Our February 2020 Newsletter concluded with the following inference:

"The recent decline of -6% to -7% in the broad-based indexes is a technical correction according to our model. We believe that this correction provides growth-oriented investors with an opportunity to add or increase growth-oriented investment exposure to their respective portfolios. We believe that it would be appropriate to reduce cash exposure by half and use it to add and increase equity growth exposure."

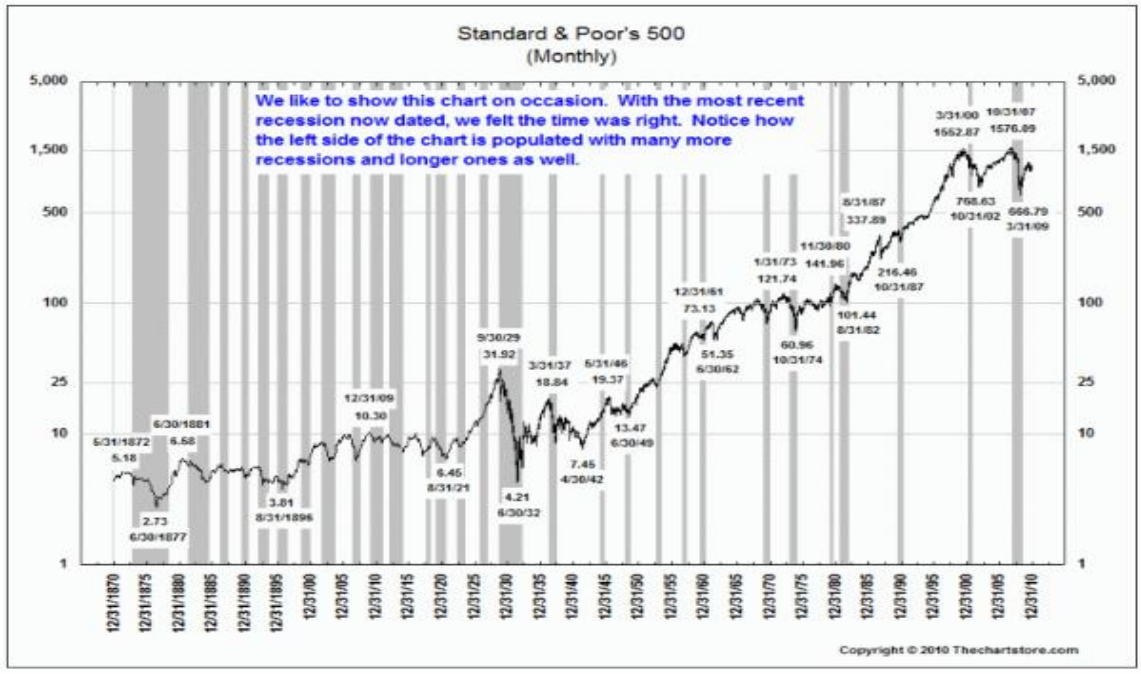
In retropsect, we were early in our estimation of the market correction. Having said that, no one could have predicted the onslot of the Covid-19 on the global economy.

Significant market correction in the month of February 2020

The US market indexes lost approximately 35% from their highs on Feb 12th, 2020. Subsequently, markets have gained 35% from the March 23rd, 2020 lows. Despite this welcomed market recovery, the major indexes are still lower by approximately 15% from the highs this year.

Obviously, there are a number of variables that attribute to the movement of capital markets. This issue of our Newsletter focuses on the evolution of the Federal Government since the great depression of the 1920s and the role it continues to play in providing support and ameliorating the magnitude of recessions.

Recessions over the last 150 years continue to become relatively shallower and of shorter durations…



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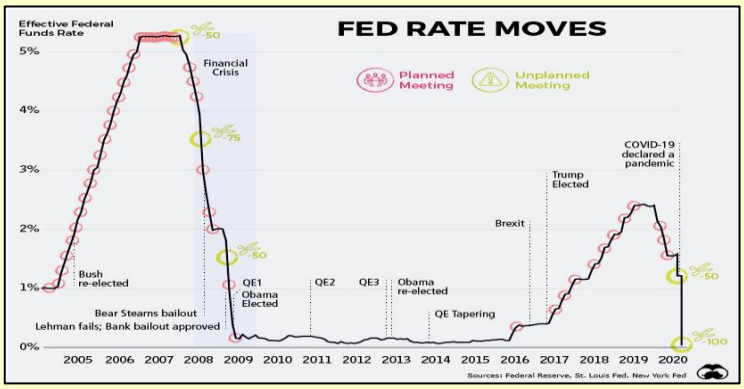
Fed Fund Target Rate

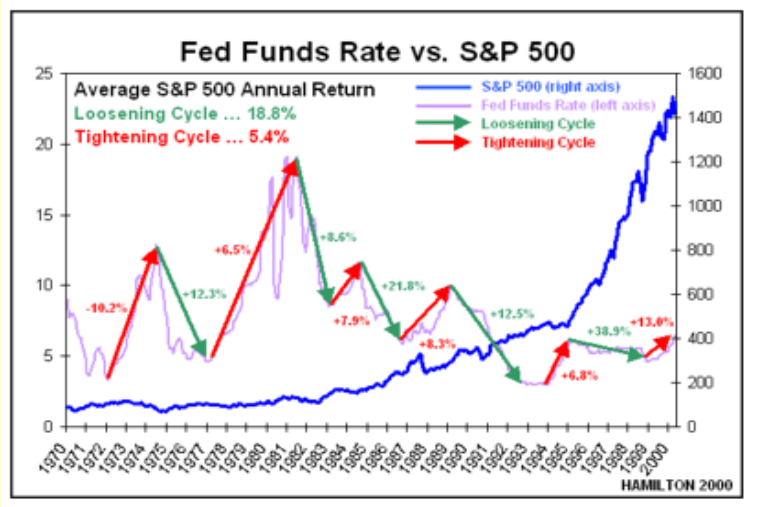
The Federal Funds Rate (FFR) refers to the interest rate that the Federal Reserve charges major US banks for overnight lending.



