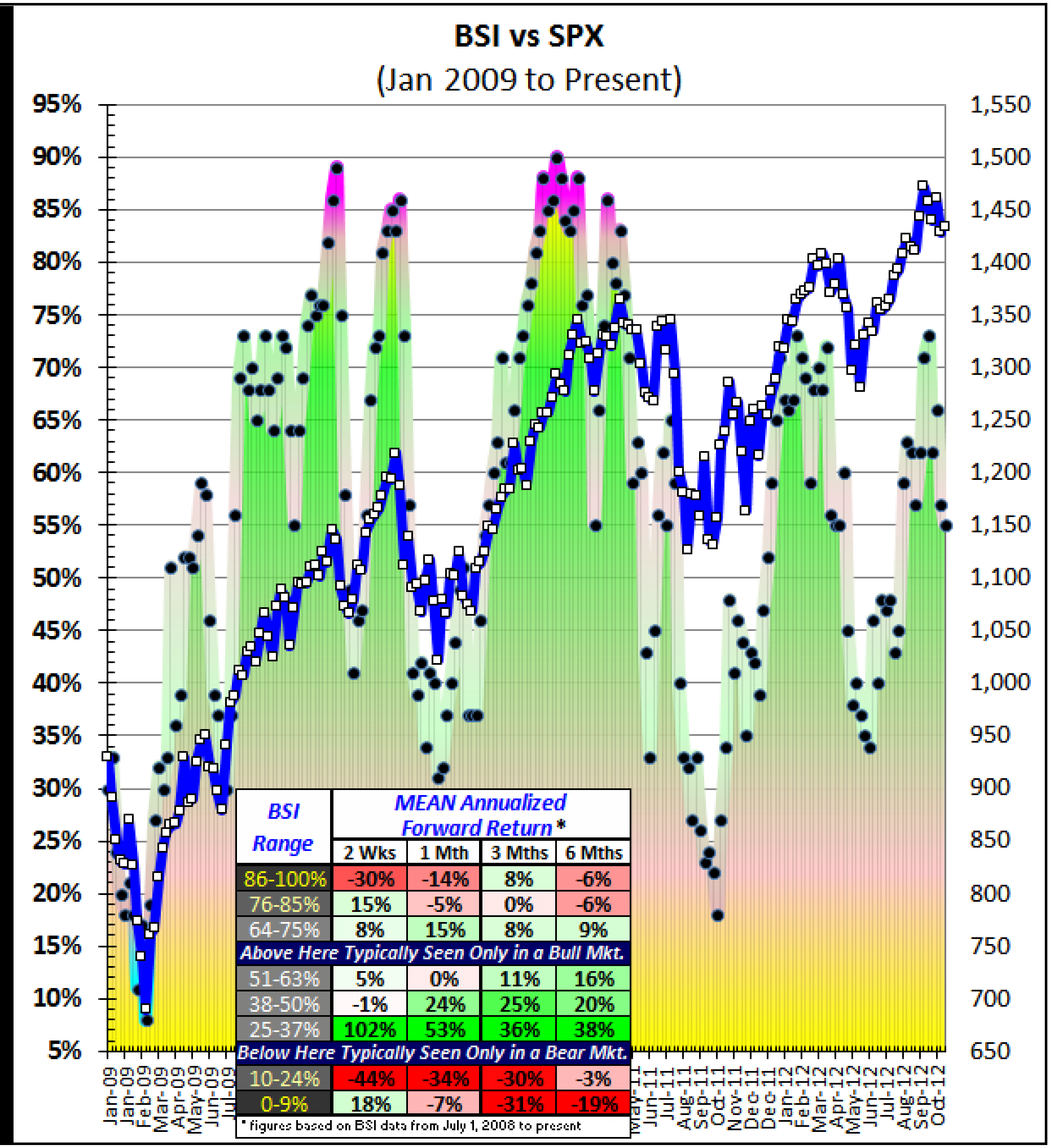
Bullish Sentiment Index (BSI) for US Equities

Rough BSI Interpretation Guidelines			
Cyclical Bull Market		Cyclical Bear Market	
Extreme	86-100%	0-9%	Minimal
Extended	76-85%	10-24%	Shallow
Neutral	51-75%	25-37%	Neutral
Shallow	38-50%	38-50%	Extended
Minimal	25-37%	51-63%	Extreme

The Bullish Sentiment Index (BSI) for US Equities is designed to provide a single, numerical, and comprehensive measurement of bullish sentiment on the US stock market at any given time. It is normalized, oscillates in a range of 0-100% (where 0% indicates there is no bullish sentiment and 100% indicates bullish sentiment is at its zenith), and is constructed through the application of custom weighting and smoothing mechanisms to various third-party sentiment gauges.

