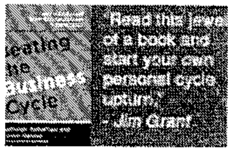
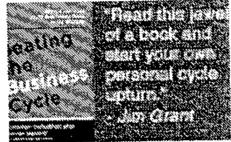
THE FULL HOUSE TRADER MONTHLY FORECAST

July, 2007 Edition
July 18, 2007

Actual slide from FHT Monthly, July 2007





Jobs report, growth & Inflation

Bloomberg News

6-July-2007

(Bloomberg News) - Lakshman Achuthan, managing director at Economic Cycle Research Institute in New York, comments on his outlook for U.S. economic growth and inflationary pressures. He spoke in an interview before the U.S. Labor Department released its June employment data today.

On the economic environment:

The recent economic data indicate "there is no recessionary kind of risk out there."

The services sector "has offset all the other weakness. That is why we never went into any kind of hard landing."

"We're talking about a stronger, healthier, firmer economy," and we see "still no big problem with inflation."

On the future inflation gauge:

"Looking at inflation, those indicators are actually coming off still."

"The clear direction" of the future inflation gauge "is that there is no runaway, upturn trend. That is the key message for policy makers."

Free ECRI Data	Level	Growth Rate	Period Ending	Download Data
Future Inflation Gauge	117.8	-4.2	Jun 2007	ECRI Light
Coincident Index	153.3	2.1	May 2007	usci.xls
Lagging Index	155.1	2.6	May 2007	usli.xls
Weekly Leading Index (monthly)	142.0	5.8 *	Jun 2007	ECRI Light
Weekly Leading Index	143.9	6.2	6 Jul 2007	ECRI Light

"No recessionary risk..."
"Inflation indicators coming off"

* Future econ. gauges at ECRI are quite positive...

Actual slide from FHT Monthly, July 2007

"While The BCA sees economy as "soft landing"

Bottom Line: Boost MBS exposure to neutral. Remain positioned for higher yields by favoring 15-year and higher coupon securities.

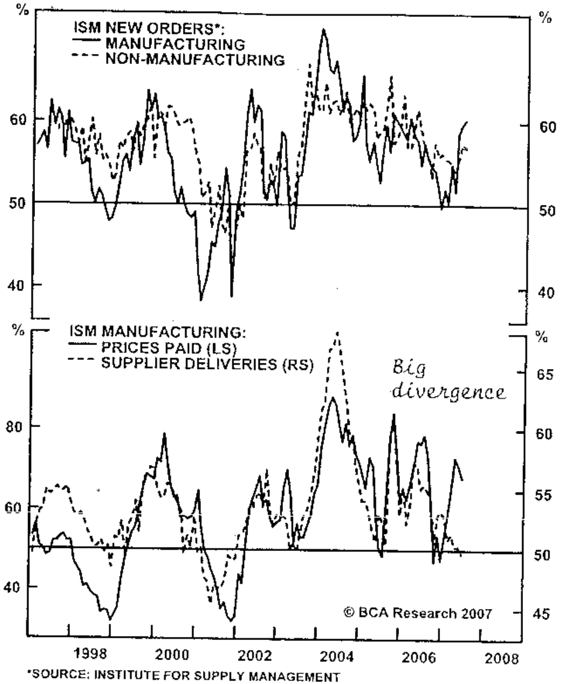
ECONOMY AND INFLATION

GDP growth rebounded in the second quarter, but this only represented an unwinding of a slump in inventories and net trade. While we expect trade to be a positive source of growth for the foreseeable future, final domestic demand growth is still in a slow-motion (albeit volatile) slowdown phase. We are still in the soft landing camp, but the difference with previous similar periods is that this slowdown is lasting longer and we do not expect any real change over the balance of the year, i.e. on average, demand growth will be slightly below potential.

The ISM manufacturing survey showed a further gain last month, underscoring that the production side of the economy has recovered after an inventory-induced slide (**Chart 11**). The weak dollar and ongoing foreign economic strength will provide support, but consumption is likely to be sluggish as consumers retrench in the face of modest headwinds from housing, energy prices, borrowing rates and even employment growth. Payrolls are still expanding at a decent pace, but the growth rate has been trending lower and our model shows a further modest deceleration ahead (see Chart 14 in last week's Bulletin). Those sectors closest to the housing slump are clearly suffering in terms of employment, but other parts of the economy are in good shape (**Chart 12**). Hiring plans and layoff announcements are still fairly supportive, but the period of excessive consumption is over and the risks are on the downside.

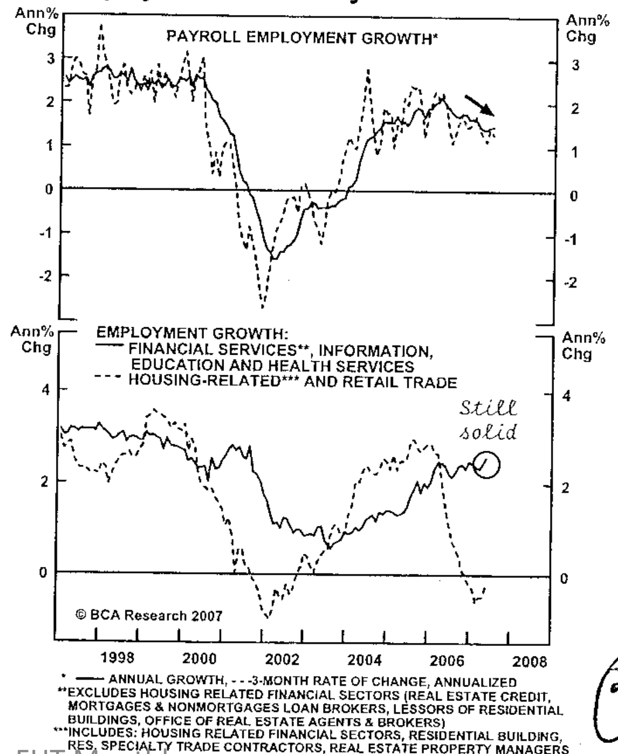
While raw material input costs remain strong (the ISM prices paid index), firms are still having trouble passing along cost increases. Bottlenecks are not an issue (see the ISM supplier deliveries

