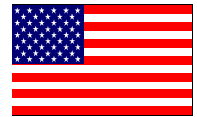


Hamilton-Bates

Update

July 14, 2008



P.O. BOX 270 Newtown Square, PA 19073 877.768.4247 www.hbir.com

Recap

A sell-off during the last hour of trading last Friday wiped out a late day comeback attempt and sent stocks lower for the sixth straight week. The S&P 500, the DJIA, and NASDAQ are all now squarely in bear market territory. As if that mattered. Waiting until the market is down 20% to determine whether you should do anything makes little sense. The time to do something was back in May and early June. Now, six down weeks later, its time to start looking for a low and rally— even if it is a temporary one. For the week, the DJIA slid 2.1 percent, the S&P 500 dropped 2.3%, and the NASDAQ 2.6%.

Fannie Mae and Freddie Mac Stock Declines Force Fed Bailout

The Federal Home Loan Mortgage Corporation— better known as Freddie Mac—led the financial companies in the S&P 500 lower, plunging 23.8 percent on Friday and 50% on the week. Its sister corporation, Fannie Mae, lost 13.1 percent on the day and a similar 50% for the week. Investors have speculated in recent days that an accounting rule change could force Freddie Mac and Fannie Mae, two of the most important market makers in the U.S. secondary mortgage market, to raise tens of billions in new capital to cover their liabilities. In the current tight credit environment, such a feat could be next to impossible without some kind of government intervention. As a result, their shares have collapsed. Although Freddie Mac and Fannie Mae are both ‘government sponsored enterprises’ created by Congress to encourage the flow of capital to the mortgage market, until this weekend their securities did not benefit from any type of statutory or government guarantee. Over the past year, Fannie Mae has lost 76 percent of its market value, while Freddie Mac has shrunk by 83 percent.

As a result of the slide, there was a bailout plan put into action Sunday night, whereby the Fed would make the discount window available to Fannie and Freddie, just as it did to the major investment banks.

This would allow them to offload mortgages for treasuries, freeing up capital. In addition, they would receive larger lines of credit from Congress and possibly even equity investment from the Treasury should it prove necessary. This bailout was a complete reversal of statements made at the end of last week, and must have come about due to a real fear that the system would seize up without the deal. This news initially buoyed stocks and the shares of FNMA and FRE, but later in the day the rallies faded. *The news is good however for the housing market, as these two key players remain able to fund and purchases mortgages. We could have seen a total seizure in the housing market without these entities.*

Earnings, Economics, and Interest Rates

Last week’s beating in the financial sector came in the face of comments by Bernanke and Paulson, who earlier in the week tried to allay concerns about the state of the financial sector in separate statements at a conference in New York. Although Bernanke said he believes the credit crunch could dog the financial sector through 2009, he also said the Fed would consider keeping open a low-interest credit facility for Wall Street firms that is due to close in September (expect it to be in force through 2010). Paulson reiterated the Bush administration’s commitment to assisting the 2.5 million homeowners facing foreclosure this year and in keeping Fannie and Freddie active in the mortgage market.

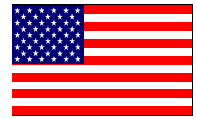
The central bank’s unprecedented moves over the last several quarters—in the form of the Bear Stearns bailout and a host of innovative lending programs designed to ease credit conditions without raising interest rates—will almost certainly come with tighter regulations down the road. In a step that can be described as closing the door after the horses have left the barn, the Federal Reserve issued rules governing the issuance of exotic mortgages—such as no-money-down payment-option ARMs. A little late though. Regulations regarding capitalization requirements or leverage ratios at investment banks—something that



Hamilton-Bates

Update

July 14, 2008



P.O. BOX 270 Newtown Square, PA 19073 877.768.4247 www.hbir.com

Wall Street has traditionally never been subject to and would likely resist mightily—could become the next major battleground as Investment Firms that benefited from using the discount window come under greater regulatory oversight which they are not used to.

