The Insider Trader

Issue 33 July 2009

Markets at a glance

Trendspotter Signals *(click on links to obtain up to-date signal)*

Dow Jones (DJ)

S&P 500 (SP)

FTSE 100 (X)

DAX (DY)

£/US$ (BP)

US Dollar Index (DX)

Crude Oil (CL)

Gold (GC)

Coffee (KC)

Orange Juice (OJ)

Sugar (SB)

Wheat

Cotton

Rough Rice

CENTRAL BANK RATES

NZD	2.50%	AUD	3.00%
GBP	0.50%	USD	0.25%
CAD	0.25%	EUR	1.00%
CHF	0.25%	JPY	0.10%

Show me the Earnings!

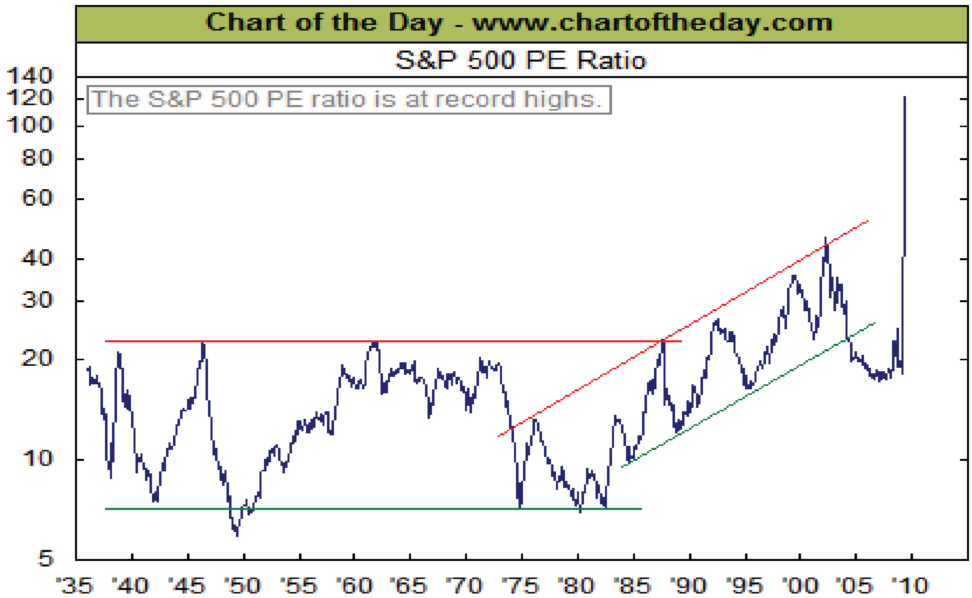
Those that remember the film Jerry Maguire which stared Tom Cruise as an aggressive sports agent will no doubt remember the classic line "Show me the Money!" But my question to the stock market this month is "Show me the Earnings!" If you cut through all the stock market hype and expose the ultimate core issue, the truth is that companies are not making as much money as they have in the past. Call me old fashioned but making a profit is the ultimate goal for any business. So far the stock market has managed to bounce on the hope of earnings being less bad rather than any sign of true recovery!

For investors there is nothing more important than earnings. Investor psychology, popular opinion, hopes and dreams, accounting tricks and positive statement can get you by over the short-term, but over the long-term the only thing that matters is the ability for companies to earn profits in their business operations.

Without long-term earnings, no company can survive. A business in a capitalist economy must earn money or else face certain doom over the long run. If we look at General Motors you see a classic example of a company that made cars that it could not sell profitably, even before the down turn GM could not make money, bailing out GM does not change the facts that there are too many cars and manufacturers and only the fittest can and will survive.

So here is my problem, whilst stocks and I refer to the S&P500 as it's the broadest index, have fallen and are down over 40% since the November

As a result of the current plunge in earnings and the recent 2.5 month stock market rally, the PE ratio has spiked to the low 120s – a record high.



2007 high the earnings have fallen even further. One of the first basics of stock investing that we all learn is when the price to earnings ratio (PE) is low then stocks are inexpensive and when the PE is high compared to historic ranges then the stocks are expensive. Historically a PE of around 20 has been the normal.

