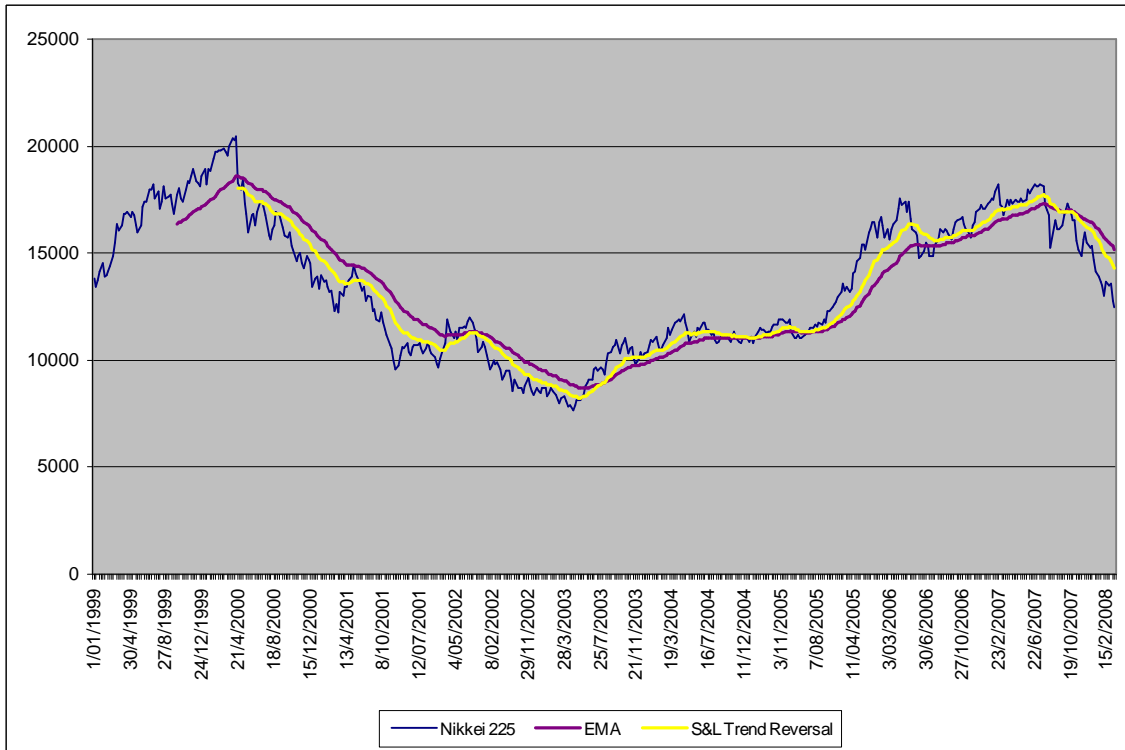
Figure 2 New Zealand




3.3 Japan NIKKEI 225

In Figure 3, the Nikkei 225 was the first major market to signal a reversal in market trend with the **S&L TREND REVERSAL**. Similar to USA and NZ markets, it currently has no signal of moving into a Bull phase; and seems headed towards erasing whatever gains made since 2003.

