THE FULL HOUSE TRADER
MONTHLY FORECAST

January 2008 Edition
Part 2: Markets
Jan. 15, 2008

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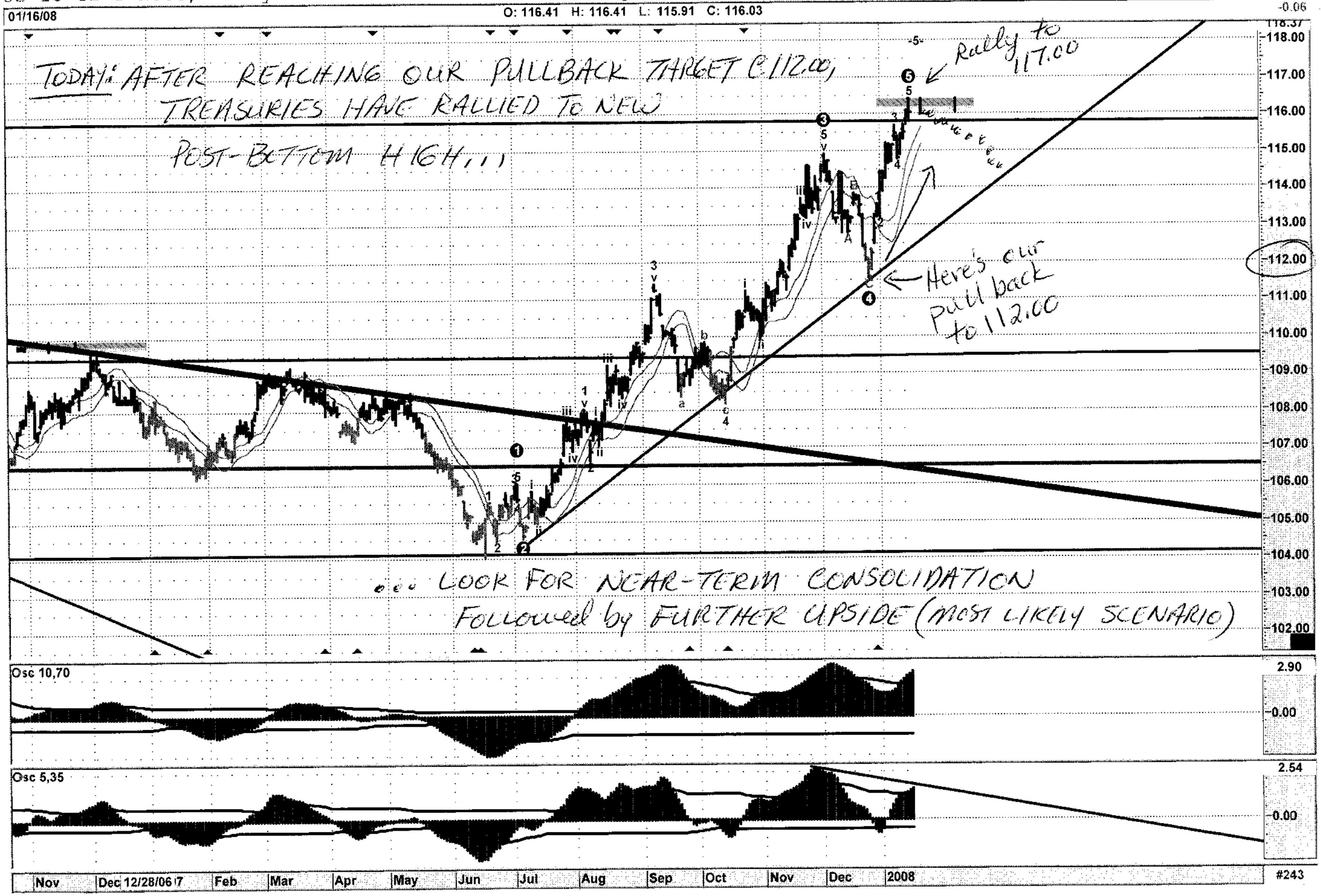

