"Patience, persistence and perspiration make an unbeatable combination for success"
--Napoleon Hill

PairCo, LLC
*www.pairtrader.com*
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# The *Art* of the *Arb*

## *PairCo Newsletter*

## *Happy New Year!*

**In my position as the Langley Bright Office and Remote Manager, overseer of Bright Trading's Mentoring Program and CEO of PairCo, LLC, I have the privilege of getting to know and working with so many of you. I want to take this moment to thank you for your enthusiasm, dedication, work ethic and participation in all that we have and do. I feel lucky in knowing good people and getting to work with them each day in such a fun and rewarding career. I appreciate your friendship, loyalty, and commitment to excellence and look forward to many more years together.**

**I'm creating this newsletter in an effort to provide value by sorting through some of the noise, taking a fresh look at some strategies, and imbedding some data. We have an incredible opportunity in today's markets which have more tools, products and knowledge available to us than ever before. Let's together make 2008 Great!**

***--Rob Friesen***

**In the New Year…**

Will that lustrious Gold trade about $1000 an ounce?
Will that liquid gold, OIL trade above $100 a barrell? (well this one already did)
Will PHM, ETFC, WM, or CFC trade to zero…over and out?
Will bottom-fishing traders seeking a bounce in homebuilders, thrifts, REITs, and banks be rewarded?
Will January erupt in a rally or a flurry of selling?

It is difficult to anticipate the future correctly but let's focus on what is known and see if we can pick up on the trends, possibilites and probabilities.

## Looking back to jump forward… *by Rob Friesen*

Here is a collection of news, thoughts and conjecture in no particular order.

- The "Climate of 2007"
  Certainly climate awareness and concerns increased this past year and we can anticipate that continuing. Can you still find some Green Companies to keep on your radar that are trading at reasonable valuations?
- In the last half of 2007, we saw corporate profits on the decline in some sectors.
  We can expect the January 2008 earnings season to have some challenges as another quarter of negative earnings growth unfolds. Overall 8.3% less earnings for SP500 companies is expected. Not all sectors or industry groups are affected the ones that everyone seems to be bottom picking right now are candidates. Think about industries that those touch. I.E. if home builders are not putting up houses like they were in the past, can you identify suppliers to that group that are impacted?
  Note that the financial sector makes up 17% of the SP500 index.
- The Gadget of the Year brought to you by APPLE, inc.
  Can the iCompany do it again in 2008? Here is a quote from Steve Jobs, Co-Founder and CEO of Apple. "To turn really interesting ideas and fledgling technologies into a company that can continue to innovate for years, it requires a lot of disciplines." So how is Mr. Jobs doing? Will Apple continue to maintain competive advantage, innovative quality products and significant earnings growth. Its current valuation depends on it.
  What can we learn from the Google's, Apples, and Nvidias? Why have they performed as companies and as stocks? I encourage you to study the top performer list I have later in this newsletter and identify their characteristics. When I looked through some groups I saw that high ROE was an key component of industry group leaders.
- Invest in India?
  The best performance in ETN's came from INP (iPath MSCI India ETN) with a whopping return of 87.1%. Why? India is a growing economy with great potential and has a democratic government which could make India far more attractive than China over the long haul. INP is currently comprised of the top 68 companies by market capitalization listed on the Nation Stock Exchange of India. Many of the companies in this ETN also trade as ADR's on the NYSE; HDB, IBN, MTE, SLT, TTM, VSL and SAY.

- ETF's: fad or the investment or trading vehicle of choice?
  A standing ovation for these performances of 2007:

| | |
|---|---|
| SLX (Market Vectors Steel) | 86% |
| EWZ (iShares MSCI Brazil Index) | 75% |
| PGJ (PowerShares Golden Dragon Halter China) | 63% |
| FXI.TO (iShares FTSE/Xinhua China) | 54% |

Brazil Carnival

  Here is some interesting information: US ETF's now have NAV of $632 B which is up $215 B or 51% from a year ago.
  Even more interesting…there are 429 ETF's currently in registration. Dominators are ProShares, Rydex and PowerShares. We certainly are seeing the long-tail of marketing in full display in the world of trading products…there are and will be more choices then ever before.