CHART 11
Mild Slowdown Intact



*SOURCE: INSTITUTE FOR SUPPLY MANAGEMENT

CHART 12
Employment Dichotomy



* —— ANNUAL GROWTH, - - -3-MONTH RATE OF CHANGE, ANNUALIZED
**EXCLUDES HOUSING RELATED FINANCIAL SECTORS (REAL ESTATE CREDIT, MORTGAGES & NONMORTGAGES LOAN BROKERS, LESSORS OF RESIDENTIAL BUILDINGS, OFFICE OF REAL ESTATE AGENTS & BROKERS)
***INCLUDES: HOUSING RELATED FINANCIAL SECTORS, RESIDENTIAL BUILDING, RES. SPECIALTY TRADE CONTRACTORS, REAL ESTATE PROPERTY MANAGERS

(2)

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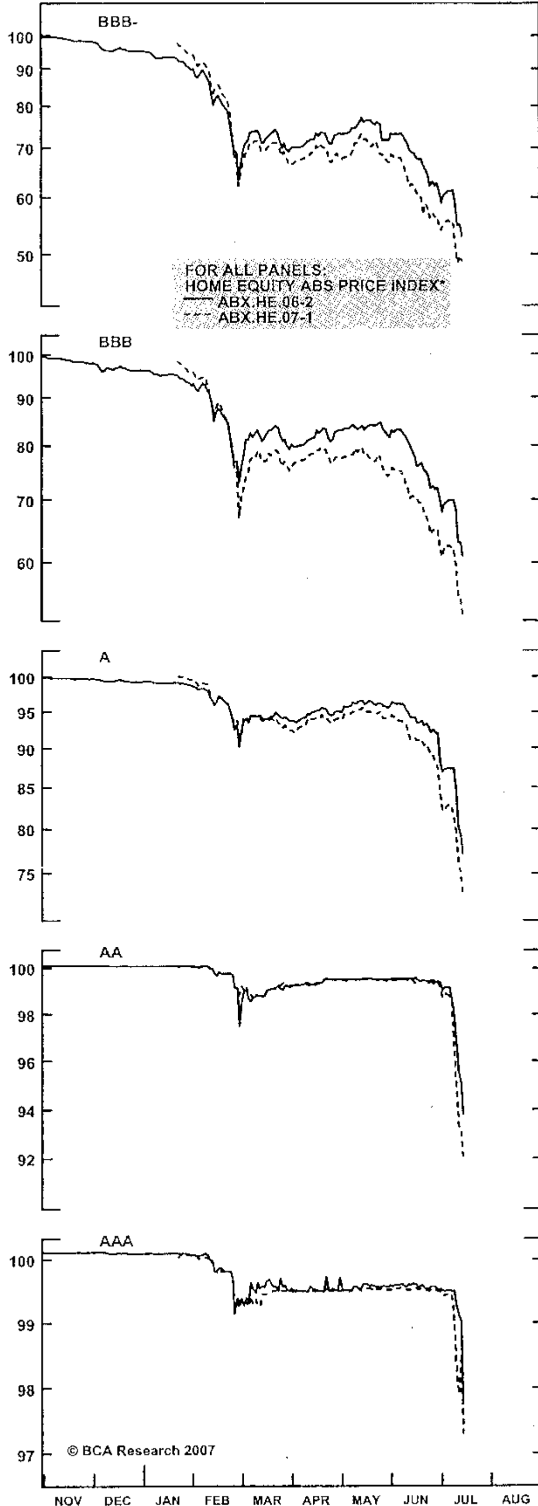
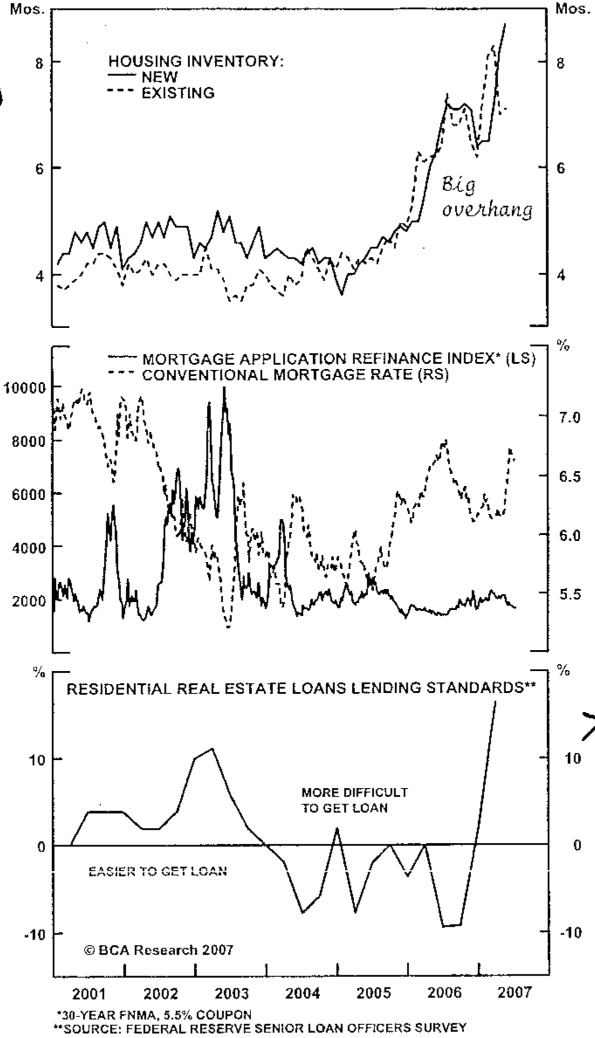
with these housing indicators its hard to see a "return to average growth" near term.

CHART 1
Subprime Takes Another Hit



*SOURCE: MARKIT.COM

CHART 2
Housing Doldrums



*30-YEAR FNMA, 5.5% COUPON
**SOURCE: FEDERAL RESERVE SENIOR LOAN OFFICERS SURVEY

of new and existing homes are very high and both housing starts and permits remain elevated as homebuilders have been slow to retrench. Higher borrowing rates and tighter lending standards mean that it may take some time to clear the overhang of unsold homes from the market (**Chart 2**).