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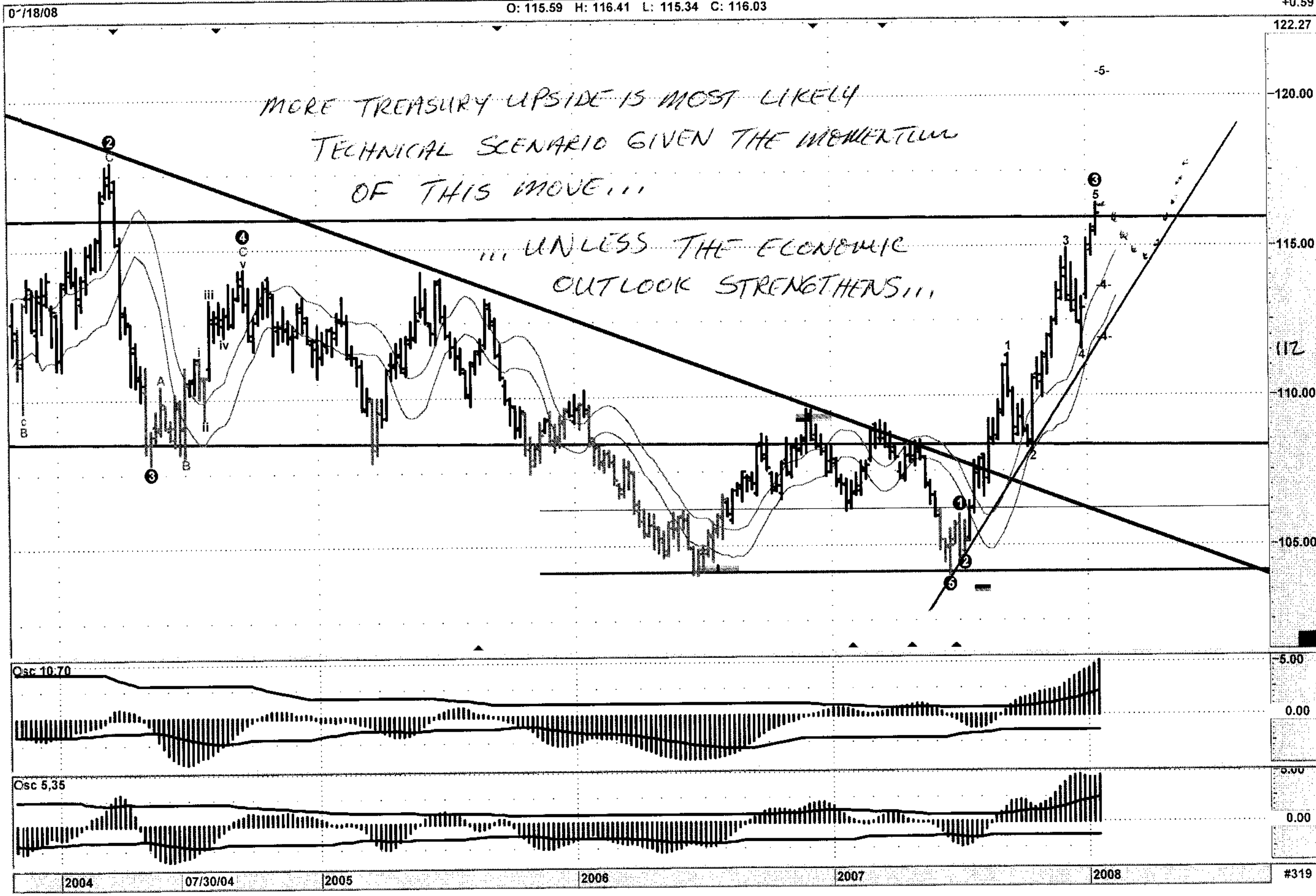
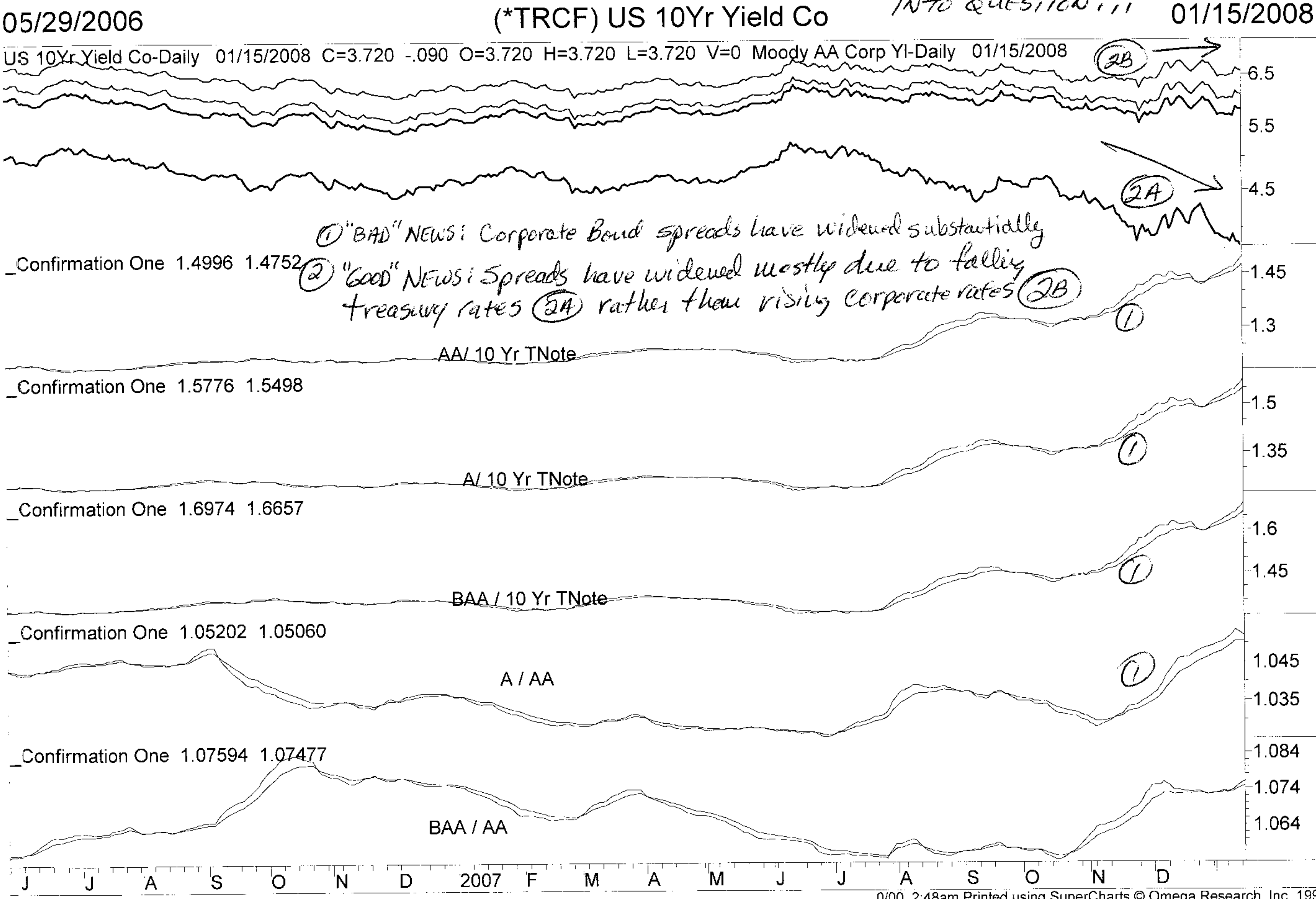


(18)

RISING CORPORATE SPREADS HAVE CALLED STOCK CO. BALANCE SHEETS INTO QUESTION...



(19)

...NOTE THAT CORPORATE BALANCE SHEETS ARE IN ABOVE-AVG. SHAPE (see next).

CORP. BALANCE SHEETS TODAY MUCH BETTER THAN 2002...

we recommend staying overweight highly rated spread product, including agency bonds, high-quality ABS and CMBS. We also maintain a slight overweight in high quality investment grade corporates, and this week upgrade junk bonds to neutral, largely based on valuation.

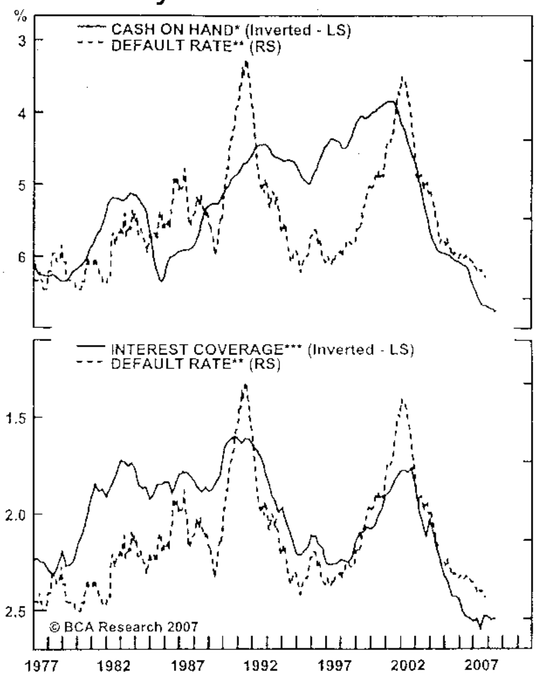
High-yield corporate spreads have more than doubled since mid-year, on concerns that the credit crunch would lead to increased default losses for low quality corporate bonds. Yet the default rate itself has continued to drop. For the 12 months ended November 2007, the global speculative grade default rate was 0.96%, its lowest level since before the 1982 recession.

Last week we reviewed some of the factors that drive corporate defaults and concluded that although some increase is probable, the recent jump in spreads is overdone given the most likely path for the default rate. We complete the discussion this week and finish with an estimate of where the default rate is likely to be one year out.