The traditional beginning of quarterly earnings season began last week when Alcoa, the world's third-largest aluminum producer, posted earnings of 71 cents per share. The consensus among analysts who follow the company was for a more modest profit of 65 cents a share. Despite that positive start, wall street consensus calls for an overall drop of 10 percent in profitability for the 30 companies that make up the DJIA, and a similar 13% decline in S&P 500 earnings. The profitability picture for energy-hungry industrials has changed dramatically over the past year, and investors are preparing themselves for a steep decline in year-over-year results. The financial sector is on track to book a 67 percent drop-off in profits, thanks to ongoing losses related to the mortgage and loan crisis. On the data front, there was some good news as jobless claims was actually better than forecast, and General Electric reported earnings right on target. Retailers report that consumers are still spending.

Market Outlook

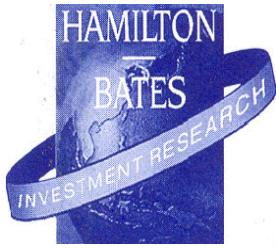
Markets again moved lower on a weekly basis with more trouble in the financial sector as the primary force driving stocks lower. Crude oil retreated \$10 from its record close before rebounding back to those levels, and the decline had little impact on the indexes. It was all about the financials.

Announcements of efforts to increase production in the US is needed before there will be any major drop for energy prices. Why should producers in the Middle East sell now if they think prices will increase further? They will only increase their output when they believe future prices will decline to competition from new oil and gas fields, alternative energy and less demand. This week the President will remove the ban on offshore drilling. Congress will need to

confirm this. Hopefully we will get some coordinated effort at an Energy plan, that includes conservation, higher MPG standards, alternative energies, AND increased production. All will be needed to stave off and energy price led recession (If we are not there already).

The major averages all remain in downtrends and trend indicators are negative. However the short-term action is down to very oversold levels and we are starting to see the indicators line up in similar fashion to prior lows in 2007-2008. We have even started to see some buying interest intra-day although it hasn't been able to be sustained. Sentiment is now quite poor, as the number of bears grows as the decline continues. As the number of bears increases, the advisory sentiment readings are getting more positive and stronger. We are now seeing the fewest bulls since July 1994 and the most bears since September 2008. This is quite bullish. The current wave of seemingly endless bad news is what you see at market bottoms. Every negative event is magnified and extrapolated even if the situations are different.

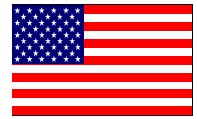
After six straight weeks of decline the market is now getting very oversold, and nearing levels that should enable the market to stem the decline and rally, albeit temporary. However, even in a bear market rallies happen, and they tend to be quite powerful. We expect a rally that could be a shock to those expecting to press the downside. We believe the indexes will find support at either the 1210-1230 area or worst case the 1180 area, and begin a rally that could last for weeks. We project an upside target of 1300.



Hamilton-Bates

Update

July 14, 2008



P.O. BOX 270 Newtown Square, PA 19073 877.768.4247 www.hbir.com

Market Charts and Technical Indicators

Back at the Lows Again (top)

The market was down again last week. However, there are several indicators that are giving strong signals that a bottom may have be near. We believe that the rally that is due will still be a bear market rally, which is usually very sharp and can be short.

The top chart at right is the S&P and the 10-day New High-New Low Indicator. It has a very good record at finding bottoms. The indicator is very oversold and over the past 10 years has only been lower at the bottoms in 1990, 1994 and 1998. In addition, selling climaxes, an indication of panic selling, reached levels similar to those at the March lows. As for upside, we believe the coming rally should take the S&P 500 back above 1300.

DJIA Busting Out Lower (bottom)

The DJIA is now though 'oversold' enough to stage a bounce, and we think one is coming as soon as the near-term selling is washed out. Heck even bear markets have rallies and we are due for a good one, just as pessimism reaches a crescendo. You can see the stochastic line turning up (red line in bottom panel). This suggests a low forming. With the DJIA dipping below 11,000 and bank failures in the news, sentiment is ripe for a washout low. The first target is to 11,500 the underside of the March lows, and then 11,900-12,000, the underside of the broken trend line dating back to the 2003 lows.

Conclusions:

The Market tested the March lows, briefly held them, and now has broken below them. This sets up the washout-capitulation phase prior to a sizable rally. The S&P is now into the general area of 1210-1230 that we gave as one of the target areas for the decline. In a market as volatile as this one, we could see our lowest target zone around 1180 reached. However, at this point that is 'just' 3% lower. The market is now in the area for a low, which should form over the next week and provide the base for a sizable rally back above 1300. It may be hard to believe, but a rally is coming.

