

Quarterly Investment Strategy Report 4/3/2008 – Q1

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The first quarter of 2008 has proven to be a difficult time for the financial markets as the credit crisis has led to the worst quarterly performance for the S&P 500 in 5 ½ years. The VIX index, which measures the volatility of the S&P, has risen to above average levels since late 2007. Some have pointed out the elimination of the “Up-Tick” rule, which occurred right around the same time of the increased volatility. This rule stated that investors could only short-sell a stock on an up-tick on that stock’s price. However, the rule was taken away as arguments against its prohibition of smooth trade flow and lack of any real effect arose. Now many investors claim short-sellers coordinate to bring down stocks as they can sell those borrowed shares while the price continues to fall. Recent accusations have surrounded the now collapsed Bear Sterns and beaten down Lehman Brothers. It is difficult to imagine that this rule had much of an effect. Traders could bid up a stock price with a small number of shares only to sell short a much larger amount. Some firms even disregarded the rule and paid the small fine. I find it interesting how people find any excuses possible for poor management. The “Up-Tick” rule did not force lenders to give money away freely. It did not force many firms, financials in particular, to leverage up their balance sheets. It did not create these poorly valued SIV’s that now make up a major market. Is Lehman Brothers’ just upset that they have had significant write-downs following poor investments in the mortgage market? It is their own fault that mortgages comprise a much larger portion of their assets than competitors like Goldman Sachs, Morgan Stanley, and Merrill Lynch. This is most likely the reason why their stock is down much more than their peers.

Indicators seem to be showing the economy is in a recessionary period. However, there still seems to be bulls running around out there searching for any possible type of value opportunity they can find. There was a recent report in mid-March from Merrill Lynch discussing the value trap. An analyst wrote that investors need to be aware of possible “value traps” that become common in a market environment such as this. She describes these traps as industries with very attractive valuation measures, but deteriorating earnings growth and price momentum. I believe this is very sound advice, and while the last day of Q1 and the first trading day of Q2 have shown a rebound in the markets, we need to be aware of the upcoming earnings. For one, although the weakening dollar is expected to help the US Trade Deficit, we need to remember that the US is one of the largest importers in the world. Now, as it is more expensive to import, I believe we will see some earnings deterioration internationally in companies and countries that are highly dependent on exports. Also, the ISM’s Manufacturing Index registered in around 48.6 for March which places the economy in contraction. Although the actual was above expectations of 47.5, a value below 50 is still illustrating a recession. So while the bulls took advantage of this and pushed the market higher, it is not evident a recession has passed. Also, the value was at 50.7 in January. Coinciding with the ISM issue, the monthly report on Motor Vehicle Sales has come in below consensus for January, February, and March. Used as a measure of consumer spending, this combines with the other indicator giving

signals of a recession. Common sense tells us that if this is the case, corporate earnings growth should decline in the upcoming quarters. However, in a Citigroup investment strategy report, they claim that we have not seen many earnings revisions to the lower end going forward. They believe that analysts are overestimating corporate earnings growth at this point in time. With negative growth expected for GDP for Q2 according to Global Insight, lower earnings seem inevitable. Yet, every time a major company disappoints, a market decline may follow. To me, this marks this rise in the market as temporary as the worse may not be over yet. Our rough \$1200 target for the S&P 500 stays intact.