- Double your fun in a single ETF. Not that we are suggesting it but many traders and funds are enamored with some of the ETF's available now that trade the inverse, 2 times the inverse or 2 times the regular way of major indexes like the Dow Jones Industrial Average.

- Dow Closed the year at 13,264.82 and gained 6.4% for 2007. On the bloodied first day of 2008 it just gave it up…and lost 220 pts. (1.7%). What lies ahead? What will the January Barometer tell us this year? It does appear that the last half of 2007 and so far in 2008 that the flight to safer financial instruments is en vogue. Watch the DJ Transports as trucking and delivery has been falling sharply signalling resession risks. Take note of support levels that may be broken on a continued decent. Perhaps 4366.78 the DJTA November low.

- All that Glitters…

  Will it be Gold or Silver that is the shiniest performer in 2008. You can go with GLD or you can play the SLV. You can watch both in the index both in XAU. In 2007, Physical Gold moved up $200 USD per troy ounce to finish at $838 up 30% for the year. On the first day of this fabulous New Year, it jumped $22 an ounce, not having been at this level since 1980. It does seem as if this commodity trend will continue as we may be entering a "Super-Cycle" in these things that come from earth. I guess we should say this: whatever you do, buy dirt, cuz they stopped making it. Seriously; fligh to safety, actual gold demand, falling US Dollar, and geopolitical concerns, assasinations are the engines behind the trend up. BTW, March Silver is trading around $15/oz, Platinum $18/oz, Palladium $380/oz and Copper $3/pound.

  P.S. Golds 30 year performance is worse than flat. What did $860 US Dollars buy you in 1980? What does it buy you today? Will it in the coming years adjust for inflation and more, making up all that lost ROI ground?

  On the supply and demand front, global gold production fell to a 10-year low and the balance would be even worse if central banks were not selling or gold producers were not de-hedging

  China has less than 1% in Gold (600 tonnes total) in stark contrast to 70% of the reserves the US keeps in Gold. China has 1.5 trillion in foreign reserves with 66% of that in US Treasuries. China is buying more Gold…what if a considerable portion of their foreign reserves is transferred to Gold?

  India as the worlds largest gold market with household income growing at a double digit pace will continue to import Gold.

- Are Traders really factoring in 100% chance of a ¼ cut at the FOMC Jan 29-30 two day meeting, and the March 18 one day event? The action of the futures and treasuries seem to indicate this confidence. Goldman, JPM and others see a ½ cut at the end of January event.

  Note: January 3 of 2001, we saw a surprise interest rate cut. Will history repeat itself with a surprise cut sometime this month?

- Merger and Acquisition activity is slowing after 2 record breaking years. We should anticipate less massive Leverage Buy Outs in light of restricted credit, but expect consolidation mergers amoung the struggling industry groups. Also, watch out for some ot the companies that were out bid in the last couple of years to try

again especially if stocks go on a fire sale. There may be a fire sale in assets of potentially bankrupt companies also.There are plenty of companies that have huge cash on the books that may be put to work in acquisitions. They are not affected by the current credit crisis as Private Equity firms are. Another item to consider is that investment banking firms that make large revenues from mergers, could be affected if things really slow down.

- Is it lights out for the US Dollar?

  Actually a global slowdown could increase the dollar's appeal again. Europe has its own set of problems and any correction in the Euro could help support the USD. The question is will slowness in the US be shared globally.
  In the short-term we could still see some pressure on the USD to to further interest rate cuts. The prime lending rate could be ¾ of a point lower by March 19th if the FOMC does what the markets are factoring in.

- Will the Top Dogs be Topped?

  Here are the Top 10 (Not Mr. Letterman's but Mr.Markets) Sp500 stocks of 2007

JEC: Jacobs Engineering Group +142%
NOV: National Oilwell +140%
AMZN: Amazon.com +138%
APPL: Apple +134%
WFR: MEMC Electronics +130%
GME: GameStop +125%
CNX: Consolidated Energy +120%
CMI: Cummins +115%
MON: Monsanto + 115%
HES: Hess Corp +106%

*Note : Performance is approx as it has been rounded.

