TAIPAN

PROFITS COURAGE FORESIGHT

JANUARY 2004 VOLUME 17 ISSUE 3

This issue went to print 12-12-03. Prices and margins quoted reflect levels at this date.

Profits at the speed of news: Leveraging the information differential to generate Dynamic Gains


J. Christoph Amberger

"No more Mr. Nice Guy," wrote *Taipan* junior editorial board member and *Value Edge* Editor Brad Colburn on the morning of December 11, a day before this issue went to print: *"I'm about to do some big-time crowing. In November 2002, I told* Taipan *readers to buy* ***Cepheid (CPHD:NASDAQ)*** *at US$4.50. CPHD is the developer of GeneXpert, a system used to detect rogue chemicals that find their way into the mail. If a letter has traces of anthrax, for example, GeneXpert detects it before the mail goes through.*

"Now, I know what you're going to say: CPHD has been one of my quietest Taipan *picks. Until now. Today, they were issued a patent covering the design of the reaction chambers used in their disposable test cartridges and tubes. This is the sixth patent issued for Cepheid's disposable cartridge technology. News of the patent sent CPHD rocketing to US$8.35. It took a while, but that 85% gain is looking very nice. It's up from here."*

But its not just the Young Turks bringing home the bacon for our subscribers. Some of our tried-and-true standbys are producing handsome gains for those *Taipan* members who not only recognize an opportunity when they see one… but act on it. *Taipan* and *e-Dispatch* reader Peter C. from Australia wrote me that same day:

"Stumbled upon Taipan *a couple of years ago and eventually subscribed. I set up a trading account in the USA four months ago (small amount—only trade options at present).*

"I just enjoyed a good result with your 'cash cow' ***Impac Mortgage Holdings (IMH:NYSE)****: Bought 22 IMH US$17.50 Jan 04 call options on 10/30/03 at US$0.10. Shares were US$15.28 at the time. Total cost US$253 (including commission). Exercised the options on 12/4/03 and sold the shares at US$18.91. Net receipts (including commission): US$3,052.10.*

"Roughly 1,100% profit in a tick over a month. What an absolute ripper! I consider myself very fortunate to have found Taipan. *I love your trading and investment philosophy. A HUGE vote of thanks to you for making IMH (and other stocks, too) known to me."*

Thank you for letting us know, Peter… and for pointing out to your fel-

over, please…

email: editor@taipanonline.com

low members that there is more than one way of making money on *Taipan* recommendations: Even if you don't use options to spread your risk and leverage your profit potential, IMH:NYSE has created handsome gains for buy-and-hold and income investors since we first recommended it at US$7 a share in the summer of 2001, bringing gains of over 170%—not counting the ever-increasing quarterly cash dividend payments.

And thank you, also, for confirming the main tenet of *Taipan*'s Dynamic Market Theory—**that you can make profits in the markets no matter where in the world you're located.**

Profits at the speed of shark

Brad's recommendation of CPHD is a perfect example of how *Taipan* editors home in on the opportunities created by Dynamic Markets. It's a solid company with a revolutionary product poised to profit from a dynamic shift in the news environment.

This approach, of course, is not exactly new. Traders have reduced it to "buy on the rumor, sell on the news" and practiced it, with the usual mix of success and disappointment, since the dawn of investing.

In "Following the Equator," Mark Twain reports on one such historical application of our Dynamic Market Theory:

In 1870, a young man by the name of Cecil Rhodes arrived in Sydney, Australia. Within a few weeks, he had not only exhausted his financial resources but also his prospects of ever landing a job. One day, as he hungrily and aimlessly prowled the harbor, a shark fisherman who had caught nothing all night asked him to hold his line for a while to "change his luck"… in exchange for the shark.

Rhodes agreed—and within a short time landed a nineteen-footer. That, he figured, was not a bad deal: the Australian government would pay him a bounty of eighty shillings for his catch, he'd have some shark meat to eat for his dinner, plus he was entitled to whatever contents emerged from the shark's stomach. After opening up the stomach, however, Rhodes abandoned his catch… to the surprise of the fisherman.

The next morning, he showed up at the home of Sydney's richest wool broker with a remarkable proposal: he wished to borrow 100,000 pounds sterling to option Australia's entire wool crop—"deliverable in 60 days."

He succeeded in his objective. Mainly because he had something the wool broker didn't: an advantage based on information.

You see, back in the 1870's, it took about 50 days for a newspaper to travel from London to Australia. What Rhodes had found in the stomach of the shark was a copy of the London Times that was only 10 days old… containing a short note that war had broken out between Prussia and France. Wool, up until then "the low-spiritedest commodity in the English market," had jumped 14% overnight, and prices were still rising.

Suffice it to say that Rhodes got his loan, securing him the first fortune he ever pocketed.

Matrix reloaded: Making money on the flow of news

At *Taipan*, we make do without sharks. But we're still employing the same principles Rhodes used in his Great Sydney Gamble: on the basis of highly researched and well-documented theories, our editors analyze stock price change as it relates to news. Or, more precisely, they gauge the rate of information flowing to the market.

