

For the Second Quarter a good Defense may be the best Offense...

As we begin the second quarter, WinningStocks.com has been looking for solid trade and investing setups for our subscriber base for the coming three months. For most investors it's hard not to be skittish about the current market, and as readers of WinningStocks.com recent market commentary know, we have adapted a neutral posture for the short-term. The declines in the market in February and March of 2004 were broad based and without regard for sectors that are poised for growth. Even in severe secular corrections, there are always sectors that emerge to provide leadership. The most promising sectors, in our opinion, are the energy, gaming equipment makers and healthcare. We are neutral on homebuilders, financing companies and regional mono-line banks and thrifts.

Energy

At \$34.00 per barrel, oil futures are currently trading at the highest levels not seen since the 1991-2 Gulf War, and while the market has seen crude spike higher on several occasions since 1991, these were proven to be temporary in nature. The current levels have the appearance of being both structural and sustainable. This is in large part due to the growing global economy, with countries such as China where GDP growth could reach 9% in 2004, and the United States, with 4% GDP growth, leading the way. The International Energy Agency is currently predicting world oil demand to increase by 1.8% for 2004 as GDP's of most industrial nations continue to expand. Also, the continuing uncertain political situation in the Middle East has added what would seem to be an indefinite premium embedded in the price of oil.

WiningStocks.com believes that the current upward trend in the energy sector will remain intact through the second quarter and for that matter through the balance of 2004.

Therefore, we think investors would do well to focus on direct drillers and energy services companies. Below is a table of the four companies that the WinningStocks.com stock screener list of long-term plays in the energy sector that carry the potential to benefit most from the up trend in oil prices:

Winning Energy Stocks		Trailing Forward		
Company	Ticker	Price	P/E	P/E
Petrokazakhstan Inc.	PKZ	\$28.15	7.22	7.32
Statoil ASA Adr	STO	\$12.10	11.39	8.7
Tsakos Energy Nav.	TNP	\$29.58	12.71	7.67
OMI Corp	OMM	\$11.24	11.45	7.16

The largest risk to this sector may very well be political. Pressure is growing on the Bush administration to look to the nation's strategic oil reserve to relieve gas prices. Those who are critical of releasing oil from the reserves say gas prices would come down only by a few cents, but keep in mind the reserve currently has 651 billion barrels stockpiled. Some state oil companies, such as

Petroleo Brasileiro (PBR, NYSE, \$33.90) boast reserves of 12 billion in comparison. In other words, a large release could negatively impact market prices and shares in oil companies

Gaming Equipment

Of all sectors of the economy, the gaming industry continues to be the most resilient, demonstrating solid growth in virtually all sub-sectors. While pure casino plays continue to do moderately well in terms of stock performance, the field is getting more crowded than ever, leading to flat revenue growth and lower EPS growth rates.

Gaming equipment manufacturers, on the other hand, will continue to outperform the market as a whole as there are a number of systemic factors that continue to play out in their favor. The first of these factors is the race by state legislatures to approve slot machine and other machine based gambling as an alternative revenue source. Also, combined with the growth of Indian Tribe gambling in a growing number of states, the demand for gaming machines is at historical highs.

<u>Gaming Equipment Stocks</u>				
Company	Tick	Recent Price	Trailing P/E	Forecast Yr/Yr EPS Growth
International Game Tech	IGT	\$45.78	39	23%
Multimedia Games	MGAM	\$23.78	22	1400%
Alliance Gaming Corp.	AGI	\$33.75	40	16%

As of today 39 states have, in one form or another, legalized gambling other than traditional lotteries. Additionally, Pennsylvania appears to be on the verge of approving riverboat gambling and limited tribal gambling. California, which already has legalized gaming on tribal land, is also looking to expand these activities.

The courts have also helped out the sector. In early March, the Supreme Court decided against hearing a case that would have effectively banned bingo type electronic games. These games were challenged by

certain states that argued such games should be banned as participants are playing against each other rather than the "House". By not hearing the case the high court handed certain companies that manufacture these devices a huge victory.

