THE FULL HOUSE TRADER MONTHLY FORECAST

August, 2007 Edition
Aug. 21, 2007

Bishop's Full House Trader

"Economic Negative Surprises" are mounting...

Timing the peak in swap spreads will be crucial to boosting exposure to high-quality assets. We are already slightly overweight CMBS and non-housing related ABS, but neutral on MBS. The Lehman MBS index lost an astounding 50 basis points versus Treasurys last week as spreads widened, and volatility surged (**Chart 7**). As a consequence however, the outlook for MBS has improved dramatically and we expect to move back to an overweight allocation very soon.

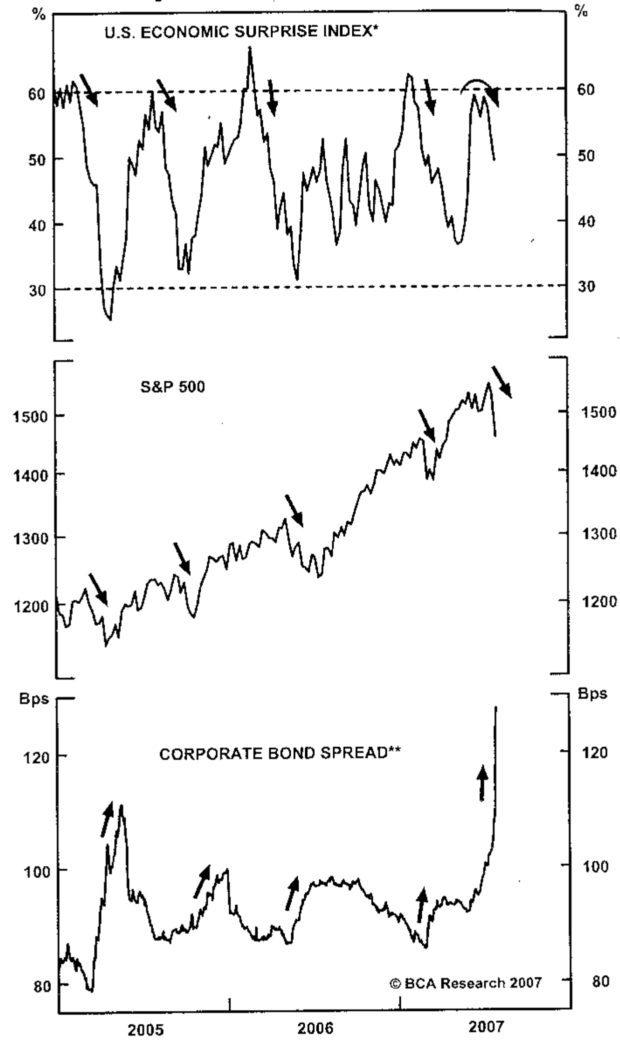
Bottom Line: Contagion from the U.S. subprime lending debacle has finally spread across nearly all risky asset classes. Corporate bonds have been hardest hit and we maintain an underweight allocation. In contrast, high-quality assets have less reason to support the current excessively-wide spread levels and we recommend maintaining overweight allocations to CMBS and ABS. Mortgage -backed securities have suffered severe losses during the past two weeks and we expect an opportunity shortly to move back to overweight.

ECONOMY AND INFLATION

A string of positive economic surprises had helped the financial markets to shrug off subprime woes up until the past week. The danger in the near run for risky assets is that economic surprises will be negative. Chart 8 shows the Westpac Surprise Index, a measure of the percentage of economic releases that beat Bloomberg consensus estimates in the previous eight weeks. The index climbed to the high end of its range this spring, but has recently rolled over. Similar episodes of diminishing good news have corresponded with pullbacks in both the equity and corporate bond markets.

We expect negative surprises ahead because consumers will retrench further in the face of a weak housing market and record energy prices. Our models of various economic variables signal that disappointments are in the pipeline. For example,

CHART 8
**Market Warning:
Economy Primed To Disappoint**



*SOURCE: WESTPAC STRATEGY GROUP
**INVESTMENT GRADE OPTION ADJUSTED SPREAD; SOURCE: MERRILL LYNCH

durable goods orders have been sluggish since late 2006 and the June data showed that companies remain cautious (**Chart 9**). Although the ISM manufacturing survey has ticked up in recent months, our investment model heralds at least another six months of decelerating growth. Importantly, recent grim housing news will reinforce the corporate sector's wariness in terms of investment, and could finally dent payroll gains.

Meanwhile, our payroll model (bottom panel, **Chart 9**) heralds a further slowdown in the growth rate to below 1% by yearend, enough

2

"SURPRISE INDEX" OF NEGATIVE ECON. REPORTS.

Growth in U.S. Payrolls Slows

Jobless Rate Inches Up To 4.6%, Another Sign Of Weakening Economy

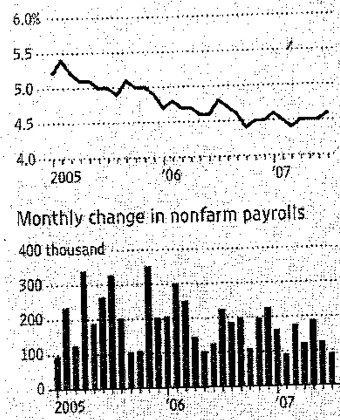
By SUDEEP REDDY And GREG IP

WASHINGTON—Weaker economic growth over the past year finally caught up with the job market in July as hiring slowed and the unemployment rate inched up.

The softer demand for labor comes amid other signs of weakness: tepid reports on manufacturing, a sharp slowdown in consumer spending and turbulence in equity and credit markets.

"The economy is slowing a little

Soft Turn for Hiring



complacent about risk and a return to normal pricing of risk was inevitable. Officials in general are deeply reluctant to give any impression they'd cut rates to stabilize the market if the economy wasn't at risk.

Even if the Fed in its postmeeting statement retains its bias toward inflation, it might acknowledge greater downside risks to the economy, a step that would nudge its stance closer to neutral. Neutral means the risks of weaker growth and higher inflation are balanced. The Fed would likely move to neutral before considering a rate cut, unless economic conditions deteriorated dramatically.

If the statement barely changes, it would signify a widening gulf in perceptions between the Fed and more pessimistic market participants. "I am finding this Fed attitude of 'What,

Shoppers Held Back in July

Retailers' Weak Sales Show Impact of Tumult In the Housing Market

By JAMES COVERT

The back-to-school shopping sea-

Back-to-School Daze?

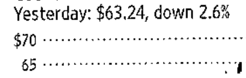
Retail sales for July 2007

Discounters	Total July sales In millions	Chg. from year ago	Comparable stores[1] Chg. from year ago
Wal-Mart[1]	$26,999.0	+6.5%	+1.9%

52-week share price

Costco

Yesterday: $63.24, down 2.6%



Auto Makers Slice '07 Sales Foreca

Ford CEO Considers Lowering Output; GM May Cut Prices

and slumping construction activity have dented demand.

For now, both Ford and GM are maintaining their current production forecasts. Mr. Mulally said Ford would decide in the first week of September

❖ **What's Happening:** The top three auto makers in the U.S. lowered their sales forecasts.

❖ **What's Behind It:** Housing and credit-market woes are

lower incentive spending, but the auto maker intends to defend its perch in the declining, but profitable, pickup market.

"The consumer's hurting. We can't be in a position where we're not competitive," said

Growth Slows at Transport Firms

UPS, Burlington Northern Cite Slump in Shipments; Outlook Dim for Peak Period

By COREY DADE And DANIEL MACHALABA

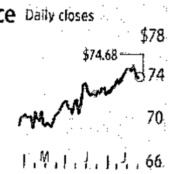
tainty about the strength of the coming period, when trains, trucks, planes and ships are packed with goods from Asia and other overseas markets ahead of the holiday shopping season.

Many consumers,

United Parcel Service Daily closes

Net: ▲ 4.1%

	2Q'07	2Q'06
Net:†	1,104	1,061
EPS ($):	1.04	0.97
Est ($):	1.03	
Rev:†	12,189	11,736



Divisional breakdown:†

	2Q'07	2Q'06		2Q'07	2Q'06
U.S. Pkg	7,579	7,462	Supply&Frght	2,110	2,041

Canadian Pacific Railway Ltd., Calgary, Alberta, reported second-quarter net income fell 30%, largely because of a tax benefit in the year-earlier period but also due to a 26-day strike by track maintenance workers and

3

"Housing bear markets last 4-5 years"...

ertheless, the models provide a good indication of whether the recent flight to quality is overdone relative to the underlying fundamentals, and thus presents a buying opportunity, or whether the selloff has merely restored a measure of value to an overbought market.

In conclusion, a short term buying opportunity in corporate bonds may be imminent, at least in the high quality issues. Nevertheless, we continue to advocate an underweight allocation for the time being. While some of the subprime mortgage market's problems have been discounted, problems in the Alt-A arena have not, and the ongoing correction in housing may yet deliver a few unpleasant surprises. Another wave of risk aversion seems likely, especially given that investment banks are reportedly saddled with $400 billion in low quality paper that they are struggling to unload. As noted above, broker spreads (and share prices) may ultimately provide the best clue as to when to add risk.