In other words, the price change of a stock is a measure of market sensitivity to news.

Taipan veteran Ian Cooper has written two academic studies on the dissemination of news and its manipulation by corporate America, the government and the media. His work includes over 500 pages of charts and tables and reams of documents devoted to this complex phenomenon. (His bibliography alone runs to 32 pages!)

His system and findings are supported by dozens of high-level studies. According to McCurdy and Maheu, authors of "News Arrival, Jump Dynamics and Volatility Components for Individual Stock Returns," the most important process affecting price movements may be the news arrival process itself.

Ian's system, the underpinnings of his *Extreme Volatility Speculator* trading service, bypasses all the conventional theories of value and price. In essence it says that news about anticipated cash flows and the appropriate discount rate is critical for individual stocks—producing either an upward or a downward swing. And the sooner you know and can act on this news, the better your chances of profiting.

In the past two years, Ian's system, the *News Evaluation Matrix,* has generated 58 winners out of 87 plays, with an average gain of 14% on each and every recommendation (losers and all)—an amazing success rate.

In this, the first issue of 2004, Ian has produced another one of his cyclical plays. He has recommended the same play five times at various stages of the news cycle over the past three years… and made money each and every time. Read on, because he's about to do it again:

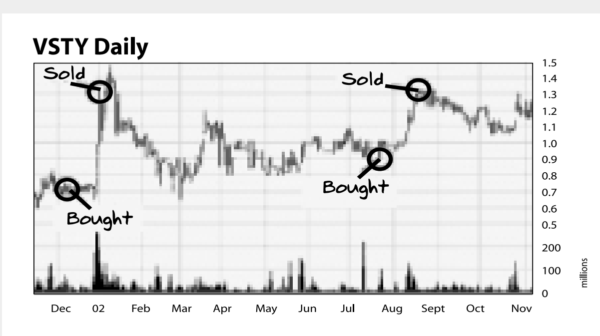
Return of an old favorite

77% in Round 1, 23% in Round 2, 77% in Round 3, and 40% in Round 4. Be prepared for Round 5 and another possible 77%.

Ian L. Cooper

Each time the *Red Zone* Team has played **Varsity Group**, we've walked away with a quick and easy profit playing the back-to-school seasons in August and January. Over the past year and a half, we've raked in 77%, 40%, 23% and another 77% in profits playing this stock. Now it's time for Round 5 and another possible 77% gain by the end of January.

Most of us have painful and expensive memories of college bookstores. You pick all your books and supplies for the semester, stand in line for about an hour, and then find out that you have to fork over US$453.67 for three books. Three books! After your last nerve has been plucked, you realize there is nothing you can do about it and hand over the cash while cursing the school.



By the end of the semester, when you're ready to sell back your books to the leeches of academia, you find out that those same three books you bought for US$453.67 are now only worth US$45. So the day after writing a 50-page paper, taking four mind-numbing regurgitated knowledge exams, and getting two hours of sleep in three days, you again curse the school and announce that you'll keep your books just to spite them.

That'll show 'em. Well, until the school prints "Master of Art" on your degree. True story. They actually left out the "s" in "Arts."

It's a fact—college bookstores charge unbelievable fees for required course books

It's a good business to get into, too. Varsity Group is in this business. VSTY is an online retailer of new textbooks and educational materials targeting the private middle and high schools, colleges, and distance and continuing education markets. Through its eduPartners division it can serve schools directly, offering a convenient, hassle-free, cheaper alternative to students.

VSTY makes most of its money in August and January. That means now. And there are plenty of catalysts for us to make another quick and easy profit this time around. Higher education continues to be a booming business. In fact, according to the US Census Bureau there are 15.5 million undergraduate and graduate students at more than 4,000 colleges and universities in the US alone.

over, please…

Plus, there are more than 5.2 million students enrolled in private schools, with about 2.84 million students in the elementary and secondary level schools. Better still, according to the Council on American Private Education, secondary school enrollment is expected to increase as much as 8% between 2000 and 2006. That should add nicely to VSTY's bottom line.

Last earnings report

For Q3 2003, VSTY posted a net profit of US$3.8 million, a 78% upsurge from the US$2.1 million recorded in Q3 2002. Revenue shot up 49% to US$21.5 million from US$14.4 million.

The company's eduPartners division served some 200 schools in the last back-to-school season in September 2003. With the addition of more schools to VSTY's roster, the company expects to deliver record earnings for the fiscal year ending December 31, 2003.

If it sounds like we're excited about pulling in profits for the fifth time with VSTY, that's because we are.

Buy Varsity Group under US$4.10 (VSTY:OTCBB) on the back-to-school trend that has paid off handsomely four times before. Contact: 1850 M Street, Suite 1150, Washington, DC 20036, tel. 202-667-3400, fax 202-332-5498. Visit: www.varsity-group.com. ■

Letting the Dogs out early

by Ian L. Cooper

Sure, it's still too early to tell with 100% accuracy which of the Dow 30 will be crowned the top Dogs of the Dow. But we're taking bets and making bold predictions. And should they prove correct, well, you'll be one of the first in line to make some handsome profits come January 2004.