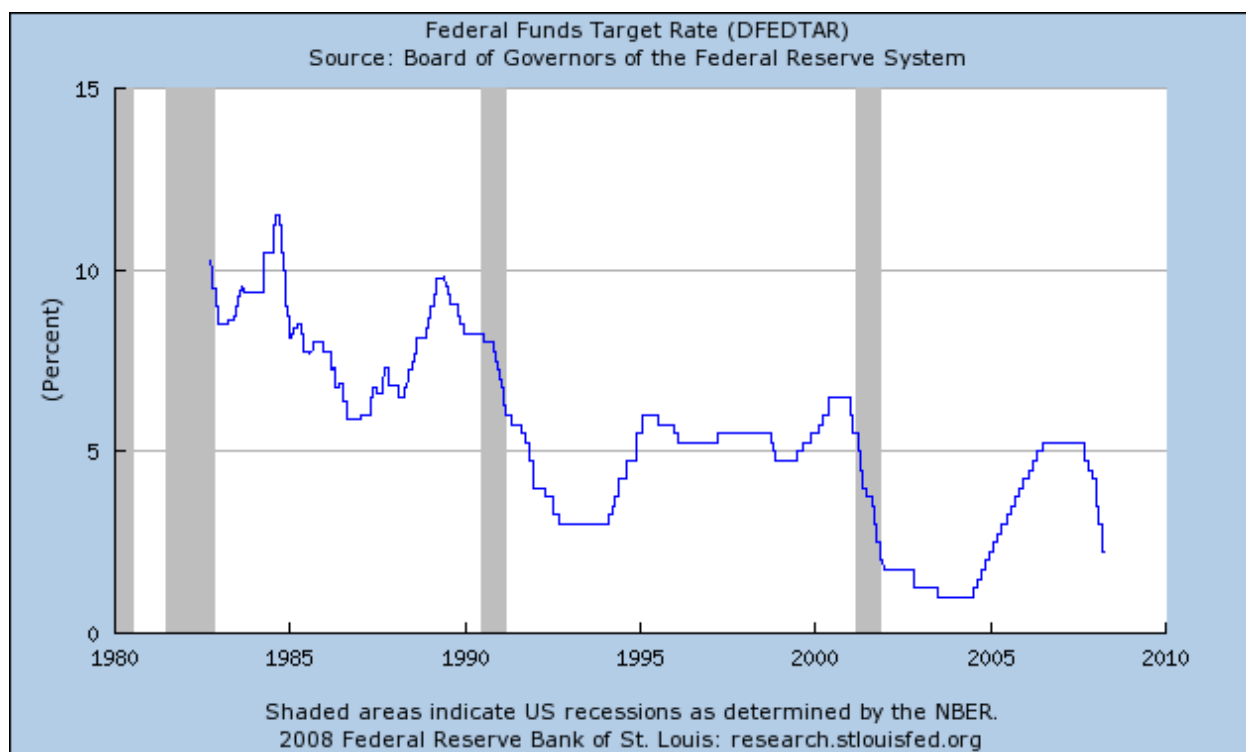
While confidence has reappeared in the market, I do not believe this is the best time to buy. Poor value investors are often caught “with their hand in the cookie jar” too early. That is not to say that the bears should go into hibernation until the recession has passed. Rather, they should migrate into the highest quality industries and equities. Surely we have seen many investors scurry into the commodities market as a way of hedging their portfolio. There have really been a couple popular plays recently. Funds have increased positions in Gold throughout Q1 as a way of protecting against the weakening dollar. Gold and the greenback move inversely to each other even though the dollar has not been backed by gold for quite some time, so they really have no ‘technical’ relation. It is possible this remains a psychological issue and will always be the case. Towards the end of the quarter, we did see some profit-taking on Gold as the \$1000 level did not hold for long. Other commodities such as silver, platinum, and copper have followed gold to higher prices as well. The second play has been oil as a hedge. Light Crude has been above \$100 for almost all of March and seems to be trading with resistance around \$108-109 and support around \$100. While some analysts have assigned the rise to increases in demand, I have mostly seen a contribution to the supply of oil. However, the EIA Petroleum Status report on oil inventories rose each week in March. This weekly report doesn’t seem to show any clear signs of supply shortage. At this point in time in the market, it is very difficult to determine if the commodities and oil have hit their highs. I am cautious to jump into these industries at this point in time as we may have missed much of their moves. I would be hesitant to purchase any companies at expensive prices with high valuations. If you can find companies that are still relatively cheap, both on a P/E and PEG standpoint, and are the “best of breed” then you will limit your downside risk, for example I still believe FCX is in this category (although it has run up recently).