Moody's Investors Service provides a good example of just how difficult it is to forecast corporate defaults. Its latest forecast sees the global default rate increasing to 3.7% in the next year. However, this is not new. It has been calling for a significant increase for more than two years, during which time the default rate has actually been cut in half.

To be fair, we too pointed to many of the same factors in last week's Bulletin that have led to Moody's overly pessimistic predictions: issuance, seasoning and credit quality. Certainly these are important factors, but they do not by themselves lead to an increase in defaults. A catalyst is needed. Lending standards are one such important catalyst and the sharp tightening in lending standards for commercial and industrial loans suggests that a sizable increase in the default rate is imminent.

CHART 5
Two Catalysts For Default



*NONFINANCIAL CORPORATE SECTOR CASH AS A % OF SALES, ADVANCED 9 MONTHS
**SOURCE: MOODY'S INVESTORS SERVICE
***NONFINANCIAL CORPORATE SECTOR CASH FLOW/INTEREST EXPENSE, ADVANCED 9 MONTHS

This week, we propose two other potential catalysts that control the pace of corporate defaults: interest coverage and solvency. Tighter lending standards will only create difficulty for leveraged issuers when cash reserves are low and interest expense is onerous relative to cash flow. These financial ratios both remain near multi decade highs (shown inverted in **Chart 5**). These ratios reflect the underlying strength of nonfinancial corporate balance sheets, and thus shed some light on why the default rate has remained well behaved (**Chart 5**).

Including these two parameters along with cash flow, growth in industrial production and lending standards creates a reasonable model of the default rate (**Chart 6**). All of the variables enter the model with a lag of nine months except for growth in industrial production which is a more coincident predictor of defaults, and enters the model with a lag of three months. (We assume industrial production

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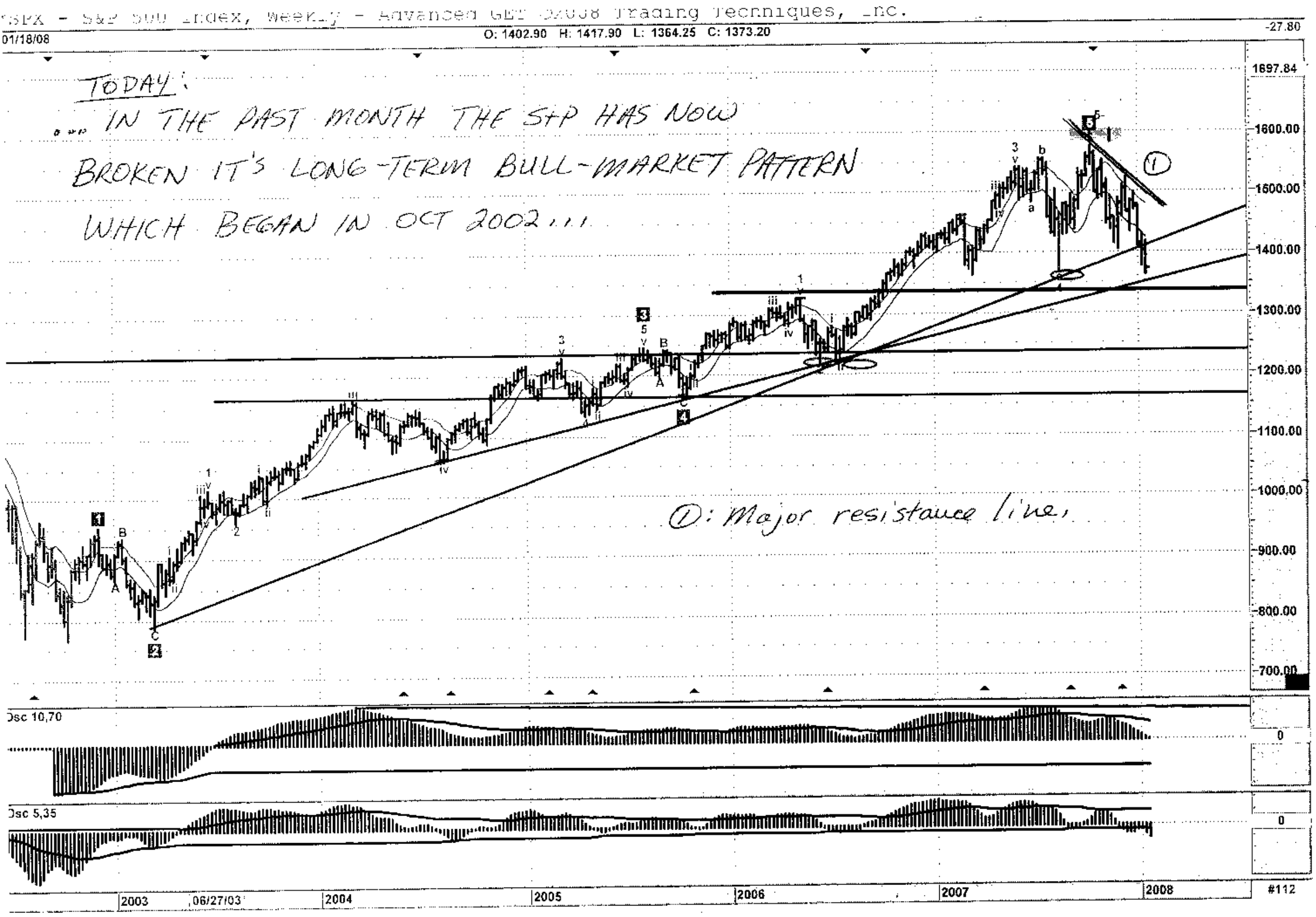
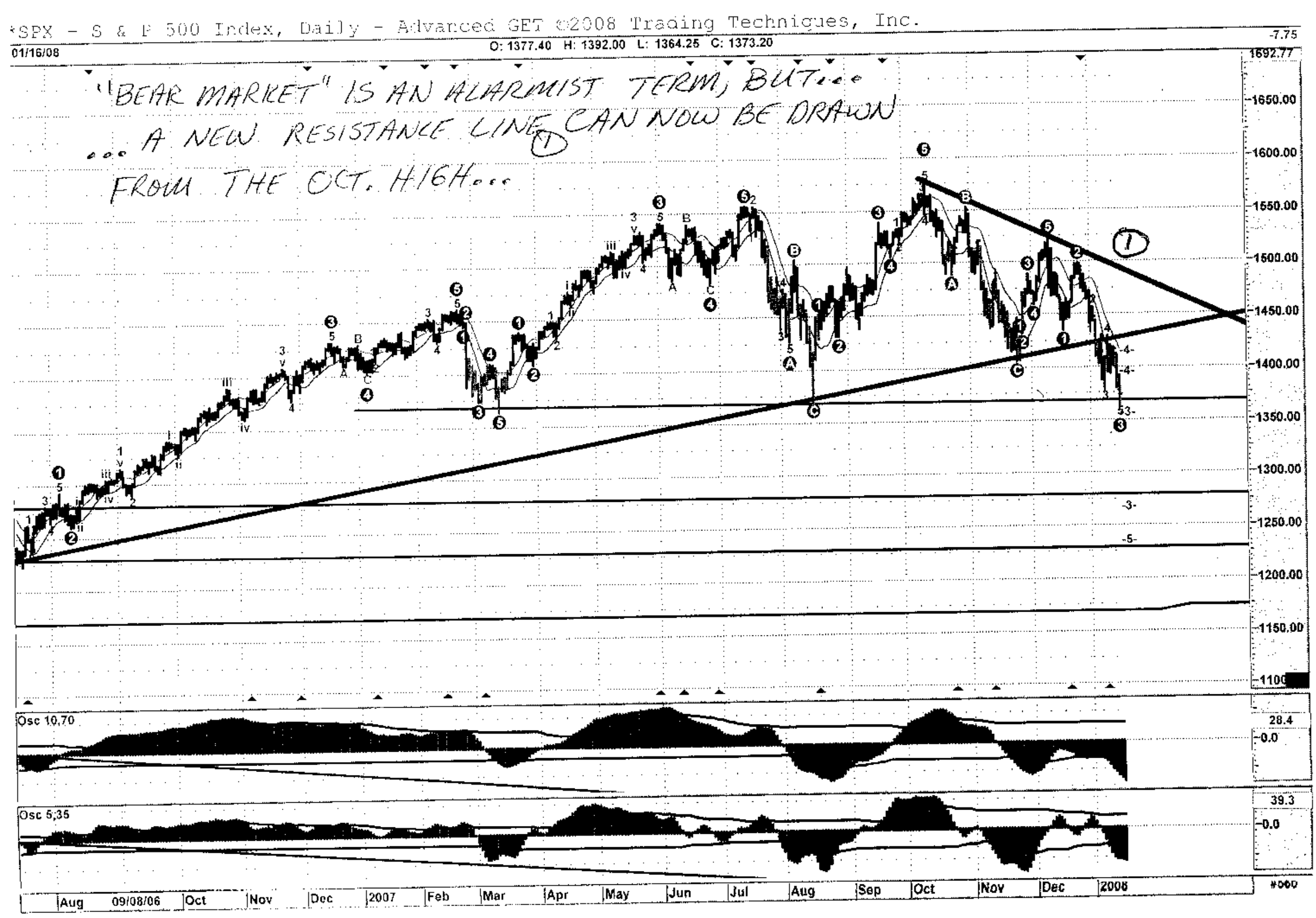

