

Traders Update

MONDAY 20TH AUGUST 2007



Brief Market Comment

When time passes, it is very possible that the last week will be viewed as a defining one for financial markets in the recent wave of uncertainty. The excessive volatility of the first four days, a pattern not dissimilar to the previous two weeks, threatened to spill over into something more serious as liquidity concerns persisted. The surprise move by the Fed on Friday lunchtime to cut its Discount Rate (the rate at which the Fed lends to financial institutions) by 50 basis points to 5.75% sent the clearest signal yet that monetary policy makers are determined that the day-to-day operation of the financial markets will not be dislocated. While the expectation of a cut in the Fed Funds Rate at the next Fed meeting on September 18th, may be somewhat premature, this latest example of monetary support to a distressed market is a clear sign that the interest cycle is about to change. From an equity market perspective this should be seen as positive on the assumption that earnings for the remainder of the year remain strong. The latest market adjustment has certainly been painful, but assuming the level of leveraged risk has been reduced, this adjustment will result in a much more stable investment environment. Now that there appears to be a clearer policy from the central banks to the recent market turmoil, investors should focus on the value available among the quality market names.

Explanations of current equity market issues

US sub-prime mortgages

US sub-prime mortgages are mortgages given to customers with either bad credit histories or no credit histories. Some of these mortgages appear to have been lent on the assumption that rising house prices would enable borrowers to re-mortgage their properties to meet repayments if necessary. However, when US house prices started to fall this year, this solution was no longer available to borrowers, causing a significant increase in bad debts for some US financial institutions and other financial institutions outside of the US with exposure to this mortgage market through CDO's in their bond portfolios. The recent knock-on effects of this increase in bad debts has been to cause to a significant reduction in the availability of credit globally, and to cause a significant increase in the cost of that credit. For example, the recent multi-billion pound bond issuance intended to fund the purchase of Alliance Boots failed to attract investor interest. In response to this reduction in the availability of credit globally, central banks have been active recently in expanding the credit supply to reduce the cost of funding for commercial banks.

Discount rate reduction

Last Friday's 0.5% reduction to 5.75% by the board of governors of the Federal Reserve in its discount rate differs from a reduction in the funds target rate, in that the discount rate reduces the cost of emergency borrowing by institutions in distress which do not have access to the Fed Funds market which is trading at 5% currently. The accompanying statement by the Federal Open Market Committee, in expressing newfound concern about the outlook for US economic growth, which has deteriorated "appreciably" versus the wording used at its previous 7th August meeting of has deteriorated "somewhat", now leaves the door open for a formal cut in the funds target rate either at or before the Fed's next scheduled meeting on 18th September. Normally, only overnight loans are available through the Fed's discount rate facility, but now loans can extend up to 30 days, offering a solid alternative to commercial paper financing, and significantly boosting liquidity in the short-term market. With interest rates at current levels, central banks now have the room to make interest rate cuts to support economic growth. Such an interest rate outlook is supportive of the interest rate sensitive sectors of the equity market, such as banks, property companies and homebuilders without material exposures to the US sub-prime mortgage market. These sectors are currently trading at 10 year low multiples of asset value.

Stock Picks

This leads us to re-iterate our **BUY** recommendations for **CRH** (€30) and **Bank of Ireland** (€13.09) at current levels, ahead of their upcoming H1 results' and H1 trading statement announcements respectively on **28th August** and **25th September**. CRH is currently trading at 10.7x consensus 2008 eps of €2.80, an 11% discount to the current sector average of c.12x, even though the group should generate double digit earnings growth in both 2007 and 2008. Its H1 results' announcement tomorrow week should result in a significant upgrade to the current consensus 2007 eps of €2.54, which already represented year on year growth of 13%. Bank of Ireland is currently trading at 8.0x consensus current year eps of €1.63, representing year on year earnings growth of 13%, and is paying a current year dividend yield of 5.2%. Continued double-digit earnings growth is being generated from strong loan growth, a very low bad debts charge and slowing margin erosion, combined with major cost savings. More evidence of this healthy earnings growth outlook should be contained in its bank's trading statement for the 6 months ending 30/09/07 on 25th September.