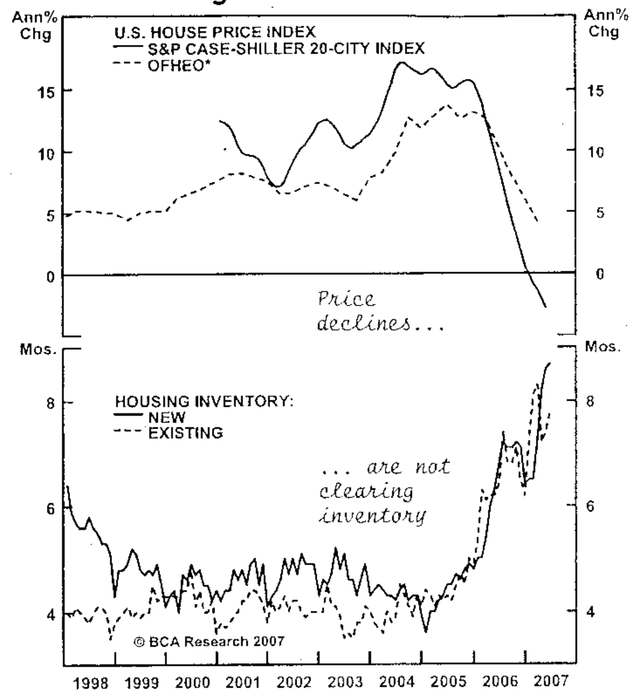
Bottom Line: Asset allocators should remain underweight corporates versus government bonds. Traders may receive a buying opportunity in corporates, but should wait until after higher default rates on Alt-A mortgage loans are discounted.

ECONOMY AND INFLATION

Pending home sales bounced slightly in June, but this will likely prove to be another false bottom in the U.S. housing market. The latest reading from Case-Shiller shows that home prices continue to fall, with the average price now down to autumn 2005 levels (**Chart 8**). The worrying part is that price declines are still not clearing the market; inventories of new and existing homes are holding at high levels.

The current bear market in housing is now about 1½ years old. Previous bear markets at the national level lasted 4-5 years in terms of housing

CHART 8
U.S. Housing Indicators: Bleak



*OFHEO = OFFICE OF FEDERAL HOUSING ENTERPRISE OVERSIGHT

starts and existing home sales. The downward adjustment in real home prices lasted even longer. An analysis of housing corrections at the State level published in a *Special Report*[1] last year showed that the downturns were shorter and shallower if the unemployment rate did not rise. Currently, payrolls are holding up well and the unemployment rate is low by historical standards, leaving hope that home sales will soon bottom. Unfortunately, the high level of inventories suggests that house prices have more downside.

The drag on real GDP growth from slowing residential investment is near a peak and will gradually fade, even if we make the bearish assumption that housing starts drop by another 20% from current levels over the next year (**Chart 9**). Nonetheless, what is more important is the fallout on consumer spending, which faces headwinds outside of housing: rising interest payments (including ARM resets), high energy prices and continuing negative geopolitical news.

5

1 "U.S. Housing: Still Bond Bullish?" *Special Report*, November 8, 2006.

HOUSING BUBBLE "PHASE 3" Credit Contraction

GLOBAL SCALE

Impact of Mortgage Crisis Spreads

How Subprime Mess Ensnared German Bank; IKB Gets a Bailout

DÜSSELDORF, Germany—Five years ago, a little-known bank that lent to small and midsize German companies decided it wanted to broaden its business. An affiliate of the bank started buying complex bonds invented in the U.S.

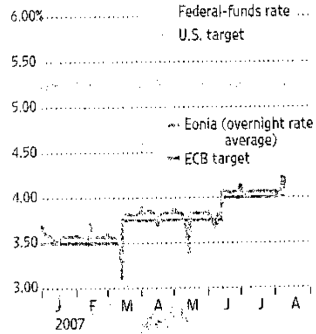
The strategy brought a sharply higher industry profile for IKB Deut-

By Carrick Mollenkamp, Edward Taylor and Ian McDonald

sche Industriebank AG. Moody's Investors Service endorsed its move, crediting the bank last year with "successfully diversifying."

Market Pricing

In the U.S. and the euro zone, short-term rate bids rose above central-bank interest-rate targets



Sources: Thomson Datastream; Prebon Yamane via WSJ Market Data

Central Banks Grapple With Rate Decisions As Markets Tumble

By Greg Ip And Joellen Perry

The world's central bankers say investors should bear the pain of their past excesses, but turmoil in credit markets is testing that hard line.

Yesterday, a French bank's surprise announcement of subprime-related losses reignited investor worries and sent short-term interest rates sharply higher. In response, the European Central Bank took unusually aggressive steps, injecting cash into money markets to bring rates back down by day's end. A few hours later, the Federal Reserve did the same in the U.S., to a lesser degree.

Nonetheless, skittish investors sent

Credit Chill Freezes Leveraged Deals

← LBO's / MA's

LONDON—The big chill gripping global credit markets has caused 46 leveraged financing deals around the world to be pulled since June 22, representing more than $60 billion in funding that companies had planned for mergers and acquisitions.

The number of deals pulled last year: zero.

The credit squeeze has slowed to a trickle the flood of debt financing that

cording to data compiled by Baring Asset Management, which also tallied the total number of pulled deals.

In addition to the $60 billion of financings that have been postponed, this total includes those deals that banks have underwritten but haven't yet tried to sell as loans and bonds to investors.

By comparison, banks last year sold some $4 trillion of loans and more than $837 billion of bonds from high-

ended down 1/32 point to yield 4.563%.

"It's the same credit-concern story," said Jason Evans, head of government trading at Deutsche Bank in New York. "This is just going to be around for some period of time, and the market is now getting very well trained to react first and to ask questions later. It's going to translate into perhaps a little excess volatility."

—*Deborah Lynn Blumberg*

Corporate Bond Market Has Come to a Standstill

← CORPORATE BONDS (+ SPREADS)

By Anusha Shrivastava

The investment-grade corporate bond market has ground to a halt, making it difficult for companies to access capital and hard for investors to find a place to put their money to work.

The problems in the high-grade market, which caters to companies with solid credit ratings, come amid turmoil in stock and high-yield bond and loan markets as investors, spooked by the troubles in the subprime-mortgage market, turn their backs on risky assets. It amounts to a major repricing of risk after years of skimpy returns and low volatility.

CREDIT MARKETS

"The market is just frozen up," said Jim Cusser, a portfolio manager at Waddell & Reed in Overland Park, Kan.

Activity has plummeted both in the secondary market, where existing bonds trade, and in the primary market, where companies sell new bonds to raise money for investment and working capital.

Banks Begin to Retreat From Financing Offers

Morgan Woes Unloading Insight for Carlyle Show Widening Credit Trouble

By Dana Cimilluca And Dennis K. Berman

Choking on a massive backlog of pending private-equity financings and a choppy credit market, investment banks are rapidly retreating from offers to finance other deals in the works.

EVEN SHORT-TERM OPERATING CAPITAL

Commercial Paper Shows Some Stress

Bad Mortgages Weigh On Low-Profile Corner Of Short-Term Market

By Aparajita Saha-Bubna

A little-known corner of the commercial-paper market where companies commonly fund their short-term capital needs—from inventories to mergers—is showing signs of stress

6

Dow Plunges on Rising Credit

Rally Ends With Thud As Stocks Fall 387.18; Hedge Rumors Continue

By E.S. Browning

CREDIT FEARS erupted again, this time in France, generating panic stock and bond selling at times and sending the Dow Jones Industrial Average to its second-heaviest one-day plunge since 2003.

Amid continuing losses at some hedge funds, the heavy stock selling dashed hopes that the nascent three-day rebound earlier this week might mark an end to the stock rout that began last month.

Corporate-bond markets were badly roiled, with investors sometimes finding it impossible to sell for a lack of willing buyers. The price of the 10-year Treasury note rose, as investors fled to its relative safety.

The selling accelerated at day's end as some investors tried to close out positions to avoid being exposed to what the markets may bring today.

Imports of gasoline and blending components, which averaged less than one million barrels a day from February to April, averaged 1.3 million in June, as refiners around the world shipped product to the U.S. to take advantage of higher prices.

The Dow industrials, which had risen for three days, plunged 387.18 points, or 2.83%, to 13270.68. The blue

Please turn to the next page

THURSDAY'S MARKETS

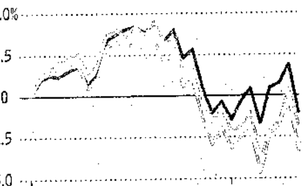
DJIA	13270.68 ▼ 387.18
Nasdaq	2556.49 ▼ 56.49
Oil/barrel	$71.59 ▼ $0.56
10-year Treasury	
Price	14/32
Yield	4.788%

Free updates at **WSJMarkets.com**

INDEX PERFORMANCE SINCE END OF JUNE

Summer Swings

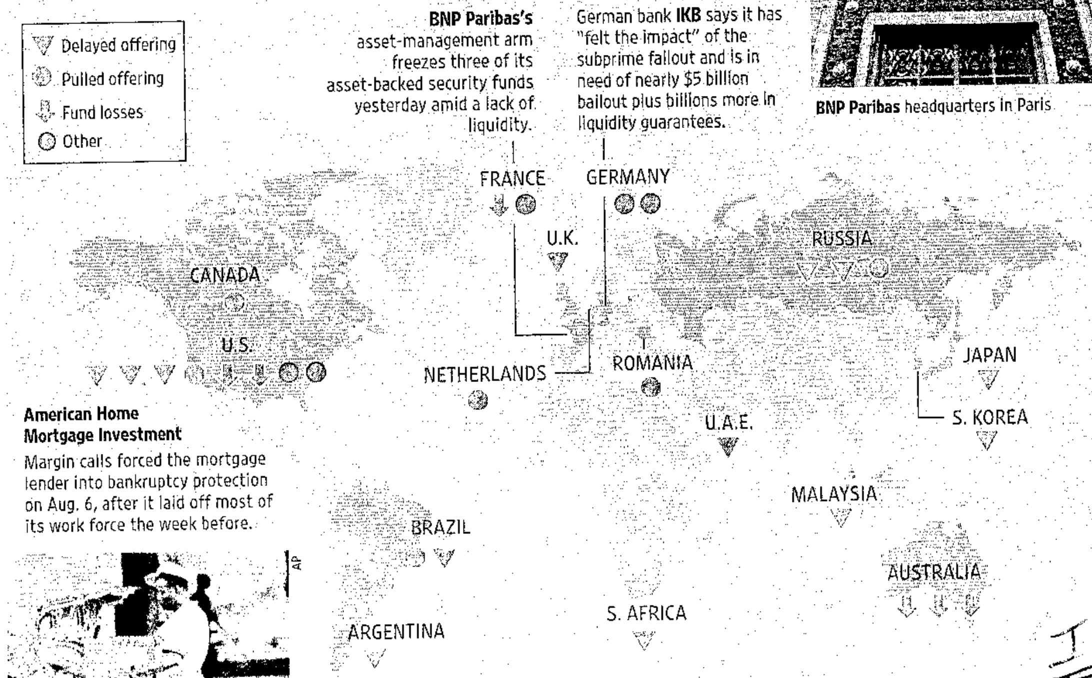
— DJIA, down 1.0%
Nasdaq Composite, down 1.8%
S&P 500, down 3.3%



Source: WSJ Market Data Group

Global Squeeze

After a prolonged period of easy credit that fed a boom in mortgages, leveraged buyouts and share buybacks, the taps have begun to tighten—and the shockwaves are reverberating world-wide. Here, a look at some of the aftermath:



BNP Paribas headquarters in Paris

A worker packs his car after last week's layoffs at **American Home Mortgage**

Researched by: Tim Annett

GLOBAL CREDIT CRUNCH...