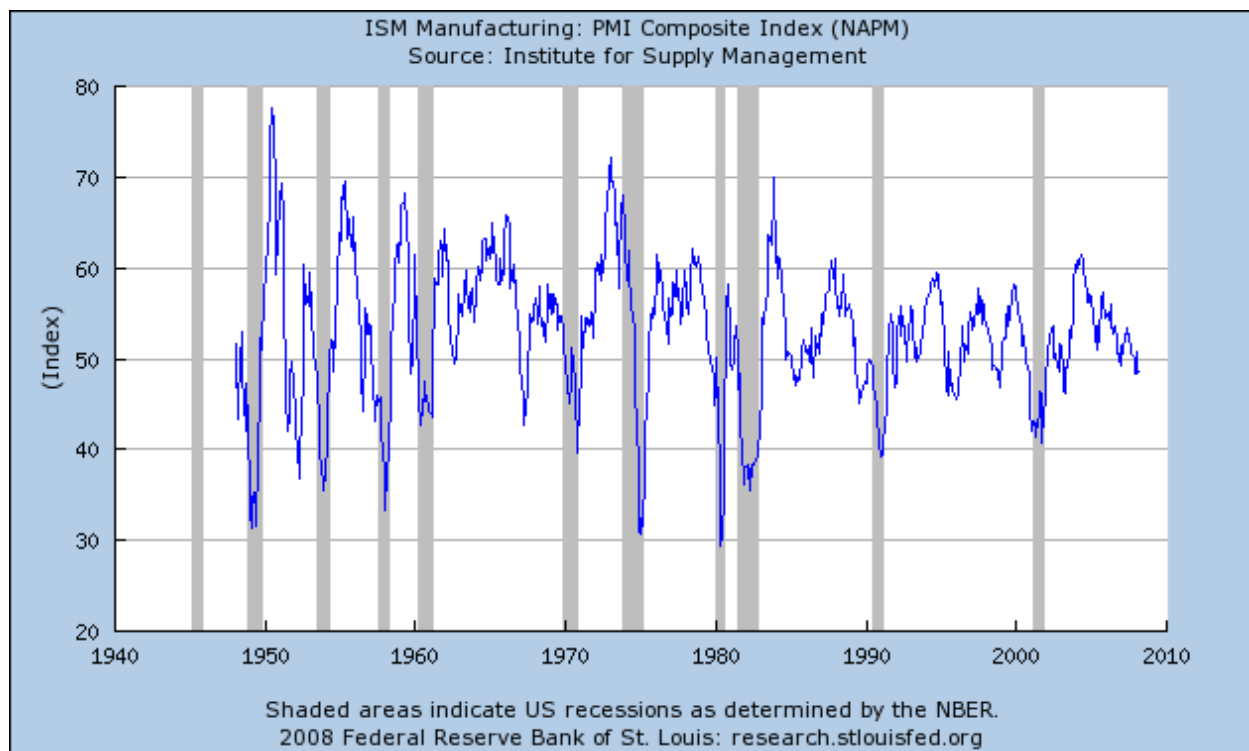
All being said, I remain a bear. Are investors all of a sudden content with the major financial institutions messing up this bad? Losing billions of dollars? The Fed has attempted to fight recession fears, yet again their cuts of the interest rates normally take months to have an effect. This still coincides with my prior opinion that we will not see any real effects of the rate cuts until at the least Q3 of 2008. Also, the market has continued to fall, and how much more room does the Fed have? Inflation is creeping, and the well-known Liquidity Trap must be on the minds of the FOMC. Without much room, it now appears obvious why the Fed was backing JPMorgan’s fire-sale purchase price of Bear Sterns. I believe the bulls may be jumping the gun. If investors are worried about hedge funds coordinating short-selling and driving prices down, then I’m taking the hedge funds side. Going forward, the Unemployment Rate comes out Friday April 4th, the Fed has their meeting April 8th, and we will see the CPI the following week. The

Capacity Utilization rate comes out that week as well. Resistance is around \$1380-1410 for the S&P 500. Risks are still higher in this market, as any disappointments in earnings or major economic indicators could send the market plummeting once again.