We have a history of playing the Dogs of the Dow and making some decent sized profits. And that's even before adding in the dividend payouts. In January 2002, fellow *Taipan* guru Christian DeHaemer recommended that you sink your teeth into a diversified portfolio of Dow stocks that were battered beyond recognition yet still paid out hefty cash dividends.

Known as the Dogs of the Dow in the bear market of 2001, DeHaemer's picks returned an average gain of 8% in less than three months.

Then, with the idea that 2003 would be a turnaround year, we did it once again.

In 2003, I recommended that you sink your teeth into Altria Group (MO:NYSE), JP Morgan (JPM:NYSE), Eastman Kodak (EK:NYSE), Honeywell International (HON:NYSE) and SBC Communications (SBC:NYSE). With the exception of SBC and HON, we did extraordinarily well, with an average return of 10%.

Here's how we did:

Stock / Symbol	Entry	Exit with Dividends	Gain/Loss
Altria Group (MO)	US$39.52	US$46.99	+19%
JP Morgan (JPM)	US$25.20	US$35.84	+42%
Eastman Kodak (EK)	US$36.58	US$30.71	-16%
Honeywell (HON)	US$24.50	US$30.20	+23%
SBC Comms (SBC)	US$28.51	US$24.29	-15%

The science of Dogs

There really is no science to choosing the Dogs. You buy the Dow stocks with the highest dividend yields and watch them outperform the market. Dogs of the Dow plays are a good buy for the following reasons.

- One: These companies most likely will not go out of business.
- Two: They are financially sound and have enough gung-ho to keep them rolling.
- Three: They pay dividends.
- Four: We're buying them at low prices.

The key to making good profits from the Dogs of the Dow is to hold the plays for a period of a year to 18 months. This gives management and the board of directors enough time to bring the stock prices up to market value. Plus, if you sell your investment after 18 months, any gains you pull in will be treated as long-term rather than short-term. Check with your financial advisor.

Possible Dogs of the Dow for 2003

Typically, investors wait until the last trading day of the year to review the Dow 30 for the Dogs of the Dow. But here at *Red Zone* we're not known for following the herd mentality of Wall Street. We're trying to beat the rush of Dog news to set you up for some nice returns. In fact, it's that "beating the news" plan that has made our publication *Extreme Volatility Speculator* so successful.

Instead of playing all ten Dogs of the Dow, we've chosen five that could provide you with some nice returns over the next year. By investing equal dollar amounts in each of the following high-dividend payers, you are safely diversified. This limits your overall risk should the market lose its mind.

Look to buy into the following positions today:

Please note that these are all speculative buys. We will look to take profits in 2004. If you should decide to buy in, plan to hold for the long haul. Happy Profiting!

Company / Symbol	Dividend as of 10/31/03
Altria Group (MO:NYSE)	5.85%
AT&T (T:NYSE)	5.11%
General Motors (GM)	4.71%
DuPont (DD:NYSE)	3.47%
Merck (MRK:NYSE)	3.34%

The "barbarous relic" gets a spit-shine:

Why a little gold in your portfolio is a no-brainer


Briton L. Ryle

I'm a pretty modern guy. I've got a cell phone and a high-speed cable hookup for my computer at home. There's a DVD player in the living room and I got my Mom to buy Sonic Solutions (SNIC:NASDAQ) at US$6.75. My wife and I even have a "fiber-optic Santa" as part of our holiday decorations.

So why, why on Earth am I about to reverse 15 years of investment progress and recommend a gold stock? I guess it's because I've come to believe gold is very likely to continue its advance over the next 6 to 12 months. And that the current weakness around the holidays may be one of the last good buy opportunities.

Now, before any gold bugs start to think they've won me over to the shiny side, let me just say that it was the Fed that got me thinking about gold. Allow me to explain.

Golden calf

I've always been a gold skeptic. It seems to me that the value assigned to a lump of shiny ore is every bit as arbitrary as the value assigned to a piece of paper bearing the hollow stare of a dead US president. But now that gold is over US$400 an ounce, the US economy is picking up, and Alan Greenspan has flat refused to adjust his inflationary monetary policy, I feel I have little choice but to become a gold bull.

Over the last few months, I've written at length about the Federal Reserve's overnight repurchase activity and the subsequent expansion of the money supply. I'm not going to bore you with the details again, so let me just say that a loosening of monetary policy is appropriate to help kick-start a recovery. But over the long term the current policy could be disastrous.

Diver down

All you have to do is look at the state of the US dollar to see what may lie ahead. Despite CNBC's best attempts to gloss it over, it's no secret that the dollar has been getting hammered over the last few months. And, for all the jawboning by Treasury Secretary Snow, the current administration is clearly in favor of a weak dollar.