Short-term or pervasive?

If pervasive what's the remedy?

1

Subprime Fallout Hits New Frontiers

BCA RESEARCH

Independent Investment Research Since 1949

U.S. BOND STRATEGY

August 13, 2007

Investment strategy and recommendations for the U.S. fixed income market

Weekly Bulletin

PORTFOLIO DURATION: At Benchmark.
We are not yet willing to deviate from benchmark duration given the current volatile backdrop.

SECTOR ALLOCATION
It is too early to buy, but high quality corporate bonds look attractive according to both our fundamental valuation model and the breakeven spread. Avoid high-yield despite the recent backup in spreads.

Valuation is compelling for inflation-indexed Treasury securities. Stay overweight TIPS.

FED AND ECONOMY
The Fed will not hesitate to take the next step and ease policy IF liquidity problems worsen in money markets and/or spread to other critical areas, such as the swaps market.

PORTFOLIO ALLOCATION

Sector	Investment Stance*	Legend
Treasurys	3	1. Maximum Underweight
Spread Product	3	2. Underweight
Agencies	*4*	3. At Benchmark
MBS	*3*	4. Overweight
CMBS	*4*	5. Maximum Overweight
ABS	*4*	
*Corporates***	*2*	
High-Yield	*2*	
Municipals	*4*	

* *Recommended portfolio weighting relative to benchmark.*
** *Investment-grade.*

SUBPRIME WOES CROSS THE LINE

The liquidity crunch in money markets has set off alarm bells among policymakers. Central banks up to now have taken the view that the turmoil in the credit markets represented an inevitable and healthy re-pricing of risk. The assumption was that the U.S. subprime mess would stay contained to securities and markets directly related to subprime. However, last week's bout of illiquidity in money markets changes everything (**Chart 1**). It was an important sign that subprime-related stress has crossed the line from being a sector-specific event, to a source of systemic risk. This is why central banks around the world have injected liquidity into the banking system; policymakers do not want to see liquidity seize up in markets unrelated to subprime.

It is impossible to know whether this action will mark the end of the crisis. Nonetheless, the Fed and other central banks will not hesitate to take the next step and ease policy IF liquidity problems worsen in money markets, or if it spreads to other critical areas, such as the swaps market. *

One implication is rate hikes are at least temporarily off the table for those central banks that previously saw the need for further tightening. There is little chance that the European central banks or the Bank of Japan will consider tightening if there are liquidity issues in financial markets, no matter how worried they are about medium-term inflation pressures. Recent tough rhetoric from policymakers, suggesting that

8

* The Fed may "take action" but will it work ?? ... or as in 2001-02 do we need tax cuts + deficit stimulus?

DISABILITY BENEFITS |

Region has a big increase

SOCIAL SECURITY BACKLOG DOUBLES

The caseload in KC's office tops 11,000. Kansas has the biggest backup of appeals in the country.

By DEBRA SKODACK
The Kansas City Star

The backlog of people in the Kansas City region waiting to learn whether they will receive Social Security disability benefits has doubled in the past three years.

And nationwide, 730,000 Americans are lined up to appeal for federal disability benefits, a national advocacy group said Tuesday.

Kansas has the biggest backlog in the country, according to the report released by the American Association of People with Disabilities, along with Allsup Inc., a company that represents claimants.

"It's not right that it takes this long. It is ridiculous that it takes that long."
LEN CARVER OF TONGANOXIE, KAN.

Missouri had the 19th-worst backlog, according to the report, the first of its kind.

Social Security's Kansas City office, which hears appeals from western Missouri and eastern Kansas, has seen its caseload swell from 5,664 in 2004 to an estimated 11,573 now.

"Each one of these numbers represents a person who needs our help," said John Garlinger, spokesman for Social Security's Kansas City region. "It's tough. We all want to do better."

Len Carver wishes they would hurry.

The 56-year-old from Tonganoxie, Kan., a

SEE DISABILITY | A6

Just in case central bank action fails to stimulate a weakening economy, can we cut taxes (AND INCREASE FEDERAL DEFICIT) just at the time that the baby-boom retirement bubble is starting??

DISABILITY: Delays during a

FROM A1

former assistant manager at a discount store, first applied for disability benefits in June 2004.

She suffered two massive heart attacks in 2003. She tried to return to work but became too exhausted. She has six stents in her heart and is now awaiting a hearing on her third appeal for benefits.

"It's not right that it takes this long," Carver said. "It is ridiculous that it takes that long."

The process starts when a person files a claim, which is examined by a state Disability Determination Service office, Garlinger said. If the office rejects it, the claimant can appeal to a Social Security administrative law judge.

Kansas officials believe the delays occur during appeals. The state says initial claims are processed in an average of 71 days, nearly two weeks less than the national average.

Kansas City lawyer Larry Dean routinely tells new clients to expect to wait two years for an appeal hearing.

"They can't believe it," Dean said. "I have 150 clients wanting to know when they are having a hearing."

Five years ago, Dean said, he would have gotten 70 to 80 of his clients into hearings in one year. So far this year, fewer than 20 of his clients have had hearings.

"They don't have the staff getting the cases ready" for the judges, Dean said.

The Kansas City office has its full complement of 11 administrative law judges, Garlinger said. That is up from eight in March 2004.

Garlinger said he could not speak about the office's staffing levels.

Kansas Gov. Kathleen Sebelius said Tuesday's report was "another unfortunate example of a federal government program that has failed Kansans."

"Seriously ill and injured Kansans who apply for (Social Security) income to pay for food, medicine and shelter are waiting far too long for answers," she said. "I would hope that the president and Congress take prompt action to eliminate this backlog, and provide Kansans the support they need and deserve."

The report's rankings were determined by comparing the number of people waiting for a hearing on their disability application to the number of people receiving disability benefits in each state at the end of 2006.

According to the report, Kansas had a backlog of 14,842

SOARING NU

The number of peop
Social Security admi
and eastern Kansas h

Cases pending

Applicants waiting y or longer for a heari

*Estimate

Note: 2004 numbers
numbers are from O

Source: Social Security Admini

DISABILITY BAC

The report took the
and expressed it as a
receiving disability b

WORST	
1. Kansas	**14,84**
2. Wash. D.C.	2,29
3. N. Dakota	2,51
4. Michigan	49,95
5. Alabama	30,97
19. Missouri	**19,64**

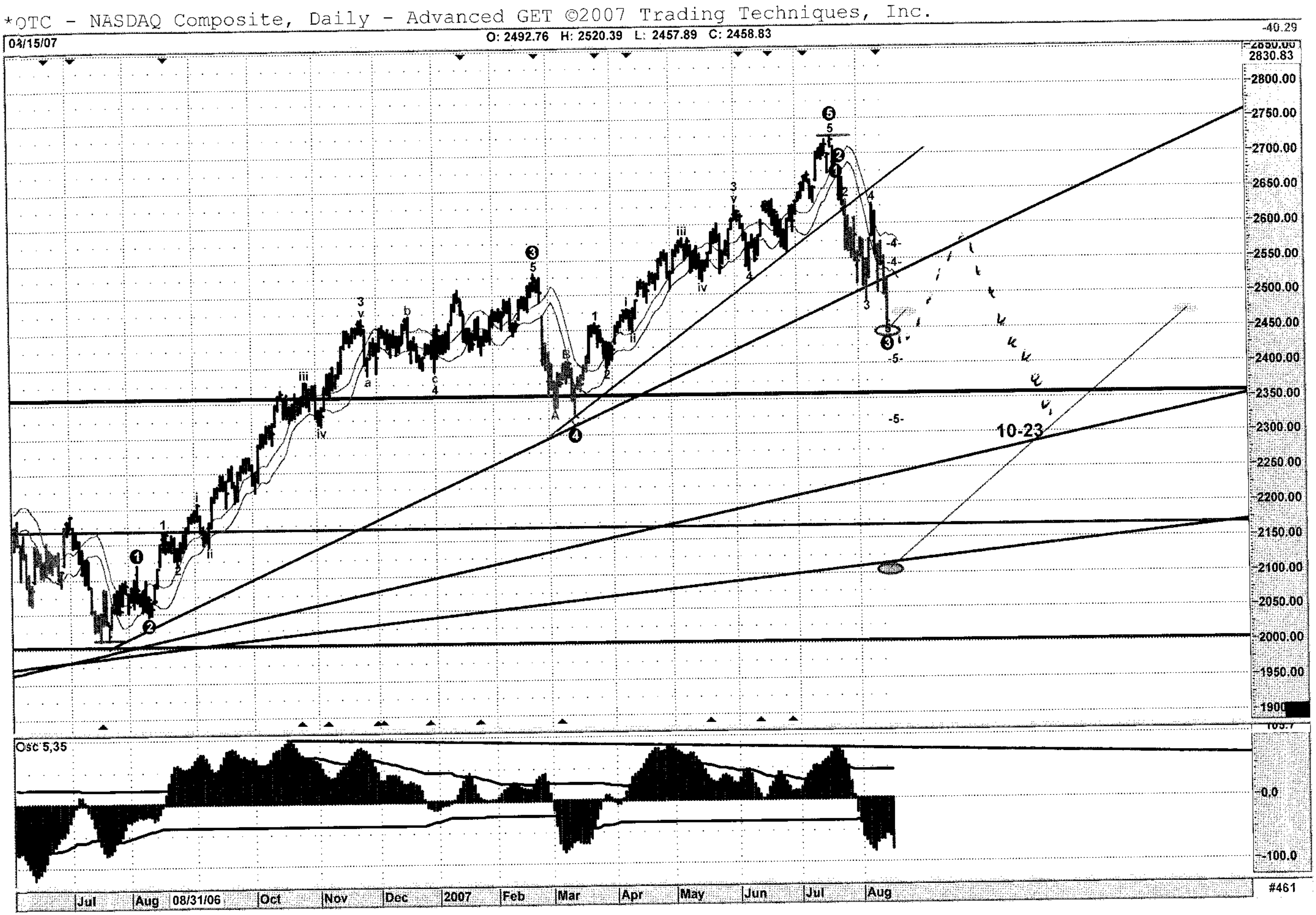
Note: Backlog figures
Dakota, Vermont and