$SPX - S&P 500 Index, Weekly - Advanced GET ©2008 Trading Techniques, Inc.
01/18/08
O: 1402.90 H: 1417.90 L: 1364.25 C: 1373.20
TODAY:
... IN THE PAST MONTH THE S+P HAS NOW
BROKEN IT'S LONG-TERM BULL-MARKET PATTERN
WHICH BEGAN IN OCT 2002...
①: Major resistance line.
Osc 10,70
Osc 5,35
2003
06/27/03
2004
2005
2006
2007
2008
#112


$SPX - S & P 500 Index, Daily - Advanced GET ©2008 Trading Techniques, Inc.
01/16/08
O: 1377.40 H: 1392.00 L: 1364.25 C: 1373.20
"BEAR MARKET" IS AN ALARMIST TERM, BUT...
... A NEW RESISTANCE LINE ① CAN NOW BE DRAWN
FROM THE OCT. HIGH...
Osc 10,70
Osc 5,35
Aug
09/08/06
Oct
Nov
Dec
2007
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
2008

...MORE TRADERS WILL LOOK FOR A "BASKET OF LONGS" & A "BASKET OF SHORTS"

PROFIT PICTURE GETTING CLOUDY,,,

THE OUTLOOK | *By Timothy Aeppel*

Profit Slump Deepens Recession Worries

U.S. CORPORATE PROFITS are being hammered by the slowing economy and credit-market turmoil, intensifying concerns that the nation may be headed for recession.

Banks and other financial companies, which have taken huge write-downs on soured bets on subprime mortgages, have been among the most visible casualties. But businesses ranging from makers of artificial hips to surf-wear retailers to overnight-delivery services are also feeling the pinch.

If profits fall far enough, it could discourage capital spending and make companies less willing to hire or retain workers. A hiring slowdown could magnify the downturn and hasten a recession. That's bad news for wage earners as well as those who own stocks.

Weaker profits ultimately translate into lower stock prices, which could further erode the confidence of American consumers, who are already feeling less wealthy as fuel costs rise and their home values decline.

"The recession in reported earnings has already begun," says David Rosenberg, chief U.S. economist at Merrill Lynch & Co. "The underlying cause is a combination of painfully high energy prices and the general lack of pricing power in many businesses, which is starting to crimp margins." (1)

Mr. Rosenberg estimates profits measured by the operating earnings per share of companies in the Standard & Poor's 500-stock index, fell 8.4% in the third quarter from a year earlier. He expects those earnings to be flat or lower for the next five quarters.

Companies with most of their business inside the U.S. are hurting most. Merrill estimates "domestic earnings," or profits derived from activities inside the U.S., have contracted in three of the past four quarters and have shrunk more than 4% for the year, the worst reading in that gauge since the fourth quarter of 2001. (2)

Most economists expect things to get worse before they get better. "We're facing a tsunami of earnings downgrades next year," says Mr. Rosenberg. (3)

The downturn in earnings started in sectors linked to housing but has spread far beyond. **FedEx** Corp. last month lowered its profit forecast for the current quarter and full year, marking the second time since September that the Memphis, Tenn., overnight shipper has cut its outlook.

FedEx said the weakening economy and cutbacks in consumer spending were making for a weaker-than-expected holiday shipping season. **Talbots** Inc., the Hingham, Mass., women's clothing retailer, also blamed tighter-fisted consumers for a downward revision in its outlook for the fall.

Until recently, strong foreign sales were a saving grace for many U.S. multinationals, offsetting softening markets at home and bolstering overall profits. The weaker dollar played a role by making American goods more attractive to foreign buyers and helping boost the bottom lines of U.S. companies when earnings in stronger foreign currencies were translated back into dollars at the end of each quarter. (4)

But the downdraft in the U.S. economy is now overwhelming those benefits, economists say.

In 2007's first two quarters, S&P 500 operating earnings rose at a high single-digit pace from a year earlier, before dropping into negative territory in the third period. That weakness followed a remarkable growth run: Through the 14 quarters ended with the fourth quarter of 2006, earnings grew at a double-digit pace.

Richard Berner, chief U.S. economist at Morgan Stanley, expects a "significant and lengthy" contraction in earnings, even if the U.S. economy avoids a recession next year. That's because U.S. companies have far more operating leverage now than at any time in the past.

COMPANIES WITH high operating leverage have relatively high fixed costs, such as retail chains that must pay rent on dozens of stores regardless of how much is sold at each location or a manufacturer with factories full of expensive machines that must be maintained even if they aren't churning out products.

"Because of operating leverage, when the economy really slows down you get a much more pronounced impact on profits and earnings," says Mr. Berner, because company results are hurt simultaneously by lower sales and thinner profit margins. He says if the U.S. economy grows only 1% or 2% next year, overall earnings might slip 2% to 5%. But if growth is lower, say flat to 1%, earnings could fall by 5% to 15%.