My best guess is that the administration is content to flirt with inflation in order to provide a boost to US exporters. Unfortunately, inflation is a force of economic nature. And it's not usually a good idea to mess with forces of nature. Just ask the scientists in Jurassic Park. Everything's running smoothly—then just one little variable goes wrong and the next thing you know Jeff Goldblum is getting his head bitten off by a velociraptor. In the world of finance, that's more or less what happened to Long-Term Capital Management. Remember them?

Inevitable inflation

At some point, the Fed is going to have to admit that inflationary pressures exist and raise interest rates. It's inevitable. The 10-year bond yield has seen its lows. And that makes a short position on the iShares Lehman 20+ Treasury Bond Fund (TLT:AMEX) a no-brainer.

Just make sure you time your entry well and have enough margin to weather a rally based on a dollar rebound. Remember, I cover TLT regularly in

over, please…

my trading service, *The Money-Flow Matrix Trader*.

Gold's move toward the historical resistance point at US$400 an ounce could be attributed simply to the reflation of the US and global economy. But the strong move above US$400 has to raise an eyebrow or two. In my opinion, this move clearly shows that inflation fears are on the rise. And they will only get worse.

The fear factor

It may be helpful to think of gold not as an asset with inherent value, but as an inflation fear gauge. Think of gold as an option (or even better as a futures contract) with the fear of inflation as its underlying asset.

From that perspective, it's easy to see that the price of gold has room to run. Because inflation is still very much a back-burner issue. We haven't even started to see headlines or roundtable discussions about it. When we do, gold has the potential to rise another 15% to 25%—a substantial move that could be very profitable.

Mining for profits

It's probably a good idea to own some physical gold, or at least a long-dated futures contract. But the simplest way to get some gold in your portfolio is by buying a junior mining company stock.

And I've got one that looks pretty good. It's a Canadian gold producer with operations in Nevada. I'm going to give you a brief rundown on the company, but I want you to remember that the primary thesis for investment in a gold mining stock is the price of gold.

The company is **Apollo Gold (AGT:AMEX)**. Apollo operates pit-mining operations in Nevada. Total proven and probable reserves are 940,800 ounces of gold. Current production runs between 110,000 and 130,000 ounces a year. A new operation due to come on line in the near future could add 70,000 ounces of gold annually.

For the trailing nine months, Apollo made CDN$65 million in revenues (around US$48 million at current exchange rates), primarily from the sale of 107,000 ounces of gold. The average price per ounce was approximately US$375.

Clearly, if the company can boost its production to 180,000 ounces a year and fetch something north of US$400 an ounce, revenues are going to rise substantially.

Apollo Gold currently trades at around US$2 a share, roughly twice annual sales. 180,000 ounces of gold times US$400 an ounce works out to US$72 million in annual revenues. And that, in turn, implies a forward valuation of just 1.2 times sales. Assuming Apollo can maintain a valuation of 2x annual sales, this company could easily add US$1 or 50% to its stock price.

And, of course, positive news for the company or a sharp rise in the price of gold, which I think is imminent, could send the stock price even higher.

So I'm rating Apollo Gold (AGT:AMEX) a strong buy at or below US$2 a share, with a 6-month price target of US$3. You can contact the company at: Apollo Gold Corp., 204 Black Street, Suite 300, Whitehorse, YT Y1A 2, tel. 720-886-9656, website www.apollogold.com.

2004: The year of Spiders and Diamonds

Maintain your SPY and DIA basket… but with a cautious trailing stop

Adam Lass

by Adam Lass, Bryan Bottarelli and Ann Sosnowski

I read the news today. Oh boy.

Sometimes, when I get up in the morning, I'm not quite sure what day of the week it is. Then there are the days when I'm confused as to which century my morning paper is from.

This morning's headlines didn't help much: They are all about the president's declaration that those godless commies in the East shall not beat us to the moon.

Further reading reveals that the President's advisors are telling him that with any luck, a "space race" would distract the populace at large from our failure to win the hearts and minds of the citizens of several small, eastern countries torn apart by insurgent guerilla movements.

Boy oh boy, that President Kennedy sure has a lot on his plate.

Intimations of things to come

Ah, well. I suppose this strange echo of past events is simply proof positive of one of *WaveStrength's* central tenets: that human activities—political or financial—play out in repeating, wave-like cycles. And that if you've seen a pattern once as a youth, you'll see it a thousand times before your senses dim.

Decade after decade—indeed century after century—the wise and wealthy are those who possess the skill and fortitude to ride these waves. Conversely, those who build castles on the beach are constantly surprised by the tides' arrival.

My point is simply this: I don't much like this rally. It is based on a remarkable distortion of the laws of economics the likes of which haven't been seen since Nixon abandoned the gold standard. And the long-term penalties may be quite similar: a decades-long grind of inflation and unemployment. (Speaking of ancient history, does anyone out there remember "WIN" buttons?)

Resistance is futile

My distaste for the machinations of the current administration, however, cannot alter the fact that from now till next November the market will probably be up, if for no better reason than that everyone knows the White House will continue to pump cash into the system.

To resist this wave is futile. So we ride it, cautiously (but we'll get into that in a moment).