Source: Nationwide Social Sec

cases, equivalent to
cent of beneficiaries.
had a backlog of 19,6
or 11.7 percent of bene

"The Social Security
actually already her
manifesting itself firs

9B



(13)

LOOK FOR FAILED RALLY + SELLOFF TOWARDS OCT. E.P.S.
(TARGET 2300)

Overseas Profits Provide Shelter For U.S. Firms

By Timothy Aeppel

As a weak housing market and a credit crunch pose increasing economic risks at home, many U.S. companies are finding shelter in their growing profits from overseas.

Foreign operations contributed to strong second-quarter results in recent weeks from a number of companies, ranging from giants like General Motors Corp. and Citigroup Inc. to smaller manufacturers like Harley-Davidson Inc. Part of this upswing can be traced to a weaker dollar, which creates an automatic gain when a company translates overseas profits back into now-devalued greenbacks.

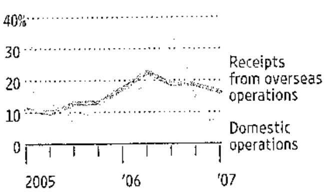
But the flush profit reports also demonstrate the benefit to U.S. companies that have intensified efforts in recent years to push into other markets. Economies in most other parts of the world—including China, Latin America and Europe—have grown faster than the U.S. over the last 18 months, providing a countercyclical balance for multinational companies. Overseas growth could provide further support for companies and investors if parts of the U.S. economy continue to worsen.

The profit surge underscores the reasons that U.S. business executives are

Please turn to page A11

Traveling Money

Change from a year earlier in U.S. corporate profits*



Note: Gross profits with inventory-valuation and capital-consumption adjustments

Source: Commerce Department data via the Investment Strategies Group at Bank of America

[STRONG GLOBAL ECONOMY + WEAKER DOLLAR] = Largest slice of U.S. gross profit growth.

Global Economic Output Growing Faster Than Expected

By Elizabeth Price

WASHINGTON—Global economic output is growing faster than was expected just a few months ago, fueled by demand in China, India and other developing countries, the International Monetary Fund said.

China alone will account for about a quarter of global growth this year, IMF officials said. For the first time, China, whose economy is expected to expand 11.2% this year and another 10.5% next year, has become the largest contributor to global growth, no matter whether its output is measured in terms of purchasing power or at market exchange rates.

The IMF, meanwhile, slightly lowered its 2007 forecast for the U.S. economy, which has been the global economy's growth engine for many years, to 2% this year and 2.8% for 2008.

"China is certainly going from strength to strength at this point," IMF Deputy Director of Research Charles Collyns said. Consumption, evidenced in double-digit increases in retail sales this year, has finally joined investment as a pillar of economic growth in China, he added. "It shows some progress is being made in rebalancing the Chinese economy." In the past, China's economic growth has been almost totally dependent on exports and investment.

Though the U.S. economy is growing more slowly, the downside risks to demand have receded, the IMF said. The slumping housing market continues to be a drag on U.S. growth, but to a lesser degree than last year. Meanwhile, business investment and inventories have picked up.

Mr. Collyns said the U.S. probably experienced a rebound in the second quarter, with data due out tomorrow likely to show an annualized growth rate for the quarter of more than 3.0%.

The German economy is performing surprisingly well, as exports and investment continue to rise, and the impact of an increase in the value-added tax this year did less damage than expected to consumption, Mr. Collyns said. The IMF raised its forecast for German growth this year to 2.6%, up 0.8 percentage point from the fund's April forecast.

Globally, booming demand has contributed to more pressure on prices, the IMF said. "With continued strong growth, supply constraints are tightening and inflation risks have edged up...increasing the likelihood that central banks will need to further tighten monetary policy," the organization said.

The fund predicted a sharp jump in non-fuel commodity prices this year, including sharp increases in food prices due to weather-related production problems and greater use of fuels derived from crops. Oil prices have been higher than expected since April, and the risk of energy price spikes remains a threat to economic growth, the IMF said.

Global Boost

Economic-growth projections

	Actual	New projection		Difference from April's projection, in pct. pts.	
	2006	2007	2008	2007	2008
China	11.1%	11.2%	10.5%	1.2	1.0
India	9.7	9.0	8.4	0.6	0.6
Euro zone	2.8	2.6	2.5	0.3	0.2
Japan	2.2	2.6	2.0	0.3	0.1
U.S.	3.3	2.0	2.8	-0.2	0
World	5.5	5.2	5.2	0.3	0.3

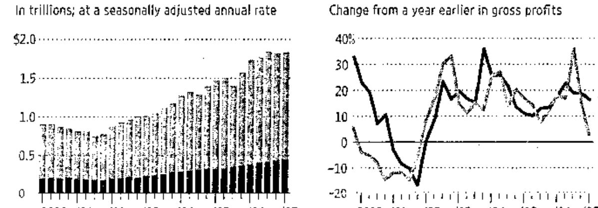
Source: International Monetary Fund

WHAT HAPPENS IF CREDIT CRUNCH SUBSTANTIALLY SLOWS GLOBAL ECONOMICS?

GLOBAL ECONOMY STILL LOOKS STRONG AND CONTRIBUTES GREATLY TO U.S. PROFITS

Help From Overseas

Receipts from overseas operations | Domestic operations



Note: Corporate profits with inventory-valuation and capital-consumption adjustments (at current costs; quarterly data)

Source: Commerce Department data via the Investment Strategies Group at Bank of America

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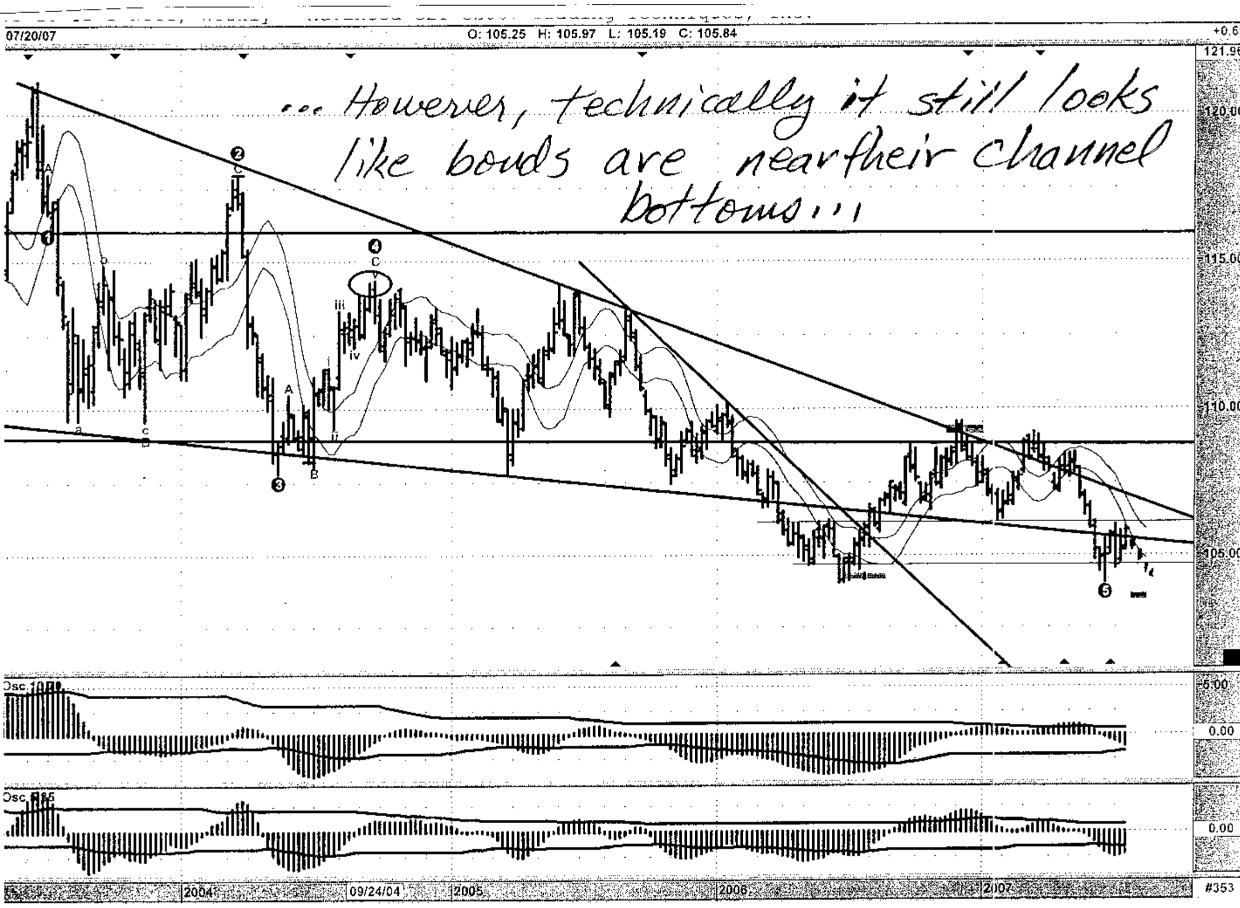

