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# AlphaProfit™

## Sector Investors' Newsletter

Service for \$ophisticated \$ector Investors



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### Economy & Markets

**The U. S. residential housing market is in retreat. Consumer wallets are being squeezed. Central banks are taking a host of measures to shore up credit availability. A weaker dollar is making U. S. exports competitive. Investors are nervous as the possibility of a recession increases.**

**Housing slump deepens.** The U. S. residential real estate market is weak and construction activity has slowed. Home prices as measured by the S&P/Case-Shiller index declined 6.7% in October 2007, the largest monthly drop since April 1991. Building permits for single-family homes too have declined to 16-year lows. Slumping real estate values have caused the world's biggest banks and brokerage firms to write down the value of their assets, including mortgage-backed bonds, by nearly \$100 billion.

**Consumer under pressure.** Consumer sentiment has fallen off in recent months with the Reuters/University of Michigan barometer hitting its lowest level since 1992 in December. Falling home prices and the expiration of low teaser rates have rendered mortgages unaffordable for many homeowners. Foreclosures have increased. The 57% increase in the price of oil through 2007 is pressuring consumer wallets through higher gasoline and heating oil prices. Massive write-downs taken by financial institutions have curtailed credit availability.

**U. S. economy's resilience under**

### Featured Quote

***'Many an optimist has become rich by buying out a pessimist.'***

**Robert G. Allen**

**test.** A deepening housing slump is beginning to take its toll on the U. S. economy. The Conference Board's index of leading economic indicators declined a greater-than-forecast 0.4% in November after declining 0.5% in October. This marks the index's third monthly decline in four months. Meanwhile, most developing economies around the world are growing at robust clip.

**Central banks trying to provide relief.** The Federal Reserve in conjunction with central banks of leading industrialized nations has been taking a series of measures to stem the housing malaise from affecting the broader economy. The Federal Reserve reduced its overnight bank lending rate by 1% during the second half of 2007. The central bank has also conducted loan auctions to improve credit availability. Central banks from Europe and Canada have joined the Federal Reserve in shoring up liquidity.

**U. S. dollar loses ground.** A weakening housing market, falling interest rates, and robust growth abroad caused the U. S. dollar to decline nearly 8% versus major currencies in 2007. The weaker currency has made U. S. exports more competitive in world markets and enabled the nation's current account deficit

### AlphaProfit Core™ Model Portfolio

As e-mailed on December 31, the Core Model Portfolio was repositioned with the following changes at the close of business on December 31, 2007.

Before Repositioning			Action
Fidelity Fund Holding (Ticker Symbol)	Value	Percent Portfolio	
Automotive (FSAVX)	\$97,658	12.70%	<b>Sell</b>
Gold (FSAGX)	\$87,906	11.43%	<b>Sell</b>
Materials (FSDPX)	\$125,601	16.33%	<b>Sell</b>
Software (FSCSX)	\$87,168	11.33%	<b>Hold</b>
Spartan 500 Idx. (FSMKX)	\$370,905	48.22%	<b>Reduce</b>
Total rounded to	\$769,239	100.00%	
Action	After Repositioning		
	Fidelity Fund (Ticker Symbol)	Value	Percent Portfolio
<b>Buy</b>	Chemicals (FSCHX)	\$76,924	10.00%
<b>Buy</b>	Comm. Equip. (FSDCX)	\$76,924	10.00%
<b>Buy</b>	Computers (FDCPX)	\$76,924	10.00%
<b>Buy</b>	Medical Equip. (FSMEX)	\$115,386	15.00%
<b>Add</b>	Software (FSCSX)	\$192,310	25.00%
<b>None</b>	Spartan 500 Idx. (FSMKX)	\$230,772	30.00%
	Total rounded to	\$769,239	100.00%

tially flirting with a recession and exports aided by a weaker dollar, we seek to shield investment portfolios while leaving room for upside.

Estimates for losses on sub prime mortgages and mortgage-related securities continue to be raised. The worst from the housing markets and mortgage-related losses does not appear to be behind.

The housing debacle has growth as well as inflation implications. The magnitude and pervasiveness of the housing malaise raises the probability of a consumer-led recession in the U. S. The backdrop of declining home values *per se* acts against inflation and raises the specter of deflation.

Our lead scenario calls for the U. S. economy to muddle along at near-recessionary levels in the near-term. A recession may be avoided if central banks around the world take adequate measures to end the credit crisis in a timely manner.

Bright spots in the economic picture include robust growth in developing nations and opportunities for U. S. firms to increase exports with the latter aided by a weaker dollar.

We pursue a two-fold objective against this backdrop. The first is to shield investment portfolios from the vagaries of the economy. The second is to provide exposure to potential upside. We gravitate towards selected industry groups in the technology, healthcare, and materials sectors we believe are worthy of over-weighting.

### Investment Thesis

In the sections below, we outline key factors and risks that could drive the performance of the recommended sectors and industries.

### Chemicals

**Agriculture represents a bright spot for chemical companies. Rapid build-out of infrastructure**

to narrow to 5.1% of gross domestic product, the lowest since the first quarter of 2004.

**Inflation lingers.** Rising energy costs and a falling dollar conjured to kindle inflation. Inflation in food prices has been notable. Even core inflation, that excludes food and energy prices, has not been particularly benign. Core inflation as measured by the personal consumption expenditures price index, the Federal Reserve's preferred inflation gauge, has remained at or near the upper end of the central bank's 1% to 2% comfort zone.

**Equity market jittery.** Investors have become increasingly jittery after the sub prime mortgage mess began to unfold. After a sedate first half, volatility in equity prices sky-

rocketed during the second half. The Chicago Board Options Exchange volatility index increased 95% in 2007, the biggest annual rise in its 18-year history.

The Standard & Poor's 500 index declined nearly 3.4% during the fourth quarter to end the year with a gain of 5.5%. Shares in the financial sector fared particularly poorly declining nearly 20% for the year. According to consensus estimates compiled by Thomson Financial, earnings for the S&P 500 members in total are expected to decline 9% during the fourth quarter with earnings at diversified financial institutions falling more than 60%.

### Investment Implications

**With the U. S. economy poten-**

### AlphaProfit Focus™ Model Portfolio

As e-mailed on December 31, the Focus Model Portfolio was repositioned with the following changes at the close of business on December 31, 2007.

