EPIC INSIGHTS

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THE WEEK AHEAD

The upcoming week of 1/26-1/30 (**Figure 1**) is jammed with data that should help provide a decisive answer to the direction of the market during 2009. Over the past few weeks, the markets have been trying to predict what lies ahead. With little company-specific information thus far, stock prices have reacted to broad economic data and concerns over the future. After another negative week, we are now approaching key price levels for the broad market. A concept I have often discussed is how the primary trend of a market influences stock prices. If the primary trend is bearish we should expect prices to cascade lower. When indices around the globe crashed to synchronized lows in November 2007 (**Figure 2**), this served as confirmation that the primary trend was bearish.

Figure 1 Weekly Calendar

Day	Date	Announcement	Time	Estimate	Prior
Monday	1/26	MCD Earnings	BMO	$0.83	$0.73
		Leading Indicators	10:00 AM	-0.2%	-0.4%
		Existing Home Sales	10:00 AM	4.40M	4.49M
		Existing Home Sales (MoM)	10:00 AM	-2.0%	-8.6%
		AMGN Earnings	AMC	$1.06	$0.97
		AXP Earnings	AMC	$0.22	$0.76
		NFLX Earnings	AMC	$0.38	$0.23
		TXN Earnings	AMC	$0.11	$0.54
Tuesday	1/27	BMY Earnings	BMO	$0.41	$0.33
		HSY Earnings	BMO	$0.54	$0.54
		TUES Earnings	BMO	$0.31	$0.50
		Case Shiller Home Price Index (YoY)	9:00 AM	-18.4%	-18.0%
		Consumer Confidence	10:00 AM	39	38
		ETFC Earnings	AMC	($0.23)	($3.79)
		RFMD Earnings	AMC	$0.01	$0.05
		YHOO Earnings	AMC	$0.17	$0.15
Wednesday	1/28	COP Earnings	BMO	$1.25	$2.69
		LM Earnings	BMO	($2.80)	$1.07
		PFE Earnings	BMO	$0.60	$0.52
		T Earnings	BMO	$0.66	$0.71
		WFC Earnings	BMO	$0.33	$0.45
		FOMC Rate Decision	2:15 PM	0.25%	0.25%
		ALL Earnings	AMC	$1.35	$1.24
		SBUX Earnings	AMC	$0.18	$0.28
Thursday	1/29	ABFS Earnings	BMO	$0.19	$0.42
		MMM Earnings	BMO	$0.91	$1.19
		UA Earnings	BMO	$0.24	$0.34
		WYE Earnings	BMO	$0.79	$0.78
		Durable Goods Orders	8:30 AM	-2.00%	-1.00%
		Durables ex Transportation	8:30 AM	-2.60%	1.20%
		Initial Jobless Claims	8:30 AM	575k	589k
		Continuing Jobless Claims	8:30 AM	4630k	4607k
		New Home Sales	10:00 AM	400k	407k
		New Home Sales (MoM)	10:00 AM	-1.7%	-2.9%
		AMZN Earnings	AMC	$0.49	$0.48
Friday	1/30	CVX Earnings	BMO	$1.81	$2.32
		PG Earnings	BMO	$0.99	$0.98
		XOM Earnings	BMO	$1.52	$2.13
		4Q GDP (QoQ) Annualized	8:30 AM	-5.3%	-0.5%
		Personal Consumption	8:30 AM	-3.5%	-3.8%

Note: BMO = Before Market Opens, AMC = After Market Closes
Note: All times are Eastern Standard Time (EST)
Source: Bloomberg

As the rally from these lows has faded, some indices have broken to new lows (i.e., CAC 40 and Dow Transports) while others have refused to confirm these lows. This raises the possibility of a bullish non-confirmation. If the strong indices can remain above the November lows and rally to a price that surpasses the January peak, the trend will begin turning bullish. At this point, I believe there is an excellent chance such bullish action will occur.

