

# Newsletter

The world of investing was surrounded by fear at the end of the first quarter 2009, as mentioned in our previous Newsletter dated March 2009. Investors of all shapes and sizes were selling first and asking questions later. Since then, things have changed. Markets have moved up 20% + from their March 9<sup>th</sup> lows. There are two dimensions in which we can view this ascent. Either the economy is in a turn around phase and the capital markets are proactively anticipating this, or on the other hand, this could be a technical rally within a bigger bearish trend.

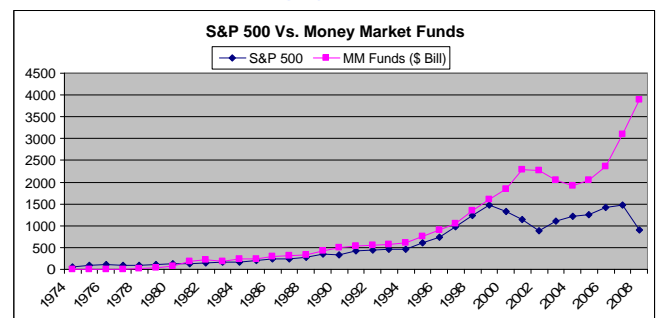
No one can deny the importance of fundamentals in the efficient working of markets, but as an investor, we can not ignore the short and medium term human psychology or technical that command market movements. In our previous issue, we addressed the role of a crucial variable; the ratio of money market funds as a percentage of the total stock and mutual fund market value. The higher the percentage or the larger the cash reserves, the higher the probability that the markets are close to experiencing a bottom. Obviously some of those money market funds have flown into the equity markets fueling the uptrend. This issue focusses on the short term movement of the capital markets and the specifics that attributed to the major moves in the various broad based indexes.

## Money Market Levels:

The adjacent chart was initially shown in our previous Newsletter illustrating the oversold conditions in the markets. The increased levels or the deviation of the cash reserves from a reasonable historic average (shown in pink) helped infer that the markets were in an oversold state and the possibility of an interim rally was high.

Now that we have had a significant move on the upside, it would be interesting and important to review which asset classes, and further more which equities have attracted most of the cash reserves. It can be observed from Table A (Page 4) :

Chart A<sup>1</sup>



1. Approximately \$400 billion<sup>2</sup> was invested into the Dow Jones Average from March 9<sup>th</sup> to March 31<sup>st</sup>.
2. The top 10 companies classified by the highest percentage gains, cummulative gained an average of 60.88% for the same period.
3. Gains were concentrated in companies like Citigroup, Bank of America, JP Morgan, GE and American Express; mostly financials.
4. The top 100 companies in the S&P 500 (another broad based index) attribute to 70% of the index movement as this is a market value based index. In addition, the Dow 30 companies are also in the top 100 companies of the S&P 500 index. Therefore, there is an overlapp of components amongst the two indexes.
5. The new asset flow of \$400 billion is approximately 9% of money market accounts at the end of February 2009. Even with a conservative estimate the money market funds as a percentage of the total market value currently should be at 35-37%. This is still high from historical perspective.

It should be noted that this technical trend could be carried further as the markets moves up in a panic similar to moving down in a panic. I do not believe that this will be a likely case as the volatility index (VIX) still indicates a relatively high level of fear or protective hedging. The VIX index closed at 44 compared to a high of 90 at the end of October 2008, and an average of mid 40s during recessions over the last fifteen years. This means that the market participants are still very cautious or the element of protective hedging is becoming a mainstream practice.

Government intervention which started with the Bush and Paulson administration and has now transitioned to the Obama and Geithner administration has had a major impact on the market. Chart B on the following page illustrates the market movement that followed the election of President Roosevelt in late 1932 to that of President Obama. Both presidents

<sup>1,2</sup> Source: CGAM, LLC

faced challenging environments. I am not suggesting that the markets will replicate the steep ascent that the Roosevelt administration experienced over the first two quarters of its administration. However, the recent rally does point to two main points; one, that there is confidence in the new administration and two, the market is factoring and anticipating a turnaround in the economy and corporate earnings, especially in the financial sector.