Meanwhile, more companies are warning investors of dark clouds ahead. **Zimmer Holdings** Inc., a Warsaw, Ind., maker of artificial joints, recently cut its projected range for fourth-quarter earnings by nearly 10%, citing "lower anticipated sequential growth rates in the Americas."

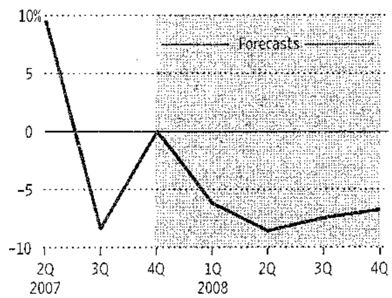
The U.S. accounts for about 95% of Zimmer's sales in this region. **Volcom** Inc., a Costa Mesa, Calif., maker of surfing and skating clothes, warned fourth-quarter profit would be lower because of the weakening U.S. retail environment.

Overseas firms with U.S. operations also are being hurt. **Neopost Group** of France, the world's second-largest maker of mailroom equipment after **Pitney Bowes** Inc., recently cut its profit target and cited problems in the U.S.

Pitney Bowes, of Stamford, Conn., also cut its outlook. "We do a lot of printing and copying for financial companies, so to the extent that they're being hit by subprime and other factors, we're seeing some echo of that in their work with us," says Matt Broder, a company spokesman.

Spreading Chill

Operating earnings at S&P 500 companies, change from a year earlier



Source: Merrill Lynch

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(1) S+P 500 PROFITS ↓ 8.4% IN Q3
(2) DOMESTIC BUSINESSES FARING WORSE
(3) TSUNAMI OF DOWNGRADES EXPECTED
(4) FOREIGN SALES MAY NO LONGER BE THE PANACEA FOR WEAK DOMESTIC

BEAR MARKETS CREATE VALUE OPPORTUNITIES...

CBOE DJ Reit Index **$DJR** (INDEX) **230.04** Change: -6.32 -2.67% Volume: n/a

Change Symbol Go

Overview News **Chart**

Basic **Advanced** Interactive

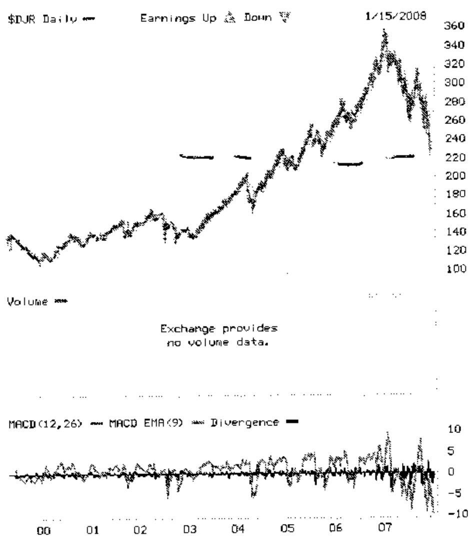
Symbol: $DJR Go

Get an Alert on $DJR at: $195.53 $264.55 other...

Draw Chart

Time: Store your settings
All Data
Daily
Custom Time
Compare:
Enter Symbol(s):
Index:
Industry:
Upper Indicator:
Show All Events
SMA
50
Lower Indicator:
Volume
MACD
Lower Indicator 3
Price / Display:
OHLC
Small
Default Style

Draw Chart



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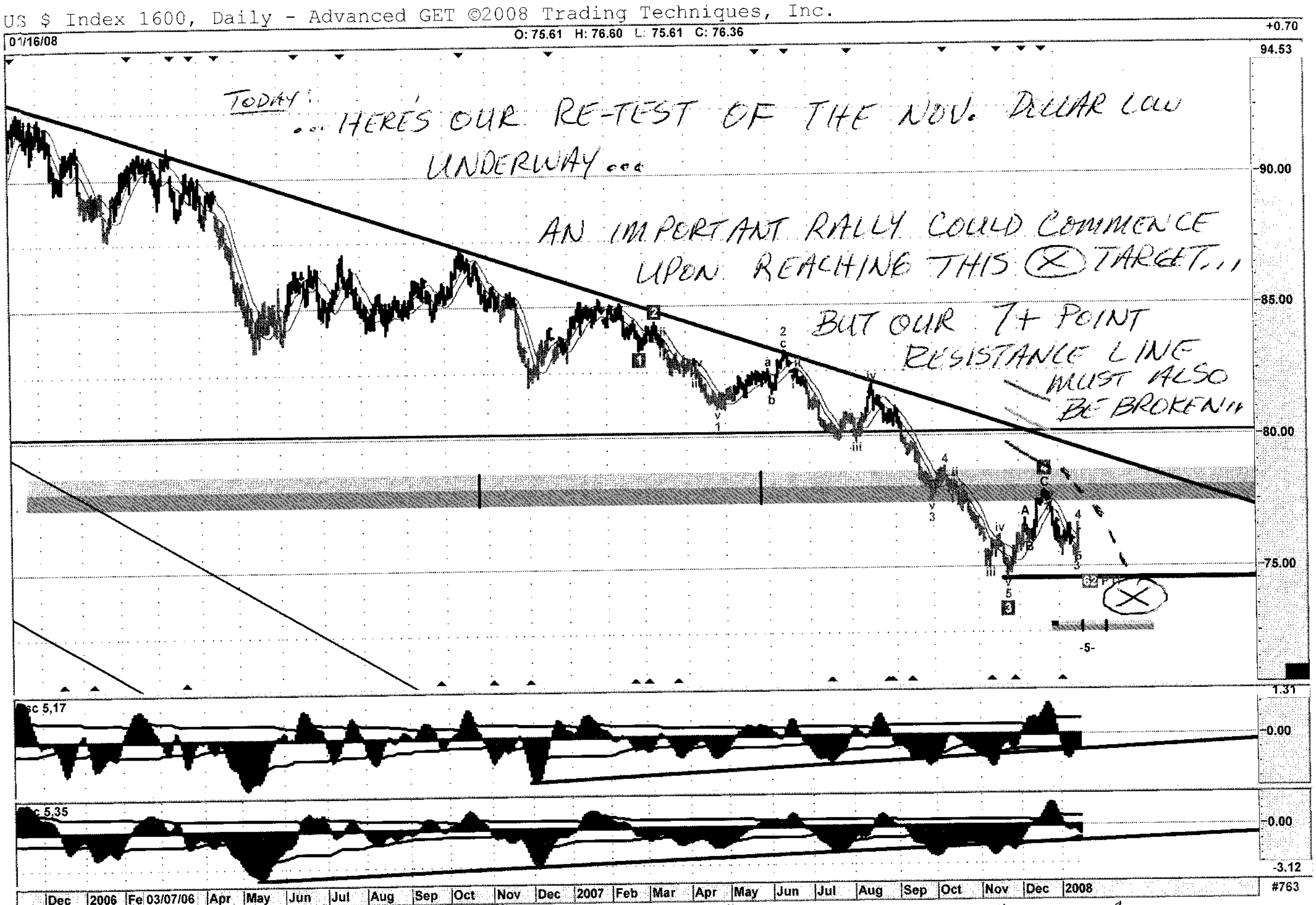
Printer-friendly

REITS ARE INTERESTING MARKET TO START WATCHING..