(3)

The key issue is whether the weakness in subprime will continue to leak into the broader credit markets and even lead to financial system disruption or failure. We continue to bet against

* NOTE SERIOUS CREDIT TIGHTENING IN REAL ESTATE LENDING (= SLOWDOWN)

Actual slide from EHT Monthly, July 2007

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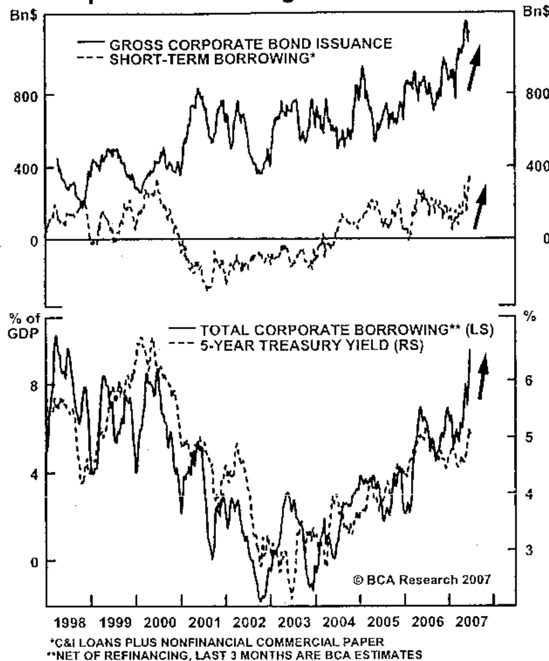
Given Global Growth & Corporate Borrowing the BCA sees conditions for higher rates and possible "Bond Bear Market" *

CHART 3
Corporate Borrowing Is Bond Bearish



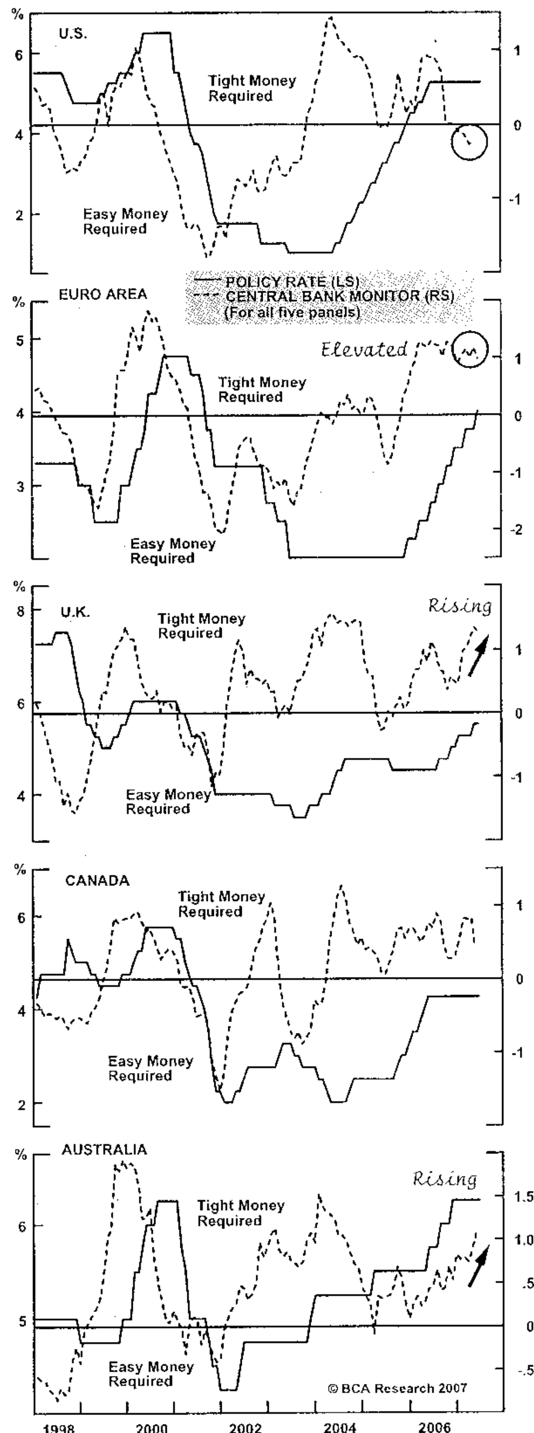
*C&I LOANS PLUS NONFINANCIAL COMMERCIAL PAPER
**NET OF REFINANCING, LAST 3 MONTHS ARE BCA ESTIMATES

countries (**Chart 2**, top panel). Real rates historically have moved well above this benchmark in past cycles. Further rate hikes of about 50-60 basis points are already discounted outside the U.S., but there may still be more upside potential.

Well behaved inflation in the major countries provides central banks with some breathing space. Nonetheless, we suspect policymakers will err on the side of restraint given the current backdrop of high resource utilization, strong money and credit growth and signs of froth in financial markets. There are few indications that the rise in policy rates so far has begun to bite; along with the global PMI index, proxies for world business and consumer confidence remain in an uptrend.

Meanwhile, few central bankers would describe the current level of interest rates as "restrictive". BCA's Central Bank Monitors are either elevated and/or rising sharply outside of North America, signaling that tighter policy is required (**Chart 4**).

CHART 4
Central Bank Monitors



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Actual slide from FHT Monthly July 2007

* Note That Bond Bear Market might = Stock Bull Market given the long-term de-coupling...

US 10 Yr T-Note, Weekly - Advanced GET ©2007 Trading Techniques, Inc.

07/20/07 O: 105.25 H: 105.97 L: 105.19 C: 105.84

...However, technically it still looks like bonds are near their channel bottoms...

US 10 Yr T-Note, Daily - Advanced GET ©2007 Trading Techniques, Inc.

07/18/07 O: 105.59 H: 105.97 L: 105.41 C: 105.84

...and the probability of substantial new lows is not high...

