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TAIPAN

FORESIGHT COURAGE PROFITS

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Crisis and opportunity: Global hotspots will spell profits in 2007

by J. Christoph Amberger

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Executive Publisher

Venezuelan President Hugo "El Comandante" Chavez was re-elected for a second six-year term in early December, campaigning on a neo-communist platform that stresses redistribution of wealth and opposition to the United States. Chavez's victory was resounding and the strength of his mandate the envy of all politicians in the age of asymmetrical politics, who depend on swaying 5% or less of the electorate. He garnered 61% of the vote; his challenger, Manuel Rosales, 38%.

Being the foremost neo-com agitator in the region, Chavez continues a streak of leftist election victories in the Americas in the last month and a half.

Venezuela has now cemented its role as a cornerstone of Latin American petro- and narco-communism. Chavez vowed to use his renewed mandate to abolish presidential term limits and create a single-party system to secure his power for decades.

Among its most outspoken allies in the region are Evo Morales of Bolivia and Rafael Correa of Ecuador (who won a runoff election recently). Both countries are heavily dependent on financial assistance from Chavez's petrodollar riches.

Neo-com reaffirmation

Socialists Luiz Inacio Lula da Silva in Brazil and reborn Sandinista head honcho Daniel Ortega in Nicaragua have won recent presidential elections. Both still pursue a less contentious course than Chavez. In Mexico, the Chavezian loser of the recent presidential election has declared a parallel government.

Here's what you can expect from Venezuela in the next three years: a complete renationalization of the oil industry and other key economic sectors (eventually leading to a drop in oil production and exploration); the establishment of a government monopoly on information and the press; redistribution of petrodollars to the Venezuelan poor in the form of food, health and education programs; an emigration wave of the Venezuelan middle class to Argentina, Peru, Paraguay and the United States; the construction of Russian armament and munitions factories on Venezuelan soil; acquisition of Russian, Chinese, Iranian and North Korean long-distance missile technology; pursuit of nuclear capabilities in cooperation with Iran, Russia and North Korea; and pursuit of continental dominance, extending its reach into Cuba.

In the coming months, Venezuela will increasingly use its role as the fourth-largest oil supplier to the United States to exert political pressure.

We believe the direct beneficiaries of the neo-coms' resurgence in South America will be U.S.-based companies with oil assets unaffected by the future South American and present African and Middle Eastern crisis points. Among our favorites is **Apache Energy (APA-NYSE)**, which currently trades close to our recommended entry price in the mid-$60s.

But Apache does not require conflict scenarios to play out to be a good investment; it is simply a great company. Apache has managed to increase its oil and natural gas reserves by 19% each year, both by acquisition of assets and by exploration. (The company has a 91% drilling success rate.) In 2006, the company added reserves of over 350 million barrels of oil equivalent. Since 1990, output has grown close to 15% annually. Even through the decline in oil prices in the latter half of the past year, Apache still increased revenues by 12% and net income per share by almost 11% — *and it still sells at just eight times earnings.*

The new wild card for oil prices

Armchair strategists inside the Beltway are betting that beating a swift retreat from Iraq is the ticket to peace and stability. They may have the peace and stability of their electorate (and, thus, their own mandate) in mind. Whether the absence of U.S. armed forces from the Middle East would actually spell

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relief to the region is a different question. After all, the crucial error in the planning and execution of the liberation, occupation and rebuilding of Iraq was the assumption that this would be taking place in a culture that would take to freedom, democracy and the American way of life like the Germans and Japanese did after World War II (and the Russians, Latvians, Hungarians and Poles did after the end of the Cold War).

What the strategists of the Iraq War did not consider (and maybe were unable to envision) were the underlying cultural factors: unresolved rifts and hatreds that had been festering for centuries and, after the destruction of the totalitarian pressure cooker that held it all together, were now at liberty to act freely and brutally, pitching Shiite against Sunni, moderate against radical, secularist against fanatic.

The American public is, rightfully, focused on the hundreds of dead American soldiers that are being sent home in flag-draped caskets each year. To a culture that no longer maintains cemeteries around new churches, banishing death to the suburbs, and reduces war to two articles in the morning paper and two video clips on the evening news, any number of dead incurred in military conflict is unacceptable: Even if the actual number of dead after four years of hot war in two countries still has not reached the number of civilian deaths incurred on a single, cloudless September day back in 2001.

But the American death toll in Iraq pales in comparison to the number of dead accumulated each day by internecine slaughter. While the administration may still be hesitant about labeling this killing as a civil war, it is becoming more and more apparent that at the core of the crisis is the Muslim equivalent if the Thirty Years' War, during which warring alliances of Catholic and Lutheran states annihilated each other over matters of liturgy and catechism between 1618 and 1648.

This regional war is unlikely to stop when newly elected U.S. politicos start kissing the babies of veterans returning from Iraq for good.

The Saudis have already indicated that they would be providing financial backing to Iraqi Sunnis in any armed conflict against the Iran-sponsored Iraqi Shiites — as soon as the U.S. forces retreat. Saudi Arabia actually would prefer to have the Americans stay in Iraq, be it only to keep Iraq's Shiites from massacring the country's minority Sunni Arab population. Given the death toll of the past weeks, this is a rational concern.

An open regional conflict that would militarily pitch the Saudis and their allies against Iran opens up an interesting line of speculation. Not only would America's absence from the Middle East be of short duration, but since Iran depends on oil revenues to finance its military and political adventures, oil could once again become a weapon of war.

Nawaf Obaid, a consultant to the Saudi ambassador, recently wrote an opinion piece in *The Washington Post* in which he argued that one of the first consequences of an American pullout of Iraq could be a move by the Saudis to flood of the global oil market with cheap oil, cutting prices in half. This move, he said, "would be devastating to Iran, which is facing economic difficulties even with today's high oil prices."

Tellingly, Obaid was instantly fired by the ambassador.