Before Repositioning			Action
Fidelity Fund Holding (Ticker Symbol)	Value	Percent Portfolio	
Automotive (FSAVX)	\$723,064	43.74%	<b>Sell</b>
Materials (FSDPX)	\$929,949	56.26%	<b>Sell</b>
Total rounded to	\$1,653,012	100.00%	
Action	After Repositioning		
	Fidelity Fund (Ticker Symbol)	Value	Percent Portfolio
<b>Buy</b>	Medical Equip. (FSMEX)	\$826,506	50.00%
<b>Buy</b>	Software (FSCSX)	\$826,506	50.00%
	Total rounded to	\$1,653,012	100.00%

**in developing nations is boosting demand for chemicals and providing manufacturers with pricing power.**

The agriculture and seeds businesses of chemical companies are growing at a rapid clip. Monsanto is upbeat on the prospects of its genetically-engineered seeds business. DuPont's agriculture and nutrition unit expects to surpass its 2007 targets of 10% growth in revenue and earnings.

Companies in the chemical group are enhancing their positions in emerging markets to benefit from business opportunities. Air Products has inked deals to construct gas separation units in China, Korea, and Taiwan. Rohm & Haas has recently increased production of acrylic materials in India. Celanese is starting an acetyls complex in China.

Chemical companies are pursuing joint ventures and acquisitions to gain greater access to feed stocks and markets. Dow Chemical has sold a 50% interest in its plastics

business to Kuwaiti partner Petrochemical Industries for \$9.5 billion. PPG is buying SigmaKalon Group, Europe's second-largest coatings maker, for \$3.1 billion.

Backed by strong demand, chemical and gas manufacturers like Nalco, Praxair, and Rohm & Haas are pushing cost increases through to customers. Meanwhile, strong pricing for its acetyl products has enabled Celanese to increase its 2007 profit forecast.

Investments in the chemical group represent a lower risk play on the materials sector as demand for some chemicals and gases tends to be less cyclical. Healthy dividends paid by large chemical companies can come in handy during rough markets. Chemical company shares could lag if growth in emerging markets slows.

**Fidelity Select Chemicals (FSCHX)** offers a pure-play on the chemicals group and we include this fund in the Core model portfolio. In the absence of pure-play ETFs for the chemicals group, iSha-

res Dow Jones U. S. Basic Materials (IYM), Materials Select Sector SPDR (XLB), and Vanguard Materials (VAW) represent reasonable alternatives. Each of these materials sector ETFs has close to 50% of its assets invested in chemical companies.

### Computers

**Hardware manufacturers are benefiting from the launch of new operating systems, strong demand from the developing nations, and increased demand for mobility.**

Sales of Microsoft's *Windows Vista* operating system for PCs are gaining traction nearly a year after launch. Following the introduction in October 2007, sales of Apple's *Leopard* operating system for *Macintosh* computers are off to a strong start. Newer operating systems typically work better on computers with faster processors and provide incentive to businesses and consumers to upgrade their computing gear.

Among PC manufacturers, Hewlett-Packard is executing well while Dell is lessening its dependence on direct sales to turn around its operations. Dell has started selling its products through leading electronics retailers Best Buy and DSG International in the U. S. and Europe, respectively. Meanwhile, robust sales of *Macintosh* computers have helped them increase their share to nearly 7% of the U. S. market.

Brazil, Russia, India and China or the BRIC nations are industrializing and seeking to improve productivity. International Business Machines is targeting such nations for its growth. Demand for computing hardware from such nations is increasing. Nearly 45% of the computer group's revenue comes from foreign sales. As such, this industry benefits from a weaker dollar.

The growing demand for mobility is driving demand for notebook computers, MP3 music players, and

## Top 10 Holdings of Preferred Mutual Funds and ETFs

Chemicals		Software	
<b>Fidelity Sel Chemicals FSCHX</b>	<b>Fidelity Sel Software FSCSX</b>	<b>Software HOLDRS SWH</b>	<b>First Trust DJ Internet FDN</b>
Monsanto	Microsoft	Microsoft	Amazon
DuPont	Google	SAP	eBay
Dow Chemical	Cognizant Tech. Soln.	Adobe Systems	Google
Air Products	Oracle	Oracle	Yahoo!
Celanese	Nintendo	CA	Verisign
Praxair	Yahoo!	Intuit	BEA Systems
PPG Industries	Apple	BMC Software	Akamai Technologies
Rohm & Haas	Satyam Computer Svcs.	Check Point Software	IAC/InterActive
Ecolab	eBay	Symantec	TD Ameritrade
Nalco Holdings	MasterCard	TIBCO Software	Check Point Software
<i>61.7% of portfolio</i>	<i>67.6% of portfolio</i>	<i>98.9% of portfolio</i>	<i>70.5% of portfolio</i>
<i>0% foreign</i>	<i>19.6% foreign</i>	<i>18.6% foreign</i>	<i>0% foreign</i>
<i>As of Sep 30, 2007</i>	<i>As of Sep 30, 2007</i>	<i>As of Dec 31, 2007</i>	<i>As of Dec 31, 2007</i>
Computers		Telecom Equipment	
<b>Fidelity Sel Computers FDCPX</b>	<b>Internet Arch HOLDRS IAH</b>	<b>Fidelity Sel Com Eqpt FSDCX</b>	<b>iShares S&amp;P Network IGN</b>
Apple	Int. Business Machines	Research in Motion	Cisco Systems
Dell	Hewlett-Packard	Cisco Systems	Qualcomm
Hewlett-Packard	Apple	Corning	Research in Motion
EMC	Cisco Systems	Qualcomm	Corning
Int. Business Machines	Dell	Comverse Technology	Juniper Networks
Sun Microsystems	EMC	Juniper Networks	Motorola
Network Appliance	Sun Microsystems	F5 Networks	Harris Corp
Seagate Technology	Juniper Networks	Powerwave Technologies	Commscope
Sandisk	Network Appliance	Motorola	JDS Uniphase
Western Digital	Ciena	Sandvine	Tellabs
<i>71.9% of portfolio</i>	<i>98.4% of portfolio</i>	<i>63.6% of portfolio</i>	<i>59.2% of portfolio</i>
<i>17.1% foreign</i>	<i>0% foreign</i>	<i>33.6% foreign</i>	<i>11.0% foreign</i>
<i>As of Sep 30, 2007</i>	<i>As of Dec 31, 2007</i>	<i>As of Sep 30, 2007</i>	<i>As of Dec 31, 2007</i>
Medical Equipment		S&P 500 Index	
<b>Fidelity Sel Med Eqpt FSMEX</b>	<b>iShares DJ US Med Device IHI</b>	<b>Fidelity Spartan 500 Idx FSMKX</b>	<b>SPDR S&amp;P 500 SPY</b>
Medtronic	Medtronic	ExxonMobil	ExxonMobil
Baxter International	Thermo Fischer Scientific	General Electric	General Electric
Becton Dickinson	Stryker	AT&T	Microsoft
Bard C R	Covidien	Microsoft	AT&T
Alcon	Boston Scientific	Citigroup	Procter & Gamble
Inverness Med Innovations	Zimmer Holdings	Bank of America	Chevron
Allergan	St Jude Medical	Procter & Gamble	Johnson & Johnson
St Jude Medical	Intuitive Surgical	Cisco Systems	Bank of America
Respironics	Waters	Chevron	Apple
CSL	Varian Medical Systems	Johnson & Johnson	Cisco Systems
<i>66.4% of portfolio</i>	<i>57.2% of portfolio</i>	<i>19.7% of portfolio</i>	<i>19.8% of portfolio</i>
<i>12.8% foreign</i>	<i>0% foreign</i>	<i>0% foreign</i>	<i>0% foreign</i>
<i>As of Sep 30, 2007</i>	<i>As of Dec 31, 2007</i>	<i>As of Sep 30, 2007</i>	<i>As of Dec 31, 2007</i>