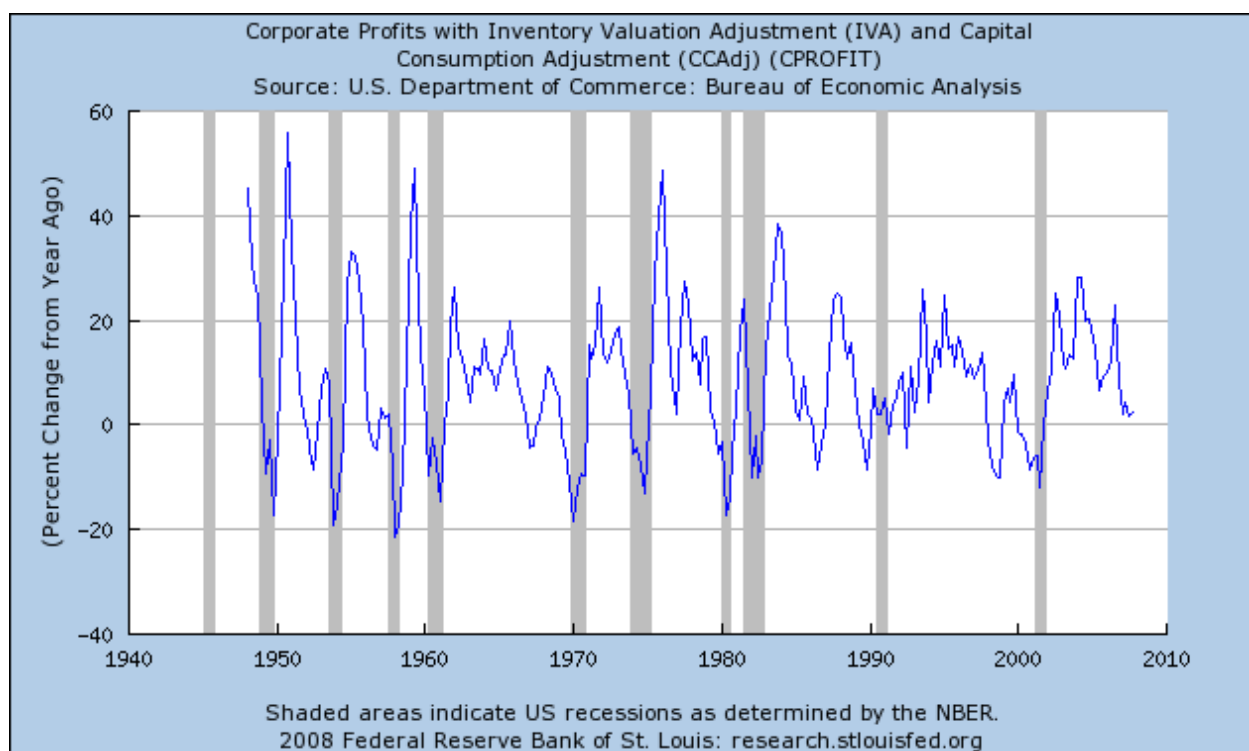
For strategy for the second quarter, I believe holding a large cash position is optimal. Allocating some money to high dividend, low beta equities may prove to be successful over the next couple quarters, too. With high oil and commodity prices, a pullback seems reasonable and probable, if not already taking place. This should simultaneously result in the dollar's declines slowing down. It would be healthy to see some consolidation over the next couple weeks. However, I believe the market will eventually continue further down which could send oil and commodity prices higher, but I'm not sure by how much. I like copper in this situation because it is still one of the most widely used metals for everyday living. It still may be best to slowly scale into solid positions over the next two quarters. This will involve looking into several Alternative Energy plays that have been beaten down. While oil and metals have risen, we have seen alternative energy such as solar fall considerably. Value opportunities are going to arise quickly in these industries. Trying to build positions at the same time the market bottoms is going to prove most difficult, but a large cash position at this point will put the portfolio in the best situation to do so.

The following pages contain long-term charts of different metals, light crude oil, and other various materials:





It should be highlighted at this point that both the ISM Manufacturing Index and Corporate Earnings are not at the levels they've reached in past recessions indicated by the gray ranges.