Defensive picks

For investors seeking more defensive sectors at this time of major equity market volatility, we continue re-iterate our current **BUY** recommendations for **BP** (£5.41) and **GlaxoSmithKline** (£12.71) as providing strong defensive characteristics at attractive current valuations. BP is currently trading at 10.5x consensus 2007 eps of 51.5p, paying a current year dividend yield of c.4%, and new start-ups at its Rosa and Plutnio fields in Angola should help drive a production increase of c.400,000 barrels per day by year end. The group's Texas City refinery is also slowly moving back to full capacity, and its Whiting refinery is expected to be operational again in Q4 2007. Following the £7.7 bn increase in the share buyback programme of GlaxoSmithKline announced last month, it has been in the market recently taking advantage of its current low share price. There is also the potential for improved pipeline news flow next month, with the EMEA expected to approve the group's important cancer drugs, Cervarix and Tykerb, and the FDA expected to approve its epilepsy drug, Lamictal XR. Its shares are currently trading at 12.9x consensus 2007 eps of 98.9p, a 24% discount to the current EU pharma sector average of c.17x, and pay a current year dividend yield of c.4%.

Capitulation evident

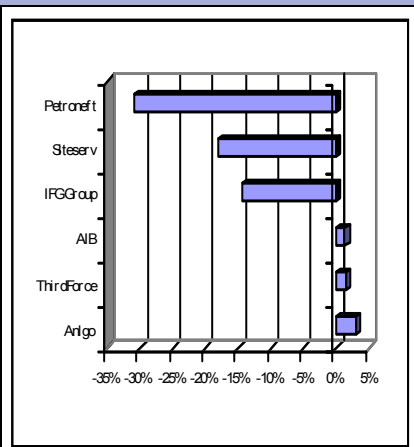
Capitulation trades occur when the last sellers panic and oversell the market. At current valuation levels believe we are there. Global growth is stronger than in many previous corrections, with the global economy forecast to grow by 4.4% in 2008. Inflation forecasts, while nudging higher, do not cause great concern. Corporate profit growth is forecast to grow at 10% in Europe and at 12.5% in the US in 2008. With developed markets trading at 14x earnings, this appears reasonable value. The Irish market suffered prior to this as a peaking property market was seen as diminishing its premium rating. However, the p/e and dividend yields of Bank of Ireland and AIB are reaching compelling valuation levels now. Management and balance sheets in all Irish banks have collectively never been in better shape. One of the largest impediments to banks buying other banks is the premium value that the target bank trades at relative to its assets. The current correction has taken care of that, and the price to book ratios of the Irish banks have fallen considerably.