Figure 3 Japan

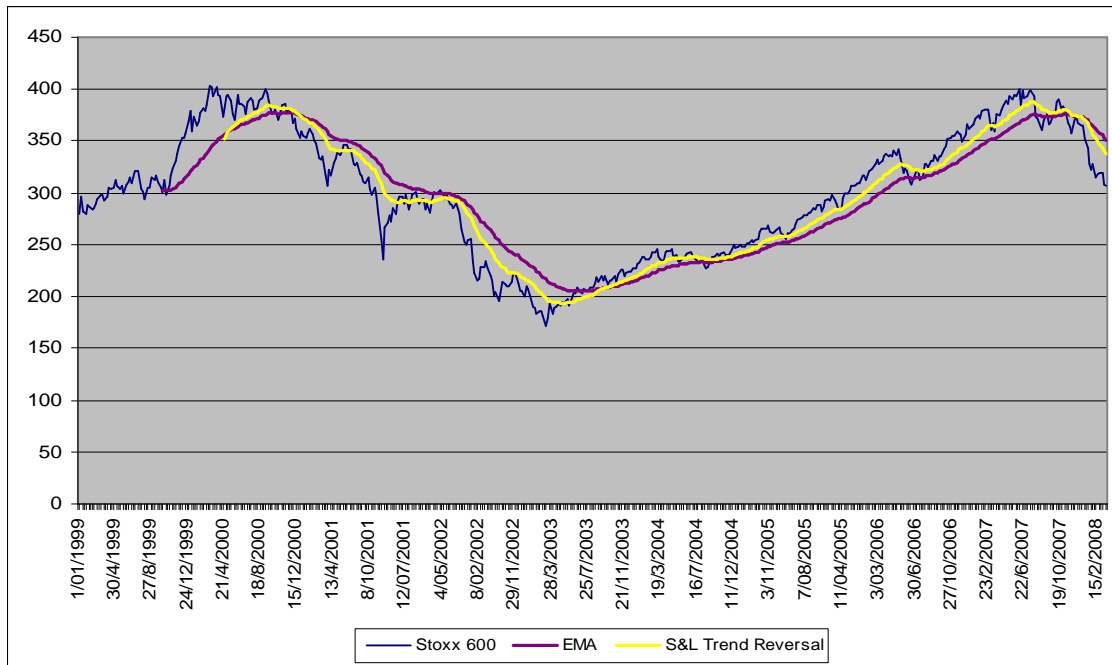


3.4 Europe STOXX 600

In Figure 4, the **S&L TREND REVERSAL** indicates that Europe remains in the Bear market situation which commenced in mid December 2007.