Gold

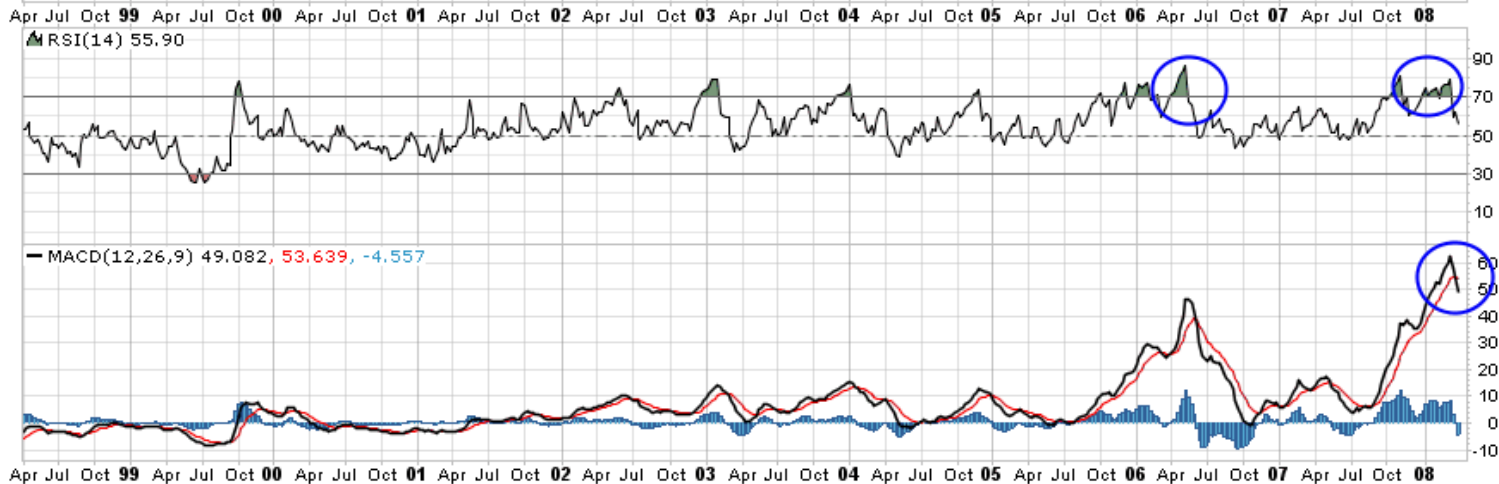
\$GOLD (Gold - Continuous Contract (EOD)) INDX

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Wednesday 2-Apr-2008

Open: **936.40** Bid: **n/a** P/E:
High: **945.70** Bid Size: **n/a** EPS:
Low: **876.30** Ask: **n/a** Last Ticks:
Prev Close: **936.50** Ask Size: **n/a** Last Size: **n/a**

▼ -3.33%
Chg: **-31.21**
Last: **905.29**
Volume: **0**



Silver

\$SILVER (Silver - Continuous Contract (EOD)) IND \times

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Wednesday 2-Apr-2008

Open:	17.91	Bid:	n/a	P/E:	
High:	18.22	Bid Size:	n/a	EPS:	
Low:	16.30	Ask:	n/a	Last Ticks:	
Prev Close:	17.94	Ask Size:	n/a	Last Size:	n/a