Chart B<sup>3</sup>

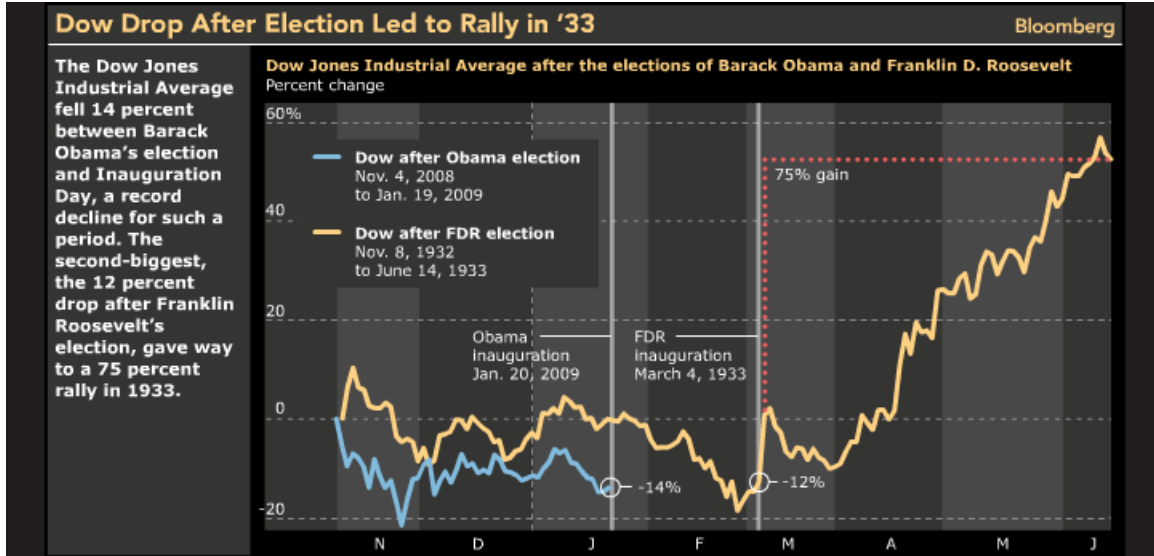


Table 1 illustrates the movement of US broad based equity indexes since the beginning of the year 2009. This is followed by the performance of the recommendations CGAM has provided via the monthly newsletters for the same time frame.

Table 1<sup>4</sup>

	Dec 31 <sup>st</sup> , 2008	March 31 <sup>st</sup> , 2009	Gain/Loss (%)
Dow Jones Industrial Average	8,776.00	7609	-13.30%
NASDAQ COMPOSITE	1,577.00	1529	-3.07%
S&P 500 INDEX	903.00	797.9	-11.64%
RUSSELL 2000 INDEX	499.51	422.8	-15.37%
<b>Average Loss</b>			<b>-10.84%</b>

Security Description	December 31 <sup>st</sup> , 2008	March 31 <sup>st</sup> , 2009	Gain/Loss (%)
UltraShort Lehman 7-10 Yr Trsy ProShares	52.66	52.03	-1.20%
Blackrock Corporate High Yield Fund Inc	4.08	4.08	0.00%
Eaton Vance California Municipal Income Trust	7.99	9.81	22.78%
Western Asset Managed Municipals Fund Inc	9.4	10.12	7.66%
Boulder Growth & Income Fund Inc	4.47	3.96	-11.41%
Ultra Financials ProShares	3.28	2.61	-20.43%
CGM Focus	25.56	22.47	-12.09%
<b>Portfolio Average Loss</b>			<b>-2.10%</b>

Following are my observations based on the data provided above:

1. Assets have obviously flown out of treasuries as the 10 year yield have moved from 2.43% in January to 2.70%<sup>5</sup> as of March 31<sup>st</sup>, 2009. As treasury yield move inversely to its price, an increasing yield means lower prices for the treasury. As investors start taking on higher risk they sell treasuries to release cash, putting pressure on treasury prices.
2. Assets have started moving into municipal and corporate bonds. It can be clearly observed that the municipal bond funds recommended by CGAM have gained the most in value followed by the corporate bond fund.
3. Equities were at their lowest over the last 52 weeks on March 9<sup>th</sup>. Since then they have started their ascent providing some indication that investors expect an economic turnaround.