So whilst share prices are down 40% the P/E on the S&P500 according to my calculations is a whopping 100, now I know that many will disagree and say that I am using trailing earnings and being overly pessimistic but even by the Standard & Poors figures its over 60 see: http://www2.standardandpoors.com/spf/xls/index/sp500pe_ratio.xls or just search Standardandpoors.com and PE.

My point here is regardless of how you dice and slice the P/E its historically high and either two things will have to happen a) earnings will need to accelerate exponentially in the next few years or b) share prices will need to fall maybe another 50% from current levels and earnings need to still go up.

This game of "beating the analysis estimates" is wearing thin, setting the bar artificially low so when the earnings or rather lack of earnings are released the media pundits can announce them as "better than expected" but this is nothing more than a confidence trick. Also cost cutting and restructuring can only go so far!

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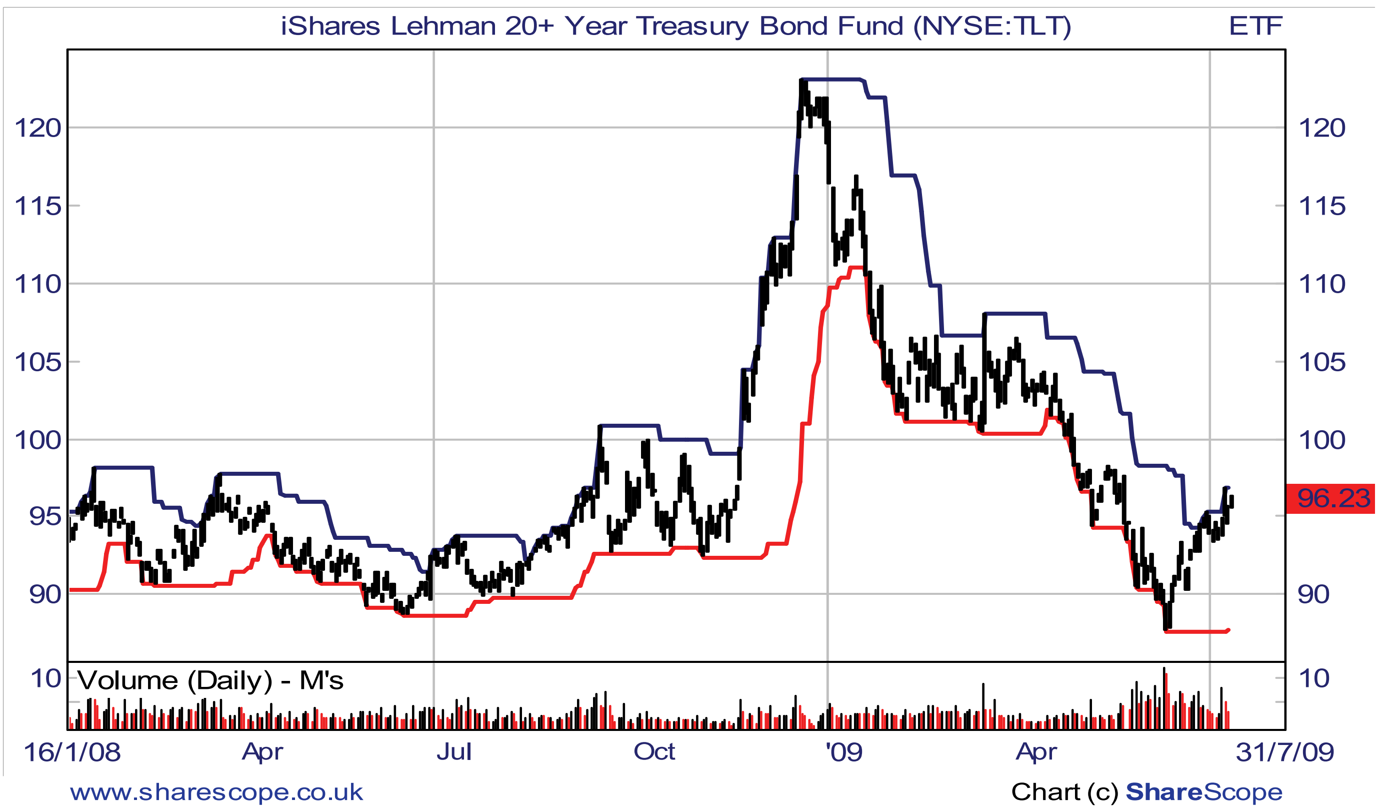
So whilst the March bounce has been interesting, I have a warning in my previous updates this is just a bear market rally and as we head into September expect to see markets fall. Of course there will also be some sharp rallies and many false hopes along the way but stocks are going lower.