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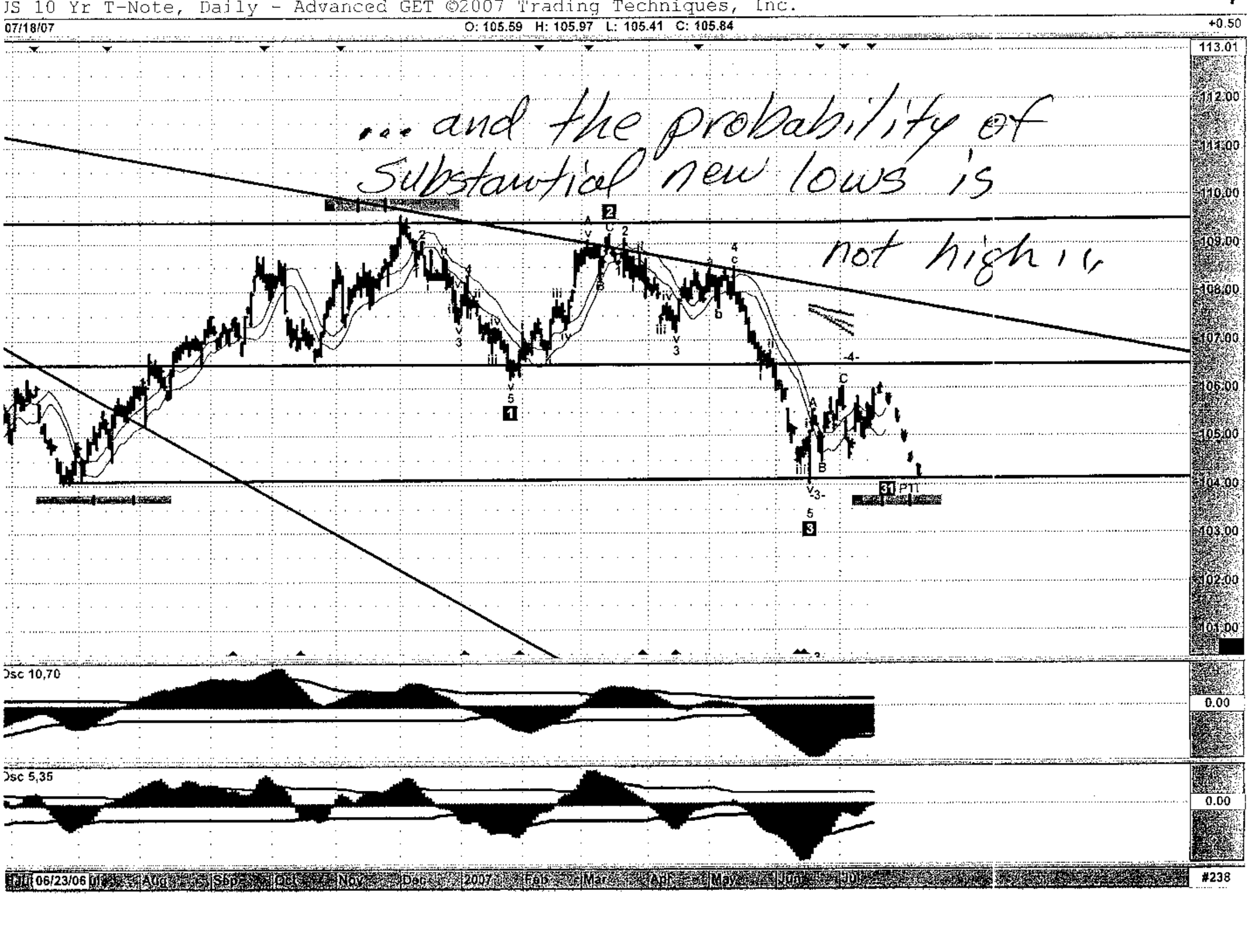

FROM JULY "BONDS NEAR BOTTOM"

17

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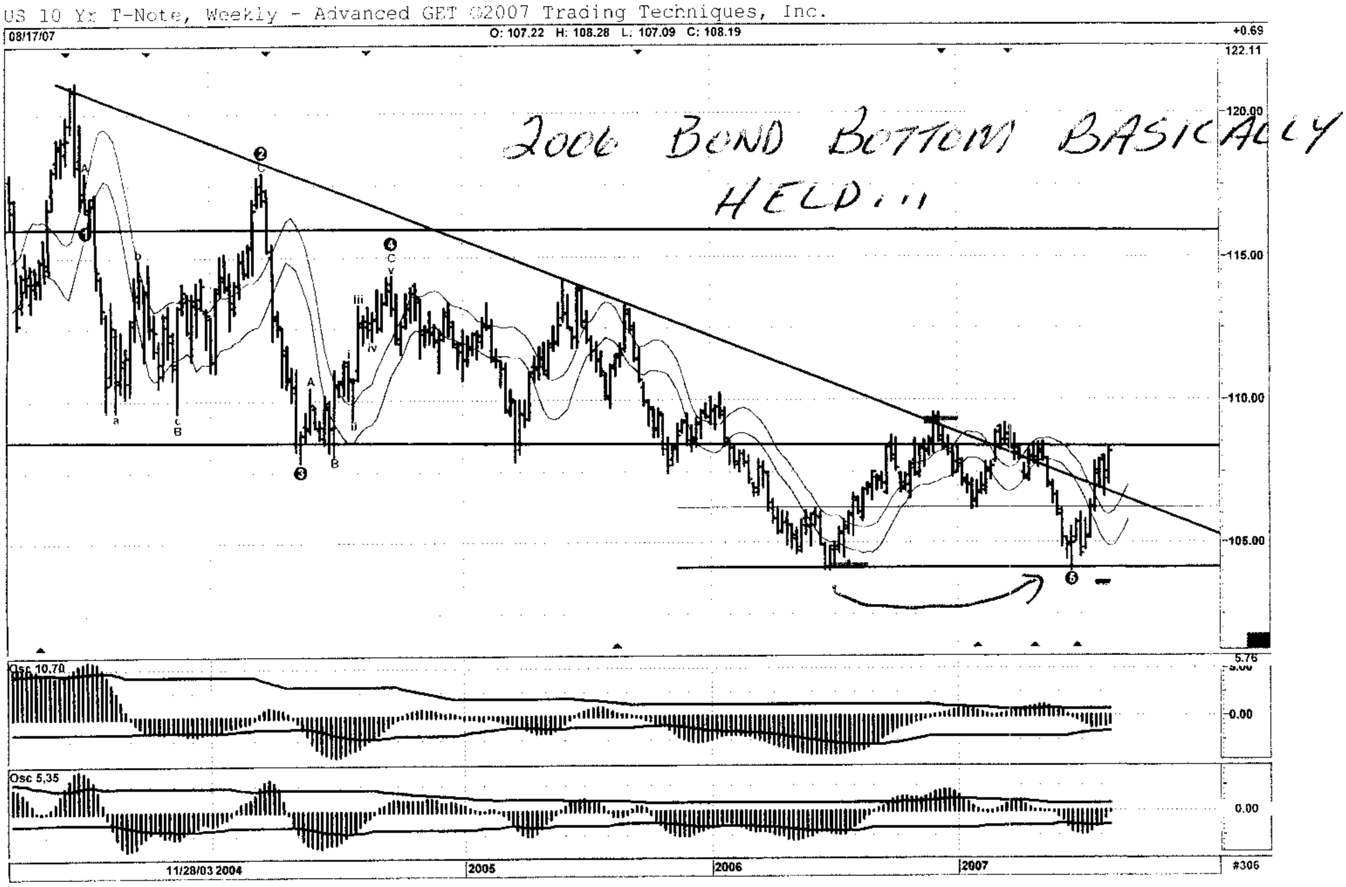