smart phones. Apple's products in these categories are popular. Strong demand for notebook com-

puters is also translating into stronger demand for disk drives made by Seagate Technology and Western Digital.

As for risks, the computer industry is cyclical and demand trends are hard to predict. A slowdown in con-

## AlphaProfit ETF and Mutual Fund Selections

Mutual fund and exchange-traded fund recommendations for playing the investment thesis discussed in the Newsletter. Preferred mutual funds and ETFs in **bold**.

Sector, Industry Group, or Index	Mutual Funds					ETFs		
	Name (Ticker)	Availability, Trans. Fees, and Min. Holding Period				Name (Ticker)	Liquidity	
		E*Trade	Fidelity	Schwab	Ameritrade			
Chemicals	<b>Fidelity Sel Chemicals (FSCHX)</b>	A, F	A, NTF, 30	R, F	A, F	iShares DJ US Basic Mat (IYM)	Good	
						Materials Select SPDR (XLB)	Good	
						Vanguard Materials (VAW)	Limited	
Computers	<b>Fidelity Sel Computers (FDCPX)</b>	A, F	A, NTF, 30	R, F	A, F	<b>Internet Arch HOLDERS (IAH)</b>	Limited	
						PowerShares Dyn Hard (PHW)	Limited	
Medical Equip	<b>Fidelity Sel Med Equip (FSMEX)</b>	A, F	A, NTF, 30	R, F	A, F	<b>iShares DJ US Med Device (IHI)</b>	Limited	
Software	<b>Fidelity Sel Software (FSCSX)</b>	A, F	A, NTF, 30	R, F	A, F	First Trust DJ Internet (FDN)	Limited	
						Internet HOLDERS (HHH)	Limited	
						iShares S&P Software (IGV)	Good	
						Software HOLDERS (SWH)	Good	
						<b>60% SWH + 40% FDN mix</b>		
S&P 500	<b>Dreyfus S&amp;P 500 Index (PEOPX)</b>	A, NTF, 90	A, NTF, 180	A, NTF, 90	A, NTF, 90	iShares S&P 500 (IVV)	Good	
		<b>E*TRADE S&amp;P 500 Index (ETSPX)</b>	A, NTF, 4m	N	N	N	<b>SPDR S&amp;P 500 (SPY)</b>	Good
		<b>Fidelity Spartan 500 Idx (FSMKX)</b>	A, F	A, NTF, No	A, F	A, F		
		Schwab S&P 500 Index (SWPIX)	A, F	A, F	A, NTF, 30	A, F		
Telecom Equip	<b>Fidelity Sel Com Equip (FSDCX)</b>	A, F	A, NTF, 30	R, F	A, F	Broadband HOLDERS (BDH)	Limited	
						<b>iShares S&amp;P Network (IGN)</b>	Good	
						PowerShares Dyn Network (PXQ)	Limited	

**Availability:** A-Available, C-Limited to current shareholders, I-Limited to Institutional investors, N-Not available, R-Limited to retail investors. **Trans. Fees:** F-Transaction fee applies, NTF-No transaction fee subject to holding period. **Min. Holding Period:** For no transaction fee (NTF) funds, minimum number of days or months a fund needs to be held to avoid both fund's short-term redemption fee and broker's transaction fee. Minimum holding period not provided for transaction fee (F) funds. **Liquidity:** Investors should consider limit orders when trading ETFs with limited liquidity. **Note:** The above table is for information purposes only. Before buying any mutual fund or exchange-traded fund, read its prospectus carefully. For securities held in brokerage accounts, read the broker's specific terms and conditions which apply to trading of the securities.

sumer spending can impact gadget demand. The demand for enterprise hardware products like servers can fall off if the U. S. economy slumps into a prolonged recession.

**Fidelity Select Computers (FDCPX) and Internet Architecture HOLDERS (IAH)** represent our preferred alternatives for playing the computer industry thesis. We include the former in the Core model portfolio.

## Medical Equipment

**The economic insensitivity of the medical equipment business renders defensive characteristics to investment portfolios. Benefiting from favorable demographic changes, medical equipment companies are generating strong cash flow.**

Inclusion of the stocks from the medical equipment group tends to shield investment portfolios from the vagaries of the economy.

The medical equipment group also has a few macroeconomic factors going for it. First, medical equipment companies are favorably positioned to benefit from demographic changes since demand for such equipment typically increases as the population ages. Second, medical equipment companies derive a substantial portion of their earnings abroad. Such earnings should benefit from translation effects of a weaker U. S. currency.