Date	Approx. SPX (SPY*10)	%Ch.	SPX Stretch from Mean (-50 to 50)	BSI	Ch.	BSI Stretch from Mean (-50 to 50)
6/29/2012	1,361	2%	12	40%	-6	-38
7/6/2012	1,355	0%	19	48%	8	-30
7/13/2012	1,358	0%	14	47%	-1	-18
7/20/2012	1,365	1%	8	48%	1	-16
7/27/2012	1,387	2%	10	43%	-5	-24
8/3/2012	1,394	0%	7	45%	2	-19
8/10/2012	1,408	1%	24	59%	14	14
8/17/2012	1,422	1%	29	63%	4	30
8/24/2012	1,415	0%	30	62%	-1	33
8/31/2012	1,412	0%	21	57%	-5	32
9/7/2012	1,443	2%	28	62%	5	35
9/14/2012	1,472	2%	38	71%	9	37
9/21/2012	1,459	-1%	37	73%	2	41
9/28/2012	1,440	-1%	18	62%	-11	31
10/5/2012	1,461	2%	7	66%	4	20
10/12/2012	1,429	-2%	-20	57%	-9	17
10/19/2012	1,434	0%	-29	55%	-2	12



"If you want to have better performance than the crowd, you must do things differently from the crowd."
John Marks Templeton (d. 2008)

BSI Summary

The BSI fell 2 notches this past week to close at 55%. Meanwhile the SPX was roughly flat.

The **SPX** currently sits approximately **3% below its 52-week closing high** and approximately **4% above its 200-day moving average**.

The current level of the BSI should be interpreted within the context of the current cyclical trend of the US equities market.

Within the context of a cyclical bull market, the current level of the BSI suggests:

- **bullish sentiment is at a Neutral level**; or
- **there is presently an average amount of underinvested market participants** available to fuel a multi-week to multi-month rally in US equities.

Understanding the BSI

The BSI may be best used as a blunt and continuous (as opposed to discrete) indication as to the general mood of global market participants toward the US equities market. With regard to the BSI's associated indicators ("SPX Stretch from Mean" and "BSI Stretch from Mean"), if their associated cells are colored blue (purple) this weekend, then they are indicating an unusually oversold (overbought) US equities market and an unusually rapid drop (rapid rise) in bullish sentiment, respectively. Overall, the BSI and its associated indicators are designed with the aim of helping market participants to gauge when to tactically increase or hedge/decrease exposure to US equities so as to help manage risk effectively and thereby maximize risk-adjusted returns. However, the BSI and its associated indicators represent merely one suite of tools that a market participant can use to analyze the US equities market with, and should not be interpreted except in combination with the interpretation of one or more other suites of tools that the market participant feels confident in comprehensively analyzing the US equities market with.

Knowledge of the cyclical trend of US equities is an important element of interpreting the BSI and its associated indicators accurately. For instance, in a cyclical bull (bear) market, it may not be unusual for the BSI and its associated indicators to remain elevated (depressed) for extended periods without US equities declining (rising) in any significant way. At the end of each calendar month, it will be evaluated for the purpose of the BSI Report (based on reader feedback or anticipated reader feedback) whether it is fitting to comment on the BSI just within the context of a cyclical bull market, just within the context of a cyclical bear market, or within both the context of a cyclical bull market and the context of a cyclical bear market.

> *"Success in investing doesn't correlate with I.Q. once you're above the level of 25. Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble in investing."*
> ***Warren Edward Buffett***

Just the Humble Opinion of the BSI Report Editor

[The BSI Report Editor will only chime in occasionally each month, if at all, partly due to time constraints].