My thoughts are that some of these stocks belong to industry groups that are in such entrenched upward trends that they have the wind at their back even outside of their own uniqued achievements. Others of these stocks may be great contrarian plays as they have risen to lofty valuations but I wouldn't get to aggressive as there has been serious momentum behind them.

Here is the top performing Russell 3000 stocks of 2007.
http://seekingalpha.com/article/58039-best-performing-stocks-ytd

- Think of these possibilites for the New Year:

  Besides the possibility of rebounds in the beat down industry groups, could small caps shine again? The leaders in 2007 have been the large caps and the larger the company, the better it performed it seemed.
  Will trading volumes continue to increase as the rise of volatility since July, 2007 has brought in a flock of day traders.
  Continuation of the Crop Land "bubble"? Farmland is going crazy, commodities going up and up. Gadgets depreciate, dirt appreciates. Look for continuation of these trends salted with industry group mean reversion.

- American Society Civil Engineers issued a warning that 1.6 trillion is needed for America's infrastructure repair and upgrade. Here is an opportunity report from U.S. Global Investors:
  http://www.usfunds.com/docs/reports/Infrastructure_WP.pdf

# Strategy Alert

## Dividend Collection the Hedged Way *by Rob Friesen*

As we face a year of expected dividend cuts by some banks, brokers, REITs, homebuilders, and mortgage related companies, we will see the impact on those stocks. Stocks of companies that eliminate or reduce dividend can drop very quickly so factor in additional risk if you are trading these industry groups. Recently WM cut its dividend from .56 to only .15 and many analysts think that C with a current dividend yield of 7.7% is next. I hear that the options market is pricing in dividend cuts for WB and BAC also. Whether we can predict which stocks will be the ones cutting or eliminating, we know that the years of growth of dividends for the SP500 companies is now under assault and those companies that continue to thrive will be command a premium.

That being said, what are the opportunities for you as a trader to collect dividends from the consistent payers on an ongoing basis? Is it a risky strategy? How do you begin?

A dividend is a distribution of a portion of a company's earnings to shareholders, and can be in the form of cash, stock or property. With mutual funds, interest and dividend income from its portfolio holdings along with capital gains from stock appreciation and trading activity is paid out as a year-end dividend to the fund shareholders.

Dividend paying stocks have a dividend amount which can be paid out quarterly or annually. They also may have special dividends that come along annually or periodically. Traders and investors don't just look at the dividend amount in dollars but also the dividend yield, which as a financial ratio is the annual dividends per share divided by the current price of the stock. This is our "bang for our buck" assessment. *Please note that very high dividend yields could mean very depressed stock prices which may lead into companies cutting or eliminating dividends altogether. What we are looking for is a high quality company, with consistent, stable and possibly growing earnings that will lower our risk and keeps that dividend flowing.

In pairs trading, we collect dividends two ways. The first is where the quality of the company is more critical as we are holding a core position in a pair for extended periods of time, as part of a portfolio. Not recommending it…but as an example, let's say we are long BAC and short JPM in a pair combination. BAC forward dividend is 2.56 (trailing was 2.40) with a dividend yield of 6.40% whereas JPM's is1.52 (trailing is 1.44) with a dividend yield of 3.60%. This pair could be held in a share neutral manner and you would make 2.80% for the year by doing nothing. (Assuming both stocks stayed in relative similar performance to each other). It would increase if you ran dollar neutral on the pair which means you would own 105 shares of BAC for each 100 of JPM. We have found interesting and rewarding pair combinations where the share size differences give us an additional advantage. For example on a different pair, we are trading it 100 shares by 200 shares (100 x 200) in order to capital balance. The stock we are short is 100 shares and we pay a .50 annually on that 100 shares but we collect 1.00 annually times our 200 shares (the stock we are long). This means we net out $1.50 for the year on this combination.