Medical equipment companies are introducing new products to improve quality of life. Alcon has received U. S. Food & Drug Administration approval for its *Triesence* injectable for use in eye surgery

while Baxter has gained approval for its *GelFoam plus Hemostasis Kit* to control bleeding during surgery. Medtronic has applied for FDA approval of a minimally invasive device that treats bulges in the aorta while Allergan is working to have wrinkle remover *Botox* approved for additional uses including migraine headaches and overactive bladder. CR Bard has recently launched the *Agento* breathing tube and intends to follow this with coated hernia mesh.

Companies in medical equipment group are using robust cash flow to fund acquisitions and buy back shares. Netherlands-based Royal Philips Electronics is increasingly targeting the U. S. market for acquisitions. In recent deal news, Philips has offered \$5.1 billion and \$620 million to buy Resprionics and Visicu, respectively. Resprionics

makes devices used in homes to diagnose or treat sleep apnea while Visicu makes patient-monitoring equipment. CR Bard is acquiring the *LifeStent* product line of stents from Edwards Lifesciences. Meanwhile, Inverness Medical Innovations continues to tuck in acquisitions to broaden its technology base.

Alcon has announced plans for buying back up to \$1.1 billion of its shares. Given their cash generation prowess, we expect Becton Dickinson and CR Bard to raise their stock buyback commitments and dividends.

While the medical equipment business is relatively immune to risks stemming from the housing slump, investments in medical equipment companies are not without risks. Product safety issues represent a key risk for companies in this group. The safety of certain drug-eluting stents and implantable cardiac defibrillators is an area of concern. The FDA is planning to release new testing requirements for drug-coated stents. Patent infringement lawsuits represent another risk.

We include **Fidelity Select Medical Equipment & Systems (FSMEX)** in both model portfolios. **iShares Dow Jones U. S. Medical Devices (IHI)** offers a pure-play on the medi-

cal equipment industry for ETF investors.

## Software & Computer Services

**Online ad spending is growing rapidly with Google targeting a lion's share of this market. Microsoft's *Windows Vista* sales are revving up. Oracle is executing well.**

Total online ad spending in the U. S. is expected to increase 28.5% in 2008 to \$27.5 billion. Google's sales are expected to increase at a substantially higher 41.6% clip in 2008 to \$16.6 billion with the company generating about half of its revenue from the U. S.

Google is targeting the wireless space for its growth. The company has recently launched Google AdSense for Mobile, a program that enables advertisements on Web content designed for mobile use. Additionally, Google is looking to its strategic relationship with The Nielsen Company to expand its TV advertising platform.

The Federal Trade Commission has approved Google's \$3.1 billion purchase of DoubleClick. Google however still faces hurdles in acquiring DoubleClick since the European Commission has called for an in-

depth antitrust scrutiny of this transaction and will rule by April 2.

Meanwhile, eBay is looking to its PayPal payments service for its growth. eBay is also focusing on operational improvements to improve user experience in its marketplace business. Yahoo! is facing challenges in growing revenue and is seen as a takeover target.

Becoming comfortable with the reliability of Microsoft's *Windows Vista* operating system, businesses and consumers are upgrading their systems in greater numbers and *Vista* sales are accelerating.

The video game software space is consolidating with Activision merging with Vivendi's game division in an \$18.9 billion deal. The transaction will form the third largest video game software maker and narrow Electronics Arts' scale advantage.

Meanwhile, Nintendo's *Wii* has become the 'must-have' video game console. Even though the company has been steadily increasing *Wii* production, supplies are tight. Microsoft's video game division that makes the *Xbox 360* console and games like the *Halo 3* is showing signs of turning around.

During its second fiscal quarter, enterprise software maker Oracle

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*continued on page 10*

earned 31 cents a share, 4 cents a share higher than analysts' estimate. Revenue increased 28% from the year-ago period to \$5.3 billion. Auguring well for the future, Oracle's software license sales climbed 38% to \$1.7 billion. Oracle forecasts software sales to rise between 15% and 25% during its third quarter.

Elsewhere, IT services providers are seeing strong demand for system development and business process outsourcing. Analysts forecast Cognizant Technology's revenues to increase 35% in 2008.

Investments in the software industry come with their share of risks as this industry is characterized by rapid changes including new technologies and new distribution methods. This coupled with aggressive pricing strategies can cause current leaders to lose their dominance over time. Rising wages and an appreciating Indian rupee could crimp margins for IT service providers. Lastly, distress in financial services firms can cause corporate spending on software to be curtailed. This risk is mitigated to an extent by the fact that software companies generate part of their sales from maintenance activity that is less susceptible to budget cuts.

We include **Fidelity Select Software & Computer Services (FSCSX)** in both model portfolios. Since software ETFs typically do not include Internet companies, we recommend a mix of **Software HOLDERS (SWH)** and **First Trust Dow Jones Internet (FDN)** in a 60/40 ratio for investors looking to exchange-traded investments.

## Telecom Equipment

**Telecom service providers are investing in Internet and wireless infrastructure. Usage of smart phones is on the rise. Cisco has ambitious plans.**

Major telecom service providers and cable companies in the U. S. are investing heavily in new infra-

## Stock Searchlight

**Stocks with appealing earnings trends and relatively attractive valuation characteristics are highlighted. Subscribers seeking stocks for the intermediate term may find the list worthy of further study.**

Company	Ticker	Price	Est. P/E	Div. Yield	Page
Oracle	ORCL	\$22.58	17.9	0.0%	7
Research in Motion	RIMM	113.40	50.6	0.0	7

Source: Reuters

structure. The impetus to provide users with high-speed Internet services is benefiting router manufacturer Cisco Systems. AT&T is buying core routers in large numbers from Cisco to upgrade the Internet backbone network.

Wireless service providers are investing in 3G wireless networks as usage of smart phones such as Apple's *iPhone* and Research in Motion's *BlackBerry* products increases. The build-out of 3G networks is benefiting wireless chipset manufacturer Qualcomm.

RIM is thriving on the strong demand for its *BlackBerry* products. The company earned 65 cents a share during its fiscal third quarter, up more than 100% from 31 cents a share earned in the year-ago period. The company doubled its revenue to \$1.67 billion from the year-ago period and added about 1.65 million *BlackBerry* subscribers during the quarter. RIM expects fourth quarter revenue to range between \$1.80 billion to \$1.87 billion, ahead of the \$1.75 billion projected by analysts.