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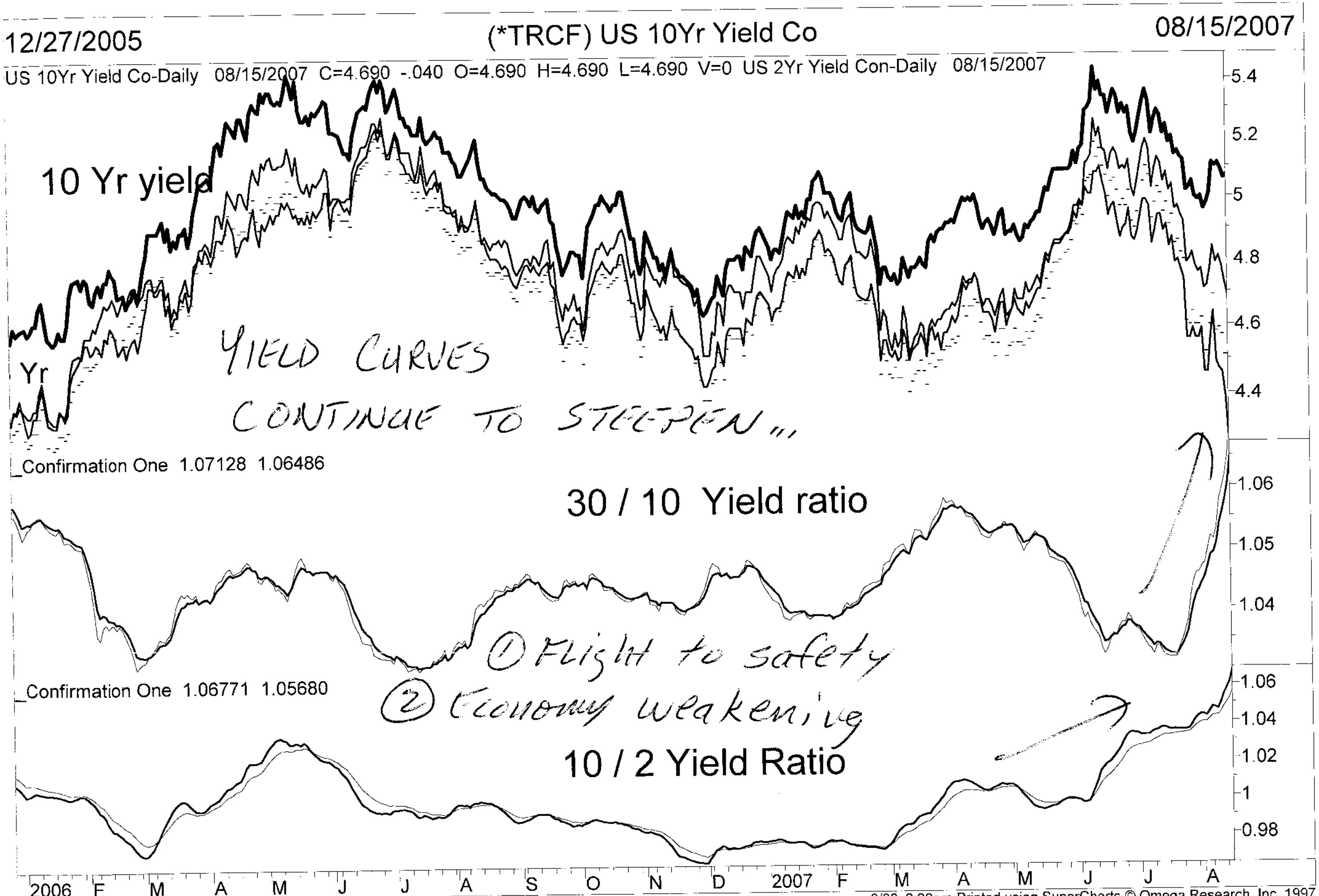
12/27/2005
(*TRCF) US 10Yr Yield Co
08/15/2007
US 10Yr Yield Co-Daily 08/15/2007 C=4.690 -.040 O=4.690 H=4.690 L=4.690 V=0 US 2Yr Yield Con-Daily 08/15/2007
10 Yr yield
Yr
YIELD CURVES CONTINUE TO STEEPEN...
Confirmation One 1.07128 1.06486
30 / 10 Yield ratio
① Flight to safety
② Economy weakening
Confirmation One 1.06771 1.05680
10 / 2 Yield Ratio
5.4
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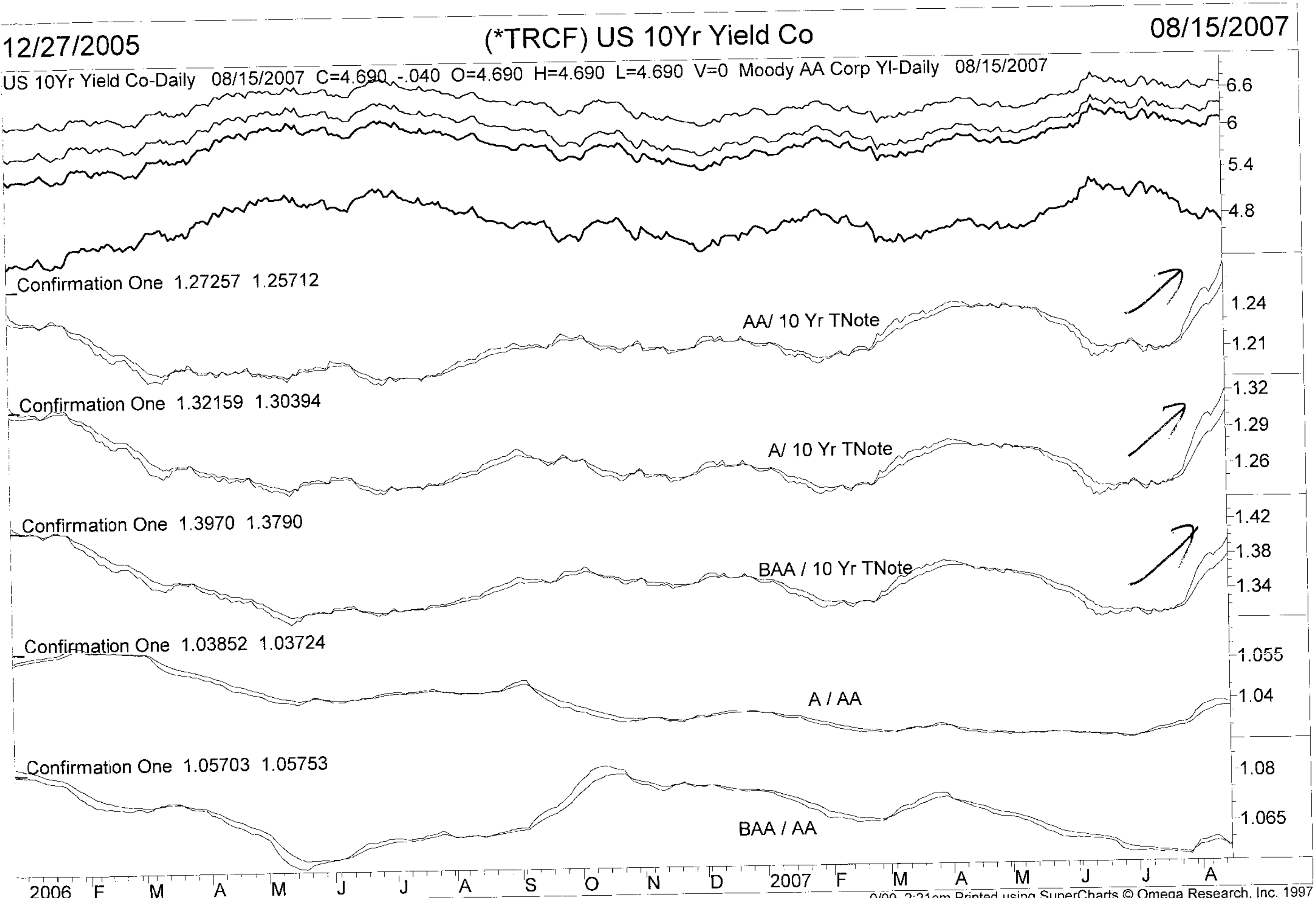
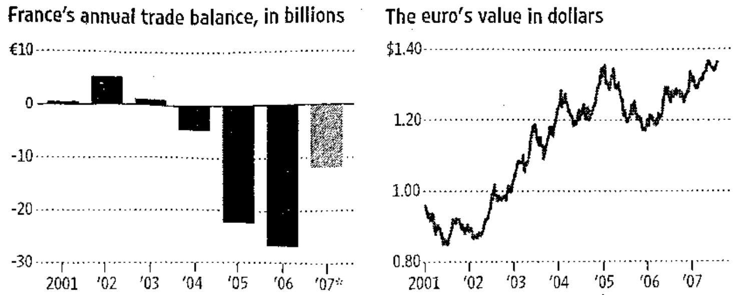


CLEAR SPIKE IN CORPORATE SPREADS

The Euro Effect

French President Nicolas Sarkozy, calling for input from political leaders into euro-zone monetary policy, has cited the toll the strong euro has taken on French exports.



*As of May; €10 billion = $13.8 billion

Sources: French government statistics; Reuters via WSJ Market Data Group

Euro Has Germany, France Clashing Over ECB Policies

By NIELS C. SORRELLS
And GABRIELE PARUSSINI

BERLIN—The soaring euro is opening new rifts between Germany and France as the leaders of Europe's two largest economies prepare for an important summit next week.

As the euro has hit ever higher levels against the dollar, the yen and other major currencies in recent weeks, French President Nicolas Sarkozy has called for more input from political leaders into how the European Central Bank sets monetary policy for the 13 nations that use the currency. Mr. Sarkozy has cited the toll the strong euro has taken on French exports—particularly plane maker Airbus, which is owned by the French-German joint venture, **European Aeronautic Defence and Space** Co., or EADS.

German Chancellor Angela Merkel has resisted any effort by Mr. Sarkozy to inject more politics into the decisions made by the Frankfurt-based ECB. On Tuesday, she told a German radio program: "I don't agree with any of this. I won't go along with it and neither will the entire government." ECB independence should be protected to help it fight inflation, which remains its top priority, she added.

The two leaders will meet Monday at Airbus headquarters in Toulouse, France, to discuss ways to streamline the complex management structure of EADS.

Beyond politics, a difference in business cultures contributes to the clash between leaders of the euro zone's two largest economies. French companies trail Germany's newfound competitiveness, which has been achieved after a long string of economic changes and corporate restructurings since German unification.

While Germany has reliably posted trade surpluses in recent years—and is the world's largest exporter—France has seen its trade deficit widen to €27 billion ($37 billion)

the ECB is expected to become an issue in future EU summits and other policy sessions in Brussels, where he has gone without public support from other euro-zone governments.

In Berlin, Ms. Merkel and her cabinet members take turns mounting open opposition.

