

The *Taipan* “House Hedge” Report

October, 2005

A “Pure” Way to Protect the Value of Your Home — and Keep Profiting from the Near-Term Real Estate Rally

By Bryan Bottarelli with Martin Denholm

Dear *Taipan* reader,

We’ve been asking it all year?

“What’s the deal with the US real-estate market?”

Is it about to tumble and fall into the Seventh Circle of Hell as the bears have oracled for four years straight now? Or will changing demographics and population increases and low mortgages continue to create an upward spiral of prices?

There are a lot of people spending an awful lot of time trying to answer this question. But the truth is, it’s a very difficult one to answer — perhaps impossible. We at *Taipan* don’t really care either way — we just want to make money.

So when it comes to the housing market, we’ve created a breakthrough strategy for translating both the upside and downside potential of US real estate into cold, hard profits is by playing both sides.

Signs of a top? and one of the best opportunities to make money by March 2006

With a 14% climb during the second quarter of 2005, homebuilding stocks jumped more than 23% over the first half of the calendar year.

Recently, however, we’ve seen increasing signs of a top.

Taipan members who’ve been keeping up with *Taipan*’s real-estate theory via the newsletter, *Taipan* e-mail alerts and daily **247profits e-Dispatch** messages, will probably remember that we developed a computer extrapolation model to forecast the future activity of the US housing market. Based on that forecast, we predicted that the US housing market would most likely begin to decline anywhere from July 22 to September 27, 2005.

Was this forecast correct? If you look at some recent data, we think it is. Check out the insider selling trends of some of the top homebuilder stocks and you’ll see that the housing sector could be about to enter a period of weakness:

- On July 29, 2005, Juan L. Elek, Director of Centex Corp (CTX:NYSE) is on record with a direct sale at US\$74.05 to US\$74.36 per share, for a total of US\$6,619,000. There's another direct sale that same day at US\$74.37 to US\$75.19 per share, for a total of US\$6,184,000.
- A week before, on July 22 (our projected D-Day), Robert I. Toll, chief executive officer of Toll Brothers Inc. (TOL:NYSE), is on record with an indirect sale at US\$57.125 per share, for a total of US\$38,462,262. Only a day before, the record indicates a planned sale of US\$56,000,000.
- How about KB Home (KBH:NYSE)? On July 12, we found an indirect sale by chairman Bruce Karatz at US\$80.2454 per share for a total of US\$54,518,724.

As you can see, all these sales come *right around* our predicted date for the bubble to burst. In fact, according to CNBC, insiders are now selling US\$27 in stock for every US\$1 they're buying.

So what's going on? Why are top insiders at the market's best home-building companies selling US\$6 million, US\$38 million, and US\$54 million shares of stock? Could this be the sign of the top?

When insiders act, it's time for you to act, too

In this case, key insiders at the top American homebuilding companies were selling massive amounts of their shares. That selling corresponded almost to the day with our predicted date for the beginning of the housing market decline. Coincidence? We think not!

Considering insiders often know more about their own company than anyone else and what they do with their shares is often a good barometer of how the market is going to



perform, we think this provides good evidence to suggest that the housing bubble could burst at any moment — and that our “House Hedge” prediction is right on track.

Now is the perfect time to get into our program — one that shows you how to make money no matter whether housing prices go up or down.

The strategy is based on the **Philadelphia Housing Index (HGX)**, a basket of the 21 top homebuilders in the US. WaveStrength play tactician Bryan Bottarelli has constructed a simple way to profit from any dramatic move in the real-estate market, while also protecting (“hedging”) yourself from any correction.

We like to think of this as an insurance policy: We believe that there still is a healthy normal demand for residential real estate based on America’s demographics and the ongoing economic recovery. But whether both factors combined will continue to warrant 40% premiums on raw land is doubtful.

Therefore, we’ll continue the House Hedge puts into March of 2006 while at the same time playing cheaper calls to protect against an near-term rallies. Below you’ll find our active recommendations for this play. But first, two more signs of a Housing Bubble?

Two More Signs of a Housing Bubble

Take even a cursory look at the financial media these days and you’ll see a lot of people talking about a “housing bubble” and an imminent market correction. It’s difficult to know exactly who to believe, since these economists and commentators have been talking about this for ages!

It’s inevitable that the market is going to slow at some point. So before issuing the new play, I’d like to offer you two more sure-fire signs of a housing bubble.

The first comes from Robert Shiller. If that name sounds familiar, it’s because Mr. Shiller is a noted Yale economist, whose book “***Irrational Exuberance***,” which hit bookstores in 2000, famously predicted a stock market downturn just before the NASDAQ lost 75% of its value over the following two and a half years. When it comes to timely predictions, there are few folks better than Shiller.

So what is he predicting now?

A 50% Fall?

Simply put, Shiller compares today’s debt-heavy homebuyers to someone who flips his brand new car on the way home from the dealership. In this case, the poor motorist now owns something ***that’s worth less than what he owes on the auto loan.***

Shiller's scary thought is that home prices could fall as much as 50% (adjusted for inflation). According to Shiller, "*Prices had better keep going up, or a lot of folks are going to be upside-down on their mortgages.*"

The second recent sign of a housing bubble comes from the summer retreat of New York's rich and famous — the Hamptons on Long Island.