Actual slide from FHT Monthly, July 2007

STOCK MARKET

SHORT-TERM OUTLOOK

1) As forecast over the past several months, the major indices have trended higher into the July earnings timeperiod. A major forecast target was fufilled on July 13th when the S&P hit 1555.10, taking out it's intra-day high of 1553.

2) The market is now quite vulnerable to at least an important short-term selloff

A) Investors Intelligence Bull/Bear ratio is nearing a bullish extreme
B) Margin Debt is at very high levels
C) CBOE Equity Put/Call Ratio is at reversal-prone (bearish) levels
D) Note also rising volatility signalling increasing short-term nervousness

INTERMEDIATE / LONGER-TERM OUTLOOK (Dec. 07 and into 2008)

1) Ultimately, should we see a selloff from the current July timeperiod we will evaluate the longer-term outlook based on the patterns that emerge...

2) Technically, there is a somewhat mixed picture as to a July top

A) This primarily stems from the RELATIVE MOMENTUM for the two main rally segments of the July 2006 to July 2007 uptrend

	Segment 1 7-06 to 3-07	Segment 2 3-07 to 7-07
S&P 500		Stronger
Dow Jones Industrials		Stronger
Value Line Arithmetic		Stronger
NASDAQ Composite	Stronger	
Russell 2000	Stronger	

At a major top, we would expect all or nearly all of these important indices to show stronger momentum under SEGMENT 1, and fading "mo" under Segment 2

B) The relative strength of the unweighted market averages (advance/decline line) vs. the major cap-weighted indices (ex: S&P 500) indicates that even after this protracted bull market from the Oct. 2002 lows, breadth has not deteriorated as would be expected from a major topping pattern.

C) The broad global stock rally & competitive dollar also support US stocks

(1)

3) Fundamentally, on the positive side, stocks have not reached extremely high valuations and the global (if not the U.S.) economy is still in solid growth mode.

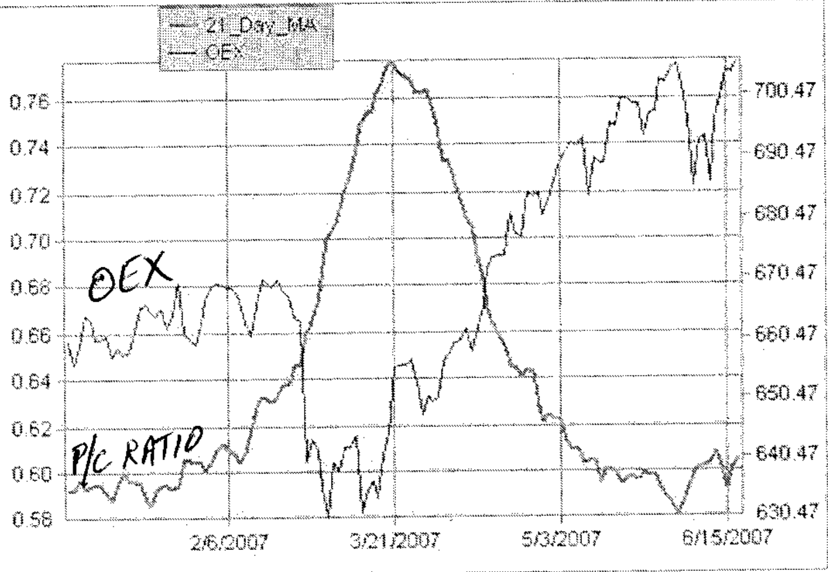
4) On the other hand, are valuations justified in light of falling earnings growth? Note that valuation pressures will mount if corporate bond spreads widen significantly

Actual slide from FMT Monthly,
July 2007

We'll let post-July technical patterns help sort-out probable longer-term direction....

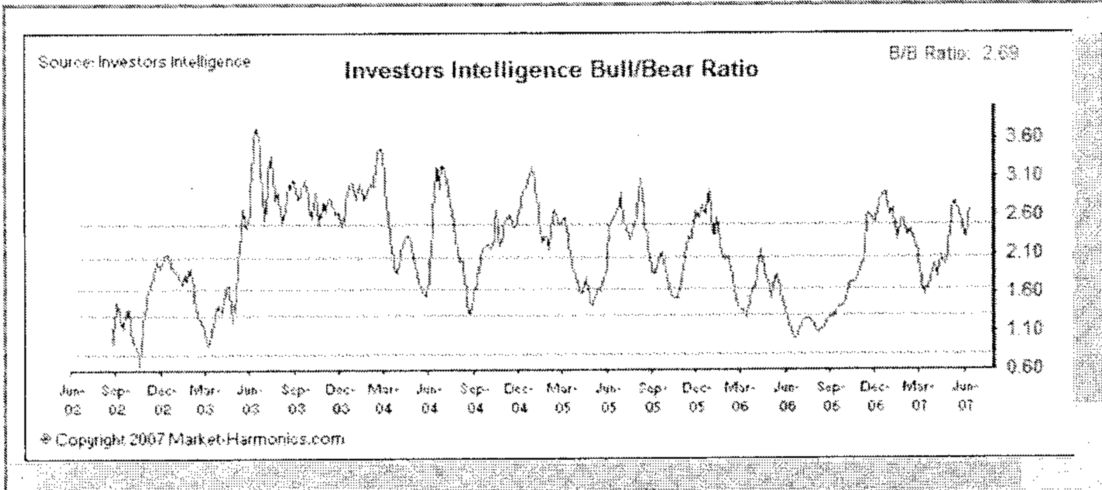
CBOE Equity Put/Call Ratio

Date	Equity P/C	21-Day MA
6/19/2007	0.665	0.603
6/18/2007	0.573	0.6
6/15/2007	0.475	0.59
6/14/2007	0.534	0.6
6/13/2007	0.577	0.606
6/12/2007	0.663	0.602
6/11/2007	0.706	0.6
6/8/2007	0.597	0.6
6/7/2007	0.725	0.597
6/6/2007	0.624	0.591
6/5/2007	0.645	0.583
6/4/2007	0.525	0.578
6/1/2007	0.502	0.584
5/31/2007	0.505	0.587
5/30/2007	0.535	0.591
5/29/2007	0.575	0.596
5/25/2007	0.558	0.596
5/24/2007	0.668	0.597
5/23/2007	0.668	0.594
5/22/2007	0.599	0.596



P.C. Ratio was sky-high at Feb/Mar '07 Stock bottom ... it now signals Short-term toppiness risk

Bullish Versus Bearish Advisors ... ditto for Bull/Bear Ratio.