In summary, gaming equipment manufacturers continue to be a leading group and WinningStocks.com expects this trend to continue into the second quarter and beyond. The field is relatively small, with just three companies holding the lion's share of business. To be sure, the group has outperformed and some observers would argue that shares are not cheap, but to fight the trend is not a way to make money in the market. Some investors may wish to wait for a pullback before initiating purchases.

Medical/HMO's

Over the years, the HMO market has consolidated and scaled down into a limited number of players. The most notable aspect of the consolidation has been how the emerging companies are demonstrating superior EPS growth as well as providing strong returns on equity. Also, these HMOs have evolved into cash generating machines. WinningStocks.com historically prefers companies that throw off a fair amount of cash, since it leaves a company with great flexibility to move share prices higher through share buybacks and debt reduction. Virtually all companies that are profitable in this sector are trading near or at their respective 52-week highs, but this should not inhibit investors from adding some of these names to a portfolio, since first quarter earnings announcements should be in record territory

<u>Leading HMO's</u>					
Company	Tick	Recent Price	Yr/Yr EPS Growth	12 Mo. Free Cash Flow	ROE
UnitedHealth Grp	UNH	\$65.49	38%	\$2.0 Bil	35.6%
Sierra Health	SIE	\$37.67	41%	\$112.3 Mil	41.3%
Anthem Inc.	ATH	\$91.84	22%	\$1.03 Bil	12.9%
Pacific Health	PHS	\$40.71	57%	\$500 Mil	13.1%

Unfortunately this sector does come with some caveats, with the largest being that the HMO's operate in a political minefield. Health costs, as everyone recognizes, are skyrocketing and this is gaining the attention of politicians who want to appear as if they are reacting to the problem. HMO's are becoming large targets for state Attorney Generals (coming fresh off the latest Wall Street scandals) and any inquiries and investigations have the potential to drag the entire sector down. If this type of weakness occurs, shrewd investors should look for buying opportunities in some of the issues.

Rates are Going Up, Driving Some Sectors Down

For the coming quarter we are not all that upbeat for the prospects of homebuilders, or for the companies that have benefited from the great American housing boom. There is no argument that the past two years were truly a golden period for companies such as Hovnanian (HOV \$40.71) and Toll Brothers (TOL \$43.73). More than anything, the homebuilders have, and will become, victims of their own success. As long as the low interest rate environment was fueling the housing boom, the quarter over quarter EPS growth outclassed every other sector. But alas, all good things must come to an end, and interest rates have nowhere else to go but north. An increase in rates will no doubt slow the housing sector and when the earnings growth rate slows the sectors will languish, if not start trending downward. Defenders of homebuilders will point to the modest valuations and they are correct, but money in the market trends towards growth and valuation, and without it stocks will have a difficult time making meaningful headway.

Pure mortgage plays are also at risk. Companies such as New Century Financial (NCEN, Nasdaq, \$47.50) and Accredited Home Lending (LEND, Nasdaq, \$35.59) will be very susceptible to the coming increase in rates. Refinancing and new mortgages have already propelled these stocks to historical highs, however, if there is anyone left in America that has not refinanced it will not be

enough to keep the stocks moving up. Sure, there may be a 10% upward bump in share prices from current levels due to a mini-rush of new mortgages and refinancing in advance of the rates rising, but it will be temporary and unsustainable in the face of rising rates.

Finally, looking at the small regional thrifts and banks we see an end to a nearly three-year run. Stocks in this area have moved upward due to growing net interest margins, (the interest rate paid to depositors, which are short-term in nature versus interest rates earned on mortgages, which are long term in nature) however these margins will begin to undergo compression, which in turn, will bring down earnings.

Conclusion

The markets continue to have the ingredients to continue to move higher; however there are some concerns. These include geopolitical problems, namely terrorism and the aforementioned historically high oil prices, which will, in all likelihood, keep the markets in check throughout the quarter. Also, as the presidential campaign heats up, market volatility has the potential to grow, and unfortunately, the market does not take kindly to political uncertainty.

The WinningStocks.com outlook for the coming quarter is one of neutrality and any advances will come grudgingly, with the downside risks to the markets being somewhat limited but not ignored.

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