If stock prices had been responding to nonspecific news over the past few weeks, the next five trading days will bring data that will allow for major moves. I would like to see this information serve as the catalyst that either drives prices lower in unison to confirm the primary trend as bearish or push us higher and allow for the non-confirmation to trigger a change of the primary trend. As for the specifics of the week, on **Monday** we will see the state of existing home sales and earnings from American Express (AXP), Netflix (NFLX), and Texas Instruments (TXN). **Tuesday** brings the Case Shiller home price index, consumer confidence and earnings from Yahoo! (YHOO). On **Wednesday**, we see earnings from Pfizer (PFE), Allstate (ALL), and Starbucks (SBUX) in addition to an announcement on interest rates from the Federal Reserve (Fed). **Thursday** is packed with data. Economic reports include durable goods and weekly employment. We will also see earnings from 3M (MMM) and Amazon.com (AMZN). **Friday** will bring the first reading on 4th-quarter gross domestic product (GDP), where the consensus calls for a shockingly large drop, and earnings from Procter & Gamble (PG) and Exxon-Mobil (XOM).

Figure 2 Index High and Lows

Index	Prior Low	Date of Low	Recent Low	Date of Low	New Low?
Dow Jones Industrial	7,552	11/20/2008	7,979	1/20/2009	No
Dow Jones Transport	2,989	11/20/2008	2,959	1/20/2009	Yes
NASDAQ	1,316	11/20/2008	1,440	1/20/2009	No
S&P 500	752	11/20/2008	805	1/20/2009	No
Wilshire 5000	7,451	11/20/2008	8,100	1/20/2009	No
FTSE 100	3,781	11/21/2008	4,052	1/22/2009	No
DAX Index	4,127	11/21/2008	4,179	1/23/2009	No
CAC 40	2,881	11/21/2008	2,849	1/23/2009	Yes

With such a busy slate, investors are advised to prepare for fireworks. Recent indications have shown a weak and deteriorating economy where certain companies continue to excel (i.e., Google and Apple) while others underperform (eBay). If this trend continues, we must watch the broad markets for indications that the worst has passed. The ability to push higher in the face of negative news would set the tone for an important reversal. Breaking to new lows would be devastating as it indicates that markets have much further to fall and the economy more room to weaken.

TECHNICAL TRADE

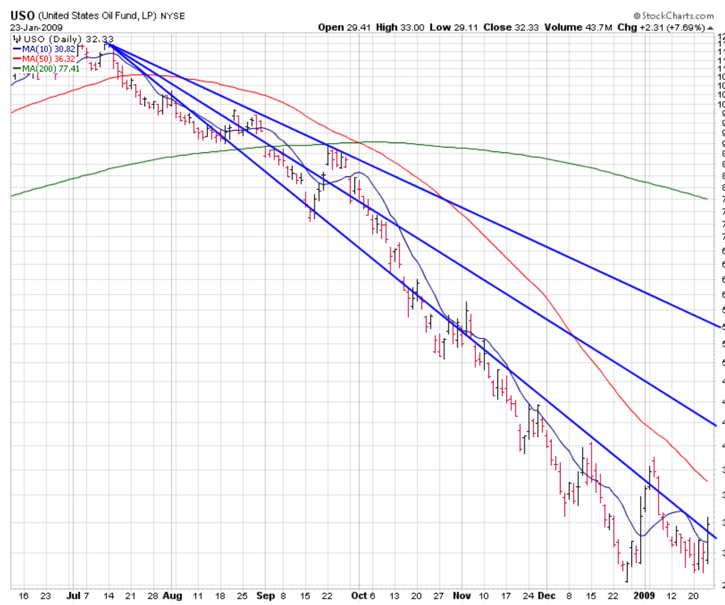
As mentioned above, I am becoming more optimistic about the ability of the market to take advantage of the non-confirmation and change the primary trend to bullish. Despite the terrible economic data and lack of clarity about how companies will navigate uncharted economic waters, the NASDAQ and Wilshire 5000 remain over 12% above the November lows and the S&P 500 is 10% above its November low. While the possibility of a major sell-off driving these markets lower remains, my job is to anticipate trends, position my portfolio, and realize gains. If I am correct in assuming that markets will head higher over the coming week and turn the primary trend bullish, the recession could end within six to nine months. As the recession ends and global growth begins accelerating, we should see inflation return and hard assets outperform. Such an expectation is the basis of this week's technical trade.

The travails of oil are known to all investors. Last summer, people turned to commodities as they were among the only asset classes working. With press reports decrying the role of speculators driving up the cost of energy products, oil closed above $145 on July 3. Since then, a cooling global economy, ineffective actions by OPEC, and massive margin calls drove the price per barrel to $31.41 on December 22 (a 78% drop in five months). Since the December low, many rallies have failed as the persistent downtrend has quelled each rally.