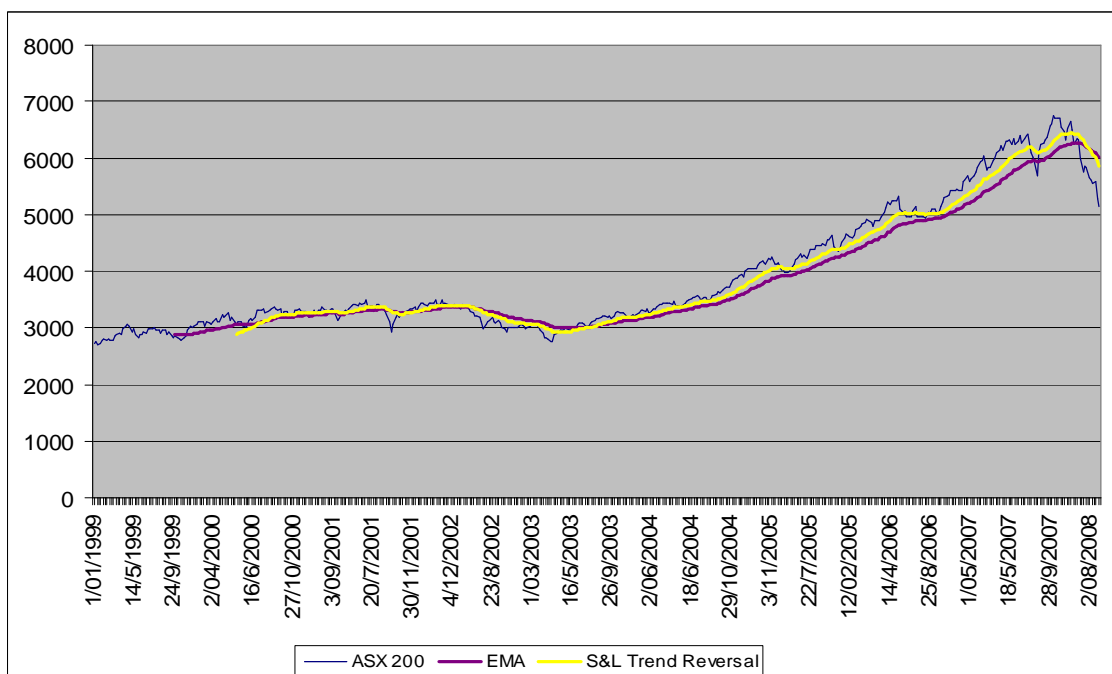
Figure 4 Europe



3.5 Australia ASX 200

The Australian market is much more closely linked to the fortunes of Asia than the New Zealand market. In Figure 5, the **S&L TREND REVERSAL** illustrates that Australia has entered a Bear market phase that began in mid February 2008 and accelerated thereafter.

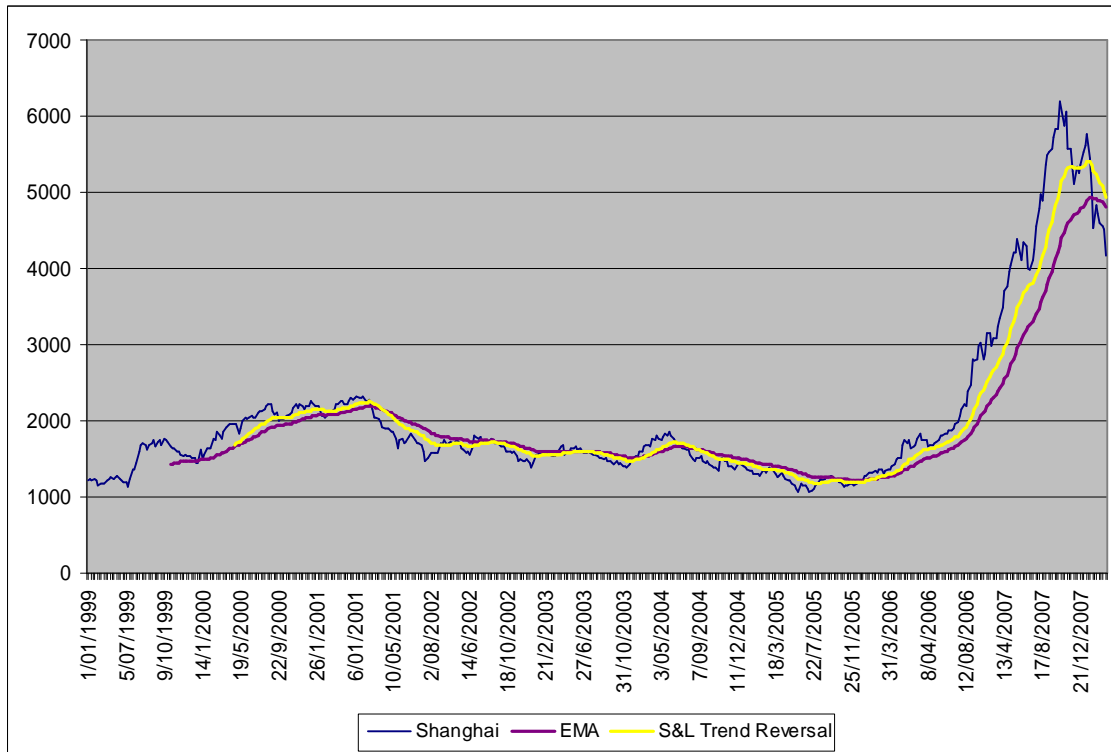
Figure 5 Australia



3.6 China SHANGHAI

In Figure 6, the **S&L TREND REVERSAL** indicates that Shanghai index is currently approaching the Moving Average, but having come from a parabolic, or “bubble” phase. All that phase has to be retraced before the indicator reacquires a normal sensitivity