The second strategy is the collection of dividends by overnight swing trades, with no intention of long-term holdings. Unlike the first strategy, in this one the quality of the company many not be as critical if the trader is only holding overnight 4 times a year.
On Ex-Dividend Day (ex-date), the stocks previous close price is adjusted (marked down) by the dividend amount that would be paid on the upcoming Payable Date. As there is an upward bias to stocks over the long sample we note it assists slightly in offsetting the ex-dividend (XD) markdown. According to Ned Davis Research, Dividend-Paying S&P500 stocks gained 10.19% per annum between 1972 and 2005 vs. 4.39% for Non-Paying. We note that in flat markets, with quality companies, we should be able to keep some of the dividend; observations and experience reveal around 8%, by taking the stock long overnight going into the ex-date. In a bull market it may increase to around 12 to 15% as an average for all the stock dividends you would go after. In a bear market it gets more treacherous as stocks usually become much weaker after XD. Adding commissions and risk, one can see that you would need a lot of capital, a very high dividend yield and the right market conditions, in order of having any chance of making money on a naked stock for dividend capture.

So how do we increase our safety and our performance and make it a viable strategy? By pairing off our long stock with a strategic or normal short and taking the pair overnight into ex-date morning.

First I will talk about the normal short and then we will get to the strategic. Let's choose LLY and PFE for the normal example. LLY pays 1.88 per share annually for a 3.5% yield. LLY has raised its dividend 41 years in a row and as a bonus in having the wind at your back raised its guidance 3 times and projects a banner year in 2008. It projects that 7 of its drugs will reach a billion dollars in sales this year. This company's stock in and of itself could be a defensive play for investors. Why I like this situation for what we do in dividend collection is that any dips on the stock have the probability of investors and traders stepping in to buy. We have also observed that the Wall Street machine supports dividend collection. Many of our traders inform us that the stock they took overnight into ex-date had an analyst upgrade on it that morning. The stock opened up significantly. They could find no other news behind the stock. As a trader, you should not count on this happening to you each time, but just note it as a positive benefit to our strategy in general. PFE pays 1.28 annually for a yield of 5.5%. The company, like LLY, has also hiked its dividend 41 times in a row. They are in fact correlated competitors with competing drugs like Lilly's Cialis against Pfizer's Viagra. There is room to trade this pair for production on a regular basis, as well as carry a core position to accomplish the dividend yield spread I mentioned in the first strategy, as well as the opportunity to have the pair on overnight 4 times a year for PFE and 4 times a year for LLY. There respect ex-dates arrive at different times. PFE is first on FEB 6 this year and LLY is next on FEB 13, so mark your calendars…

**In practice:** On Feb 5 you take PFE long and LLY short and take the pair overnight into Pfizer's ex-date. PFE previous day's closing price would be adjusted down by the quarterly dividend amount; 32 cents. This is a real adjustment to your holdings. If you had purchased 1000 shares at the close on Feb 4, you would now have lost $320 as it is .32 lower than what you paid for it. (Note that you have an offsetting dividend coming)
**In observation:** Traders see that PFE is discounted, many are not even aware that it is ex-date morning. Pair Traders see that the pair has shifted to a discount of PFE to LLY and again many are not aware that it is ex-date. This is also a Pair that is widely traded

and has proven itself to be elastic and mean reverting over the years. Sector traders may also notice a discount of PFE to LLY.

**The theoretical:** Traders and investors whether they know about the dividend or not see a discount and buy PFE. Pair Traders see the pair discount and buy PFE and short LLY. This brings the spread between the two stocks in slightly which allows the Pair Trader to keep some of the dividend. So why not just put the pair trade on in the morning and forget about the overnight altogether? Excellent question! It's a case of opportunity lost versus the risk. If a trader combines two good stocks together in the form of a pair, the market risk is reduced although there is still stock specific risk. Our experience has been that the trade is rarely a loss, often a wash, and often a significant profit for a short-term trade. In other words, the money lost on the mark down, is made up by the dividend so there is no loss except for transaction costs and time (that is the time until the dividend payable date) You are without the dividend until this date. More on the opportunity lost: In a perfect world the spread comes in all the way allowing the Pair Trader to keep 100% of the dividend. In an "alpha perfect world", PFE gets upgraded by 3 analysts that cover the pharmaceutical sector and the stock jumps $1.00 allowing you to profit on the pair trade as well as keep the entire dividend.