Actual slide from FHT Monthly, July 2007

On the NYSE, 'Margin Debt' Jumps to Record $353 Billion

By PETER A. MCKAY

Investors are borrowing record sums of money to finance trades on the New York Stock Exchange, according to data due out from the Big Board today.

NYSE officials attribute the trend to recent regulatory changes effectively allowing both small and big investors to take on more leverage, or borrowed money, from their brokers. So-called margin debt, a broad measure of leverage, jumped 11% to $353 billion at NYSE in May, up from nearly $318 billion in April.

Wall Street has had a love affair with leverage in recent years, typified by hedge funds and private-equity firms that make use of it to buy companies and stocks and bonds.

Such financing can also amplify losses if investors' bets go the wrong way. But regulators say that doesn't necessarily translate into more risk. "I wouldn't necessarily say that leverage equates to risk," said Grace Vogel, executive vice president for member regulation at NYSE. "We feel that the amount of margin being collected by the firms is appropriate, given the strategies in [their customers'] portfolios."

Under the financial industry's old rules, investors who wanted both to buy shares in a company and use so-called options contracts on that stock to guard against an unexpected drop in the value of those shares would have to put up separate collateral for both the stock and the option. If the shares dropped in value, the customer might get a margin call, or request for additional collateral, from a broker to cover the price of the shares, even if the value of the option had increased.

Under a pilot program that the NYSE launched with eight brokerage firms in April, brokers can assess the portfolio as a whole. So if one part of the portfolio goes down but the other part goes up, the investor won't necessarily get a margin call. The upshot for investors is they don't have to tie up as much money on one particularly investment, allowing them to borrow more to make other investments if they want to.

Doug Engmann, a managing director at Fimat USA, one of the brokerages participating in the program, says the change has reduced some of his customers' financing costs by 80%. He estimates reductions of 25% to 50% are the norm.

"This type of financing is not for everyone, just sophisticated, options-trading customers at this point," said Mr. Engmann. "As the industry gets used to it in the next few years, I suspect we'll see it used more widely."

...meanwhile market leverage reaches an all-time high...

Actual slide from FHT Monthly, July 2007

AHEAD OF THE TAPE

Rising Volatility Risks Strangling Liquidity Flow

INVESTORS SPEND A LOT of time worrying about big jolts to financial markets. But a rising frequency of little tremors could be the more important concern.

For the past several years, financial-market volatility has been strikingly low. But that could be changing. Last week, there were two days when the Dow Jones Industrial Average moved more than 1% in one session—one up and one down—bringing the number of 1% days this year to 15. That compares with 24 such days in all of last year.

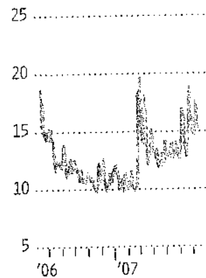
By Justin Lahart

The Chicago Board Options Exchange's implied volatility index has been trending higher this year. Known as the VIX, the index is based on prices for S&P 500 put and call options, which let investors buy and sell the index at prearranged prices. The more investors worry about sudden moves in stocks, the more they'll pay for those options. In practice, investors' volatility expectations are based on what they've seen in the rearview mirror. The rise in the VIX merely reflects how volatile the market has been lately.

Other financial assets, including high-yield corporate bonds, emerging-market debt and, of course, anything backed by subprime mortgages, have also become more vola-

A continued rise in volatility would have important consequences. One reason that financial-market liquidity—funds available for investing—has been so ample in recent years is that low volatility has made investors more willing to make bets and lenders more willing to extend credit to market participants. If volatility continues to rise, it could stanch the flow of liquidity.

The CBOE Market Volatility Index



Source: Thomson Datastream

A bank's overriding concern when making a loan is that it gets back its capital. If an investor wants to put $10 down for a $100 investment with the bank lending him the remaining $90, the bank needs to feel fairly certain that the investment isn't going to suddenly drop by more than $10.

When the markets got roiled by troubles at two Bear Stearns hedge funds last month, part of the problem was that the funds' investments fell to the point where their lenders were worried that they wouldn't get back the money they'd lent. As a result, the lenders—Wall Street firms—moved to sell the investments they held as collateral in an effort recover at least some of their capital.

In that case, it wasn't stocks that had become more volatile. It was complex derivatives backed by subprime mortgages. Bear and its lenders had expected these investments to be less volatile than they turned out to be, something many other hedge funds are also discovering about subprime-backed bonds these days.

If financial assets are becoming more volatile, points out Jeffrey Rosenberg, head of credit strategy at Banc of America Securities, lenders are going to be less willing to extend as much credit to investors. That would restrain what has been an important source of liquidity for financial markets.

What's more, with fewer buyers and sellers to agree on price, less liquid markets can be more volatile. What has been a cycle of very low volatility and rising liquidity could be in the process of becoming a little less virtuous.

NOTE: Volatility not only reflects trades uncertainty but also likely pressure on Corp. bond spreads vs. treasuries...

*DWI X - Dow Jones Index, Daily - Advanced GET ©2007 Trading Techniques, Inc.

07/18/07 O: 13955.05 H: 14020.89 L: 13768.73 C: 13918.22

Dow shows more momentum under March-July rally...

Osc 10,70

Osc 5,35

*SPX - S & P 500 Index, Daily - Advanced GET ©2007 Trading Techniques, Inc.

07/18/07 O: 1549.20 H: 1549.20 L: 1533.65 C: 1546.15

... Ditto S+P...