Cisco is working to broaden its revenue sources and geographic diversification. The company has high hopes for its high-end video conference system called *TelePresence*. Cisco is looking to push the deployment of Internet protocol based networks in developing countries to make them the preferred medium for transporting data, video, and voice traffic.

While investments in the telecom equipment industry can prosper in a recovering economy, they carry a higher degree of risk. Equipment or-

ders garnered by telecom equipment firms are typically sensitive to the state of the economy. As exemplified by Motorola's loss of dominance in the cell phone market, the industry is characterized by rapid changes that can cause companies to quickly lose market share. Intellectual property battles like those involving Qualcomm can cause companies to prematurely lose competitive advantages and thereby, their franchise value.

To play the telecom equipment thesis, we include **Fidelity Select Communications Equipment (FSDCX)** in the Core model portfolio. We feature **iShares S&P GSTI Networking (IGN)** as the preferred alternative for ETF investors.

## S&P 500

**We include exposure to a broad index to diversify the Core model portfolio. Our preference for the S&P 500 Index is based on valuation, risk, and international exposure considerations.**

With relatively few sectors and industry groups worthy of overweighting, we include exposure to a broad index to diversify the Core model portfolio. Among several indexes available, we choose the S&P 500 for its large-cap leaning. Larger company stocks typically perform better than those of smaller- and mid-sized firms when economic growth is less robust. Larger firms tend to have a broader diversity of businesses. They are usually better positioned to benefit from international business opportunities.

**Valuation.** Since the bull-run began in 2002, investors have generally

## December and Year 2007 Review

In December, the Core and Focus model portfolios lost 0.4% and 1.7%, respectively compared to the Dow Jones Wilshire 5000 index's loss of 0.6%.

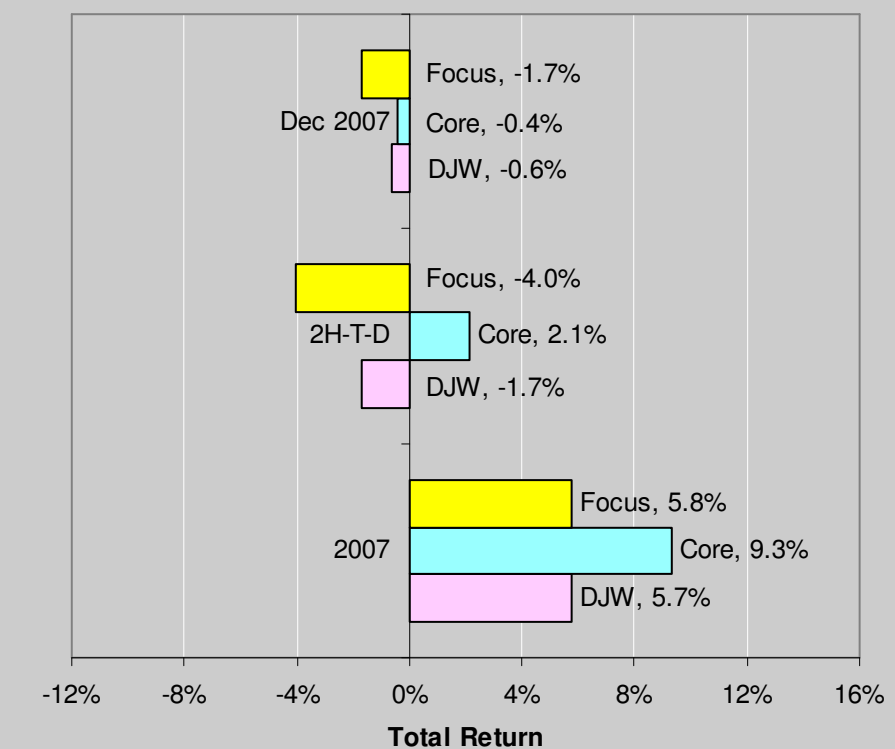
Equity prices started December on a positive note driven by expectation that the Federal Reserve will cut short-term interest rates by 0.5%. Disappointment over the 0.25% cut provided by the central bank led to a barrage of selling around mid-month. Stock prices then staged a rally prior to Christmas on optimism over holiday season sales. Equity prices ended the year on a weak note as concerns of a recession increased when oil rose towards the \$100 per barrel mark. The Core model portfolio benefited from exposure to the software group while exposure to the auto group hurt the performance of both model portfolios.

Agnico-Eagle Mines and Monsanto with gains of 13.5% and 12.4%, respectively were the Core and Focus model portfolio's top performers. General Motors with a loss of 16.6% was the worst performer in both model portfolios.

Exposure to the auto group detracted the performance of the model portfolios during the second half of 2007. Shares in the auto group declined in November and December. Fears of auto demand plummeting in 2008 intensified during these months. Major financial institutions increased their estimates for losses suffered on sub prime mortgages and credit availability worsened. The damage reversed the gains ac-

avored small- and mid-cap stocks over large-cap stocks. Over the past five years, the former group has returned over 16% per year or 4% points higher than the latter. The forward P/E ratio for the S&P 500 companies is currently 20% lower than that of companies in the small-cap Russell 2000 index. As such, large-cap stocks, appear attractive on a valuation basis.

**Risk.** During the past three years, the S&P 500 has been 40% less volatile than the Russell 2000 as



crued in September and October after domestic auto makers successfully renegotiated their labor contracts with the United Auto Workers.

Losses suffered in Fidelity Select Automotive caused the Focus model portfolio to lose 4.0% during the second half of 2007. Strong gains recorded by Fidelity Select Gold and Fidelity Select Software & Computer Services enabled the Core model portfolio to gain 2.1% during this period. The DJW 5000 benchmark lost 1.7% during the second half of 2007.

During the second half of 2007, two 'Favored Buy' calls were made on Fidelity Select Automotive, one in September and one in October. Select Automotive outperformed the DJW 5000 index by 2.3% and 4.7% in September and October, respectively. During the two-month period from September through October, Select Automotive gained 13.1% and outperformed the DJW 5000 index by 7.3%.