Looks like retreating from Iraq could have two political benefits for then-incumbent Democratic candidates in the 2008 elections: the troops will be home and oil may be cheaper than milk again. The Middle East, however, may be burning. ■

RECOMMENDATION 1

Graying Reds spell green:

Ride the Chinese IPO wave with this options play on an imminent Chinese A-share mega-IPO

by J. Christoph Amberger

After dragging their feet for the better part of the year, the Chinese investment banks must have caught the New York bonus bug: Trying to re-engineer the already hefty balance sheets (and prospective bonuses), more than a dozen companies whipped through initial public offerings on the Shanghai Stock Exchange in the last three weeks of 2006.

One of them was our top recommendation from the September issue. And boy, were they in a hurry: Less than two weeks after receiving approval from the Chinese Regulatory Securities Commission, **Guangshen Railways (GSH: NYSE)** made nearly $1.3 billion in its initial public offering on the Shanghai Stock Exchange. Projected dates for the public offering were in the first quarter of 2007.

In the fourth-largest domestic Chinese IPO this year, Guangshen sold 2.75 billion shares on the Shanghai exchange, receiving 3.76 yuan per share. Investors ordered 119.9 billion shares, nearly 44 times the number on offer, after Guangshen announced a range of 3.3 yuan to 3.79 yuan per share.

As we explained in the original recommendation, the company will use the IPO proceeds to buy a rail line between the Pearl River Delta city Guangzhou and Pingshi, a suburb of Lechang, more than 100 miles to the north. Currently owned by another subsidiary of its parent company, the acquisition marks Guangshen's first move outside of the Pearl River Delta.

Along with expansion, the company plans to construct a fourth line between Guangzhou and Shenzhen, which is the closest city to the Hong Kong Special Administration Region. Guangshen operates the only commuter trains between Guangzhou and Shenzhen and provides service to and from Hong Kong.

Even though we've already racked up a 45% gain on our initial investment since our publication date in the second half of August 2006, we continue to recommend that you hold on to your Guangshen shares for at least the next two years. With Chinese government backing and plans for major railway expansion, Guangshen is just getting started.

IPO mania

Guangshen attracted about 460 billion yuan worth of bids in the share sale, making it China's fourth-biggest IPO this year, right after Industrial & Commercial Bank of China Ltd., Bank of China Ltd. and Daqin Railway Co.

But even before the Guangshen offering, Chinese IPOs had set new records: Companies raised $18.2 billion selling shares on Chinese exchanges this year, more than eight times the number realized in 2005.

Part of that is due to the sheer backlog in IPOS. (China's government had ended a yearlong ban on new equity offerings only in May.) But the success of the domestic offerings is creating its own momentum, much like Internet IPOs did in the late 1990s. The surge in A-share offerings, on the Shanghai and Shenzhen exchanges in particular, has encouraged even Hong Kong-listed Chinese companies to raise equity on the mainland markets.

At least seven Hong Kong-traded Chinese companies are expected to raise a combined $13 billion in the coming months, including such longtime *Taipan* favorites as PetroChina Co., China's largest oil company.

Another company with long-standing Hong Kong market history is **China Life Insurance Co. (LFC:NYSE)**, which is getting ready to claim its stake in the A-shares market next year.

I like this company so much that I decided to steal this recommendation from my colleague, Todd Schoenberger, who had been following the stock since summer.

Here is the back story: China's insurance sector is by now growing at a double-digit clip each year. Beginning in 1980, the country's insurance market grew at an average rate of 26%. In 2001, total premiums reached $20 billion. By 2005, that figure had jumped to $34 billion — a 70% increase.

There are several reasons to be bullish on this. China's large, underinsured middle-class population still represents tremendous growth potential in its insurance sector. The country's fast-growing economy and low penetration make China one of the most attractive emerging insurance markets in the world, and there are very few players involved in this space right now.

But the best news is in the bad news. If you think that the funding of the U.S. or European retirement systems are a catastrophe in the making, China's are downright dire: The Chinese social-security system is notoriously underfunded. And the country's decades-long one-child policy will virtually guarantee that there will be severe shortfalls in funding the retirement of the Communist-era parent generation through the payroll deductions of their offspring.

Other than in the United States, where people tackle the problem of planning for retirement by either funding equities-based retirement accounts, such as 401(k)s or 403(b)s, or ignoring the problem altogether, most other countries have a long-standing habit of using life insurance policies for their retirement planning.

Fifty-five percent of market share

Beijing-based **China Life Insurance Company** is China's largest life insurance company with a market share of 55%. It was founded in 2003 after a restructuring of China Life Insurance (Group) Company, the state-owned insurer that still holds a 72% ownership. China Life mainly conducts three lines of business: life insurance, accident insurance and health insurance. All three are rampant boom industries! The firm provides insurance services to over 100 million policyholders. Life insurance accounts for about 80% of its revenue.

Structurally, China Life is the best-positioned life insurer with the most extensive agency network. As the largest life insurance company in China, it boasts of having over 668,000 sales representatives and tied agents, 60 million life and annuity policies, and more than 4,500 branches across China.

Even with increased competition, China Life continues to hold up its market share in the country's insurance industry. Outside of Beijing and Shanghai (the third- and fourth-largest insurance markets in China), China Life continues to gain market share in other top 10 cities. Demographic shifts in China continue to be significant driving forces for the development of the insurance industry outside of the familiar cities.

China Life is forecast to generate 18% average annual premium growth and 21% earnings growth over the next five years, based on outstanding growth prospects and product development. These growth prospects are assuming an exchange rate of 8.03 yuan per U.S. dollar. This does not account for potential yuan appreciation against the dollar, which represents further upside to any fair value estimates to the stock. (Every 5% increase in the value of the yuan relative to the U.S. dollar, a $2 increase is calculated for the stock's ADR.) In addition, analysts are expecting a 14% average return on equity for the next five years.