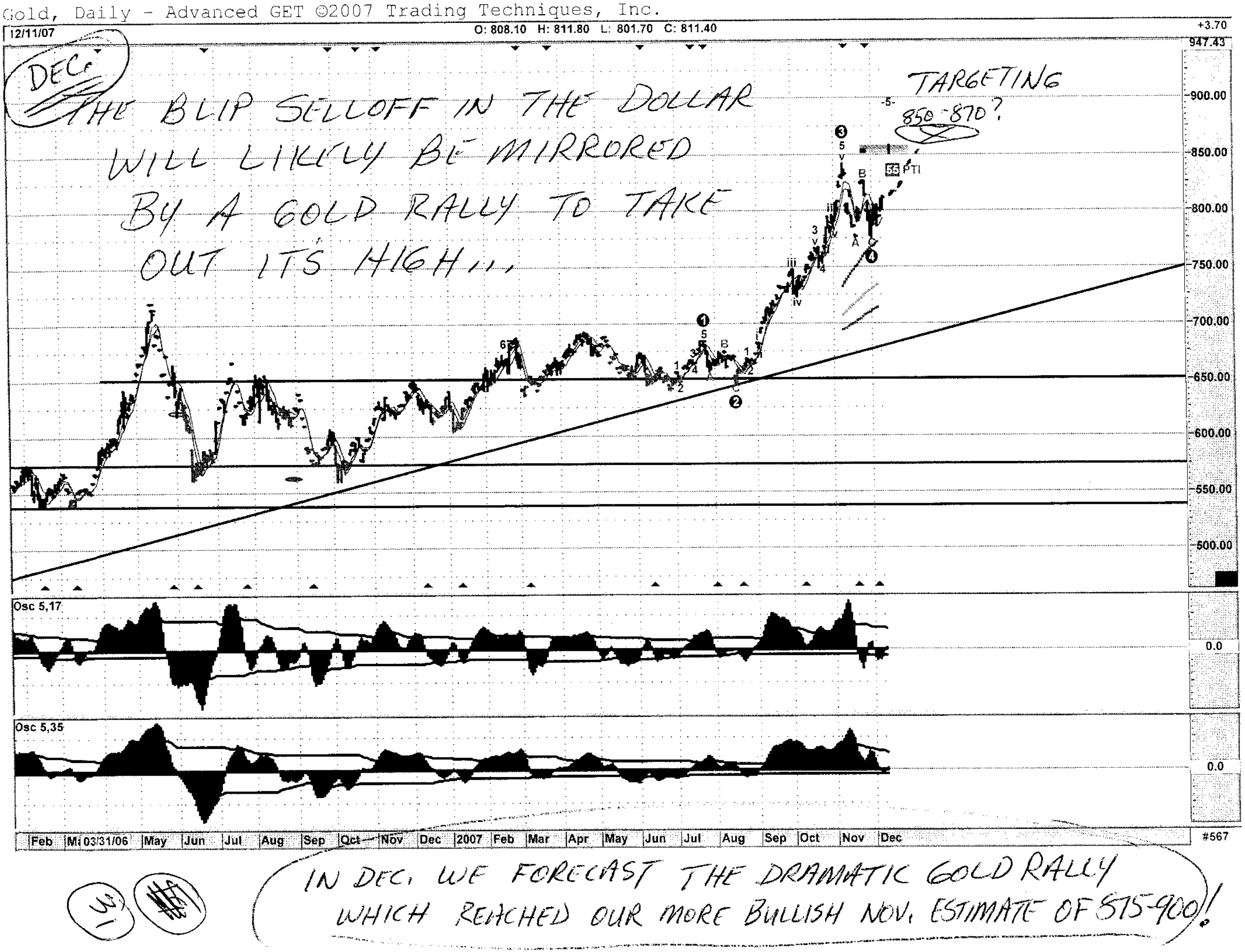
DIVIDENDS ↑ AS PRICE ↓

28

SOME SECTORS / COMPANIES HAVE SOLD OFF OR ARE SELLING OFF INTO INTERESTING VALUE RANGES.



...NOTE: Sharp "final" plunge in U.S. $ could spark mirror rally in Gold towards $1,000...


Gold, Daily - Advanced GET ©2007 Trading Techniques, Inc.
12/11/07
O: 808.10 H: 811.80 L: 801.70 C: 811.40
+3.70
947.43
DEC.
THE BLIP SELLOFF IN THE DOLLAR WILL LIKELY BE MIRRORED BY A GOLD RALLY TO TAKE OUT IT'S HIGH...
TARGETING 850-870?
-5-
PTI
900.00
850.00
800.00
750.00
700.00
650.00
600.00
550.00
500.00
Osc 5,17
0.0
Osc 5,35
0.0
Feb M 03/31/06 May Jun Jul Aug Sep Oct Nov Dec 2007 Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec
#567
IN DEC, WE FORECAST THE DRAMATIC GOLD RALLY WHICH REACHED OUR MORE BULLISH NOV. ESTIMATE OF 875-900!
31