The Core and Focus model portfolios gained 9.3% and 5.8%, respectively in 2007, compared to a 5.7% gain for the DJW 5000 index.

measured by the standard deviation. We believe large-cap stocks will hold up better than small-cap stocks if measures taken by the Federal Reserve fall short of what is needed to avoid a recession. Given the inclusion of volatile groups such as computers, software, and telecom equipment in the Core model portfolio, we include the S&P 500 index to lower portfolio volatility.

**International exposure.** Economic growth in emerging markets is likely to be higher than that in the U. S. in

2008. Large-cap companies on average derive about a third of their profits from abroad, nearly twice that of small-caps. Large-cap companies are thus better positioned to benefit from growth overseas than the small-cap ones.

The S&P 500 Index diversifies the Core model portfolio by providing exposure to several sectors of the U. S. stock market. Looking at sector weightings, financials and information technology comprise about 18% and 16%, respectively while

## The Fund Deletions

*(Dow Jones Wilshire 5000 index returns for corresponding periods in parentheses.)*

With the exception of the software group, many of the sectors and industry groups represented hitherto in the model portfolios are no longer worthy of overweighting. Looking at each deletion ...

The outlook for the auto industry has deteriorated as U. S. demand is being adversely affected by lack of ready credit availability and rising oil prices. In 2007 U. S. auto sales declined to 16.1 million units, the lowest since 1998. With consumers continuing to weather macroeconomic headwinds, sales may well fall short of 16.0 million vehicles in 2008. We have removed Fidelity Select Automotive (FSAVX) from both model portfolios. During its 6-month tenure, Fidelity Select Automotive lost 16.1% (-1.7%).

The price of gold has moved substantially since the beginning of 2007, driven largely by fears of inflation from

rising oil prices and a weakening dollar. Going forward, we believe downside to the dollar may be limited if European economies slow. Additionally, there is risk of deflation particularly in the U. S. since residential real estate prices are declining. Accordingly, we have removed Fidelity Select Gold (FSAGX) from the Core model portfolio. During its 18-month tenure, Fidelity Select Gold gained 36.2% (18.4%).

Even though international demand for materials remains strong, U. S. demand for most materials is being impacted by weakness in the housing and auto markets. Tight credit conditions diminish takeover appeal that has hitherto been a key driver of stock prices in the materials sector. We prefer to play the materials theme with the less volatile chemicals group at this juncture. We have removed Fidelity Select Materials (FSDPX) from both model portfolios. During its 6-month stay, Fidelity Select Materials gained 8.0% (-1.7%).

good to trade at.

In the near-term, we expect stock price volatility to remain at levels seen since November.

Investors are likely to focus on housing and economic data and look for clues on the future course of the housing market and the U. S. economy.

Fourth-quarter earnings reports should start to flow in earnest around the middle of January. Corporate comments on the outlook for earnings in 2008 are likely to be among the key factors impacting stock prices.

The Federal Reserve has been easing monetary policy for some time in an attempt to stem weakness in the housing market from undermining the broader economy. The central bank's Open Market Committee is scheduled to meet on January 29 and 30 to set short-term interest rates. We believe expectations for a 0.5% cut in short-term interest rates are likely to run high ahead of this meeting. Investors are likely to harshly deal with any disappointment here.

The S&P 500 index closed December 31 at 1468. We expect this index to be range-bound between 1400 and 1550 until there is a clarity that the worst from the housing and home finance markets is behind. Disappointments can lead to the August low, i.e., 1370 being revisited or breached.

**AlphaProfit Investments, LLC**  
**Date: December 31, 2007** ■

health care, industrials, and energy comprise 12% each. Consumer discretionary and consumer staples account for 10% and 9% respectively. The remaining 11% is split roughly evenly among materials, telecommunication services, and utilities sectors.

In sum, we believe the S&P 500 by virtue of its emphasis on large-cap stocks can outperform other indexes like the Dow Jones Wilshire 5000 that include a modicum of mid-cap and small-cap stocks. We provide exposure to the S&P 500 members in the Core model portfolio through the **Fidelity Spartan 500 Index Fund (FSMKX)**. **SPDR S&P 500 (SPY)**, our preferred ETF alternative, offers a cost effective

and liquid means to owning members of the S&P 500 index.

## Market Outlook & Sector Portfolio Indicator Reading: Buy

**The outlook provided by corporations for 2008 earnings and the Federal Reserve's decision on interest rates are likely to be important contributors to stock price movements in the near-term. Barring major disappointments, we expect the S&P 500 to hold its August lows.**

With the model portfolios repositioned, the AlphaProfit Sector Portfolio Indicator is reading 'Buy'. This implies current prices are generally



The AlphaProfit Sector Investors' Newsletter™ is edited and published by Dr. Sam Subramanian, Managing Principal and Chief Investment Officer of AlphaProfit Investments, LLC. Sam is an avid stock market investor and has tracked Fidelity Select Funds for several years. With a strong quantitative and analytical bent, Sam has honed his skills in security research and analysis. Sam developed the ValuM Investment Process™ for managing investments. The ValuM Investment Process has helped Sam build a successful track record in managing his investments since 1985. Prior to founding AlphaProfit Investments, LLC, Sam worked in positions of increasing responsibility in Finance and Corporate Strategy advising in Acquisitions and Divestitures, Asset Valuation, Trading, Bankruptcies, and Risk Management. Sam graduated with honors from the MBA program at the University of Michigan and has a Doctorate Degree in Chemical Engineering from Syracuse University. Sam also holds 16 U. S. patents.

## ETF and Mutual Fund Facts

Industry/Index	Mutual Fund/ETF	Style	Risk Rating	Manager/Index Tracked
Chemicals	Fidelity Sel Chemicals	Mid Cap Blend	Below Average	D. Fischer
Comm Equip	Fidelity Sel Com Eqpt	Large Cap Growth	Above Average	C. Chai
	iShares S&P Network	Mid Cap Growth	Above Average	S&P GSTI Multimedia Networking
Computers	Fidelity Sel Computers	Large Cap Growth	Above Average	H. Lawrence
	Internet Arch HOLDRS	Large Cap Growth	Above Average	19 stocks chosen by Merrill Lynch
Medical Equip	Fidelity Sel Med Eqpt	Mid Cap Growth	Below Average	E. Yoon
	iShares DJ US Med Device	Mid Cap Growth	Below Average	Dow Jones U. S. Select Medical Equip
Software	Fidelity Sel Software	Large Cap Growth	Average	M. Tandon
	Software HOLDRS	Large Cap Growth	Average	13 stocks chosen by Merrill Lynch
	First Trust DJ Internet	Large Cap Growth	Above Average	Dow Jones Internet Index
S&P 500	Fidelity Spartan 500 Idx	Large Cap Blend	Below Average	Geode Capital Management
	SPDR S&P 500	Large Cap Blend	Below Average	S&P 500 Index Total Return

**ETF Purchase Requirements:**

Exchange-traded funds like those offered by First Trust, iShares, and SPDR can be purchased in 'round lots' of 100 shares or smaller with the minimum number being one share. Check prospectus for details.