For my own trading I am building up short positions in various sectors as well as the major indices. **On the buy side I like US Treasury Bonds which you can spread bet or you can buy spread bet the ETF tracker. Whilst I don't like T Bonds long term, short term and I mean between now and the end of the year I see Treasury Bonds moving up as stock move down. <u>Also I don't see any inflation pressures certainly until 2010 so no inflation will help T bonds.</u>**

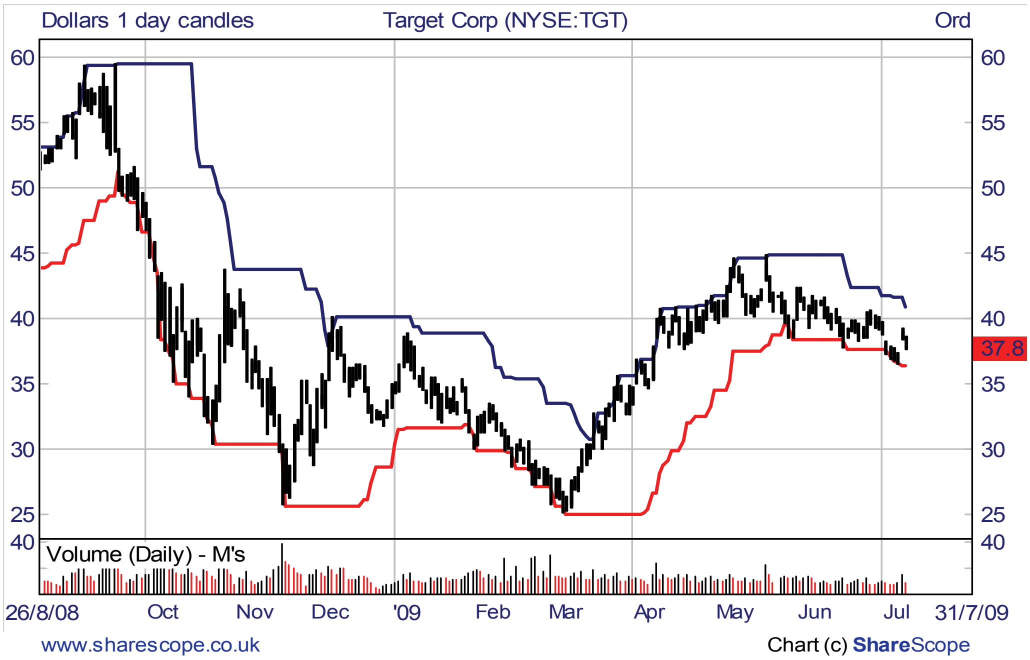
One of the few companies that I do like at present is **Kraft Foods (KFT) at $25.50 it offers a yield of 4.5%** and should hold up well in any downturn, also stands to benefit from a fall in commodity prices. Kraft reports its second quarter on the 4th August after the market close and I expect a solid performance. Kraft has many respected middle of the market brands such as Milka Chocolate, Maxwell House, Oreo cookies, Ritz Crackers and Philadelphia cheese to name a



A few.

Retail shares are no Bargain

Since the March stock-market lows most sectors have had a nice bounce and shares of companies in the retail sector are no exception. The Retail HOLDRS ETF (NYSE:RTH) which tracks US retailers has moved up over 30% since the low, however, I see little value in this sector and now would be a good time to start selling. I am looking at US retailers and focusing more on the discretionary retailers rather than the essentials, so rather than sell the whole sector short you need to pick the individual shares.