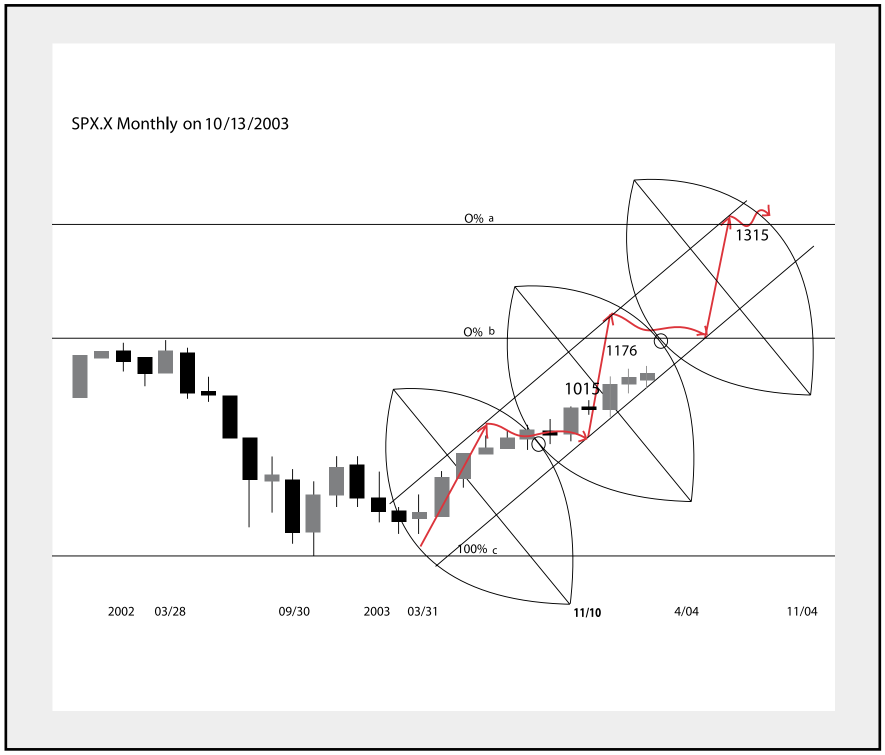
For now, up is up:

- U. S. housing starts in October were at an all-time high of US$922 billion, despite rising real interest rates.
- U.S. productivity is screaming up at an annual rate of 9.4%.
- And, despite the whining of the modestly reemployed, new job creation is also up.

(A quick historical note on that subject: Over the past four decades, when unemployment is above 7% on election day, American presidents get evicted from Pennsylvania Avenue pretty darn quick. But when unemployment drops to the high end of 4%, wage-based inflation surges up almost immediately. Since the greatest threat to this economy is inflation, I'll bet that a nice median figure like 5.5% looks very attractive to both the White House and the Fed right about now.)

Still long (with reservations)

So in the end, we're still long the Dow, S&P and NASDAQ. But only because the charts (which, after all, are only a reflection of the sum total of the relative wisdom of every buyer and seller) tell us that the upside comedy is still somewhat more likely than the downside tragedy.



Note that the market continues to follow our S&P 500 predictive chart from the past few months with new high after new high. At this point, another strong move toward 1,176 is still in the cards. Indeed, the index may be there almost by the time you read this.

Yes, we are still long. We can afford to be long, despite the inherent silliness some find in the fundamentals of this market, because we have long-dated S&P puts in our back pocket that aren't losing much value even as market climbs. Why? Because anyone who doesn't have his head in the sand is buying them too.

Indeed, we may be the only "anti-printing press" economists who see the short-term advantages as

over, please…

well as the long-term risks of this market. Warren Buffet has said that Wall Street has no stocks worth buying at current prices, while George Soros has pledged to spend millions, perhaps even billions, to defeat President Kennedy, er, Nixon, no, Bush (get it straight!) next November. (Curious that with such business-oriented enemies, he is still referred to as a "pro-business" president.)

All that said, it's time for our:

2004 Position Update

If you've been following our *Taipan* alerts since mid 2003, you know that we've recommended the **S&P Spiders (SPY:AMEX)** at two prices: first for US$99.50 and then again for US$102.00.

As we write, the Spiders are trading for US$107.39 and looking to break out to a new high. This gives you a gain between 5.3% and 7.9% over the course of three months.

For the "traders" in the group, we also initiated an upside SPX call option in the November issue of *Taipan*. If you recall, we recommended buying **SPX March 1150 Call (SPT CJ)** options between US$6.20 and US$7.00. At the moment these calls trade for US$6.30. Since they're still within our original trading range, they remain an active and open "buy" in our *Taipan* portfolio.

Looking to the upside while protecting the backside

Following Adam's chart above, we're sticking to the upside price target we gave for these calls in the December *Taipan* issue. That is, at SPX 1,176, we'd expect these calls would trade for approximately US$39.00 per contract, good for a 520% gain over the next four to five months.