High flyers

Following its inclusion to the World Trade Organization (WTO), China's "open" insurance market, China Life enjoys an economy-of-scale advantage over its new foreign competitors as it keeps expanding its operations.

China Life successfully went public on both the New York Stock Exchange and Hong Kong Exchange in December 2003, making it the first Chinese financial entity to list in both the United States and Hong Kong. China Life's IPO generated $3.5 billion dollars, which was the world's largest IPO in 2003.

We expect that China Life's issuing of A-Shares on the domestic Chinese exchanges is going to rank among the top IPOs of 2007 worldwide.

The company is trading on the NYSE as an ADR under the symbol LFC. Since Todd recommended the stock below $60 a share in the summer of 2006, prices have almost doubled. Trading at over $115 today, this stock not only looks like a prime candidate for a stock split, but is probably a tad on the expensive side to be entered into your portfolio.

That's why I asked *Diligent Investor* strategist Ann Sosnowski for an options play on the stock. She writes:

"To take advantage of China Life's continued success, without spending over $100 for its stock, take a look at the **LFC July '07 105 Calls (LFC GA)**. These call options are currently in-the-money by approximately $10. Current bid/ask spread on these calls is $20 to $20.80.

"**Buy contracts of LFC July '07 105 Calls (LFC GA) at or under $22**.

"Be advised that since these are LEAP options more than six months out to expiration, the call symbol will change closer to expiration in 2007." ■

INCOME

Ice-cold yields: Part II

How to make 12% on FDIC-insured Icelandic kronur CDs

by J. Christoph Amberger

In the November issue of *Taipan*, I highlighted the incredible potential of Icelandic bonds as a prime income vehicle in any portfolio (see "Double-digit yields on the rocks," p.10)

You will recall the gist of my argument: After a swift and massive decline of the Icelandic kronur in spring — a result of the global capital shifts that were turning out of the carry trade back into blue-chip stocks — the kronur has regained most of the ground it had lost against the U.S. dollar.

With the decline (but not collapse) of the speculative attractiveness of the carry

trade for the last couple of months, I think most of the downside risk for the Icelandic currency is contained. Even the trigger that had provided the spark for the last sell-off, an unfavorable rating of Iceland's economy based mainly on the country's new debt levels, appears to have lost its ability to spark another decline.

Chuck Butler, author of the *Daily Pfennig*, writes: "Iceland continues to be the 'whipping boy' of the Fitch Ratings Agency. However, with Fitch's last comments about Iceland, the kronur was able to hold onto its gains that have been put on the books since May.

"The krona continues to see activity on the other side of the 'carry trade' with Japanese yen acting as the 'funding currency.' As long as the carry trade exists, the kronur will be underpinned, with a bias to strengthening as the dollar continues to weaken."

The attraction of Icelandic bonds and Icelandic interest rates is the high yield of 12.01% APY. With inflation still running above 7%, the central bank should keep rates at current levels as we head into 2007.

If you're able to purchase Icelandic bonds without too much trouble, you should do that right now. But, as I discovered during my meeting with EverBank's Frank Trotter last Tuesday, there is an even easier way to siphon high Icelandic yields into your income portfolio.

I was, of course, aware that EverBank had been offering kronur-denominated CDs for about a year. (We at *Taipan* have been recommending the bank since they were Mark Twain Bank and one of the few, if not only, banks in the United States that would enable normal investors like you and me to profit from high international exchange rates in FDIC insured CDs, checking and savings accounts.)

Frank admitted that the plunge in the kronur last spring had hit hard. But those investors who stayed with the program were able to make up most of the short-term drop in value by the subsequent rise in the kronur's valuation and, of course, the high yield rate.

EverBank's Icelandic Krona Single Currency CD is offered in a three-month term only, with a $10,000 minimum and FDIC insurance of up to $100,000. Some currency-conversion fees apply when converting to/from foreign currency to U.S. dollars. Their rates as of 11/17/2006: APY 12.01% on an interest rate of 11.50%. To learn more and apply for the Iceland krona CD offered by EverBank, visit their Web site at www.everbank.com/iceland or call their toll-free number at (866) 326-6241. Mention that you read about this CD in *Taipan*. ■

WORLD CURRENCY

Outlook for currencies in 2007

by Jack Crooks

Japanese yen: We can blame the carry trade for how weak the Japanese yen was in 2006. Right now, the yen is the most undervalued of all major currencies. But I expect the yen will rally hard against the U.S. dollar, and other major currencies, in 2007 when the carry trade comes undone.

The fundamentals behind the Japanese economy are simply stronger than market players realize. The Japanese economy is normalizing. As Eric Roseman pointed out, bank lending is growing. Corporate profits are increasing. Capital expenses are expected to grow sharply. And the Japanese government is moving forward on structural reforms. Japan is also becoming increasingly integrated with China. And I expect China's growth momentum to continue next year.

Aside from the underlying economic fundamentals improving for Japan, there are two other reasons why I expect the yen carry trade to unwind in 2007. First, I expect volatility to return to the market in 2007, after one of the least volatile years ever in 2006. Increased market volatility makes the carry trade a riskier proposition. I also expect the Bank of Japan to be more aggressive with its rate hikes in 2007. If that happens, the cost of the carry trade will also rise.

The yen could surprise everyone in 2007 if we see a violent end to the carry trade. This happened once before in 1998. The yen carry trade quickly unwound because the Asian financial crisis increased market risk. As a result, the yen rocketed 32%!

Euro: I expect the euro to hit a new all-time high against the greenback in '07. The previous high was 1.3666 (set back in December 2004). The euro should be powered higher because the European economy continues to surprise on the upside. Business confidence has returned and consumer confidence is improving.