Figure 6 China

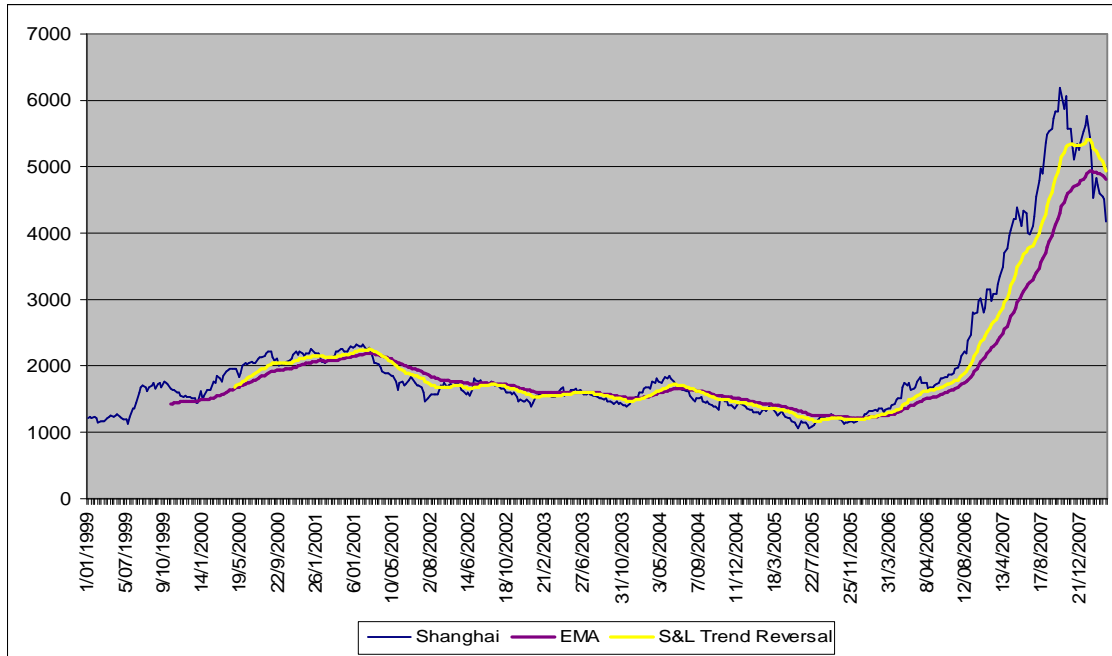


3.7 Hong Kong HENG SENG

In Figure 7, the **S&L TREND REVERSAL** presents a similar picture as Shanghai, an index that is moving into a Bear trend since early March 2008. Being closely correlated to the above Shanghai Index the same considerations apply.