It can be observed in the corresponding chart that the FFR is at historically low level and is expected to stay in this range for the foreseeable future.

Impact of Fed Fund Rates on the major market indexes…

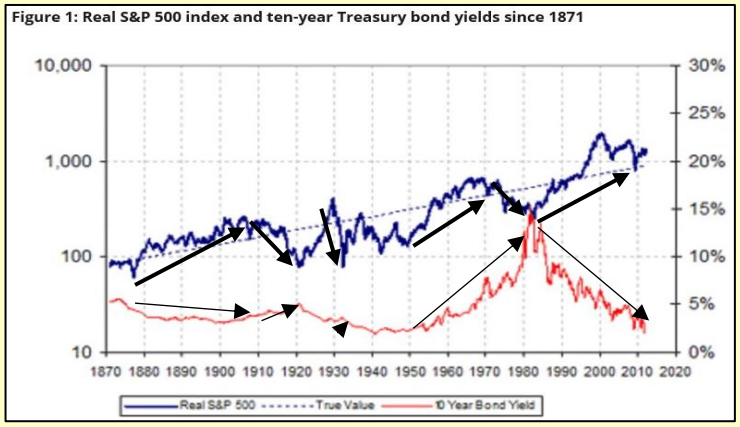
We can observe in the adjacent chart that the S&P 500 has performed much better during loosening rate cycles.



In other words, lower interest rates or accommodative monetary policy has been favorable for the capital markets. We believe that the Federal Open Market Committee (FOMC) has been more than accommodative during the Covid-19 pandemic and continues its quest of providing liquidity to stabilize the overall economy.

Cost of Capital or interest rates have a negative correlation to capital markets…

The adjacent chart[1] show a negative correlation between the interest rates and the major market index.



We believe that the Federal government will continue to keep rates low for the forseeable future. This is evident based on the Federal Funds Rates[2]. These rates have been reduced to almost 0% since August 2019. In addition, Mr. Jerome Powell, the Chairman of the FOMC, has clearly stated their accommodative intent in terms of monetary and fiscal policy.

[1] *Source: Thompson Reuters*
[2] *Federal Funds Rate: Rate charged by the Federal Govt., to major banks for overnight lending.*

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Market Valuation…

CGAM's Proprietary Market Model:

We have developed our proprietary Market model, which has helped guide us in understanding the direction of the broader markets. We have used the S&P 500 index as the proxy for the US broad based markets. The model was developed on the belief that investor behavior repeats itself based on a combination of economic fundamentals and investor psychology. The model is dynamic, as it constantly reviews the change in the index based on the changes in statistically significant economic variables.

The table below is an illustration of the variables used to project the 12 month target on the S&P 500. Our regression model uses six variables (shown on the extreme left column), which attributes to 93% of the movement in the S&P 500.

Fundamental Variables	**FY 2020 (Estimate)**	**Market Projections**	***As of April 30th, 2020***
S&P 500 Earnings	$130.00	S&P 500 (12 Month Projection) =	2,684.00
S&P 500 Expected PE Ratio	16.00	S&P 500 (April 30th, 2020) =	2,896.00
10 Treasury Bond Rate (%)	0.70%	***S&P 500 Estimated (Gain/Loss) =***	***-7.32%***
Inflation Rate (%)	2.00%	***Standard Error***	**+/- 5.20%**
Volatility (VIX) Index	33.00		
Unemployment (%)	20%		

Obviously, the chaos caused by the Covid-19 aka Corona Virus, has rattled economic normalcy. To predict markets in normal times is an ambitious task, but to do so in such unprecedented and uncertain times is rather dumb-witted and bordering on narcissism. Having said that, we have attempted to evaluate a fair market value using significant reduction in economic fundamentals. We have reduced the 2020 earnings expectations by -20%, price/earnings (investor sentiment) by 15% and increased US Unemployment to 20%. Certain variables like the volatility Index (VIX) or the investor fear gauge, have the propensity to be significantly more volatile than the rest of the fundamental variables. Even though it is nearly impossible to time the markets, factoring the VIX in our proprietary market model gives us some guidance of the market sentiment as a contrarian indicator.

Conclusion…

The capital markets in the US have experienced a significant reversal since the lows seen at the end of March 2020. Using our proprietary market model, we would lean towards a defensive stance for aggressive portfolios. As a long-term investor, it does not pay to time the markets, but the economy will continue to suffer due to the high unemployment rate. Therefore, it makes sense to increase cash and recalibrate respective portfolios. It would be advisable to gravitate towards sectors like Online retail, Healthcare, Technology and Consumer Staples. In addition, we would avoid Leisure & Tourism, Transportation and Industrials.

PLEASE REMEMBER: Each investor is unique and should invest to complement their respective financial conditions and objectives.

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Please review the following disclaimer

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