The European Central Bank (ECB) will likely remain aggressive in hiking rates, given its strict inflation targets. I expect the ECB to hike benchmark rates once again early in 2007, taking rates up to 3.75%. I predict the euro will rally hard on a strong economy and rising interest rates. Or, in other words, the euro will do the exact opposite of the U.S. dollar. And if the U.S. economy does head into a recession, the U.S. Fed will likely cut rates quickly. If that happens, short-term euro rates could cross above U.S. rates. That would give the euro a mighty boost.

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British pound: The pound continues to be my favorite long-term play against the U.S. dollar. That's because I expect the UK economy to continue to gain momentum and shock the markets. This will happen if the economy continues to benefit from strong international capital flow tied directly to its strong and vibrant service sector.

London has more foreign exchange trading and other international transactions than New York, Tokyo and Frankfurt combined. This means the United Kingdom will be one of the prime beneficiaries of the ongoing transition from manufacturing to services in the global economy. The UK economy is better poised to leverage off the global economy than any other industrialized country.

I expect the BoE to raise rates sometime during the first quarter of 2007 to enhance the United Kingdom's already attractive interest yield. Benchmark interest rates in the UK are poised to cross above those in the United States early in 2007. Just as the case for the euro, strong yield and economic growth will be powerful drivers for the pound in the months ahead. The pound is poised to test the $2 level against the U.S. dollar. Many traders think the pound couldn't possibly go as high as $2, but remember, the pound has traded as high as $2.60 against the U.S. dollar in the past. If you consider that, $2 per pound doesn't sound so outrageous.

Swiss franc: The Swiss franc is lagging behind both the euro and British pound. Though I see it moving higher against the U.S. dollar next year, I believe it will continue to trade in the euro's shadow. The Swiss franc has lost a bit of its shine as a safe haven currency. It's no longer backed by gold; it has a relatively low yield; and it lacks appeal as a central bank deposit currency (those are currencies central banks want to keep in their reserves like the U.S. dollar, euro and British pound). So I'm giving the Swiss franc third place for European bets, after the euro and pound.

Australian dollar: Of all the commodity dollars — Australian, New Zealand, Canadian — the Australian dollar is my favorite for two primary reasons. First, the Australian economy is increasingly tied to the fortunes of China. And China should continue to be the major growth engine throughout 2007. Second, the Aussie sports the highest interest yield among the major currencies. The Aussie is extremely vulnerable to a pullback in the commodity prices. But if global growth can continue at a reasonable level despite the slowing U.S. economy, then I expect commodities will still perform well in 2007. And that's good news for the Aussie.

Canadian dollar: Recently the Canadian dollar has acted poorly compared to the rest of the major currencies. It seems the currency players have marked the Canadian dollar for a slowdown because Canada's growth is tied closely to the United States. Either the Canadian dollar could have a significant rally in 2007, because of Canada's strong financial position and rising commodity prices, or it could decline as their exports decline when U.S. demand slows. So for now, I am neutral on the Canadian dollar in '07.

Easy ways to profit

So how do you invest in my top currency plays for 2007? You can hold your currency of choice in a multi-currency account at either EverBank in the U.S. or Jyske Bank in Denmark. At these banks you can also hold a basket of my top four favorite currencies: the pound, euro, the Japanese yen and the Aussie.

Jack Crooks is The Sovereign Society's Currency Director. He has close to 20 years experience in the currency, equity and futures arena. Jack is a seasoned investment advisor who has held key positions in brokerage, money management, trading and research. You can reach him by e-mailing editor@sovereignsociety.com. You can also check out his new Web site at www.crooksoncurrencies.com. ■

WAVESTRENGTH MARKET FORECAST

The broad market stalls, but an old flame is suddenly looking attractive again

by Adam Lass

As I write to you, the major markets are "resting," much in line with my prediction of last month. Yes, I know: We have seen a few tepid intraday highs, but none of them stuck, and the overall direction is sideways at best and indicative of a tendency to roll over into a modest (and long overdue) trough.

The one exception is gold, which has broken out of its downside trend with a massive upside tick last month on rumors of a drop in the Fed rate.

Is this drop coming? I do believe that it is. However, I don't think that it is coming as soon as the gold bugs were hoping (or fearing). The Fed has its own "wall of worry" to climb before it can act. And that delay will function as the trigger for a rather attractive opportunity.

Real estate sucks up all available cash

Let's begin with the flipside of that rate drop. For more than a year, the Fed raised rates hoping to cool down a real estate market that was sucking all the air out of stocks. And, much like the end of the previous investing cycle, they did indeed manage to torpedo the asset class that had them so worried.

Real estate is certainly "unpopular" right about now, with article after article hitting your desktop touting failing sales and falling prices. And yet the sector as a whole continues not only to hold on, but rally in the face of all this bad news.

The failure of the real estate bubble was quite predictable (indeed, I predicted it in these very pages). Longtime *Taipan* members will no doubt recall the profits they made on our 2005 Housing Hedge play. However, the comparisons between this asset bubble and the previous tech bubble were misplaced then, and are equally misplaced now.

Nothing there!

You see, with tech stocks, the first thing you need to know is a lot of the companies that were being touted as pure gold weren't even dross. Rather, they were pure fantasies — little more then nifty ideas scribbled on the back of napkins or cool-sounding Internet domain names — for which investors had paid out millions of dollars.

The second thing you need to know is that the modern stock market is pretty darn efficient at both creating and destroying bad ideas. The central exchanges allow immense quantities of shares to be sold off remarkably quickly at whatever price (high or low) the market will bear.

Real estate is completely different; it has no central clearing house to compare to the stock markets. However, it is approaching the idea: During the last boom, real estate brokers did get rather adept at putting their properties onto the Net.

Unique location negates fungibility

While stock shares may vary in the price that an individual bought and sold them, once held, they are, for all practical purposes, fungible. Houses, on the other hand, are unique and immobile. What's more, they are encumbered by their mortgages. As such, the relationship between the price paid and money owed very much affects the ability of an owner to resell their property.