As illustrated in a chart that traces the peak in July to current levels (Figure 3), oil has exhibited a classic fan pattern. With a fan, the trend has not fully reversed until the final of three trend lines has been violated. With respect to oil, this would require a move through $65 per barrel.

While risk-averse traders may prefer waiting for such a price move to confirm that it is now safe to reenter the commodity markets, I have seen enough positive attributes to warrant immediate action.

Figure 3 United States Oil Fund June 2008 - January 2009



Source: Stockcharts.com

With a strong rally on Friday, oil prices have violated the first of three major downtrends. Further, the shares are trading above the 10-day and 50-day moving averages (MA). With the 10-day MA turning higher, I expect it to serve as support for a rally that should move toward the two remaining downtrends ($53 and $67). By using the 10-day MA as a stop loss order, a long position in oil offers tremendous upside with minimum downward risk.

For individual investors, the U.S. Oil Fund (USO) offers an excellent option for owning oil. **Using the 10-day MA as a stop loss (currently $39.41), I recommend a 5% weighting in USO as this week's technical trade.** (Subscriber note: The portfolio currently holds a position in USO as a hedge to ConocoPhillips (COP) and Exxon (XOM). To maintain the long oil position, I will be closing the XOM and COP shorts while maintaining the long position in USO.)

Fundamental Trade

When analyzing a company's value, I follow an exacting process. I read all the data available on the company and its competitors, analyze the footnotes and financial statements, and make multiple adjustments to the reported income statement and balance sheet. This process often enables me to derive an accurate view of what lies at the heart of the company as opposed to accepting management's reports at face value. Once I have normalized for my adjustment, I derive fair value using seven different earnings methodologies and then work toward one consensus number. Even though I have analyzed all relevant information fairly and objectively, I still need a discount factor that reflects the possibility that my analysis is flawed. To create a margin of safety, I only buy the company's stock if I can purchase the shares at a 20% discount to fair value.

When I apply these steps to making an informed investment decision, many stocks fail to meet my requirements. Most well-known companies that operate strong franchises sell at a premium that reflects both the value of the company and its position in the market. This usually forces me to consider lesser-known companies or those facing serious business problems. However, I occasionally find an opportunity to purchase a solid company at an attractive price level. This week I have found such an opportunity–Coca-Cola (KO).

KO possesses one of the best-known brand names in the world. They offer a ubiquitous product that is sold around the globe. Over the years, their business has been run well as the balance sheet is conservatively managed, capital is efficiently deployed and turnover ratios continue improving.

Having followed KO stock for a decade, I never felt the price was at the right level to justify purchasing the shares. From a valuation perspective, the market had always assumed KO could achieve long-term growth rates in excess of 10% and had decided a price earnings (PE) multiple above 20 reflected its business prospects. While I admire the business prospects and strong economic moat, I believe the long-term growth rate should be closer to 6%. With such a growth rate and a variety of valuation models, I feel KO should trade near \$52. Applying a 20% margin of safety, I derive an entry point of \$42 per share.

With KO trading near its 52-week low, the price has finally reached a level that I find attractive. Having waited so long to buy the shares, I will take advantage of this opportunity and recommend a 3% weighting in KO as this week's fundamental trade.

Option Trade

Option contracts are among the most misunderstood instruments in the financial markets. Seen by many as overly risky, they are often dismissed. However, used properly, they offer an excellent risk-management tool that allows you to create profit profiles that are unavailable with standard stocks.

One trade we have used many times is the collar. We have constructed bearish collars on the Dow Jones Industrial Average (Dow) and NASDAQ by selling a call option and then using the proceeds to purchase a put option. Having spent no money out of pocket, we profited when stock prices fell. While I have used collars bearishly in previous recommendations, for this week's option trade I will use a bullish collar to express my view that the markets are prepared to move higher.