In a display of pure lunacy, a Swedish industrialist recently purchased a 40-acre Hamptons estate for US\$90 million, smashing the previous record paid for a residential property — the US\$70 million that New York billionaire Ronald Perelman forked over for a mansion in Palm Beach, Florida, last year.

The sale nearly triples the US\$32 million Jerry Seinfeld paid for Billy Joel's mansion in 2000.

These astonishing figures remind us of the price multiples of tech stocks at the tail end of the NASDAQ bubble. (Remember when Qualcomm traded for US\$600.00 a share?) In fact, according to calculations on realtor.com, if you took out a 30-year fixed loan with an interest rate of 5.625% on a US\$90 million home, you're looking at monthly payments of a whopping US\$518,090.76!

However you figure it, all the signs of a bubble are here. Insanely high prices and bubble tops typically go hand in hand. The tricky part is trying to figure out how long the euphoria will last before the inevitable meltdown begins.

Double-Edged Profits

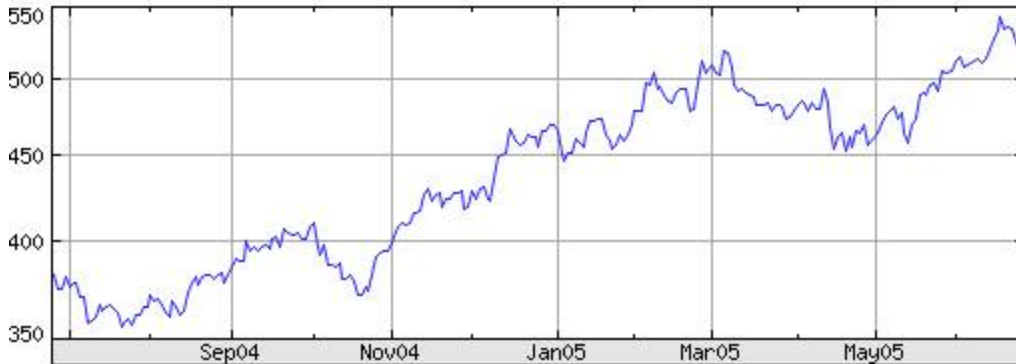
In this case, we're going to implement a *shorter-term hedge play with a longer-term put play on the home-building sector*. In doing so, you'll profit from a near-term rise — and you'll also profit from a longer-term fall.

We'll implement this new play using the **Philadelphia Housing Sector Index (HGX)**, which contains 21 of the top homebuilder stocks on the market. Take a look at a two-year HGX chart and you'll see that the index has been on a tear, going from US\$300 to US\$523 — a 74% gain. That's why it's best to play both sides of the market.

A look at some companies that make up the HGX:

(BZH) BEAZER HOMES USA
(CTX) CENTEX
(DHI) D.R. HORTON
(KBH) KB HOME
(LEN) LENNAR
(PHM) PULTE HOMES
(RYL) RYLAND GROUP
(TOL) TOLL BROTHERS

PHLX HOUSING INDEX
as of 24-Jun-2005



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**HEDGE: Buy the HGX December 600 Calls (GHE LT) at or under US\$6.00.
Current bid/ask spread is US\$4.60 to US\$5.60.**

**MAIN PLAY: Buy the HGX March 540 Puts (HGX OH) at or under US\$40.00.
Current bid/ask spread is US\$35.80 to US\$36.60.**

How do the two options work together?

Let's run some numbers and consider the various scenarios?

Scenario #1: Short-Term HGX Rise:

HGX: Up move from US\$540 to US\$580 in 20 days:
HGX December 600 Calls: US\$5.00 to US\$13.50
Short-Term Gain: 170%

Scenario #2: Longer-Term HGX Fall:

HGX: Down move from US\$540 to US\$440 in 100 days
HGX December 600 calls: worthless
HGX March 540 puts: US\$36.00 to US\$80.00
Long-Term Gain: 122%

In short, play a near-term housing market rise using HGX calls and play a longer-term fall using HGX puts.

CBS MarketWatch, June 23, 2005:

U.S. existing home sales down 0.7% to 7.13M in May

WASHINGTON (MarketWatch) – “Existing home sales fell 0.7% in May to 7.13 million units on a seasonally adjusted basis, the National Association of Realtors said. The fall in May’s sales was roughly in line with expectations. Economists had forecast that sales would fall a slight 0.2% to 7.14 million units. Inventories of unsold homes rose 4.9% to 2.55 million units, representing a supply of 4.3 months.”

When it's all said and done, we're positioned to profit from a rise AND a fall!

Action Summary:

HEDGE: Buy the HGX December 600 Calls (GHE LT) at or under US\$6.00.
Current bid/ask spread is US\$4.60 to US\$5.60.

MAIN PLAY: Buy the HGX March 540 Puts (HGX OH) at or under US\$40.00.
Current bid/ask spread is US\$35.80 to US\$36.60.

P.S. What do current Taipan members think of the play. Just ask Frank O. from Cambridge, MA USSR. He writes...

“Bought 1 HGXXD at 24, another at 20, and based on the last few minutes, looking at 40% return. Thanks to all...(and yes, I'll use the profits to renew my subscription...)”