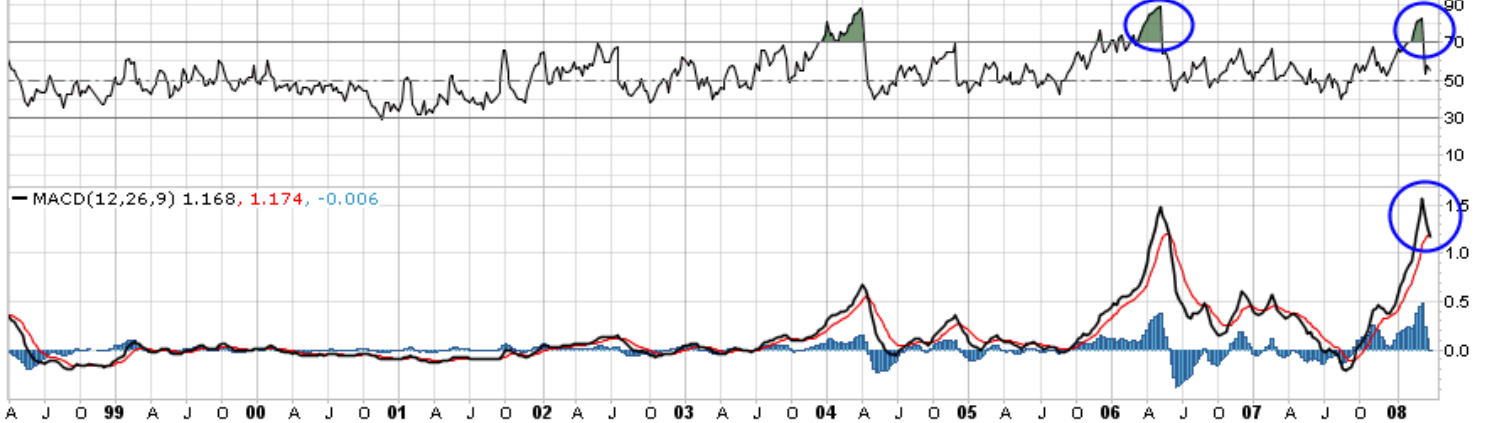
▼ -3.22%
Chg: **-0.58**
Last: **17.36**
Volume: **0**

\$SILVER (Weekly) 17.36

MA(50) 14.65
MA(200) 10.69
MA(20) 16.67
MA(100) 13.60
MA(290) 9.01
Volume undef



RSI(14) 54.56



Platinum

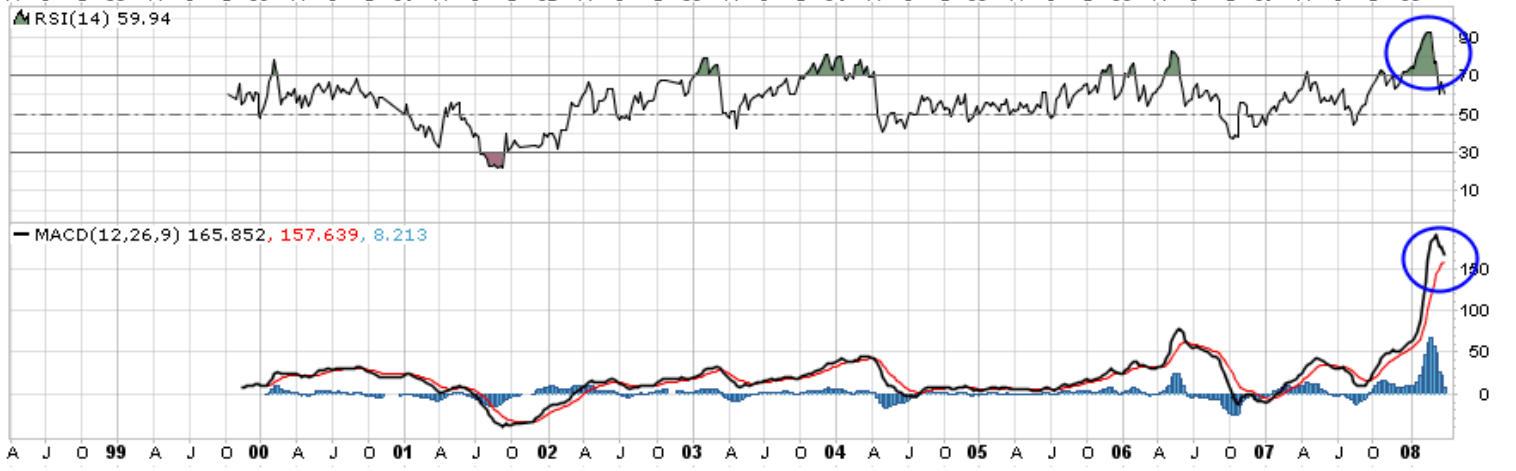
\$PLAT (Platinum Futures) INDX

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Tuesday 1-Apr-2008

Open:	2025.00	Bid:	n/a	P/E:	
High:	2052.50	Bid Size:	n/a	EPS:	
Low:	1887.00	Ask:	n/a	Last Ticks:	
Prev Close:	2048.80	Ask Size:	n/a	Last Size:	n/a