In addition to your two S&P positions (the SPY and the more aggressive SPX March calls), we'd also like you to maintain your long position in DIA. We recommended the "Diamonds" via our daily *247profits e-Dispatch* on November 10, 2003, for US$98.00 a share. As a quick reminder, the Diamonds act as a low-cost proxy for the Dow Jones Industrial Average. They trade for 1/100th the cost of the Dow. Right now, as the Dow threatens to crack 10,000, this position is showing a modest yet respectable one-month gain of 2%.

Since we're still optimistic about the future market upside, we recommend holding all positions. At the same time, you should use a measure of caution and place a 10% trailing stop on your SPY and DIA positions. At current levels, that equates to US$96.87 on the SPY and US$90 on the DIA. As for your SPX March 1150 Calls, place a protective sell order at US$4.00 per contract. ■

How the 2004 campaign will affect *Taipan's* Dragon plays

Siu-Yee Ng

During George W. Bush's presidential campaign in 2001, he said "China is not our friend in the Far East. Our friends are Japan, Taiwan and South Korea." Although he didn't see China as a friend, he still felt that "It's our country's advantage to have trade with China... it's to our advantage to open up Chinese markets to farmers and producers and entrepreneurs."

Two years later, the American public is complaining about China's "unfair" trade advantage. All this complaining in an apparent recovery that seems to have traction. Investment spending is on the rise, and the employment outlook looks promising. And the rest of the world, once a drag on economic vigor, is improving.

So why are Americans whining over US unemployment and the loss of income because of China? Do the Bush Administration and the American public understand the implications of imposing tariffs on Chinese goods? Haven't we learned from the steel tariffs fiasco?

Let me remind you what happened.

Winning votes

The Bush administration imposed a tariff on non-American steel in 2002. Initially, the tariff did give the US steel industry some relief. But prices eventually increased for domestic manufacturers. And jobs were lost as a result.

Finally, threats of sanctions from the European Union and other trading partners forced Bush to lift the tariff. This will only help long-term US economic growth.

Think about it. Cheaper steel will add to the bottom line of US companies who were suffering because of high steel prices. This means higher corporate earnings. Not to mention that a trade war would do more harm than good to the US.

So why are we imposing tariffs on our Chinese trading partners? Hasn't the Bush Administration learned from its mistake? The answer is simple. It's all about the 2004 presidential election.

Taming the dragon

Everyone from industries to the common man is banging on Washington's doors, blaming overseas competitors like India and China for lost jobs and income.

Since the US trade deficit with China was US$103 billion in 2002 and the deficit for 2003 will exceed that number, it is easy to pinpoint a culprit. After all, "everything is made in China."

Under pressure, the Bush Administration slaps a tariff on some Chinese textiles. Has anyone really thought about what this will do to the American consumer and the economy as a whole?

Granted, tariffs aren't a catastrophe like a sudden spike in the price of oil. But in the long term, tariffs and other trade barriers eventually drag down the economy.

American consumers benefit from the cheap goods coming into the States. They could be paying twice as much for certain goods. And what about the companies that depend on these cheap goods? Their bottom line will suffer. Didn't we see that with the steel tariff?

About this trade deficit everyone keeps harping on: In 2002 China imported US$300 billion worth of goods and exported just a little over that. So it was just a modest trade surplus, despite the US$103 billion deficit with the US. But compared to the rest of Asia, China actually has a trade deficit of around US$60 billion. With its economy improving, China is increasing its imports, which helps the global economy, including the US.

And all the complaints about China taking manufacturing jobs from the US—give me a break! The Chinese are strong in sectors that aren't a big part of the US economy. For example, China exports a lot of PC's, a product not many American workers are making anyway.

Most US manufacturing jobs are in autos and steel, and the competitors are Japan, Europe and even Korea—not China.

But with China's growing economy and emerging economic dominance, it becomes an easy target for the US.

Protecting the homeland?

Research shows that the protectionist approach the Bush Administration is taking will do more harm than good. Living standards, wealth, innovation and competitiveness will suffer.

Granted, tariffs aren't a catastrophe like a sudden spike in the price of oil. But in the long term, tariffs and other trade barriers eventually drag down the economy.

And remember that threat of a trade war with Europe? Well, it's begun with China. After the Bush administration announced in November that the US would impose a quota on Chinese textiles, the dollar started falling, eventually plunging to a record low against the euro.

China retaliated by withdrawing a plan to purchase US soybeans.

And China's plans to spend billions of dollars on other US products could be in jeopardy.

What is this doing to all our Dragon plays? Our second half of the **China Yuchai (CYD:NYSE)** position is sitting on a hefty gain of 540%, down from 728%. **Zindart Ltd. (ZNDT:NASDAQ)** is up 71%, down from 106%. **LJ International (JADE:NASDAQ)** is up 11% and **Guangshen Railway (GSH:NYSE)** is at breakeven.