So this strategy supports a variety of scenarios like; lose slightly <u>or</u> wash <u>or</u> get some of the dividend <u>or</u> get the entire dividend <u>or</u> get your cake and eat it too. You may even make money on the spread before the close on the day before ex-date and not even take it overnight. In order for any strategy to work properly the losses must be contained. I recommend that just as you initiated the trade with validity, you continue to ask the question: is this trade still valid? Remember, your purpose in the overnight trade was to collect a portion of the dividend; NOT to marry a losing position!

**Now for the art-form:** If everything were as mechanical as buying the div stock and shorting something against it and making money on an overnight trade, we could automate it all and kick our feet up. The truth is that in time has to be spent in research and pairing the best choices of stock together for maximum yield. Also, in order to minimize your downside you must get the spread on for a great price. Even if the dividend play does not pan out, you still want to exit that pair with minimum damage. Conduct your research like it is the only thing that matters and at the same time choose your entry and execute as if that is the only thing that matters. Some stocks have incredible runs on the day before the ex-date. I can recall one trade on CVX – XOM where CVX had a 2.00 move up. I was going to try and collect the dividend of .50 but by the end of the day, after the spread went in my favor 2.00, I decided to take that profit and not hold it overnight for the .50. It looked to me that CVX run up a bit too much and that could open up my risk the next day. The goal in trading is not to build a perfect widget (system) but to make a profit, and in this case I had entered the trade for the purpose of making money from the dividend, and the stock decided to give me my profit that day instead of the next…and I am o.k. with that. ☺

The Strategic Dividend Play: This strategy involves finding a short against your dividend long that provides the maximum potential bang for your buck. It's different than just shorting PEP against KO every time the KO dividend rolls around or visa-versa, but rather involves looking for the most strategic short. It could be the recent trade short C against long BAC, JPM or WFC that some of our pair traders were doing. The flexibility here is that if your trade goes right, you may be able to extend this trade out for many days, weeks or months. So what started as a valid dividend trade provided extra validity for a longer term trade. You might look for post-event set-ups, extremely overvalued red-flagged stocks, or use an ETF as some traders have, although you must

reduce expectations of mean reversion using ETF's against a stock. It may work better with something like XOM or CVX against XLE (Energy Select ETF) as XOM as a component is19.57% of XLE while CVX is 12.33%. On the other hand if you were trading WFT; it only makes up 2% of XLE so it would be more strategic to short SII against WFT, benefitting from a higher correlation than the use of XLE as the hedge.

Are these forms of Dividend collection new strategies for Traders/ Pair Traders?
No. I have been teaching these strategies in classes in public since 2001.
They are also written about in the Art of the Arb manual and in previous newsletter publications. In my upcoming classes I will teach on increasing your edge further by the pairing of multi-strategies together and how to identify high probability pairs and trades.
Please note that the Advanced Pairs Class in March, conducted by Dave Sheldon and I will include software designed to collect, analyze and implement these strategies.

I recommend you start by becoming aware of the dividends that are available and then forming basic relationships of common household name stocks and putting those together in an effort to collect some. Start with small size and learn the structure, nuances and the art form that is required. We have many combinations of pairs in our database on www.pairtrader.com along with their dividend amount, date and yield. Remember to always check 2 or 3 sources of data for the ex-date and dividend amount, as errors have been noted occasionally.