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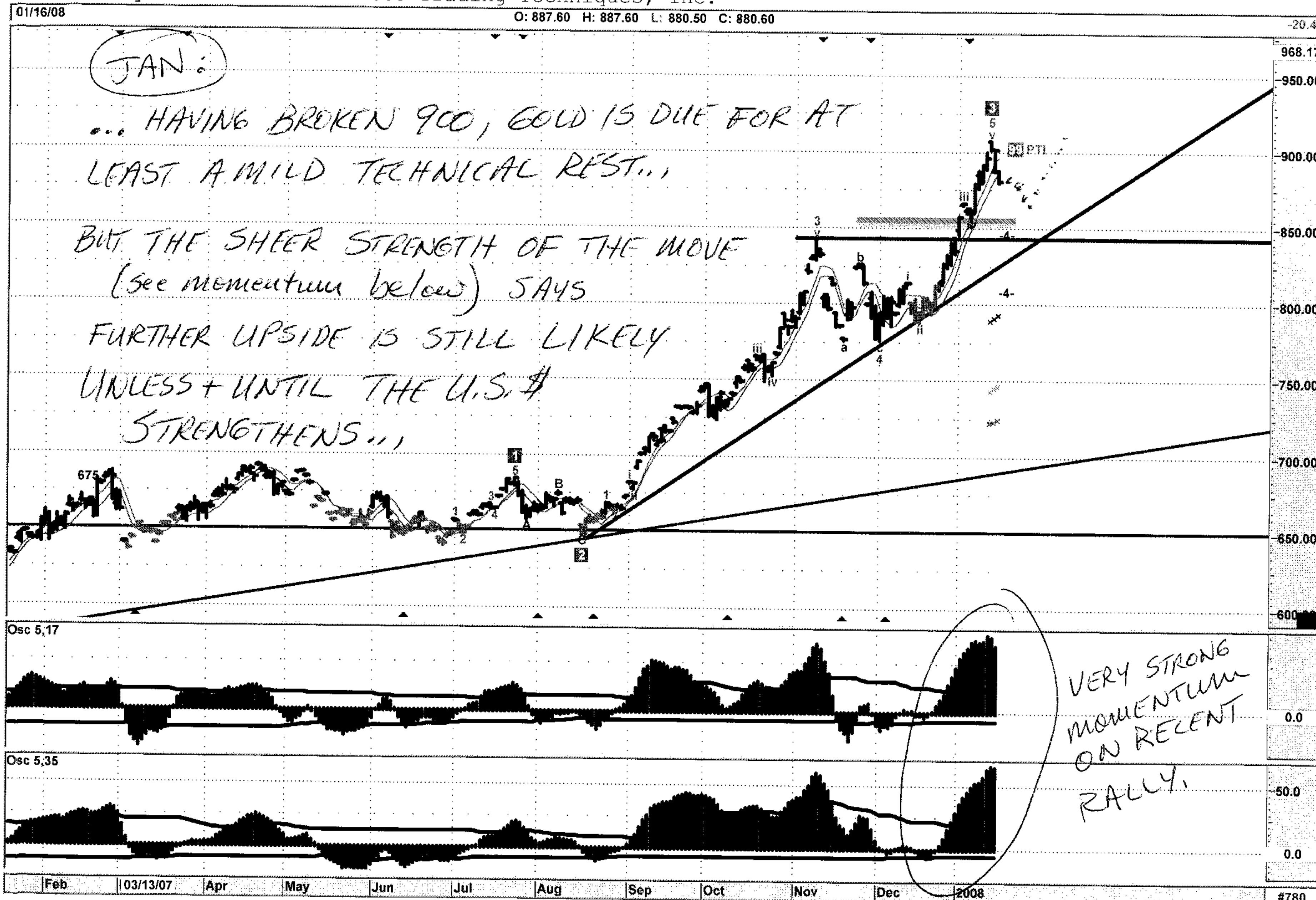

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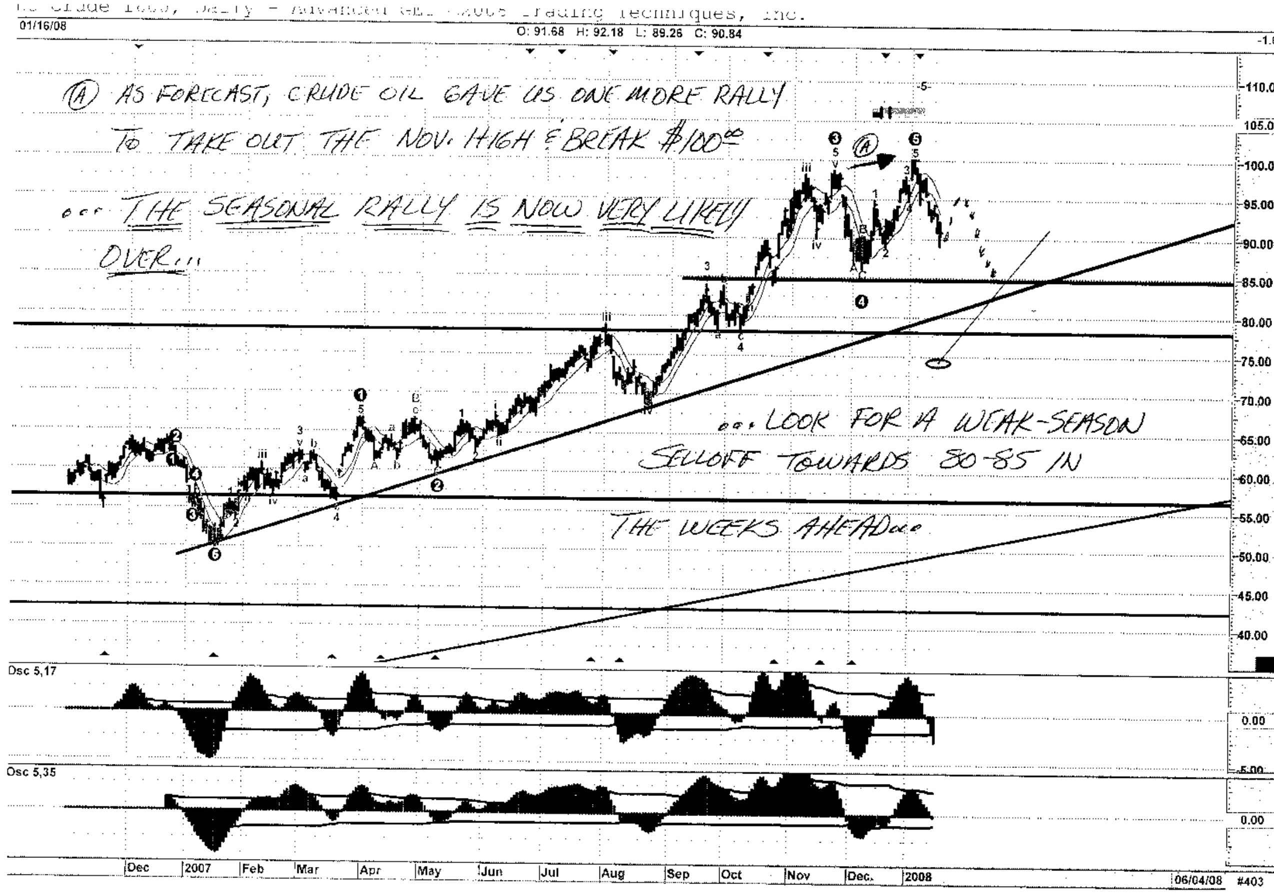

... LONGER TERM, CRUDE IS LIKELY TO PUT IN
HIGHER HIGHS LATER IN 2008...