The uncertainty surrounding US-China relations clouds the inevitable fact that China is and will continue to be a global player. Good, solid Chinese stocks will benefit. **Continue to hold all our Dragon plays.**

Other positions:

Quinenco SA	LQ	103%	Hold
SGL Carbon	SGG	36%	Hold
Omi Corp.	OMM	10%	Hold

over, please…

A flourishing portfolio in 2004


Martin Denholm

When I see a company with a high P/E ratio, I'm usually skeptical. With the collapse of the dot-com sector still fresh in memory, my first thought is, "Overvalued, too expensive, too dangerous." And I swiftly move to a better candidate. So if I told you there's a stock out there with a P/E ratio of 53 that's considered *undervalued*, you'd probably be surprised.

And if I recommended you add the stock to your portfolio, you might be shocked! But let me explain why I'm willing to make an exception in this case…

Keeping the punters flocking back for more

I've personally given this company my business before and received goods and services second to none. So I feel comfortable with it. Others do too. Repeat buyers represented over 58% of orders during the company's recent first quarter. The company also attracted 484,000 new customers. And after taking a closer look, what I found really piqued my interest.

Your play is **1-800-Flowers.com (FLWS:NASDAQ)**. Now, put aside any preconceived notions you may have about companies with high P/E ratios. Don't get jittery at the "dot-com" part either. Here's the point: With 27 years of retail experience under his belt, chairman and CEO Jim McCann acquired FLWS in 1986. He quickly set about growing the business, ensuring it was viable and trustworthy, and boosting profits through a solid customer base. In 1992, he took the company online and launched the full "1-800-flowers.com" website in 1995. FLWS has a proven business model.

Diversity breeds sales

And despite the name, it's not all about flowers. Thanks to its subsidiaries, FLWS is a diverse company offering a wide range of products like gift baskets, plants, candles, gourmet candy and stuffed toys. Its subdivisions include:

- *Plow and Hearth*, which sells home and garden products.
- *Children's Group*, which operates under the *HearthSong* and *Magic Cabin Dolls* umbrella and sells toys and games.
- *GreatFood.com* and *The Popcorn Factory*, which sell the company's gourmet food products.

In August 2003, 1-800-Flowers went into partnership with stylish designer Jane Carroll (you may have seen her on Oprah, or read about her in USA Today or People magazine). Thanks to strong sales, the alliance has now expanded to include Carroll's full range of products.

Because of this strong business model, sales have risen consistently for the past six fiscal years:

- 1998: US$220.6 million
- 1999: US$295.9 million
- 2000: US$385.3 million
- 2001: US$442.2 million
- 2002: US$497.2 million
- 2003: US$565.6 million

This year's revenue translates to a healthy US$8.43 per share.

During the first quarter of fiscal 2004 (June-September), a sharp 20% increase in website traffic helped sales continue the upward trend, bringing in a rise of 7% to US$95.2 million over Q1 of fiscal 2003.

And speaking of the web…

'Tis the season for online retailers

While traditional bricks-and-mortar stores failed to shine in November, web retailers took a bigger slice of the pie. According to BizRate.com, which tracks sales at 2,000 online companies, e-tailers enjoyed a 30% sales increase on Thanksgiving Day alone—almost US$200 million worth of merchandise. Over the four-day Thanksgiving holiday, sales zoomed to US$820 million—an 11.5% gain over Thanksgiving 2002. And Forrester Research says online sales from Thanksgiving to Christmas this year will surge by a massive 42% ($12.2 billion) over 2002 numbers.

As an online retailer, 1-800-Flowers is able to cut overhead and market to a massive global consumer base through its worldwide network of partners. So you can expect the company to take profitable advantage of the current gift-giving season and extend its success into 2004 and beyond.

Second quarter solidity

In addition, 1-800-Flowers is approaching the end of what has been its best fiscal quarter in terms of revenue and earnings per share (EPS) for the last two years.

Despite being hampered by a sluggish economy, the company's second fiscal quarter of 2002 (October-December 2001) yielded revenue of US$162.3 million and EPS of three cents. In the corresponding period of fiscal 2003, the company smashed those results, recording revenue of US$197.4 million and EPS of 15 cents. And it achieved this during one of the poorest holiday seasons on record (overall sales rose just 2.2% in 2002). Now, with an improving economy, greater consumer spending and lower unemployment, and the growing popularity of the Internet as a buying tool, I expect 1-800-Flowers to benefit again this year, possibly grabbing a third of its annual revenue during this quarter alone.

Don't let the P/E deceive you

If you think a trailing 12-month P/E of 53 is high, that's understandable. But only if the company couldn't justify it with some dazzling sales and earnings numbers. 1-800-Flowers delivers.

You know about the sales growth. Now consider the company's earnings growth rate for fiscal 2004 (ending in June), which is expected to hit a remarkable 89%. The industry average? A pathetic 2.5%. Earnings-per-share growth is expected to roll in at 75% or more.

Provided sales and earnings are solid, growth investors are undeterred by a high P/E. As you can see, 1-800-Flowers enjoys both.

But if you're still wary, consider this: The company's projected P/E for fiscal 2005 is 23. Earnings growth for that year is projected at 34%. That gives the company a PEG ratio (price to earnings growth) of 0.74—undervalued by investment standards. Over the next five years, earnings growth is expected to average a robust 24%.