... this is more typical of short-term than MAJOR toppiness

Osc 10,70

Osc 5,35

Actual slide from FHT Monthly July 2007

OTC - NASDAQ Composite, Daily - Advanced GET ©2007 Trading Techniques, Inc.

07/18/07 O: 2695.28 H: 2699.87 L: 2674.26 C: 2699.49

whereas the OTC & RUT do show stronger signs of a top

Osc 10,70

Osc 5,35

Jul A 08/15/06 Sep Oct Nov Dec 2007 Feb Mar Apr May Jun Jul #469

*RUT - Russell 2000, Daily - Advanced GET ©2007 Trading Techniques, Inc.

07/18/07 O: 849.65 H: 849.65 L: 835.80 C: 845.90

Osc 10,70

Osc 5,35

06/27/06 Aug Sep Oct Nov Dec 2007 Feb Mar Apr May Jun Jul #35

Actual slide from FHT Monthly
July 2007

Profit Outlook For Fourth Period Seems Too Rosy

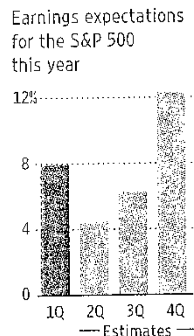
WALL STREET'S always-optimistic stock analysts would like to welcome you to the earnings trough.

Corporate earnings are in the midst of their weakest period in years. Second-quarter profits, excluding one-time items, among Standard & Poor's 500 companies are expected to be up just 4.4% from a year ago, according to Thomson Financial. Third-quarter earnings are forecast to rise 6.2%, a far cry from the double-digit growth rates registered in the past few years. But analysts see a quick return to robust earnings gains—their projection for the fourth quarter is a 12.3% year-over-year increase.

→ will we get this quick return to double-digit EPS growth in light of longer-term economic "soft landing"?

Analysts might have been expecting the housing market to be out of the woods by year's end. This week's news could help dissuade them. Credit-rating downgrades on mortgage-backed securities by Moody's and Standard & Poor's and earnings warnings by the likes of **D.R. Horton**, the nation's biggest home builder, suggest housing isn't nearly out of the woods.

Earnings expectations for the S&P 500 this year



Source: Thomson Financial

"Fourth-quarter estimates are looking a bit Pollyannaish right now," said Briefing.com analyst Patrick O'Hare. "We're likely to see expectations dialed down."

The other key to their forecast is the outlook for consumer-discretionary companies, which include restaurants, retailers, auto makers and other companies that cater to consumers. The sector has been hit hard. Consumer-discretionary earnings were down 7% in the first quarter from a year earlier, and they are projected to be down 10% in the second quarter.

But analysts see the sector's profits bouncing by 25% in the fourth quarter as the economy picks up speed and earnings by auto makers and home builders rebound. They might be getting ahead of themselves on that count, too. On Tuesday, **Home Depot** and **Sears Holdings** cut their earnings forecasts, citing worsening housing conditions.

If the analysts prove right, it will be a testament to the economy's resilience. But the latest news suggests they are getting ahead of themselves...again.

Meanwhile, valuations are not at extremes →

RISING MARKET, CHEAPER STOCKS

Stock prices have nearly doubled since October 2002, yet today's market is actually cheaper, as measured by the ratio of stock prices to company earnings.

P/E Ratio*

Date	P/E Ratio
10/10/02	27.1
10/10/03	25.8
10/10/04	19.3
10/10/05	18.5
10/10/06	16.3
5/15/07	17.7

*Price-to-earnings ratios are for stocks in the Standard & Poor's 500 index, based on trailing 12-month earnings for the S&P corresponding to each date.

Source: Standard & Poor's

PHIC BY USN&WR

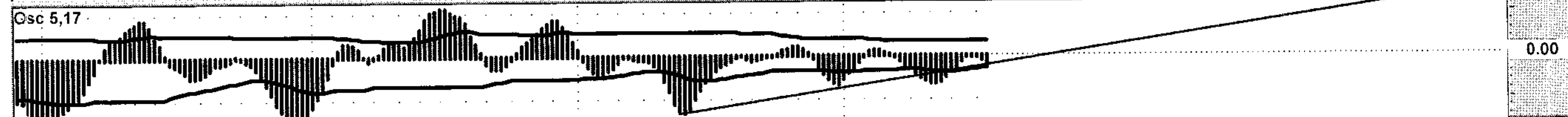
Actual slide from FHT Monthly, July 2007

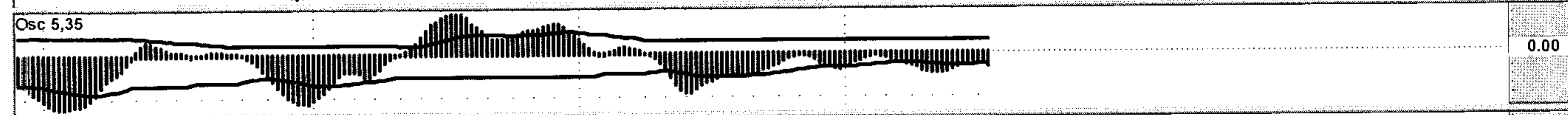
US $ Index 1600, Weekly - Advanced GET ©2007 Trading Techniques, Inc.

07/20/07 O: 80.35 H: 80.49 L: 80.13 C: 80.25

The U.S. Dollar has now reached our target of 80.50, taking out the Dec. '04 low. (hit 80.13 on 7-18)