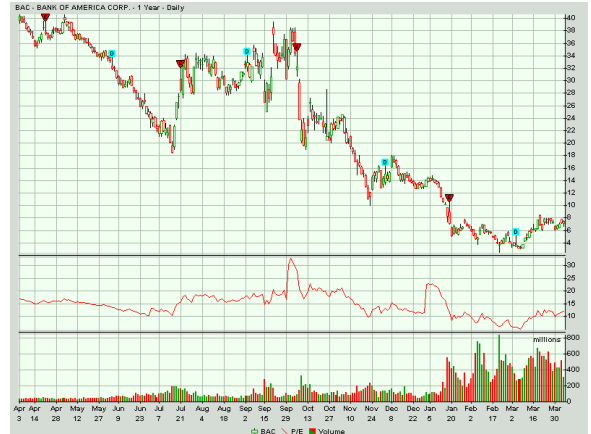
<sup>3</sup> Source: [www.bloomberg.com](http://www.bloomberg.com)<sup>3</sup> Data Source: [www.msnmoney.com](http://www.msnmoney.com) <sup>4</sup> Data Source: [www.yahoo.com](http://www.yahoo.com)

## Investment Themes

**Bank Of America (BAC)**<sup>6</sup>: \$6.82 as of March 31<sup>st</sup>, 2009.

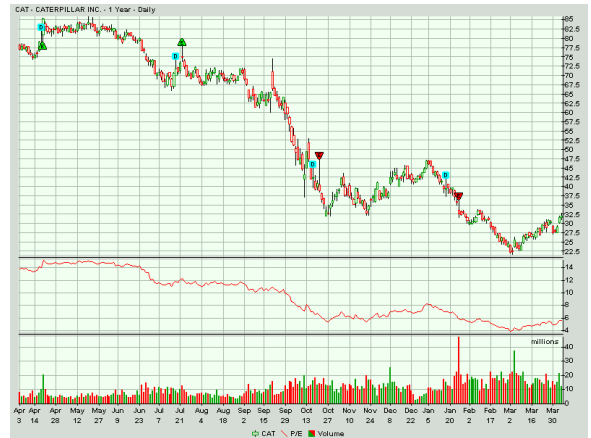
We are recommending that aggressive investors with a 12-18 month investment holding horizon start building positions in BAC. Following are major reason for this investment opportunity:

1. Bank of America has over \$110 billion in revenues with actual profits for 2008. The new accounting ruling could help the bank realize write ups that could attribute positively to profits.
2. Mr. Kenneth Lewis, the CEO of BAC has been buying stock for his personal account in the open market along with the company's senior executives.
3. The acquisition of Countrywide could be accretive to the company's earnings when the housing market turns around.
4. Merrill acquisition will be economically fruitful in the wealth management and investment banking areas.



**Caterpillar Inc. (CAT)**: \$27.96 as of March 31<sup>st</sup>, 2009

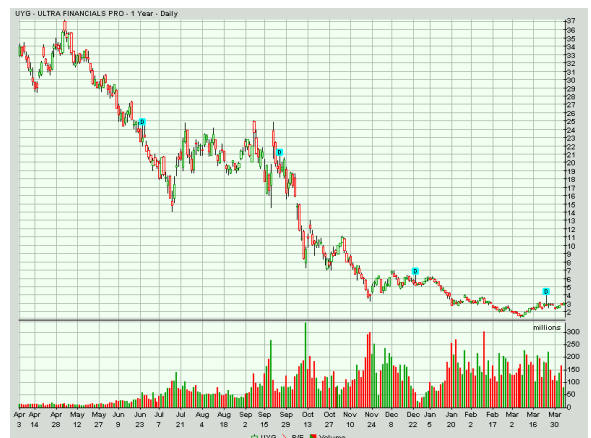
1. Caterpillar has annual sales of over \$51 billion in the area of Heavy Machinery and Engines. Despite the deceleration in the World's GDP, major infrastructure endeavors are still being undertaken worldwide, especially with the stimulus packages to be implemented by developed and developing countries. CAT would be a direct benefactor of this phenomenon.
2. Current market value of the company is approximately \$17 billion, which is .33 times its sales. This ratio has been in the range of 1.2-1.3 historically. Even with reduced sales of \$40-45 billion, CAT could double in 12-18 months.
3. CAT has over \$1.5 billion in cash and a current ratio of 1.2. This means that CAT has the capacity to currently pay 1.2 times its liabilities.
4. 52 week High and Low: \$85.96-\$21.71.



**Ultra Financial Proshares (UYG)**: \$2.62 as of March 31<sup>st</sup>, 2009.

UYG was also recommended in our February issue with emphasis on building position gradually in this fund. We believe that the earnings for major banks should improve during the second half of the year, hence the bullishness.