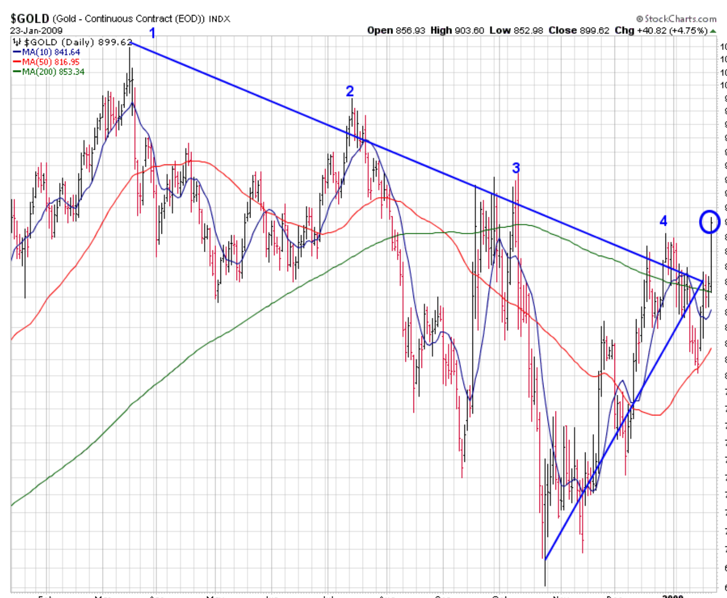
Even though a picture of the NASDAQ does not portray overly bullish features (**Figure 4**), I remain convinced that the markets are preparing a massive move higher. With general opinion overly bearish, this is the perfect time to construct a bullish collar. Using the Powershares QQQ as proxy for the NASDAQ, the at-the-money March puts sell for prices in excess of the same calls. By selling the put and buying the calls, I receive cash upfront while also having bullish exposure to the NASDAQ.

For the specifics of the trade, **I recommend selling three March 29 puts (QAV+OC) and buying three March 29 calls (QAV+CC) for a net credit of $0.30.** If I am correct and the NASDAQ challenges the January high of 1,652, this trade will work wonderfully. However, given the open-ended nature of the trade, we must watch for a break lower as well. Were the NASDAQ to violate its November low and close below 1,316, this trade must be closed immediately.

Figure 4 NASDAQ November 2007 - January 2009

Source: Stockcharts.com

Figure 5 Gold January 2008 - January 2009



Source: Stockcharts.com

CURRENT RECOMMENDATIONS

Last week was not fun. A week ago, I described how we correctly predicted that gold would break lower from its triangle (Figure 5). We were correct for a few days, but a dramatic 5% rally Friday not only shattered our thesis, but saw gold break to a higher high (represented by the circle). This move may be impressive enough to justify becoming long, but instead I will use it as an indication that the short position should be covered.

Despite taking a loss on our largest holding, our portfolio continues to perform well. For the week, **our portfolio declined 1.7% while the S&P 500 declined 2.1%. Since inception, we show a portfolio gain of 1.8% versus a decline of 14.1% for the S&P 500 (Figure 6).**

Figure 6 Portfolio Composition and Performance

Position	Quantity	Purchase Price	Current Price	Total Cost	Current Value	% Tota
AAPL	100	$91.33	$88.36	$9,133	$8,836	9%
AAPL 90 Call - Feb	(100)	$2.88	$3.40	($288)	($340)	0%
BAC	120	$6.45	$6.18	$774	$742	1%
C	228	$3.40	$3.42	$775	$780	1%
COP	(61)	$50.80	$48.18	($3,099)	($2,939)	-3%
DIS	93	$21.29	$20.68	$1,980	$1,923	2%
EVF	1,236	$3.32	$3.80	$4,104	$4,697	5%
FSLR	14	$145.50	$137.76	$2,037	$1,929	2%
GE	135	$14.68	$12.02	$1,982	$1,623	2%
GIS	37	$58.05	$59.38	$2,148	$2,197	2%
GS	11	$69.65	$74.94	$766	$824	1%
HYG	41	$75.25	$74.00	$3,085	$3,034	3%
IAU	(132)	$81.83	$88.49	($10,802)	($11,681)	-11%
JNS	248	$8.27	$5.36	$2,051	$1,329	1%
JPM	37	$20.95	$24.48	$775	$906	1%
LQD	31	$100.19	$98.46	$3,106	$3,052	3%
MOT	490	$4.19	$4.60	$2,053	$2,254	2%
MS	52	$14.81	$18.91	$770	$983	1%
MSFT	100	$19.90	$17.29	$1,990	$1,729	2%
NLS	363	$2.83	$1.45	$1,027	$526	1%
NOK	189	$15.90	$12.29	$3,005	$2,323	2%
PFE	126	$15.76	$17.45	$1,986	$2,199	2%
RIG	42	$52.39	$52.18	$2,200	$2,192	2%
STI	40	$19.19	$15.03	$768	$601	1%
TBT	90	$40.19	$44.56	$3,617	$4,010	4%
TGT	70	$28.28	$33.47	$1,980	$2,343	2%
USO	158	$32.88	$32.33	$5,195	$5,108	5%
UYG	225	$4.40	$3.17	$990	$713	1%
WFC	46	$16.90	$15.93	$777	$733	1%
XOM	(41)	$75.10	$78.04	($3,079)	($3,200)	-3%
GOOG Bull Spread	(400)	$8.40	$11.00	($3,360)	($4,400)	-4%
QQQQ 31 Call - Feb	(600)	$1.52	$0.40	($912)	($240)	0%
QQQQ 31 Put - Feb	600	$1.72	$2.65	$1,032	$1,590	2%
Cash Position					$65,453	64%
Portfolio Total					$101,830	
Portfolio Metrics:						
Portolio Return			1.8%			
Return on Invested Capital			0.5%			
S&P 500 Return			-14.1%			
Portfolio Beta			0.5			
Portfolio Yield			1.9%			
Net Exposure			36%			
Total Exposure			76%			