**Fidelity Select Portfolio® Fund's Initial Purchase Requirements:**

The minimum initial investment for regular as well as Traditional, Roth, and Rollover IRA accounts in any Fidelity Select Portfolio Mutual Fund is \$2,500. The minimum initial investment is \$500 for SEP-IRA and Keogh accounts. Check fund prospectus for details.

**Fidelity Spartan 500 Index® Fund's Initial Purchase Requirements:**

The minimum initial investment for regular as well as all retirement accounts in the Fidelity Spartan 500 Index Fund is \$10,000. Check fund prospectus for details.

**HOLDRS Purchase Requirements:**

Merrill Lynch HOLDRS trade only in 'round lots' of 100 shares. HOLDRS may be traded in lots of 100 shares subject to a minimum of 100 shares. Check prospectus for details.

**Disclosure continued from page 6**

We calculate total returns based on price changes, assuming reinvestment of all distributions in the funds in which they were paid. The 3% Fidelity Select Portfolio® front-end load, taxes, and costs such as brokerage transaction fees are not factored in the results. On Sept. 23, 2003 Fidelity Investments eliminated the 3% front-end sales load on Fidelity Select Portfolio fund deposits.

Fidelity Investments typically provides updates on top 10 holdings excluding money market instruments and/or futures contracts held by Fidelity mutual funds at the end of each quarter around the middle of the month following the end of the quarter. All of the fund's holdings are not reported and the holdings may change at any time. Several of the companies discussed herein were held by the mutual funds in our model portfolios, per reporting date mentioned in this report. The mutual funds may or may not currently be invested in the companies mentioned in this report.

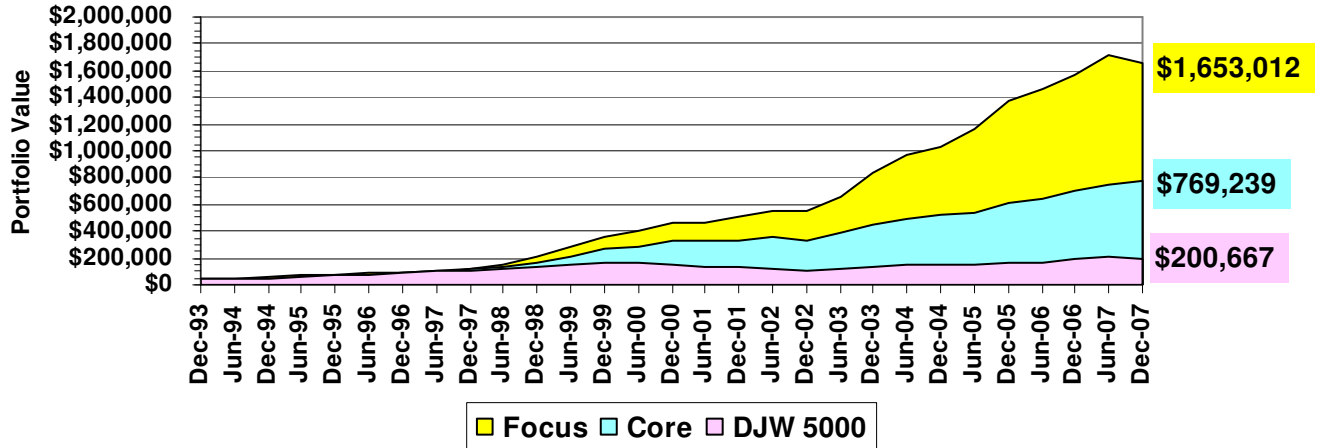
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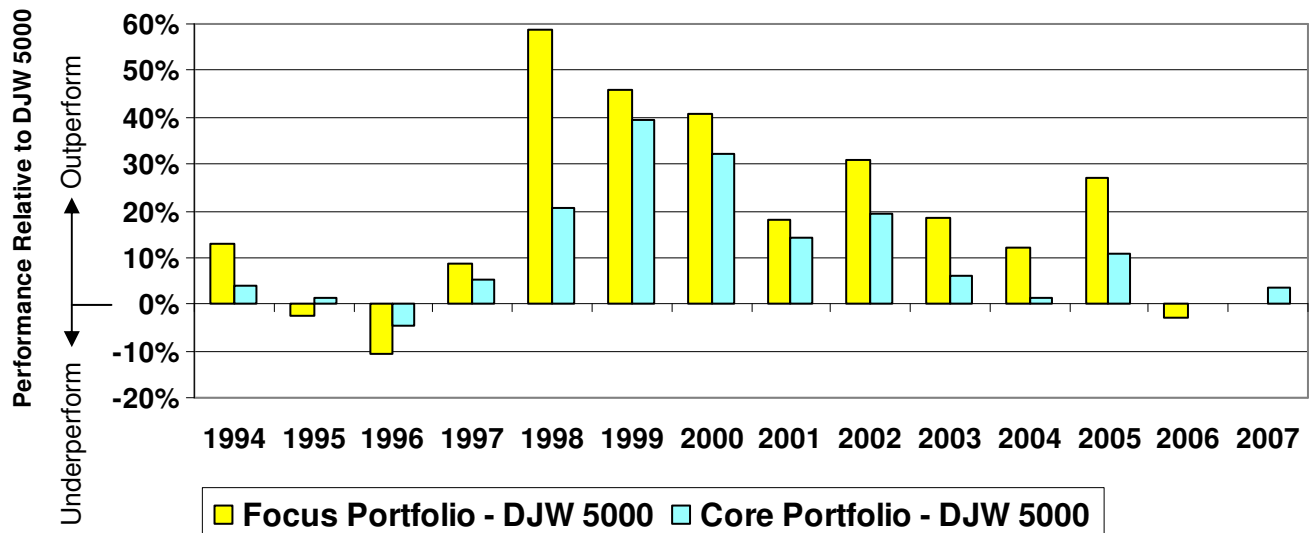
### AlphaProfit Model Portfolio Long-Term Performance

The Core and Focus Portfolios were initiated on December 31, 1993 each with a \$50,000 value. No new capital is added. All distributions are reinvested in the fund in which they are paid. The performance shown below is as of December 31, 2007; the returns do not include the one-time 3% front-end sales load charged by Fidelity Investments® for deposits made in the Fidelity Select Portfolio® funds. On Sept. 23, 2003, Fidelity Investments eliminated the one-time 3% front-end sales load for deposits in Fidelity Select Portfolio funds.