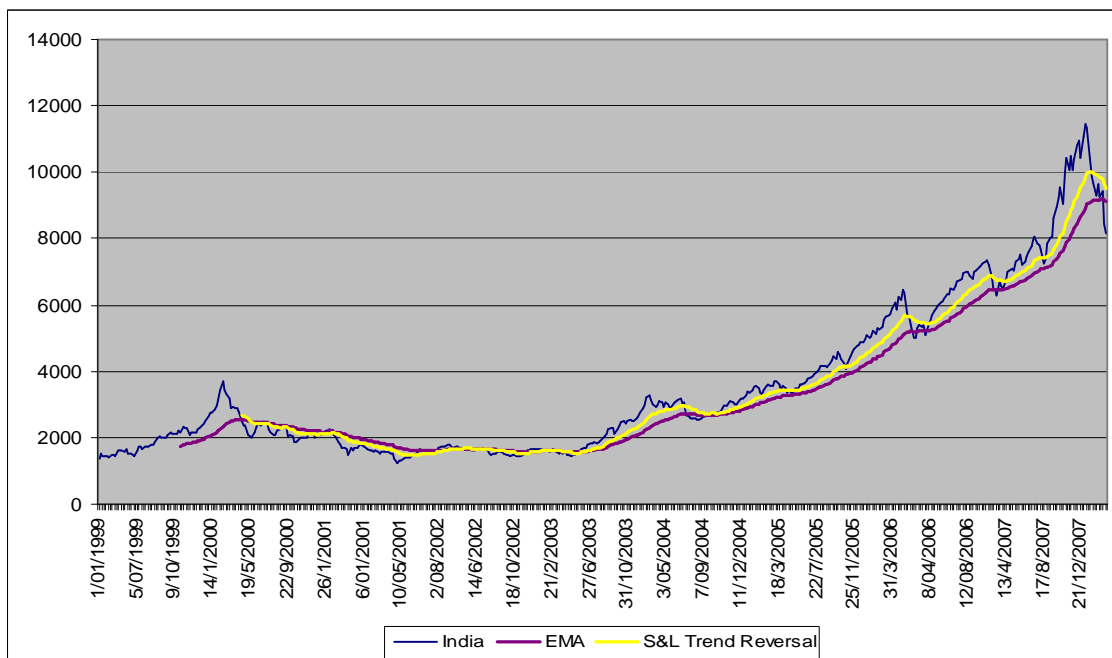
Figure 7 Hong Kong



3.8 India BSE 100

In Figure 6, the **S&L TREND REVERSAL** indicates that the India index is still within a Bull market phase. However, the margin between the **S&L TREND REVERSAL** and the MA is decreasing. More of the same, a bubble needs to be almost always reabsorbed before the indicator returns to normal behaviour and more typical sensitivity.

Figure 8 India





4. Conclusion

Based on the application of the **S&L TREND REVERSAL** and its comparison with the respective underlying movements in each market with data analysed up to **13 March 2008** at this time our conclusions include the following:

- The USA, European, Japanese, New Zealand, Australia, Chinese equities markets are entering or extending and consolidating a Bear phase
- The India stock market remains in a Bull market.

Whilst the **S&L TREND REVERSAL** is a lagging indicator, the underlying algorithms used by S&L are designed to minimise the extent of this lag whilst at the same time ensuring no false signals trigger an inappropriate asset re-allocation.

A strong suggestion is to consider the historical correlation of all the markets, once two of the major pan-continental indexes signal a trend reversal, a total rethink of the portfolio Strategic Asset Allocation is highly advisable. Action along these lines could have preserved a great deal of the value accumulated in the Australasian markets over the previous few years.

When the market trend turns bullish again, the opportunities will be there, however investment managers need to preserve capital for this to be effectively exploited. S&L relies on the S&L TREND REVERSAL indicator to identify this trend change, without too much delay, to allow asset allocations to be re-oriented to a Bull market phase not too far from the market bottom. The unfolding of this current crisis, which is exhibiting international price movements above and beyond the 2000-2003 Bear market phase, is cause for reflection on the use of Asset Allocation methodologies and their linkage to changes in market trends.

The reality of Financial Markets is that they surprise us much more than any hypothesis or forecast would suggest, and operational experience and limited institutional memory do not always assist in evaluating the best way to respond.

Systemic crises happen every 4-6 years, this means that sometimes it is difficult for investment committees to attach the significance to them they need to in order to optimise the financial performance of the monies under their supervision. Where such turning point events have not been planned for the trust and confidence of investing clients can be quickly lost.

The S&L TREND REVERSAL indicator is one mechanism to assist in investment managers meeting this challenging task and preserving client confidence.

You can email mail@savingsandloans.co.nz to subscribe to future newsletters and research papers.

The above information does not constitute the provision of investment advice. Any views expressed reflect the current views of the author, which do not necessarily correspond to the opinions of Savings & Loans Superannuation and Investments Limited or its affiliates. Opinions expressed may change without notice. Opinions expressed may differ from views set out in other documents, including research, published by Savings & Loans Superannuation and Investments Limited. The above information is provided for informational purposes only and without any obligation, whether contractual or otherwise. No warranty or representation is made as to the correctness, completeness and accuracy of the information given or the assessments made.