▼	-5.42%
Chg:	-111.00
Last:	1937.80
Volume:	0



Copper

\$COPPER (Copper Futures - COMEX) INDX

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Wednesday 2-Apr-2008

Open: **383.95** Bid: **n/a** P/E:
 High: **387.15** Bid Size: **n/a** EPS:
 Low: **370.90** Ask: **n/a** Last Ticks:
 Prev Close: **383.15** Ask Size: **n/a** Last Size: **n/a**

▼ -0.70%
 Chg: **-2.70**
 Last: **380.45**
 Volume: **0**

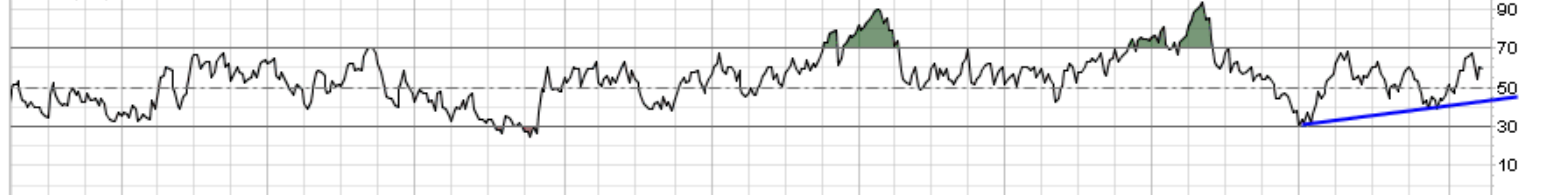
\$COPPER (Weekly) 380.45

MA(50) 343.92
 MA(200) 250.23
 MA(20) 341.57
 MA(100) 332.51
 MA(290) 200.60
 Volume undef

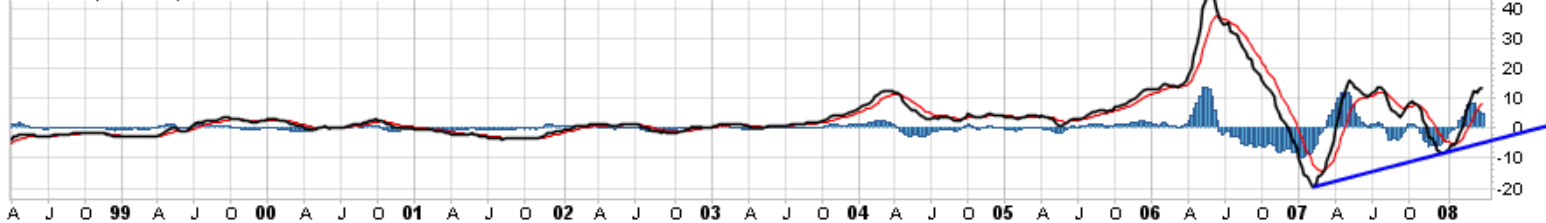
We may see some more short-term consolidation, but the overall trend seems to be a bullish flag pattern unless we get a breakout through the support trend line