Target: Late Nov. or Early Dec Bottom





Volume 30

2004 07/30/04 2005 2006 2007 #626

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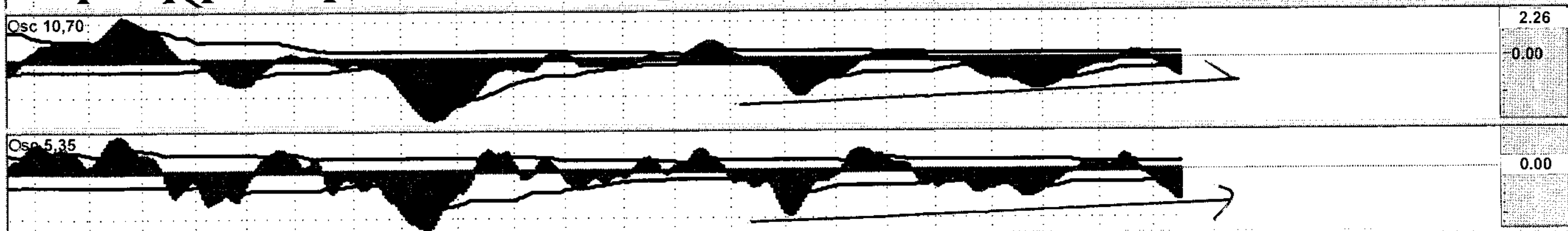
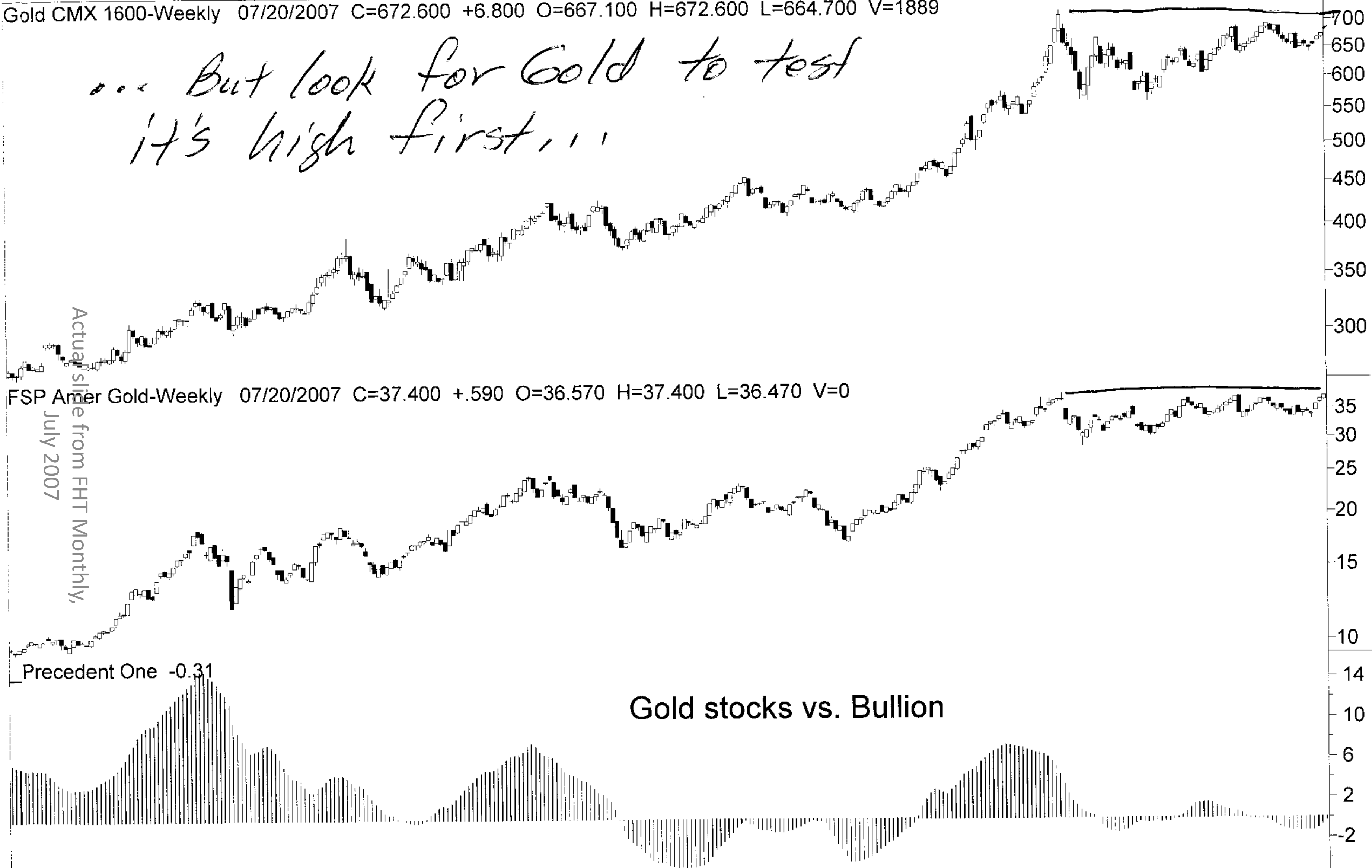


Actual slide from FHT Monthly, July 2007



Actual slide from FHT Monthly, July 2007

NOTE The relationship btw gold & the welfare state.

Money Meltdown

"saddled with long-range government spending commitments"

By David Ranson
And Penny Russell

Interest rates are on the rise in the Eurozone, Great Britain and Japan, as well as in India and China. But the Federal Reserve has again elected to keep its target rate on hold despite repeated assertions that inflation risk is still its predominant concern. Are central banks abroad recognizing a threat that their American counterpart has yet to acknowledge?

The Fed seems to believe that inflation has something to do with "excessive" demand. Although it admits that inflation is already running at an unacceptable pace, the majority of its policy officials cling to the belief (or hope) that the U.S. economy is slowing down, alleviating the inflation threat. Both of these assumptions are inconsistent with historical evidence.

> Forget the rise of the pound and euro against the dollar. The real story is the decline of all paper currencies when compared to gold.

What's more, the recent rise in the euro and sterling relative to the dollar has obscured the fact that the world economy has embarked on another classic "run" on paper currencies that is driving inflation up everywhere. For several years now, as was the case in the 1970s, all the world's currencies have been depreciating relative to stable benchmarks such as gold. Since the end of 2001, these declines have ranged from 38% (in the case of the euro) to nearly 60% (in the case of the dollar).