DOLMEN STOCKBROKERS Traders Update

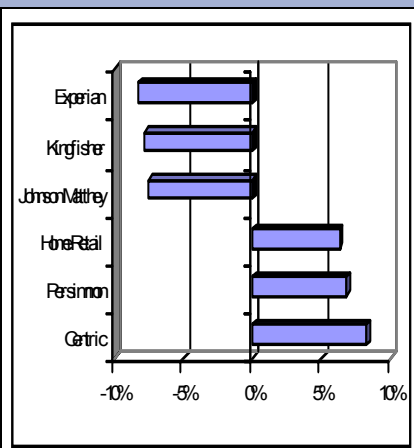
Last Weeks Best/ Worst Performers

13/08/07-20/08/07

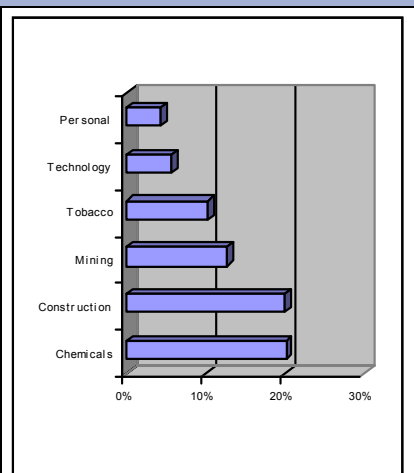
ISEQ



FTSE



Sector changes YTD



Dolmen Dozen

WEEKLY UPDATE

COMPANY	CLOSE	WTD	DD RETURN*	RELEVANT NEWS
AIB	18.65	1.36%	-14.96%	Recently reported 1H pre-tax profit that rose by 9% to €1.3bn and raised full year guidance
Aviva	7.05	3.07%	-11.41%	The group's said its initial UK flood cost estimate of £175m remains unchanged
BP	5.41	0.56%	0.49%	The groups Texas city refinery is moving back to full capacity
B. Land	12.41	5.89%	-25.70%	Increased its NAV per share by 2.9% to £17.16
C&C	5.70	-7.32%	-39.80%	The competition authority approved the sale of its soft drinks division to Britvic
CRH	30.00	-4.91%	-2.46%	Ahead of H1 results next week
GNC	4.41	-7.16%	-2.51%	Moved to the pre planning stage at it c. €500m redevelopment plan for its site in Mallow
GSK	12.71	-0.39%	-1.27%	Increased its share buyback programme by £7.7bn to over £12bn
LAD	3.73	-4.36%	-4.81%	Reported that H1 operating profit increased 28.9% to £195m
RBS	5.76	2.49%	-5.91%	Shareholders voted in favour of the ABN takeover at a company EGM last week
Ryanair	4.93	-7.50%	-7.44%	Added 6 new routes from Dublin and reiterated that it expects to grow FY profit by 10%
Vodafone	1.54	1.32%	13.92%	Citigroup upgraded its rating on the stock to buy from hold

DD Unrealised gain YTD	-8.72%	ISEQ YTD	-13.78%
DD Realised gain YTD	2.71%	FTSE YTD	-1.17%
DD Total YTD	-6.01%	Average performance	-7.48%
Relative performance YTD	1.47%		

* DD Return (Includes dividends & FX changes since stocks inclusion)

What it says in the 'Sundays'

- "CFD rules set for major overhaul" - **Sunday Business Post**
- "Grafton to scale back new store openings in Ireland" **Grafton - Sunday Business Post**
- "Tries aplenty for a lending giant" **Anglo Irish Bank- Sunday Times**
- "O'Reilly still riding high" - **Sunday Times**
- "Smurfit Kappa's slip is showing as debt levels creep up" **Smurfit - Sunday Independent**
- "Could head up MBO street" **Grafton - Sunday Tribune**
- "Government to abstain from vote" **Aer Lingus - Sunday Tribune**

Recent Corporate Visits

COMPANY	CHANGE ON YEAR	MEETING DATE	RELEVANT NEWS
Anglo Irish	-10.88%	09/08/07	David Drumm stated the current sub-prime panic would appear to be generating an attractive competitive environment for Anglo in the US.
Metro Baltic	-11.49%	13/07/2007	James Kenny re-iterated that the company has now has fully invested 95% of the funds raised. He also stated that going forward the company will concentrate on St. Petersburg.
Bank of Ireland	-23.83%	22/06/07	CFO J O'Donovan re-iterated that the only 10% of the groups PBT comes from Irish mortgages and he expects loan book growth of 15% for next year

Last Weeks Moves

Equities

	Level	Change WTD	Change YTD	Dividend Yield	P/E
ISEQ	8106	-2.88%	-13.84%	2.26%	12.96
FTSE 100	6064	0.43%	-2.52%	3.92%	12.11
DAX	7378	0.48%	11.84%	2.65%	12.95
DJ INDUS. AVG	12996	-1.64%	4.49%	2.22%	15.76
S&P 500	1434	-1.15%	1.31%	1.91%	16.62
NASDAQ	2483	-2.18%	3.07%	0.75%	35.80
DJ STOXX 50	3643	0.35%	-1.48%	3.68%	11.98
NIKKEI 225	15274	-8.89%	-11.33%	1.27%	32.26

Sector

	WEEKLY MOVE %	YTD MOVE %
Chemicals	-2.46	20.14
Construction & Materials	-2.05	20.05
Mining	-0.07	12.79
Tobacco	2.94	10.24
Technology Hardware & Equipment	-1.30	5.61
Personal Goods	-2.60	4.40
Media	-0.14	3.85
Beverages	1.10	3.26
Automobiles & Parts	-1.24	3.24
Telecommunications	1.46	0.01
Oil & Gas Producers	-0.38	-0.33
Food Producers	-2.47	-3.19
General Industrials	-1.26	-3.33
Leisure Goods	-1.40	-4.17
Gas, Water & Multiutilities	2.18	-4.97
Pharmaceuticals & Biotechnology	0.10	-5.55
Insurance	0.68	-7.40
Banks	-0.02	-8.37
Software & Computer Services	-2.32	-9.56
General Retailers	-0.26	-10.04