RSI(14) 59.35



MACD(12,26,9) 13.398, 8.458, 4.941



Light Crude Oil

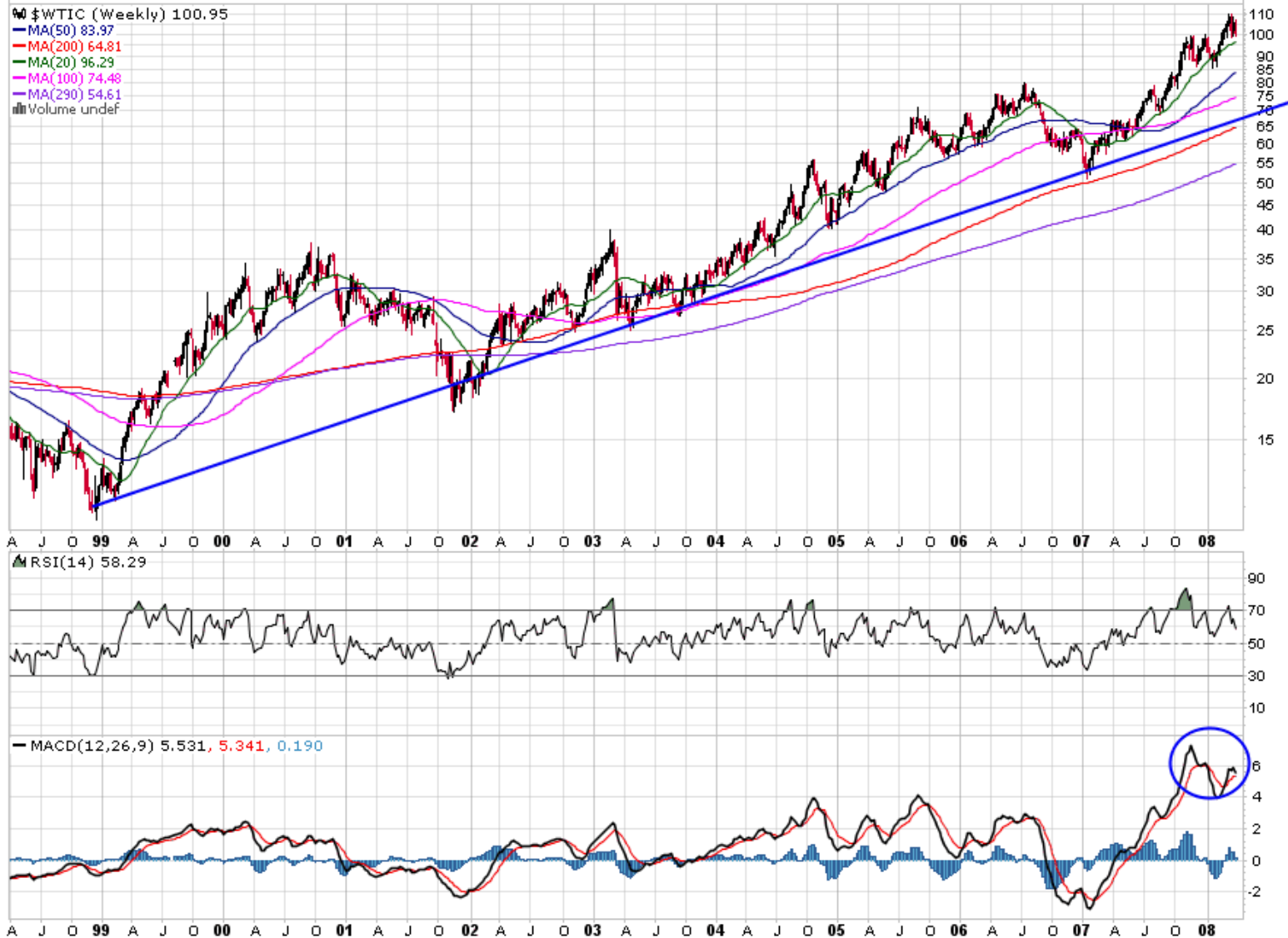
\$WTIC (Oil - Light Crude - Continuous Contract (EOD)) INDX

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Wednesday 2-Apr-2008

Open: **105.12** Bid: **n/a** P/E:
 High: **106.78** Bid Size: **n/a** EPS:
 Low: **99.55** Ask: **n/a** Last Ticks:
 Prev Close: **105.62** Ask Size: **n/a** Last Size: **n/a**

▼ **-4.42%**
 Chg: **-4.67**
 Last: **100.95**
 Volume: **0**



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