If you sell a share of stock for a loss, you have a tax shelter (and hopefully, a learning experience). If you sell a house for less than what you owe, you have a problem, possibly leading to bankruptcy.

Slow to move

As a result, housing bubbles are very slow to deflate, but for the most part, the assets remain tangible and usable. Folks don't really need useless tech stocks, but folks will always need somewhere to live. Several population cadres are still looking for better housing, including both very active retiring boomers looking for golf course estates and their upwardly mobile kids looking to move up from their post-college starter condos.

The end result? The "bad news" coming in on housing — such as high-end housing champ **Toll Brothers' (TOL: NYSE)** announcement of a 44% drop in sales last quarter — is already priced in and doesn't seem to be touching the **Housing ETF (XHB: AMEX)** as a whole anymore, or Toll Brothers, for that matter.

But that's just the long trend. What about immediate catalysts? There is only one story here, and that's the Fed and interest rates.

Whither will rates go?

By the time you receive this, the Fed will have put out a statement saying that it will not lower rates in 2006. Not only that, but they will also say that they are very, very concerned with the threat of inflation.

This, of course, is pure bunk. Mr. Bernanke is indeed watching inflation, but not because he wants to stop it. Rather, he desperately wants to lower rates — but he must wait for a report or two that he can hang his hat on. The recent news that the dollar is actually rising in value may very well be that report, but don't expect action here until next year.

A narrow range of tolerance

The Fed is also watching the employment figures with great concern, but again, their concern is not with the folks who are looking for jobs. Instead, it is based entirely on the extremely narrow employment range that the American economy can tolerate.

Historically, no party has retained the White House when unemployment was over 7% or under 4%. In the former circumstance, there are enough annoyed loiterers to actually alter the end result of an election. In the latter case, there are so few competent workers available for hire that they can actually dictate wage terms. And since they seldom ask for less, this is a strong inflationary stimulant. Unemployment is currently hovering in the 4.5% range.

The Fed basically needs a bunch of folks to get fired — and soon. This will enable them to lower rates and retrigger real estate sales. The annual post-Christmas layoffs will most likely be the right excuse and the two-day January FOMC meeting the right time to announce either an actual drop or at least the inclination to do so.

Three ways to capitalize on a bulletproof sector

Once this happens, it's off to the races for homebuilders. It will also be too late to buy into the rally already underway. The good news? There are three decent ways to get onboard now.

First off, you can buy shares of the **SPDR Homebuilders ETF (XHB)**. This will automatically load you up with shares of four of the biggest home-

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builders, as well as builders' faves like **Home Depot (HD: NYSE)**, **Sherwin Williams (SW: NYSE)** and **Mohawk Textiles (MHK: NYSE)**, among others.

Another good choice is **Weyerhaeuser Corp (WY: NYSE)**. I find its ability to build on its own land particularly attractive. This asset also offers exposure to the commodities list, always a good move during inflationary cycles.

Poster child for hidden value

Finally, I like **Toll Brothers Inc. (TOL: NYSE)** in particular. They build high-end properties primarily in the still robust Mid-Atlantic market.

Toll Brothers is the poster child for beaten-down homebuilders. Not only has it fired its CEO, but, as mentioned earlier, it recently announced a 44% drop in fourth-quarter 2006 profits.

Toll had buyers canceling their orders in droves and had to walk away from optioned land. But now the deed is done and the books are reasonably clean going into 2007.

What's more, this completely outrageous loss did little to outrage analysts, as Toll only missed estimates by one thin cent. Didn't seem to tick off stockholders much, either: TOL actually climbed almost a buck on the news. In point of fact, TOL, much like the sector as a whole, has clearly absorbed and priced in the drop in housing prices.

Froth gone, but value remains

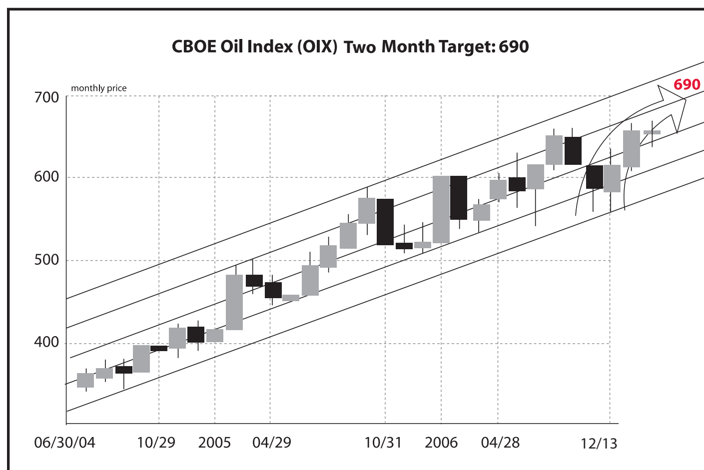
Maybe the froth is gone, but home building continues to be a viable business for those who know how to do it well. This is reflected in the clear buy signal, with price rising through the prime moving average and money flow moving into the positive.