Commodities

	CURRENT	YTD CHANGE
Crude Oil	\$71.90	9.02%
Gold Spot	\$657.31	3.30%

Exchange Rates

	CURRENT	YTD CHANGE	YEAR END(E)
EUR-USD	1.349	2.23%	1.35
EUR-GBP	0.681	1.09%	0.665
EUR-JPY	154.1	-1.82%	145.00

GDP Growth

	YEAR END 06	YEAR END07(E)
Ireland	6.00%	5.00%
Euro Zone	2.70%	2.50%
UK	3.00%	3.00%
US	2.60%	2.10%

Central Bank Interest Rates

	CURRENT	YEAR END(E)
Euro Zone	4.00%	4.00%
UK	5.75%	6.00%
US	5.25%	5.25%

Credit Market Summary

Credit markets had quite a subdued week this week with all of the excitement concentrated on Friday with the Fed cutting the discount rate – the effect was 10% fall in high yield spreads and a 7% fall in investment grades spread to 338bps and 54bps respectively. Why the rate cut? Mortgage defaults in the US have prompted banks to rein in lending, thereby draining liquidity from credit markets and raising investor concern that the global economy is headed for a slump. Spreads will likely remain elevated (HY spread 194bps June 19th) as they have priced in slower economic growth outlook.

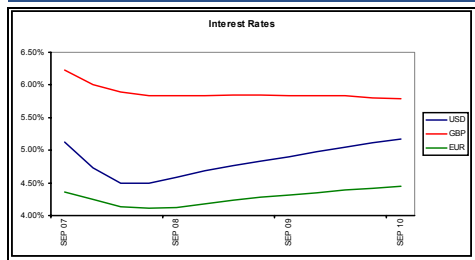
Credit Sector Movements for week ended 17/08/07

Automotive: Wider across the board – GM President commented that the current weakness in the mortgage market, and its subsequent effect on the US consumer, will have a detrimental effect on auto sales. In Europe both German and French automakers were wider this while in the US GM was 141bps (20%) wider and Ford was 136bps (17%) wider again on fears of weakness in US consumers – Rescap, the residential mortgage arm of GMAC, which was partially sold during the year, this week announced 29% of its loan portfolio was sub-prime

Retail: Wider in the sector – all retailers widened on the back of fears of consumer weakness, reinforced this week by poor results and revised earnings outlooks from both Wal-Mart and Home Depot, good barometers for consumer spending in the US. Retailers were all wider – MKS +10bps (17%); Dixons +14bps (16%); Kingfisher +10bps (10%) and Alliance Boots +22bps (4%).

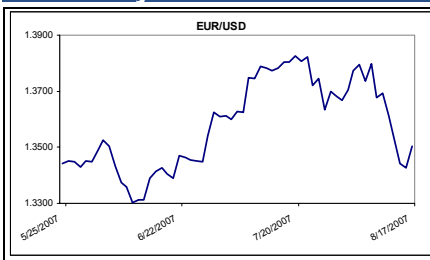
Building materials: Wider in the sector – poor housing data in the US confirmed fears that the housing market has not bottomed out – Biggest mover was Saint Gobain widening 6bps (11%) – other movers included La Farge +7bps (11%), Heidelberg +14bps (15%) and CRH unchanged.

Interest Rate Outlook

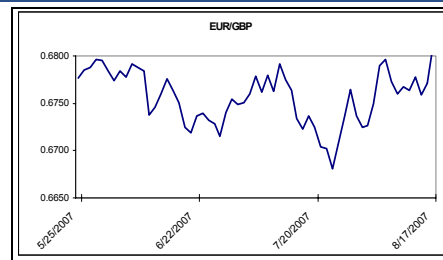


The Fed's decision to lower its discount rate by 50 basis points to 5.75% put downward pressure on government bond yields last week. The yield on the US 10-year treasury fell by 7 basis points to 4.70% and is now well below the 5.30% it reached in June as the 'flight to quality continues' amid concerns in world credit markets. The yield on the 10-year bund also declined amid hopes that the ECB rate rise for September may now be postponed.

Currency Comment



Last week the main focus in the currency markets was on the unwinding of the carry trade. As a result, the Yen staged a strong rally against all major currencies as sharp declines in equity markets triggered a liquidation of carry trade positions where the low-yielding Japanese currency is sold to fund the purchase of riskier higher yielding assets elsewhere.



The € traded relatively flat with £ last week despite expectations that the ECB may postpone raising interest rates to 4.25% at its governing council meeting on September 6th. Trichet had signalled that a 25 basis point rate rise was on the cards, however recent turmoil in global credit markets may force the ECB to hold off on raising interest rates.



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