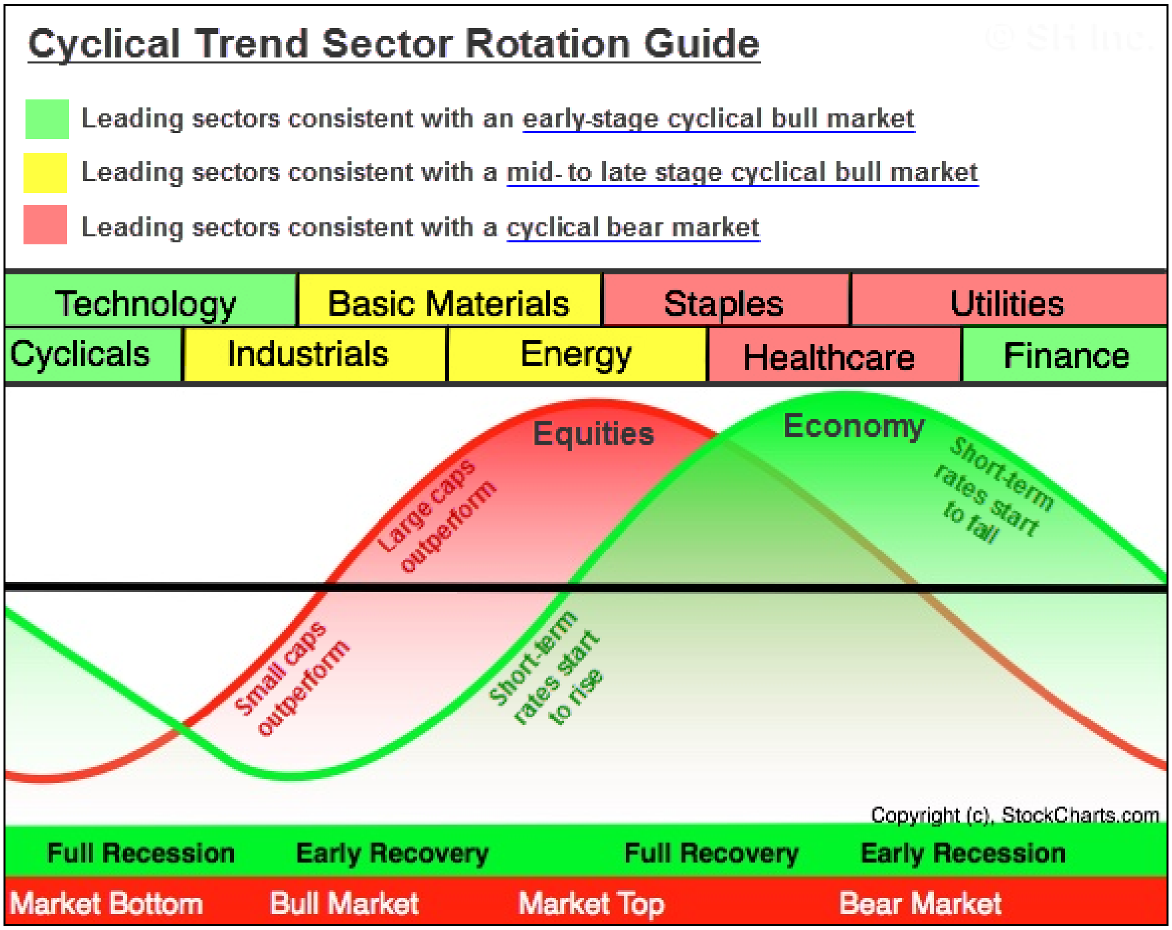
It is interesting to watch the relative performance of the different indices during the current market dip. The SPX and commodity-heavy Canadian TSX are holding up quite well in this decline relative to the small cap Russell 2000 and technology-sensitive Nasdaq Composite. I think we will see more of this – i.e. large cap and commodity outperformance – as this cyclical bull market ages, as per the “Cyclical Trend Sector Rotation Guide” pictured on the next page.

Of course, whether commodity outperformance continues may depend (except perhaps for gold) on how the next cyclical bear market and recession will unfold – whether from an overtake of inflationary forces or loss of confidence / deflationary forces. I personally think the seeming willingness of the Fed to monetize until it sees significant inflation, the recent strength of energy and materials stocks coming out of what may be a multi-year cyclical low for them, their relative (under)valuation compared to other SPX sectors, as well as the likelihood of the TSX outperforming the SPX over the next several months from a cyclical perspective, bodes well for an inflationary beginning (and perhaps a deflationary follow-through) to the next cyclical bear market and recession (which seems quite likely to me to begin sometime in 2013 or perhaps early 2014 given how old the current cyclical bull market is getting and the maturation it is showing from a style leadership, sector rotation and – most importantly – market breadth perspective).