	Cumulative Return			Compound Annual Return			Sharpe Ratio	
	3 year	5 year	Inception	3 year	5 year	Inception	5 year	Inception
<b>Focus</b>	59.7%	198.8%	3206.0%	16.9%	24.5%	28.4%	1.10	1.02
<b>Core</b>	48.3%	132.6%	1438.5%	14.0%	18.4%	21.6%	1.18	1.01
<b>DJW 5000</b>	30.3%	93.1%	301.3%	9.2%	14.1%	10.4%	0.88	0.39

	Total Return													
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>Focus</b>	13.0%	34.2%	10.4%	40.1%	82.1%	69.3%	29.9%	7.1%	10.0%	50.0%	24.8%	33.4%	13.2%	5.8%
<b>Core</b>	3.9%	37.6%	16.7%	36.7%	44.0%	62.8%	21.4%	3.3%	-1.4%	37.6%	13.9%	17.0%	16.0%	9.3%
<b>DJW 5000</b>	-0.1%	36.4%	21.2%	31.3%	23.4%	23.6%	-10.9%	-11.0%	-20.9%	31.6%	12.6%	6.3%	15.9%	5.7%



## Glossary of Terms Used

**Alpha:** Difference between the sector fund's expected return and its "fair return" based on its historical responsiveness to market movements.

**AlphaProfit Core™ Model Portfolio:** Generally comprises of 7 to 8 Fidelity Select Funds. When fewer number of Select Funds appear attractive, the portfolio includes Index funds. Model portfolio is usually fully invested in equity funds. Turnover of funds in the Core Portfolio is lower than in the Focus Portfolio. Subscribers seeking long-term capital appreciation in retirement or regular accounts may find this portfolio suitable.

**AlphaProfit Focus™ Model Portfolio:** Typically includes 2 Fidelity Select Funds deemed most attractive. Model portfolio is usually fully invested in equity funds. Typical holding period for Select Funds included in this portfolio is 6 months. Turnover of funds in the Focus Portfolio is higher than in the Core Portfolio. Subscribers seeking aggressive growth of capital in retirement or regular accounts may find this portfolio suitable.

**AlphaProfit Sector Portfolio Indicator™:** AlphaProfit's proprietary short-term indicator used to assess attractiveness and risks in investing additional capital. Indicator is assigned one of the three readings: (a) Buy - Current prices are good to trade at. (b) Buy on Dips - Weakness may likely develop and may be used as buying opportunity. (c) Wait - Defer investing cash.

**Basis Point:** Equal to 1/100th of a percent.

**Beta:** A measure of the responsiveness of a security such as sector fund or ETF to market movements.

**Compound Annual Return:** A calculated number that describes the rate at which an investment has grown, if it grew at a steady rate.

**Cumulative or Holding Period Return:** Total return earned by the fund or portfolio over the referenced holding period. All distributions are reinvested in the fund paying the distribution.

**Dow Jones Wilshire 5000® (Full Cap):** Measures the performance of all U.S. headquartered equity securities with readily available price data. Over 5,000 capitalization weighted (stock price times number of shares outstanding) security returns are used to adjust the index. The index is an excellent approximation of dollar changes in the U.S. equity market.

**Exchange-trade funds (ETFs):** Baskets of securities that trade like individual stocks on an exchange. ETFs are traded throughout the trading day and can be bought on margin.

**Favored Buy:** Fund rating assigned when a particular fund's risk-reward ratio is deemed superior to those of other funds in the model portfolios. Rating is removed when the fund becomes as attractive as the other funds in the model portfolios. Rating is provided for Subscribers investing in model portfolio funds on *ad hoc* basis.

**Fidelity Select Portfolio® Funds:** A group of 41 equity mutual funds that focus their investments on a particular sector or industry group.

**Fidelity Spartan 500 Index® Fund:** Seeks to provide investment results corresponding to the total return of common stocks publicly traded in the U.S., as represented by the Standard & Poor's 500 Index (S&P 500®).

**Fidelity Spartan® Total Market Index Fund:** Seeks to provide investment results corresponding to the total return of a broad range of U.S. stocks. The fund normally invests at least 80% of the fund's assets in common stocks included in the Dow Jones Wilshire 5000.

**Fund Style:** Fund style information obtained from Morningstar, Inc. at <http://www.morningstar.com>.

**Liquidity:** Degree to which an ETF can be traded without affecting the ETF's price. ETFs with limited liquidity tend to have higher bid-ask spreads.

**Minimum holding period:** For no transaction fee (NTF) funds, minimum number of days or months a fund needs to be held to avoid both fund's short-term redemption fee and broker's transaction fee.

**Risk Rating:** AlphaProfit's classification of Fidelity Select Funds into 3 categories, 'Above Average', 'Average', and 'Below Average' based on the fund's standard deviation of returns over the last 8 years. Shorter history is used for newer funds.

**Sharpe Ratio:** A commonly used measure of risk adjusted return. This ratio is calculated using the formula, (portfolio return minus risk free return)/standard deviation of portfolio return. The return on the Vanguard® Prime Money Market Fund is used as a measure of risk free return.

**S&P 500®:** A market-capitalization weighted index of 500 stocks chosen by Standard and Poor's, Inc. It is used as a benchmark of U.S. equity performance.

**ValuM™ Investment Process:** The proprietary process used by AlphaProfit Investments, LLC to select investments. The investment process selects sector funds for including in the model portfolios based on the sector's momentum, valuation, and news quality.