A few weeks ago, I indicated that the markets were preparing to fall and took a series of actions to protect us. As I have repeatedly indicated in this newsletter, I now believe we are set to rally and will make a series of changes that will allow us to prosper in the weeks ahead.

In addition to covering the gold short, cover the XOM and COP shorts as well (to reflect the bullish call on oil). Also, since we are implementing a bullish collar on the QQQQ's, we should cover our current bearish collar. Making these changes will arrange the portfolio to allow us to profit from an expected rise in the markets.

USERS' GUIDE

This guide describes how to use the data provided in the newsletter by section. The key to each section is as follows:

The Week Ahead – Here I identify economic reports, earnings releases, and other events that could lead to swings in stock prices. Note that I only list items I find relevant and ignore many pieces of data that other investors may find notable. This is not meant to be a complete list of upcoming events for the next week.

Technical Trade – I prefer to use simple trends and moving averages to identify trading opportunities.

This section either provides a new trade idea or revisits a prior trade. All new trades are accompanied by prices at which the trade should be closed. For me, ending price is the only one that matters and will be used to judge trends, stop-loss price, and other pieces of information.

Fundamental Trade – As a long-term value investor, I use this section to highlight my research. I never use stops on fundamental positions, but revisit the investment rationale when a stock moves 20% against me. Upon review, I must either increase or close out the position—maintaining the status quo is never an option.

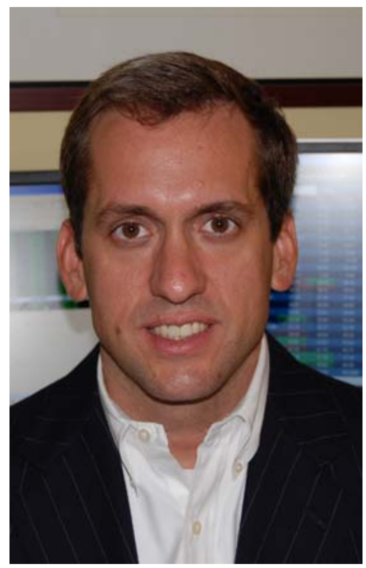
Option Trade – Based on the market environment, I will recommend option trades. In general, I prefer to write, rather than buy, options and will always look for opportunities to receive premium while hedging my risk.

General Comments – Here I share any relevant thoughts I may have on topics ranging from the capital markets to the economy to politics.

Current Recommendations – This section is where I track my investment recommendations and performance. All trades are based on a portfolio size of $100,000 as of 11/1/08 and will be scaled to represent the portfolio weightings mentioned throughout the newsletter. All new positions will be initiated at the opening market price each Monday morning, and closing trades will be based upon closing prices mentioned in the letter. Cash balances will earn LIBOR -100 basis points, and no transaction fees will be charged.

Author Profile

Sean Hannon, CFA, CFP, is the President of EPIC Advisors LLC. EPIC is a Registered Investment Advisor offering separately managed accounts to clients ranging from high–net worth individuals to young families who are just starting to invest in the market. Sean has over 10 years of financial services experience, having worked for both Goldman Sachs and JP Morgan Chase prior to starting EPIC. Through solid research and disciplined risk management, EPIC portfolios have been able to outperform during various market cycles.



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