"This is an exchange rate we can live with," German Economics Minister Michael Glos said last week, noting benefits such as cheaper imports brought on by the strong euro. "The economy is booming and there are no current problems."

Not so in France, where some of France's industrial champions—particularly Airbus—are feeling the pinch.

EADS Chief Executive Louis Gallois warned in an interview published yesterday in the financial magazine Challenges if the dollar sinks more over time, the airplane maker would have to consider if it can continue to make planes in Europe.

He said each 10 U.S. cents the euro rises against the dollar shaves €1 billion from the company's operating result.

Airbus's chief rival, **Boeing** Co., has 80% of its costs in dollars, while 50% of the costs born by Airbus parent EADS are in euros, according to Mr. Gallois. He said the company's Power8 restructuring program is based on an exchange rate of one euro to $1.35.

The euro hit a new high against the dollar of slightly less than 1.38 yesterday. The currency peaked at $1.3797 before settling back to $1.3788 later in the day.

The dollar is softening on a weakening U.S. economy and perceptions of a rising risk in the U.S. subprime credit markets. Europe, by contrast, continues to show robust growth that could force the ECB to continue raising interest rates, which makes the euro attractive to global investors.

"France has a supply problem: It doesn't produce what is in high de-

Note The rising Euro is becoming a problem for European policymakers..

24

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FROM JULY "DOLLAR TO BEGIN BOTTOMING PROCESS..."

55

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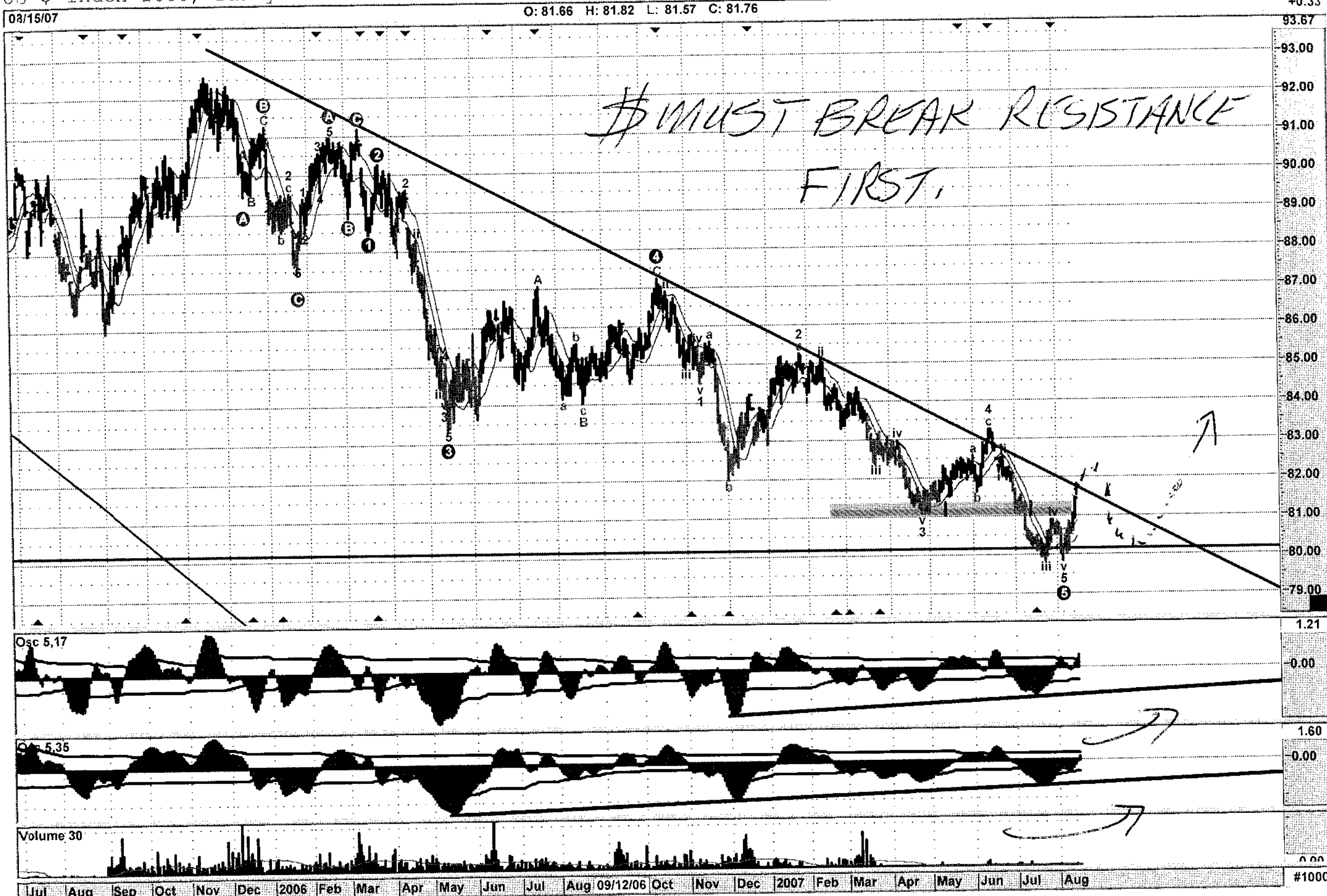

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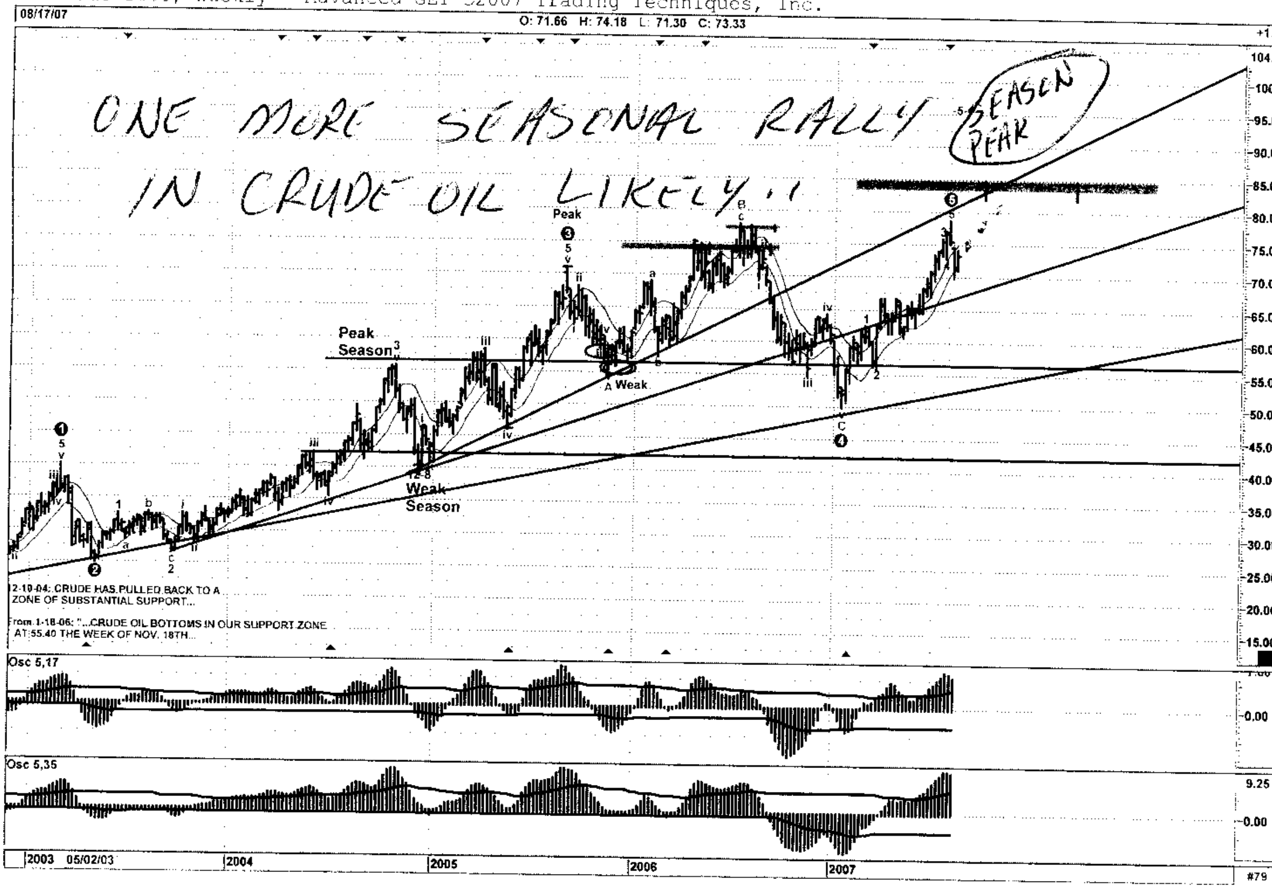