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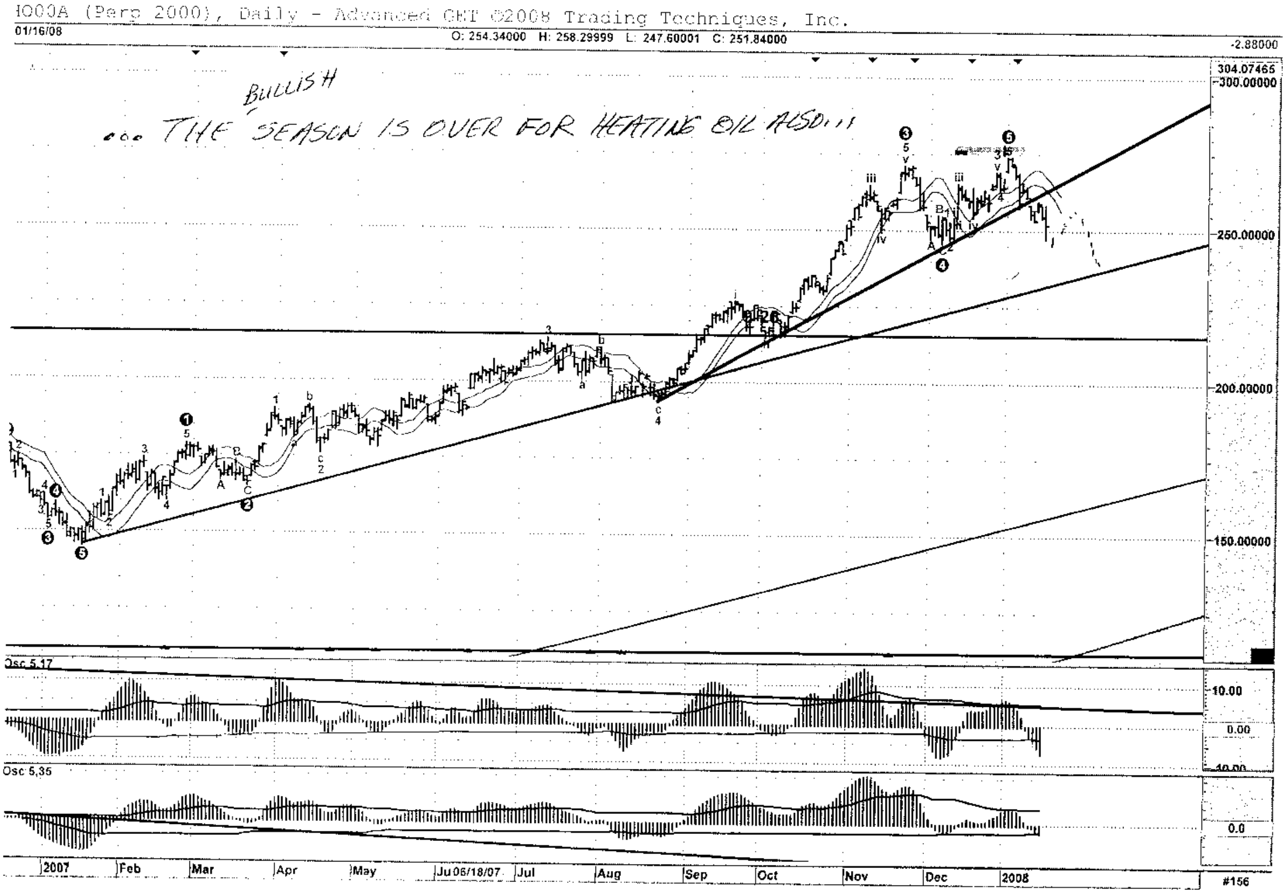

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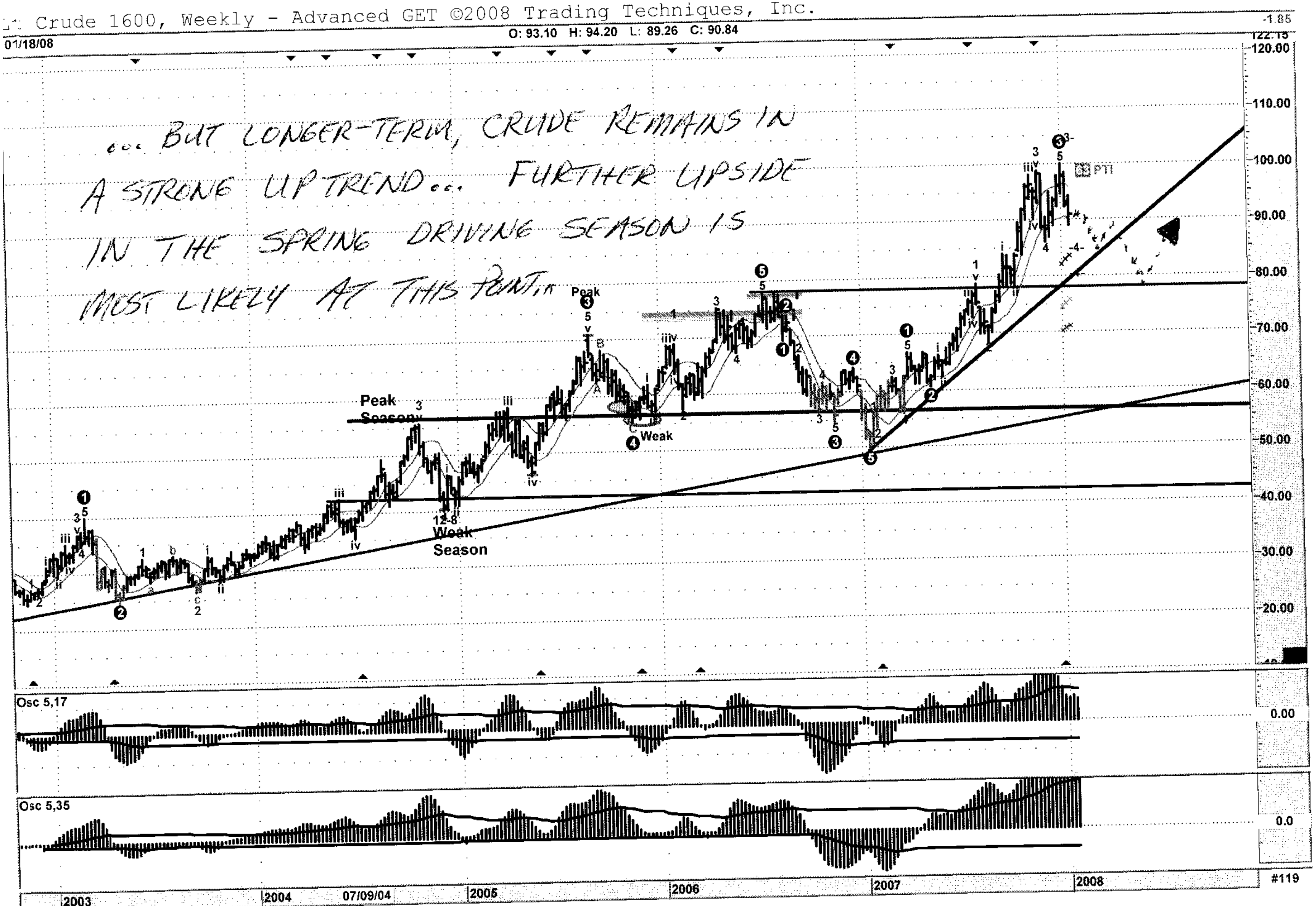
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O: 93.10 H: 94.20 L: 89.26 C: 90.84
01/18/08
... BUT LONGER-TERM, CRUDE REMAINS IN A STRONG UPTREND... FURTHER UPSIDE IN THE SPRING DRIVING SEASON IS MOST LIKELY AT THIS POINT.
Peak Season
Weak Season
Peak
Weak
PTI
Osc 5,17
Osc 5,35
2003
2004
07/09/04
2005
2006
2007
2008
#119

35