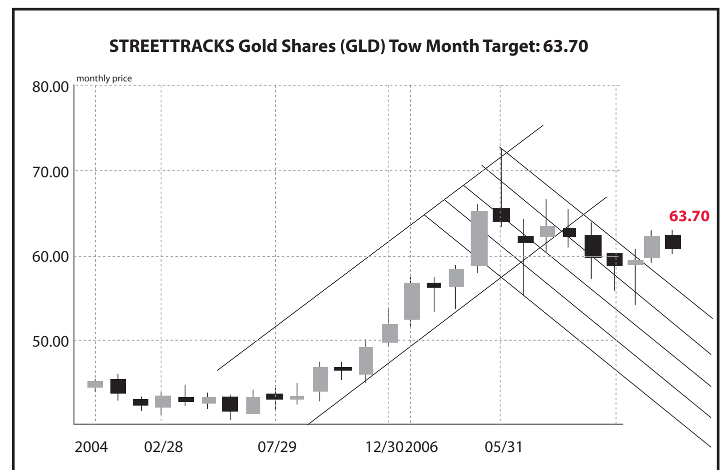
We are not looking for explosive growth here. Those days are probably gone until the spring of 2008. But winter of 2007 offers you a chance to enter a sector that promises to double from its current values over the next 12-18 months. ■

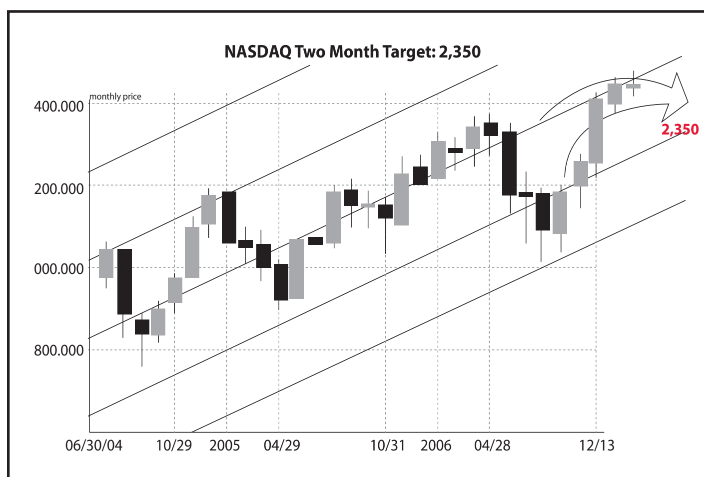
EXECUTIVE BRIEF

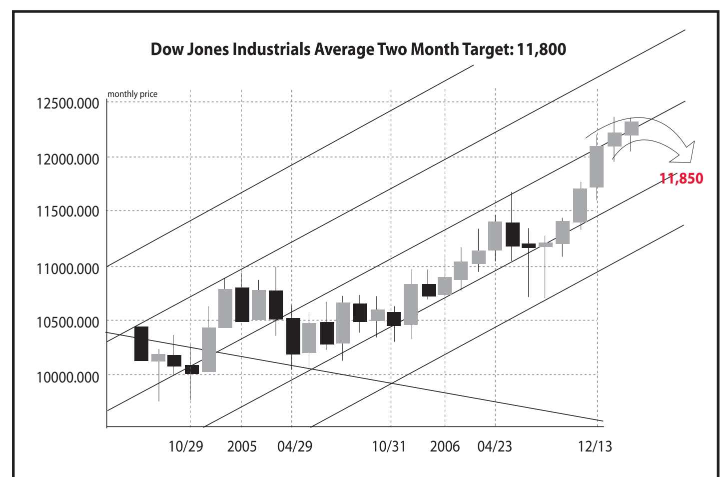
Buy:

- SPDR Homebuilders ETF (XHB: Amex)
- **Toll Brothers Inc. (TOL: NYSE) at current rates between $30-35 or better**
- Weyerhaeuser Corp (WY: NYSE) **at levels below $65 as contrarian medium-term speculations on the turnaround in the U.S. housing industry in late 2007.**









Use the gloom and doom about real estate to stock up on this dividend-producing mortgage company

by J. Christoph Amberger

If you listen to the PR machine of the National Association of Realtors, the U.S. housing slump is all but over. According to the NAR, sales of previously owned U.S. homes will grow to an annualized 6.29 million in the first quarter of 2007. They're less sanguine about new-home sales. Those, according to NAR, "won't recover until 2007's fourth quarter when transactions will grow to an annualized rate of 967,000 after falling to a low of 944,000 in the third quarter."

The property peddlers have hitched their hopes to falling mortgage rates. Indeed, fixed rates have actually been falling for most of the last four months after hitting a high of 6.8% in summer. Last week's average rate for a 30-year fixed loan was 6.11%.

Real estate will need more than lower mortgage rates to rebound: The boom we have experienced over the past five years was not at all about lower rates. It was a combination of demographic factors (with parents of the Echo Boom generation upgrading, triggering a domino effect for the rest of the market), of money flow shifts (with speculative capital reallocating from the bruised stock market into the "easy money" in real estate), and then, last of all, of lower mortgage rates.

But there are indeed some positive indicators. Rather than roll over and die, the **Homebuilder's SPDR (XHB: AMEX)** has continued to play out the run-and-rise pattern that has been rooted in place since mid-July: This index priced in the idea that real estate is dead way back in summer. It's old news now! Companies that bought real estate portfolios at the top are firing CEOs and posting hefty write-downs this quarter. They will be able to carry these losses forward for decades.

We expect there will be a boost to mortgage and title companies in late spring, when the Fed will cut rates for the first time in years. This will be a more or less symbolic gesture, which will be used by beleaguered mortgage lenders to launch a refinancing campaign, reviving a segment of their cash flow that has withered throughout 2006.

The good news is that that every home that is sold due to a better mortgage rate, will trigger another half-dozen sales.

Talk to anyone who's trying to sell his house right now and chances are he'll tell you he has a buyer lined up — on the condition that *that* buyer has to sell *his* current home first (for which he already has a buyer with a similar clause in the contract).

We will see a cautious start to the home-buying season in late February and early March... the traditional beginning of the real estate season that had all but fallen out of fashion in the last couple of years. Early movements in the market will trigger a strong if short-lived burst in mortgage and refinancing activity which may or may not be helped along by any rate cuts the Fed wants to throw in home buyers' way.

I believe it is high time to get back into one of our favorite income stocks:

EXECUTIVE BRIEF

Buy **IMH: NYSE** at current levels as a medium-term speculation on temporary peaks in mortgage activity and mortgage-related revenues around $9 or better. IMH has shown strong buying activity right before the ex-dividend date, resulting in strong quarterly price increases followed by drops back into the pre-spike levels. Given the sizable dividend, we believe this pattern may become prominent again. It then would be exploitable by short-term option plays, which we will leave to your own discretion and will not cover in our bookkeeping.