Let's harvest these while we have an edge! We have always tried our best to collect these but over the last 18 months traders have noted increasing productivity and yield. What is a healthy expectation for this currently? As I need to live in the percentages and not the absolutes, my current expectation is to retain 35% of the dividend on a basic, no frills, and overnight dividend collection trade. Let's put some very conservative numbers to this: If you have a dividend yield of 1% quarterly (4% annually) on a $50 stock you would have a dividend amount of .50 quarterly ($2.00 annually). Pair this stock together with another $50 stock and take a position of 2000 x 2000 shares. Let's say you do not realize a significant profit before the close on the day prior to ex-date and therefore take it overnight. Using the 35% expectation you have a gross profit of .175 per share or $350.00. Using costs of $15 on the 2000 shares and round-tripping the pair, we have approx costs of $60. Some traders have to add in overnight holding costs also. So on a basic no frills strategy, our expectation would yield $1160 annually on this one stock being in the trade for 4 to 10 nights a year. I added a few nights incase you take a weekend trade. Do note that this will reduce your yield due to higher weekend risk and increased holding costs. Let's drop our yield down to 3% as an annual average but expand our business to include an average of ONE trade per day. Not too hard to do from the universe of stocks we have on the NYSE, NASDAQ and AMEX that pay healthy dividends. Using the $50 stock, 2000 shares and 35% of the 3% yield, on trade a day would profit you $50,625 after commissions for the year. You can increase your earnings through higher dividend yield, increasing size on lower priced stocks, doing more than an average of 1 trade per day and adding additional strategies to your trading business.

Many traders try to predict direction, or pick that home run stock, or just chase stocks around all day, whipped around by the noise. The structured traders are looking for a defined strategy where they can clearly identify when it is working and when not, and using the noise and chatter of the market rather than being emotionally affected by it.

If you choose not to use this strategy, at least be aware that the good, growing, dividend paying stocks have an upward bias along with the market and if you short the stock and pay the dividend without having specific reasons and an overcoming edge from your strategy, you have are trading with a negative expectation over the large sample.

If you are concerned that in sharing this, it will reduce its potential…it might, but on the other hand there are plenty of skeptics and those that will not take the time to develop the strategy properly. Due to the efficiency of the strategy, sloppy trading, carelessness and mistakes must be eliminated.

"Success is the result of small efforts
repeated day in and day out"
-- Author unknown

## NYSE Circuit Breakers for First Quarter 2008 *by Rob Friesen*

**1350 points down or 10 percent of the .DJI**

| | |
|---|---|
| Before 2:00p.m. | = 1 Hour halt |
| Between 2:00 and 2:30p.m. | = 30 Minute halt |
| After 2:30p.m. | = NO halt |

**At 2700 points down or 20%**

| | |
|---|---|
| Before 1:00p.m. | = 2 Hour halt |
| Between 1:00 and 2:00p.m. | = 1 Hour halt |
| After 2:00p.m. | = Market closed for the rest of the day. |

A plunge of 4000 points or 30% anytime during the day would close the market completely for the day.

NOTE: While there always seems to be a bid on stocks when things are selling off, things are primed for a major event one day. We have seen the elimination of the uptick rule and the program trading curbs. All that is left is the dark liquidity pool where who knows if there will be liquidity or not when it's really needed and these circuit breakers. A fall of 1350 points until the first circuit breaker will be quite an event though so fasten your seat belt. I can make these predictions: volatility is with us for a while yet and the emotions of fear and greed will always be with mankind.

**"Courage is resistance to fear, mastery of fear – not absence of fear."**

**Mark Twain (1835 – 1910)**

# BEWARE the Value Trap *by Rob Friesen & Richard Rubinstein*

I have a good friend in Richard Rubinstein, formerly Senior Vice-President of Oppenheimer Funds with an exceptional performance spanning more than 30 years. We were discussing a-while back what are the warnings signs and what contributes to a value trap stock. These are stocks that look much discounted to their industry peer group but can be traps that bleed away your capital. You will never be able to catch all the problems but considering these points you should catch some. Here are excerpts from our discussions.