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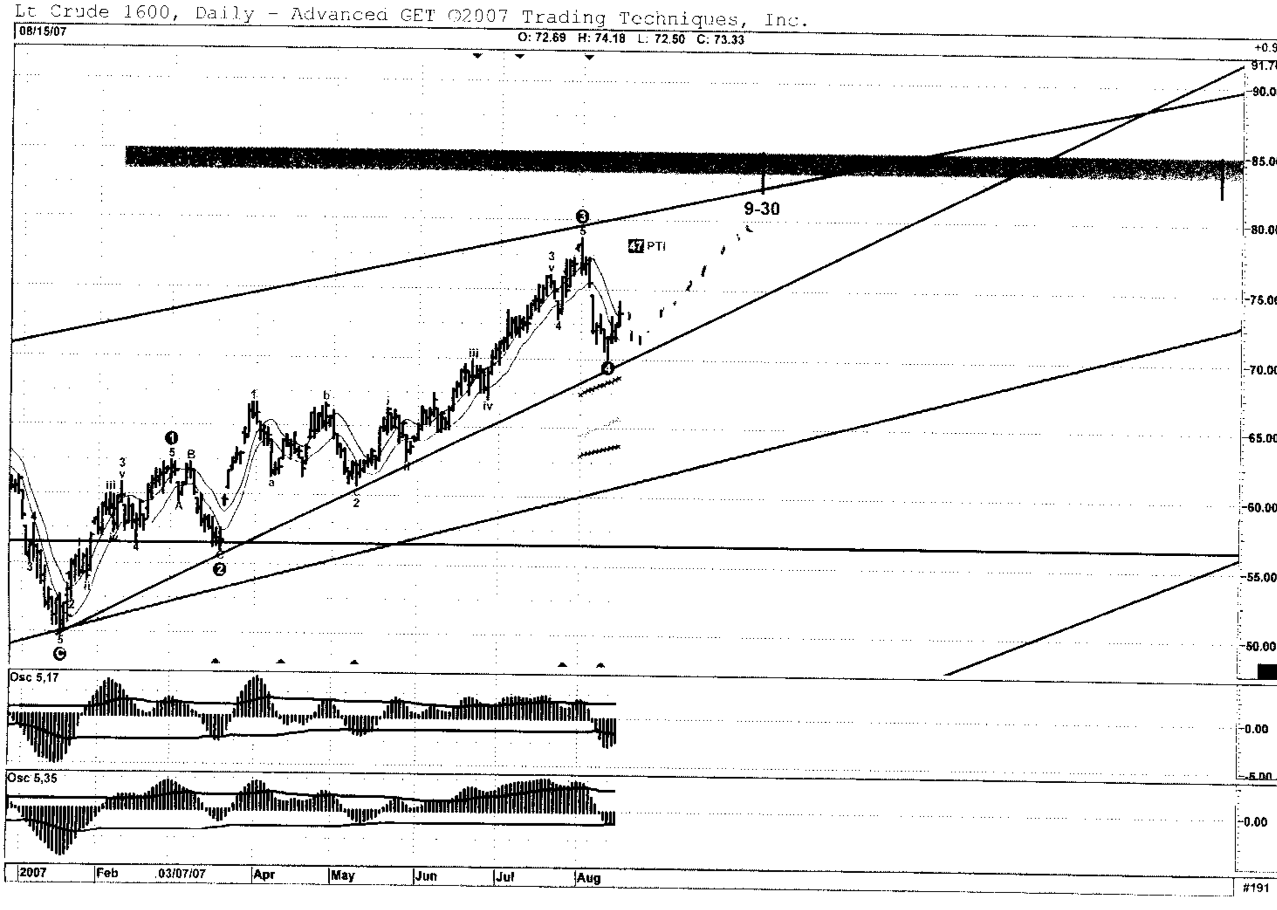

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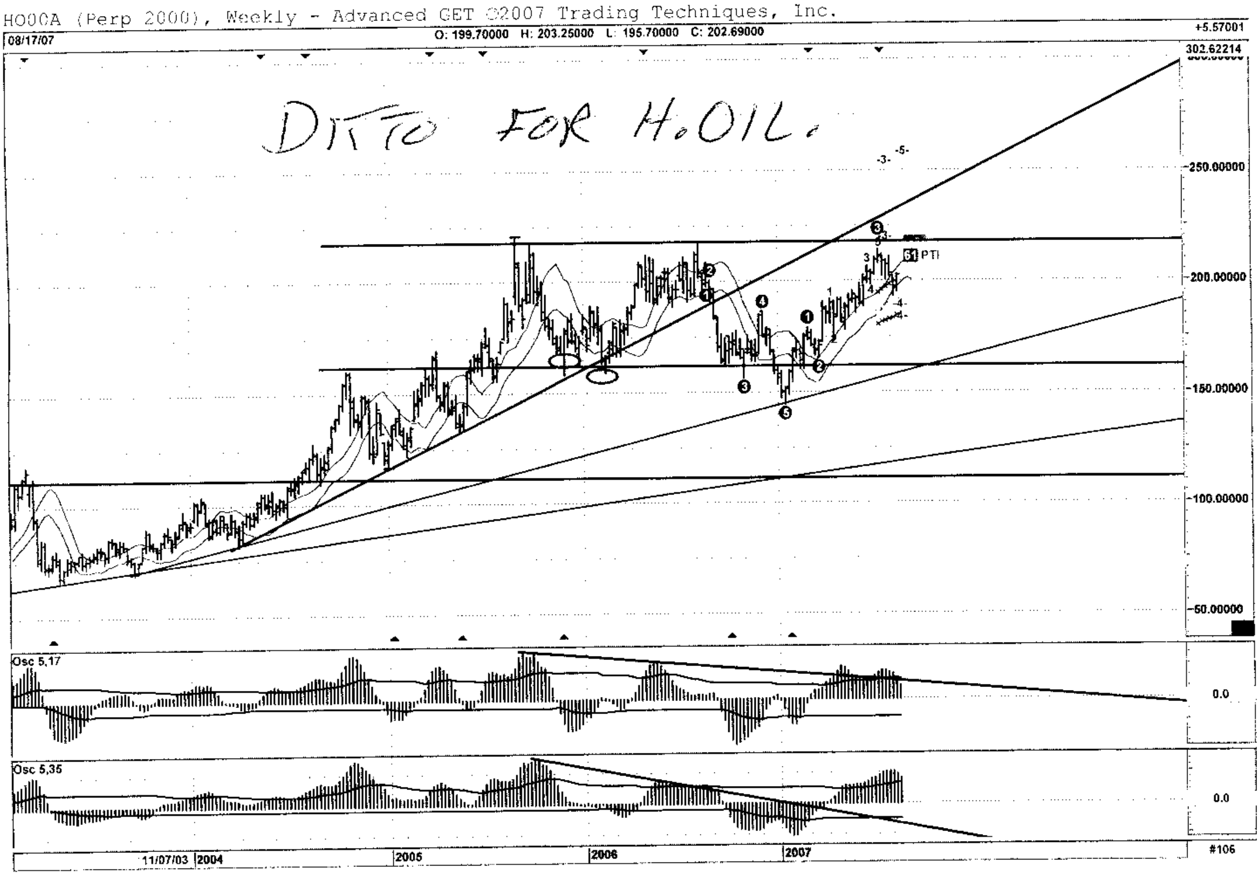

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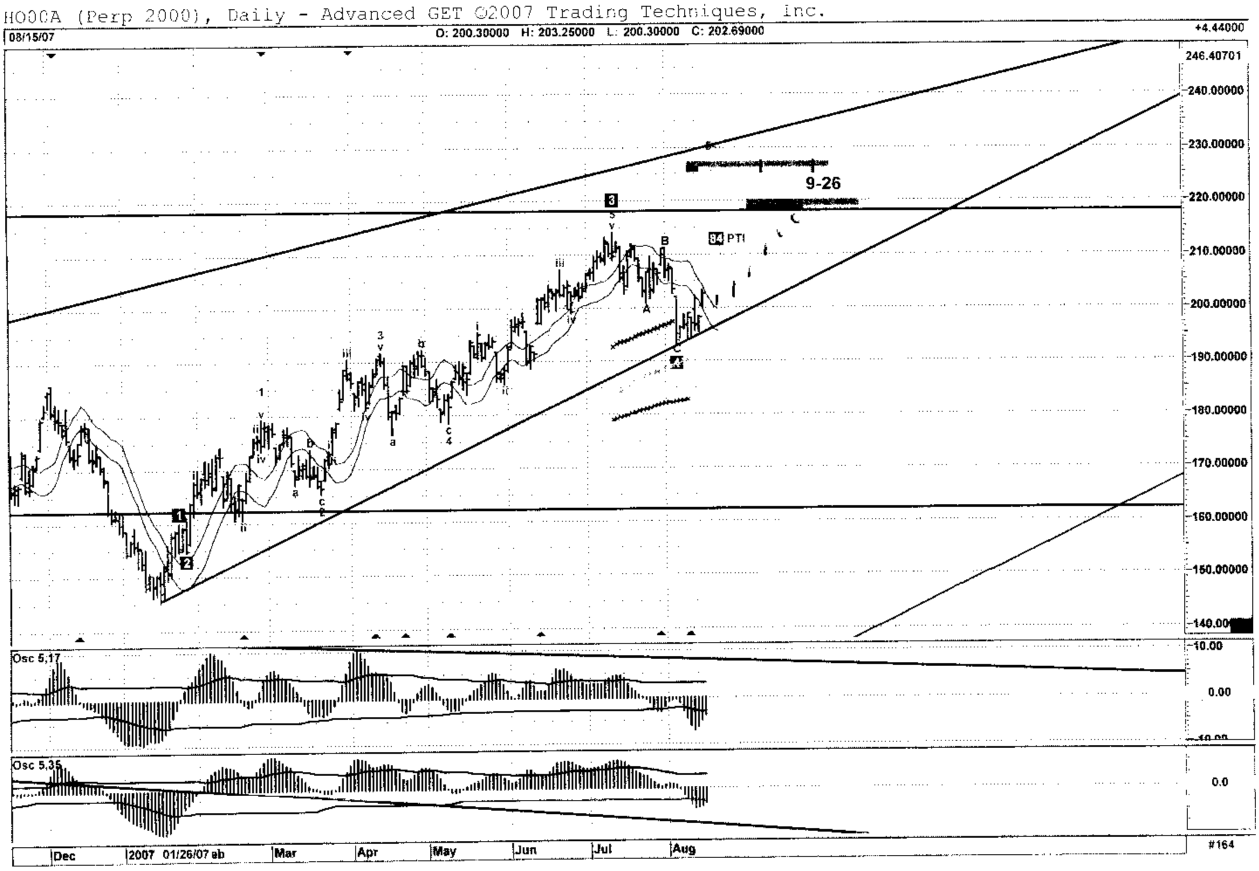

29