We first recommended **Impac Mortgage Holdings (IMH: NYSE)** back in the summer of 2001, when it was a lowly Amex-traded stock priced at $7 and change. We rode it all the way to the top, letting our 25% trailing stop get us out with most of our profits intact as the market (and IMH's stock price) started heading south. In the meantime, we collected ever-increasing dividends that the company was pumping out each and every quarter.

After dropping back to just below where we got started at $7, IMH is now trading in the $9 vicinity. And it still pays an 11% dividend at this level. That's a comfort margin that, in my opinion, makes it worthwhile sitting on as we wait for the sector to build up momentum again. ■

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Taipan Track Record Grid: *Open Recommendations as of December 20, 2006*

STOCK NAME	STOCK SYMBOL	BUY DATE	BUY PRICE	ADJ PRICE	DIVIDEND	CURRENT PRICE	GAIN
Columbia Greater China Fund	NGCAX	01/01/02	$16.00			$38.82	142.6%
Serono	SRA	03/01/04	$16.80			$22.38	33.2%
Soco International (2nd Half)	SIA.L	03/29/04	£315.00			£1,424.00	378.4%
Southern Company	SO	08/02/04	$29.20			$37.31	27.8%
Bally Technologies	BYI	08/02/04	$13.75			$19.38	40.9%
Companhia Siderurgica Nacional (2nd half)	SID	08/31/04	$15.45		$5.59	$29.24	125.4%
Suncor Energy	SU	08/31/04	$27.80			$81.63	193.6%
America First Apartment Investors Inc.	APRO	10/01/04	$11.58			$19.68	69.9%
Anthracite Capital Inc.	AHR	11/29/04	$11.76			$12.74	8.3%
Grupo Televisa	TV	11/29/04	$62.00	$15.50	$0.64	$28.20	86.0%
LAN Airlines	LFL	02/28/05	$35.60		$0.68	$50.10	42.6%
DTE Energy Co.	DTE	03/15/05	$46.41		$0.53	$48.78	5.1%
Symantec	SYMC	05/01/05	$18.90			$20.94	10.8%
Penn National Gaming	PENN	05/01/05	$30.98			$39.00	25.9%
BG Group	BRG	07/20/05	$39.93			$68.26	70.9%
Advance America Cash Advance Centers	AEA	08/05/05	$14.30			$14.62	2.2%
Palomar Medical Technology	PMTI	08/05/05	$26.70			$53.29	99.6%
Telefonos de Mexico SA	TMX	09/01/05	$19.25		$0.18	$27.56	44.1%
Lionsgate Entertainment Corp.	LGF	10/28/05	$8.70			$10.97	26.1%
Cemex	CX	11/28/05	$56.00	$28.00		$33.12	18.3%
Chesapeake Energy	CHK	01/06/06	$32.25			$31.45	-2.5%
Coeur d'Alene Mines Corp.	CDE	01/27/06	$5.00			$5.15	3.0%
Flextronics	FLEX	01/27/06	$10.81			$11.73	8.5%
Agrium Inc.	AGU	02/27/06	$24.36			$30.65	25.8%
DG Fastchannel	DGIT	02/27/06	$0.60	$6.00		$11.50	91.7%
Elan Corp.	ELN	02/27/06	$14.14			$14.11	-0.2%
Archer-Daniels-Midland Company	ADM	02/27/06	$31.28			$32.62	4.3%
Uranium Participation Fund	U.TO	04/06/06	$8.90			$12.66	42.2%
Perficient Inc.	PRFT	04/06/06	$12.48			$17.80	42.6%
Intel Corp.	INTC	04/28/06	$19.99			$20.77	3.9%
EI DuPont de Nemours	DD	04/28/06	$43.62			$48.40	11.0%
Shanda Interactive	SNDA	04/28/06	$12.32			$20.09	63.1%
PowerShares Wilderhill Clean Energy ETF	PBW	05/01/06	$21.60			$17.93	-17.0%
Gazprom	OGZPY.PK	06/01/06	$42.20			$46.16	9.4%
Apache Corp.	APA	06/26/06	$63.76			$69.85	9.6%
Tata Motors	TTM	07/12/06	$16.65			$19.28	15.8%
Videsh Sanchar Nigam	VSL	07/12/06	$17.10			$18.07	5.7%
Morgan Stanley India Investment Fund	IIF	07/12/06	$42.50			$52.40	23.3%
India Fund	IFN	07/12/06	$43.20			$47.17	9.2%
Cyberkinetics Neurotechnology Systems Inc.	CYKN	07/24/06	$1.50			$1.30	-13.3%
Suntech Power Holdings Co.	STP	07/24/06	$24.95			$32.18	29.0%
Guangshen Railways	GSH	08/21/06	$20.18			$28.95	46.4%
Healthways Inc.	HWAY	08/21/06	$53.00			$47.65	-10.1%
The9 Limited	NCTY	09/25/06	$21.81			$26.99	23.8%
Activision Inc.	ATVI	10/02/06	$14.99			$17.52	16.9%
United Industrial	UIC	10/27/06	$44.84			$50.53	12.7%
Wipro	WIT	10/27/06	$14.80			$15.60	5.4%
Lifecell	LIFC	11/27/06	$22.93			$22.08	-3.7%

*** All open positions are considered a "HOLD." We encourage *Taipan* readers to set, follow, and rigorously observe a 20%-30% trailing stop on all open positions, depending on your subjective risk tolerance.**

Allowing the blind to see with their tongues... again!

by Stephanie Grimmett

In the June issue of *Taipan*, we introduced you to a breakthrough in medical technology. Wicab's BrainPort device is designed to make the blind process visual signals… by using their taste buds!