**Value TRAP Checklist**

- Is there international competition with competitive advantages? (e.g. TM vs. GM) In this example, Toyota had lower manufacturing costs, cars that were designed for today's rising fuel costs and less legacy costs giving it competitive advantages. It was positioned well to take market share away from GM and other domestic automakers. TM has displayed its Kaizen (continuous state of improvement) and competed brilliantly in today's global environment.
- Does the company have book value growth significantly different than earnings growth? (Exception would be companies buying back their own stock). Companies sometimes affect book value when they write off special items below the line in an effort to maintain earnings growth. Earnings history could be fraudulent.
- Questionable receivables. Are there significant differences in revenue growth and/or accounts receivable with earnings growth? Supply line companies can have problems with customers paying on time. Quality problems…questionable receivables.
- Has company ROE come down from previous peak levels and stagnated while earnings growth is reduced? This may indicate that something has happened to their competitive position. Saturated product lines...no new products in the pipeline. MOT: Motorola was an example of this as it has relied on the RAZR phone for much of the past years and saw its global market share erode from 23 percent at the end of 2006 to only 13 percent by the summer of 2007. Samsung and Nokia with more innovative product lines punished Motorola in the marketplace. There may be a new chapter written on MOT in the coming years but not without them introducing some unique new products.
- Does the company have high or expensive debt and if so what is their ability to service this debt? There are some ratios like Debt/Total Capital that shed some light on this. This debt leverage increases fixed expenses and makes a company more vulnerable to cyclical factors. Those that have access to a Bloomberg screen have been able to look at widening corporate bond spreads to tip them off of problems in the company.
- If you are analyzing a retail company; do they have stagnant inventory or deteriorating product lines? We have observed many companies like CHS: Chico's and GPS: Gap suffer from product lines that are not keeping step with what consumers want and the business slows, inventories are not turned over.

- A company may show declining or negative cash flow or free cash flow. By focusing in on a firm's free cash flow (cash from operations less capex), looking very conservatively at future earnings growth, and applying a discount rate which is basically the return your require given a firm's business risk, you may be able to evaluate whether it is trading above or below its intrinsic value. You can judge whether you have a margin of safety. You want a company with ample free cash flow whose stock price is currently on sale. In terms of our current market sell-off, try screening for companies that have high FCF and see whether they are on sale.
- As we discussed in the dividend strategy, be careful of high dividend yield especially if revenues, cash flows, and earnings are declining. This may indicate that the company is issuing more cash to shareholders than it can afford.
- Basic shares outstanding don't take into account shares issued to warrant, option or convertible debt holders so for serious valuations, look at diluted shares outstanding.
- What were the engines that drove the stock down to current levels? Can you identify any internal or external catalysts for an upward move?
- Note: Tax-Loss Selling: Applies to the same security. Rules don't apply to correlated products. This means that investors aren't necessarily looking to pick up that stock again in the New Year that they sold for a tax loss. They may have been able to use a correlated product to offset.
- Is it a good business run by talented managers? Sometimes taking a contrarian approach can get you caught by looking at how cheap something is. Cheap stocks are not companies that have declined in price or had bad relative performance but rather are stocks that are depressed in price and still have great fundamentals, or are improving. Great companies at discounted prices are what we are after.
- Remember that we occasionally still find ourselves owning stocks with some of the above problems, but with this checklist, we may be able to catch some of the issues before they set us back too much. Loss control is still the key with all trading and investing strategies.

Finally, Richard and I wish you great success as you navigate all the discounted stocks in a few ailing industry groups at this time. Richard currently manages RHR Services www.rhrservices.com and consults on market fundamentals and integrated trading and investment styles.


Limited Seating

**Experience** a Transformational and Practical Mentoring Event

Learn by seeing, hearing and doing! Be immersed in a class that is not only theory but includes real-time trading of pairs. 84 hours of instruction, manuals, excellent meals, Art of the Arb, transportation and hotel discounts are included.

End of January Class is fully booked by an exclusive group whereas the **February 24 to 29, 2008** has **4 seats left.**
**Check website for other upcoming events.**

***Email Rob Friesen for more details – First booked basis.**

## PairCo, LLC Products and Services

**Available through www.pairtrader.com**

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Programs are issued on a two-week free trial basis.
All programs come with 1-year free technical support and upgrades
If you have other trading strategies you would like automated give us a call.
Group pricing available. All prices quoted in USD.

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**"Men fail much oftener from want of perseverance than from want of talent."**

**--William Cobbett (1763-1835)**

## BTM Mentoring Program

BTM

**Get some mentoring.** If you are struggling and not sure of what strategies are working in today's market, get some help! If you do know what works but can't seem to do it, have someone coach you and hold you accountable. If this sounds like what you need, call Rob or Dave Sheldon at 604-539-8700 and discuss your options and needs. We can't fix everyone or guarantee your success by we can increase your odds, provide value and counsel. Let BTM Mentors, assist you in sticking to your plan through accountability. Passion for the business, the art-form, the trader's edge and the fight are all foundational to success.