Target bounce back from the March lows but starting to roll over, next stop $30

Before I go through the individual companies lets back up a minute. With unemployment continuing to rise it's hard to see how retail spending can start to get back to anywhere near 2007 boom levels. Credit cards and store cards are also becoming harder to obtain with many credit card companies reducing credit limits which mean that even if consumers wanted to shop on credit they cannot. Also the trend in the US has been for consumers to start saving money and pay off debt - all bad news for retailers. If that's not enough fixed costs remain high, wages, rents and day to day running expenses have not come down, so you have reduced sales, reduced margins yet your fixed costs have remained the same – not a good business model. Also with fierce internet competition many consumers go to retail stores to do research and then make their final purchases online.

Here are some of my picks which can all be sold short using most major spread betting companies, I would suggest using the December contract. **Macys (M), Target (TGT), Staples (SPLS) and Best Buy (BBY)**

British Airways £1.28p Short Sell

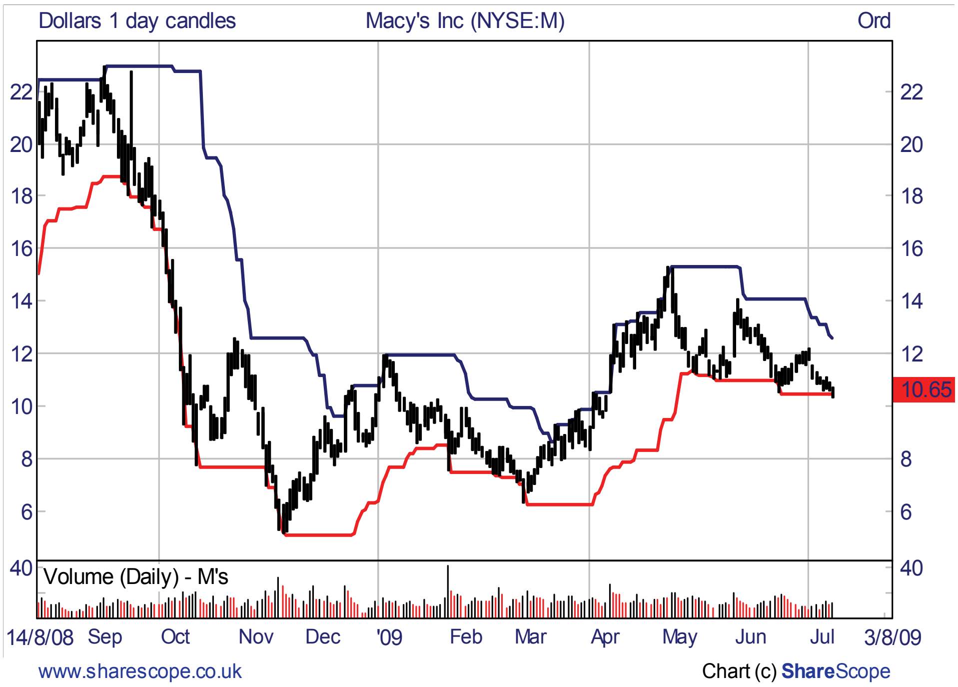
Bluntly this company is a disaster and without a government bailout or some miracle I really cannot see how this business can last. The share price is already factoring the massive amount of financial stress however my own research shows that its even worse than it looks!

A fair value of 60p is the best that shareholder could expect from any merger/partnership. One thing for certain is that this company cannot survive in its current state more than another 12 months.

With the choice of a bankruptcy on its hands world governments will allow some sort of global alliance to finally go through which could be BA/AA/Iberia and even a few others. They would also need to raise a massive amount of new capital hence current shareholders will be diluted.

The British Airways 1.30 PUT warrant is a way to get downside exposure SI73 or just short via a spread bet.

Of course you will get some "good news days" and see a few sharp up moves but overall its a losing battle just like General Motors and Chrysler.



US Department store Macys on its way back to the March lows of $6 before the end of the year.