I recently received an update from Wicab CEO Robert Beckman, who informed me that BrainPort is now available commercially in Canada and Europe, and Wicab is pursuing FDA approval in the United States.

Any way you cut it, BrainPort is an odd device. Remember when you were a kid (or when your kids were kids), and someone kept yelling, "Don't put that in your mouth!"? BrainPort flies in the face (literally) of all of those years of concentrated parental efforts to keep small objects out of our mouths.

The device uses the bundle of nerves in the tongue to transmit information to the brain. And, naturally, you have to stick one end in your mouth to make it work. Through what looks like a plastic tongue depressor connected to a battery pack, BrainPort sends sensory data to the brain.

Right now, doctors are using BrainPort to help patients with severe inner-ear balance problems. The technology, which delivers electrical impulses through the tongue-depressor end, lets the brain "know" where the patient's head is in relation to what he or she is seeing. With continued therapy, patients who couldn't walk without a cane or someone to aid them before BrainPort are now walking, running and driving on their own again.

But BrainPort has the potential for much more glamorous applications. Studies have shown that the technology can literally allow the blind to see. As Brad Colburn put it in his June article, "it is not necessary for the information to be presented in the same form as the natural sensory system." In other words, the brain can receive visual information about surroundings through the tongue and translate it into images in the mind's eye.

BrainPort has the potential to help those with autism and Parkinson's disease make their movements more fluid by reducing tremors and allowing clearer vision. And it can provide limited sight for the blind.

Beckman told me Wicab is working with the U.S. military under confidential research contracts. Just imagine how the military could adapt BrainPort's technology for night raids and underwater missions. As for a possible IPO, Wicab is currently considering only institutional investors at the moment, but Beckman said the company probably may go public for several more years. As soon as we know anything new, so will you.

To find out more about the company's BrainPort technology visit the Wicab Web site at *www.wicab.com*. Enter the Canadian and UK versions of the site to see before and after footage of patients who used the technology. ■

IMPORTANT INFORMATION

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TAIPAN UPDATE

Is it time to buy back into SURG?

by Stephanie Grimmett

Some *Taipan* readers asked us about **Synergetics (SURG: NASDAQ)**, a stock we bought and sold for nearly 85% returns in the first half of 2006. The stock price has dipped considerably in recent months, and some of you could be wondering if you should get back into SURG now that the price is back down.

Breakaway Investor editor and frequent *Taipan* contributor Andrew Mickey writes: "There's no way I would even think about touching this stock at this point. It may be on its way to a short rebound, but it's currently mired in a lawsuit with a key competitor. Granted, lawsuits are common practice in the medical industry, but this one, from surgical-laser producer Iridex, has the potential to almost ruin Synergetics' entire business.

"Synergetics receives 59% of its revenue from its ophthalmological products division. As a result, a big win for Iridex could absolutely destroy Synergetics' main cash cow. Legal proceedings are very unpredictable, and trying to bet on one side or the other is for gamblers, not traders or investors.

Synergetics' other primary division, neurological products, is highly dependent on one customer. In fact, 17% of the company's entire revenue last year came from this same customer, which gives the client too much negotiating power when it comes time to talk price. The situation could really hurt Synergetics going forward. Rarely does any good come from this much reliance on a single customer. In the end, it all boils down to risk versus reward. In this case, the risks far outweigh the reward." ■

S. R. Nunnally gave us some words of wisdom on her **PowerShares Wilderhill Clean Energy ETF (PBW: AMEX)** pick back in May.

In case you missed her advise in our weekly Hotline, here's what she told me:

It's always difficult buying at the top, as we did with PBW back in early May 2006.

We did plan for a slight pullback, but when the whole market got slammed, PBW fell a lot further than we anticipated. Not even higher oil prices, which PBW had been moving in lockstep with, could pull this ETF back above its 200-day Moving Average.

And yet, PBW has continuously rebounded to that level. In the past six months, PBW has tested its 200-day Moving Average no less than 10 times.

Now, we're trading just below it, with higher lows and a higher volume. This to me looks like we're gearing up for a breakout. And that's all PBW needs — enough momentum to get back above (and stay above) its 200-day Moving Average.

In all, PBW remains one of the best sector plays in alternative energy, and, moving forward into 2007, you'll see it garner a lot more attention. Just look at how trading volume's been increasing since October. Average daily volume was 214,000 on October 2. December 14's volume was 379,400, with peaks of more than a million in between.

Hang on to PBW, and watch for a pop once it regains the 200-day Moving Average.

As for the rest of our portfolio, **Companhia Siderurgica Nacional (SID: NYSE)** was up 12% this month. After news that the company lost its bid for U.S. steelmaker Wheeling-Pittsburgh, SID made an offer on British-Dutch steel producer Corus.

Grupo Televisa (TV: NYSE), **Shanda (SNDA: NASDAQ)** and **Suntech Power (STP: NYSE)** were all up more than 20% in December.

And Erin Beale issued a sell at current levels of **Chesapeake Energy (CHK: NYSE)** this month.

RINGING IN THE GOOD NEWS FOR PENN NATIONAL GAMING

In 2004, Pennsylvania passed a law allowing 14 different sites to install up to 61,000 slot machines in the state in an effort to generate revenue without taxation. That's more slots than in Atlantic City and on Mississippi's riverboat casinos. This week, regulators cleared the way for Philadelphia to become the nation's largest city with a casino.

This will prove to be good news for our position in Penn National Gaming (PENN: NASDAQ), which operates 16 facilities in various states, including Pennsylvania.

In other PENN news, the stock received several big broker upgrades to "buy" ratings following the failure of Penn's bid for rival casino operator Harrah's. The stock is currently sitting around $41, just below its 52-week high, and we're sitting on gains of roughly 32%. Shares of Penn National remain a hold.