**"Success is being able to go from failure to failure without losing your enthusiasm"**
**--Winston Churchill**

Then learning from mistakes, loving discipline and reducing emotional decisions assist the process towards profits. There have been many that have walked in your shoes, either on the path to victory or failure, so you are not alone. If you are trading at home, you can get the idea that you are all alone and your hardships are unique to you. The BTM team and I understand your challenges and are committed to providing you value and improving your knowledge of professional strategies. -- *Rob*

## Some FACTS from 2008 Stock Traders Almanac

Just wanted to introduce you to Yale Hirsch's Stock Traders Almanac. This is a valuable resource for traders and investors. It helps you see what the probabilites are so that you can either observe history repeating itself or the deviation from it. For example, we did not recently experience the Santa Claus rally, but rather the Grinch came and stole Christmas for Wall Street. Knowing what historically occurs can assist you in evaluating business as usual or are we experiencing something else. It may also help you see the Black Swan events as they occur. As with the credit crisis that completely shifted things around and we had a very different year in the various industry groups performance and in the normal seasonalilty.

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| First 5 Days of January: | Early Warning System. It has been 86.1% accurate over last 36 years. |
| January Barometer: | As January goes…so goes the year. Follows the SP500's performance by the end of January. Only been wrong 5 out of last 57 years. |
| January Expiration Day: | Dow has been down 8 out of the last 9 times with BIG losses. |

January usually ends BEST 3 MONTHS of the year

*Bottom Line: Buy the Book!*

**"The man who des not work for the love of work but only for money is not likely to make money nor find much fun in life."**

**--Charles M. Schwab**

Do you want to have fun, structure and discipline in trading? Try our programs!

## Harvesting your Portfolio with Automation *by Ullrich Fischer*

### PairRangeTraderTM

Fully *automatic* trading based on business plans in which you choose the parameters determining bias, total number of layers, and capital allocation over those layers.

- With a single click, create intraday business plans on the fly based on % of Average True Range in which the software calculates the spread price moving off the previous close, or current days open, or day's high or low.

- Vary the distance between successive legs in your business plan in an exponential progression.
  E.G. if the distance to your first planned entry point is 1, the distance between that entry point and your second could be 1.25, and the distance between your 2nd and 3rd entry points could be 1.25 * 1.25, etc.

- Vary the number of legs you put on at each entry point to increase the amount you bet as the pair moves to a more extreme spread number throughout the day.
  E.G. if you put on one leg at your first entry point, you could put 2 legs on at your 2nd entry point, 3 legs on at your 3rd entry point, etc.

- Set up simulated OPG pair orders which either get hit within a specified time after the pair opens (both members of the pair are open) or don't get submitted at all.

- Suppress orders if your pair opens at too much of an extreme move during a specified time after the open.

- Switch from your intraday % of average range based plans to your longer term fixed layers based business plan at any time during the trading day.

- Keep multiple business plans and switch among them at will.

- Keep track of what might have been and which parameters might have given better results for each member of your pairs list with the snapshot pair tracking feature.

- Build out your business plans for your existing positions.

Attention: As I occasionally produce a newsletter, I would appreciate your feedback in what you liked or disliked, what you would like to see in the future and if you can contribute content to this effort. I apologize if the content isn't grammatically correct or written with literary proficiency. Please contact me: robfriesen@brighttrading.net

Newsletter compiled and produced by Rob Friesen, CEO of PairCo, LLC

## Contacting PairCo, LLC

**Rob Friesen**
*Chief Executive Officer*
robfriesen@brighttrading.net
Suite 108
20486-64th Ave.
Langley, B.C. V2Y 1N4
Tel: 604-539-8700
Fax: 604-539-8701
**www.pairtrader.com**

**Darren Clifford**
*President, CFO*
darrenclifford@brighttrading.net

**Ullrich Fischer**
*Chief Technology Officer*
4WEL@brighttrading.net

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***DAY TRADING, INVESTING and any purchase or sale of equities can be extremely Risky and you can lose some or all of your money.***

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