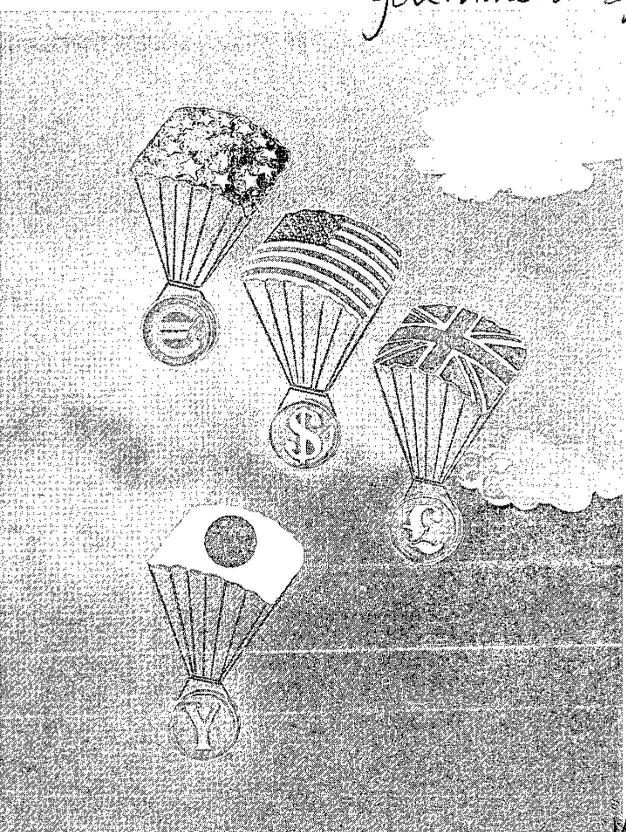
Why then has the pace of consumer-price inflation to date been so much less noteworthy than the pace of currency depreciation against gold? The answer lies in the timing: Gold is a fast-moving leading indicator, whereas consumer-price indices are slow-moving indicators that lag far behind. We all learned in the period between 1975 and 1985 that consumer prices do eventually catch up. It is the size of the move in the gold price, rather than in the consumer price index, that is a true and timely indicator of the magnitude of the inflation problem.

In 1975, Yale economist Richard Cooper described the process that now appears to be driving world inflation as "a general loss of confidence in money, a psychological mood that can be transmitted across national boundaries . . . [that will] lead individuals to try to convert their assets into physical form: goods or housing or real estate."

But why does this phenomenon break out at some times and not at others? Why is it sometimes local and sometimes global? History provides the answer. Following World War II, rapidly rising prices began to be accepted as an inevitable—even "normal"—fact of life. But in reality, up to and including the 19th century, significant inflation had been the exception rather than the rule. And when it did occur it was usually local rather than global. In the U.S., for example, cumulative consumer-price inflation was zero from 1820 to 1913, just prior to World War I. In the United Kingdom, consumer prices were lower at the beginning of World War II than they had been in 1800. In England the prices of consumables rose at an average annual rate of less than 0.4% over the centuries-long run between 1210 and 1940.

Against this relatively stable background, inflation erupted when nations faced acute fiscal stress, particularly in times of all-out war. A government that lost a war of survival typically saw the value of its paper currency evaporate to zero. In the final stages of this process, hyperinflation and astronomical interest rates accompanied economic chaos. The defeated government either did not survive (such as the Confederacy in 1865) or had to be rescued from its currency crisis by the victors (as in Germany and Austria in 1923 and Germany and Japan after 1945). Even the winners of all-out wars, especially those that emerged seriously impoverished (such as Britain in 1945), resorted to currency devaluations and suffered high inflation as a result.

In all cases, inflation was related to the inability or unwillingness of the governing authorities to maintain a stable currency in times of war-related government spending and debt. Although we are not entirely at peace today, U.S. military activity is at nothing like the all-out scale from 1917-1918 or 1941-1945. So why are we having an inflation problem, and why is it global in scope? There are two culprits.



First, since 1971 no government had made an attempt to fix the gold value of its currency, and every political initiative that raises long-term government spending leaves the financial markets free to price currencies at a lower gold value. Depreciation of currencies relative to gold has become unpredictable, chronic and planet-wide.

Second, the massive increase in the public-sector share of the economy that occurred in World War II (and was reinvigorated in the late 1960s) has become permanent. In place of war-related debt, public finance is now saddled with long-range government spending commitments, including burgeoning debt in the form of unfunded liabilities associated with national pensions and health insurance. The popular notion that inflation is the way politicians reduce public debt without formally abrogating it is not far from the truth. In a nutshell, inflation is a manifestation of looming government insolvency.

This problem vastly overshadows the federal budget deficits with which Washington is obsessed. The military costs of the "war on terror" and the Iraq conflict are mere addenda to a mountain of obligations, which financial markets are warning that the federal government can only discharge by inflating away.

Not that the other world economies are in any better fiscal shape than America's. In fact, throughout the 20th century, the U.S. has been a sort of lender of last resort. If we had not been on the scene in 1923, who else could have underwritten a new and viable currency for Weimar Germany? Though in recent times our allies in North America and Europe have been less warlike than us, they long ago adopted much more generous social "safety nets" and thereby undermined their long-term solvency to an even greater degree than here.

Inflation was negative following the Civil War, when the price of gold fell back to its pre-war parity. Inflation was likewise low after World War I when the price of gold remained fixed. In contrast, inflation charged ahead after World War II as the market price of gold was permitted to rise. Broadly speaking, although a rise in the price of gold is a sufficient condition for consumer-price inflation, it is not entirely necessary. The shortages that occur in a widespread war (such as World War I) may be sufficient to push up the price level, despite price controls and adherence to the gold standard.

Inflation is not intrinsically global—it is obvious that some countries experience more inflation than others. But currencies depreciating against gold across the board is a sign of world-wide inflation—and it has begun to set off alarm bells in many major economic capitals. But in Washington, our own central bankers remain placidly confident that everything will turn out all right.

Unsustainable peacetime spending is a much slower process than the unsustainable war spending. Far from sudden death, currencies these days are facing death by a thousand cuts. The unfortunate result is that the current crisis of confidence in paper money goes largely undiagnosed by the bulk of economists and policy makers.

Mr. Ranson and Ms. Russell are principals of H. C. Wainwright & Co. Economics.

"unfunded liabilities"

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Actual slide from FHT Monthly, July 2007