I would be at least a bit surprised if the SPX does not make it to its 2007 high of 1565 (especially with the equal-weighted SPX having recently done so) – if not to somewhere in the 1600-1800 zone – before the current cyclical bull market ends (particularly as we continue to see easy monetary policy accompanied by a lack of excessive optimism from market participants). In any case, I am trying to carefully watch how factors such as new highs in underlying components of the SPX statistically erode as the index (which is cap-weighted) makes each successive high en route to its eventual cyclical bull market peak. Such erosion has been occurring since April 2010 (in both the SPX and Nasdaq Composite) and historically very rarely lasts for more than a few years before a cyclical bear market ultimately begins. Of course, it is worth remembering that we are living in an unusual economic environment and may thereby see unusual economic outcomes.

Additional Segment: Cyclical Trend Sector Rotation Monitoring

The following "Cyclical Trend Sector Rotation Guide" is the BSI Report's staff's adaptation of a chart made available by John Murphy, CMT, the 'father of intermarket analysis':



The top five performing sectors of the SPX over the trailing quarter are highlighted below and color-coded according to the above guide:

Sector	Performance		
	1 Month	3 Month	YTD
Financials 4 Industries	+0.10%	+8.55%	+21.37%
Energy 1 Industry	-0.73%	+6.57%	+5.52%
Consumer Discretionary 5 Industries	-1.68%	+6.26%	+20.25%
Materials 1 Industry	-1.89%	+5.46%	+12.31%
Health Care 2 Industries	+0.67%	+4.17%	+18.60%

Sector rotation may be one tool for a market participant to consider use of (among a number of others) in helping to determine the current cyclical trend of US equities. Based on the color-coded table shown above, sector rotation currently appears to be consistent with US equities being in a mid- to late stage cyclical bull market.

Largely for reasons detailed in earlier reports, the BSI Report Editor continues to view US equities as being in a mid- to late stage cyclical bull market.

Additional Segment: Magazine Cover Confirmation Indicator

Far more often than not, popular magazine covers will be of little or no use to market participants. But, on occasion, one or more of these covers will **confirm** unsustainably bullish or bearish sentiment toward one or more publicly-traded asset classes or securities, and thereby mark a turning point or near turning point in one or more of these asset classes or securities, depending on the nature of the cover(s) in question. As financial commentator Barry Ritholtz has noted: *"*The magazine cover contrary indicator works when it reflects a fairly long lasting, well understood concept that is reaching a climax."

In light of Ritholtz's comment, here are the magazine covers this weekend (from the widely read magazines linked to at the bottom of this segment or that the BSI Report's staff find intriguing) that may be of interest to market participants:

For those in any way involved with the Indian equity market (which can be invested in through certain American ETFs), these first two covers may be of interest…

Cover is from UK-based New Statesman. Caption reads: "The economic miracle implodes."

Cover is from TIME (all ex-US editions). Caption reads: "Can the nation recover its magic?"

This cover from The Economist relates to South Africa (which can also be invested in through American ETFs):

The above covers on foreign countries come after a scary cover last week from Time related to China (one of many negative covers on China we have seen in recent months).

More in tune with the domestic equity market, here is a cover from Barrons relevant to PC-related companies (including DELL, HPQ, INTC, MSFT, etc. – a few of which I know certain highly regarded value investors are closely looking at or are already significantly invested in):

Caption reads: "As the personal-computer era wanes, Microsoft and Intel scramble to remain relevant. Apple and Google feast on the spoils of tablets and smartphones. What last week's scary earnings reports mean for investors."

Here are links that will allow one to (at least) view a thumbnail of the covers of (some of, if not most of) those weekly magazines that have enough readership and relevance for a market participant to consider monitoring each week, ordered in a descending fashion based on recent US public circulation numbers (Time Magazine is by far the most widely read):

1. Time Magazine
2. Newsweek
3. New York Times Magazine
4. Businessweek
5. The Economist

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"Start keeping a diary. Write down every time you are convinced that the market is going up or down. After a few years, you will realize that your insights are worth nothing. Once you realize that, it becomes much easier to float on that ocean we call the market." **Meir Statman**