And it's not like 1-800-Flowers is ridiculously priced relative to its current P/E. It trades for just US$10.72. You're getting a bargain.

Feed off insider confidence

Although the company's operating and net profit margins of 2.5% aren't exactly mind-blowing, at least they're positive. The industry average for the latter is awash in red at minus 15%. And with almost US$50 million in cash, the company should be able to use this extra leverage to its advantage.

You can also expect a decent return on your investment. Return on assets is a tidy 7% this year—the fourth consecutive year of gains. And return on equity is 11%, signifying strong management.

Strikingly, insiders own two thirds of the company. Such strong insider ownership indicates confidence in a company's prospects. And with financial institutions holding just 35%, you have a chance to get in before the mutual funds do.

1-800 Flowers.com is on pace to report record second-quarter results. With solid December sales likely to continue into the New Year in the run-up to Valentine's Day, the stock is a buy under US$12. ■

over, please…

Buy while it's cell-ing cheap and drive away with profits

Erin Beale

In the ever-expanding move to help our dear Mother Earth take a load off, our new (very PC) fascination is with environment-friendly cars. The push makes sense—not only in an effort to preserve the ozone layer, but also to deny funds to the evil Middle Eastern oil empire—but will mainstream consumers really buy it?

The trend started just a few years ago when we began spotting small, bug-like vehicles cruising the highways. After the initial double take, these weird hybrid cars became much more appealing when we discovered that they were not only eco-friendly but got excellent gas mileage as well. Nothing like killing two birds with one stone. Since its mainstream introduction in 1997, the Toyota Prius hybrid has sold over 120,000 vehicles worldwide, and company president Fujio Cho recently announced his goal to sell 76,000 more in the coming year.

Bush's baby

Enter the next wave of the clean-air car crusade—the hydrogen (fuel cell) car. Recently championed by President Bush's US$1.7 billion FreedomCar and Fuel Initiative, a five-year federally funded project to develop hydrogen-powered fuel cells, hydrogen cars will be vying for the top spot in gas engine alternatives in the coming years. Many experts are touting hydrogen fuel cells as the replacement for diesel, petroleum and natural gas over the next 20 or so years.

GM announced in October that they aim to sell one million fuel-cell cars by 2020, claiming that they will make hybrids obsolete. And the company is currently pumping 25% of their R&D into fuel-cell technology development. GM will break into the market with their HydroGen3 (H3), a hydrogen-powered minivan, which was approved in March to become the first-ever fuel-cell vehicle permitted to drive in Japan. And they recently passed safety and emissions inspections in Washington, D.C.

Nevertheless, I must regretfully burst the fairy-tale hydrogen bubble. One of the main problems, as anyone who has taken Chemistry 101 can tell you, is that hydrogen in its natural state is found in chemical compounds, not as a gas. Converting it to a gas is a lengthy and pricey process. And then you have to liquefy the gas for storage—again expensive.

Profit potential

Here's where we can move in and take profits on the fuel-cell phenomenon. This company has devised an innovative system for converting natural gas into hydrogen. Because natural gas gridlines are already in place around the country, gas stations could in the future sell hydrogen for cars as easily as gasoline.

The company is **Plug Power (PLUG:NASDAQ)**, an innovator in fuel-cell applications. Plug recently announced the creation of GenSite, a product line that operates on natural gas to provide 99.95% pure compressed hydrogen gas. This is a huge first step in the direction of commercially viable hydrogen-powered vehicles.

Plug's price has bounced all around the chart for the past few years, hitting a high of US$130 in February 2000. After a huge selloff and a roller coaster of ups and downs, Plug is currently pricing around the US$5.75 mark. This is our opportunity to buy while it's cheap and ride the upward wave.

Over the next few years, hybrid and fuel-cell cars will become more the norm and not the redheaded stepchild of the automotive family.

Buy shares of PLUG under US$7.00. This is one to stick in your back pocket for a while. ■

TAIPAN

Publisher:
J. Christoph Amberger

Editors: Christian DeHaemer, Brian Hicks, Siu-Yee Ng, Briton L. Ryle, Adam T. Lass, Bryan Bottarelli, Ian Cooper, William Colburn, Martin Denholm, Ann Sosnowski Erin Beale

Managing Editor:
Ned Humphrey

Art: Elliana Brocato

Fulfillment: Alex Ferguson

Tours and Conferences:
Barbara Perriello

Customer Care:
Call (508) 368-7498
9 A.M. to 5 P.M. Eastern Time

Email:
Taipan@agora-inc.com

Taipan (USPS#008-049) is published monthly for US$129 per year by Agora Taipan LLC, 808 St. Paul St., Baltimore, MD 21202, USA. Periodicals Postage Paid at Baltimore, MD, and at additional mailing offices.

Postmaster: Send address changes to *Taipan*, 808 St. Paul Street, Baltimore, MD 21202 USA.

www.taipanonline.com

USERNAME:
taipanmember

PASSWORD:
fencers