1. The fund invests in the US financial sector with 22% of the fund's assets invested in the top 7 US national banks. This fund uses leverage and derivatives to attempt to generate 2 times the performance of the Dow Jones financial index.
2. 52 Week High-Low: \$41.96-\$1.37. Current Yield: 8.41%.
3. It is important to note the dividend yield could be diminished over the next few quarters as more financial institutions could cut dividends in order to contain cost and bolster their capital structure.



**This fund should be treated as an opportunistic investment and is not for faint of heart.**

<sup>6</sup> Source: Charts and quotes from [www.fidelity.com](http://www.fidelity.com)

Table A<sup>7</sup>

Dow Jones Industrial Average (30 Components)	Stock Price March 9 <sup>th</sup>	Stock Price March 31 <sup>st</sup>	Market Value on March 9 <sup>th</sup>	Market Value on March 31 <sup>st</sup>	Asset Flow into the Company (\$ Bill)
JPMorgan Chase & Co	15.02	26.58	\$56,475	\$99,941	\$43,466
General Electric Co	6.88	10.11	\$72,653	\$106,762	\$34,109
Microsoft Corp	15.1	18.37	\$134,239	\$163,309	\$29,070
Exxon Mobil Corp	62.87	68.1	\$310,578	\$336,414	\$25,836
Bank of America Corp	3.2	6.82	\$20,480	\$43,648	\$23,168
AT&T Inc	21.62	25.2	\$127,342	\$148,428	\$21,086
Chevron Corp	57.51	67.24	\$115,020	\$134,480	\$19,460
Wal-Mart Stores Inc	47.3	52.1	\$185,416	\$204,232	\$18,816
IBM Corp	83.02	96.89	\$111,247	\$129,833	\$18,586
Johnson & Johnson	46.25	52.6	\$128,113	\$145,702	\$17,590
Hewlett-Packard Co	25.39	32.06	\$60,936	\$76,944	\$16,008
Intel Corp	12.3	15.03	\$68,388	\$83,567	\$15,179
Merck & Co Inc	20.05	26.75	\$42,306	\$56,443	\$14,137
Coca-Cola Co	38.73	43.95	\$89,466	\$101,525	\$12,058
Verizon Communications Inc	26.1	30.2	\$74,124	\$85,768	\$11,644
Home Depot Inc	17.49	23.56	\$29,733	\$40,052	\$10,319
Procter & Gamble Co	43.93	47.09	\$128,715	\$137,974	\$9,259
Citigroup Inc	0.99	2.53	\$5,455	\$13,940	\$8,485
Pfizer Inc	12.38	13.62	\$83,441	\$91,799	\$8,358
3M Co	41.2	49.72	\$28,580	\$34,490	\$5,910
E I du Pont de Nemours & Co	16.05	22.33	\$14,486	\$20,153	\$5,668
United Technologies Corp	37.4	42.98	\$35,289	\$40,554	\$5,265
Walt Disney Co	15.46	18.16	\$28,756	\$33,778	\$5,022
American Express Co	9.86	13.63	\$11,438	\$15,811	\$4,373
Boeing Co	29.96	35.58	\$21,755	\$25,836	\$4,081
McDonald's Corp	51.31	54.57	\$56,954	\$60,573	\$3,619
Caterpillar Inc	22.72	27.96	\$13,667	\$16,819	\$3,152
Kraft Foods Inc	21.16	23.05	\$31,105	\$33,884	\$2,778
Alcoa Inc	5.16	7.34	\$4,137	\$5,885	\$1,748
General Motors Corp	1.51	1.94	\$921	\$1,183	\$262
Total					\$398,512

We ended our March issue with the following words "[...It is true that momentum feeds on itself and markets could stay irrational a lot longer than an investor can stay invested.](#) On the other hand years from now, we shall look back and think; what a no brainer it was and why we didn't invest in the highest quality companies at the cheapest they had been in over two decades..."

Since the lows of March 9<sup>th</sup>, the market has rallied over 23%. It seems that this rally is factoring in the government intervention as a true catalyst for the economic turnaround. The upcoming earnings announcements and more importantly the future guidance would command how market move forward. In the interim, we believe that US large companies are trading at very attractive valuations, but it is crucial to invest using the concept of dollar cost average during market pull backs.

**Needless to say, each investor is unique and should invest to compliment their respective financial conditions and objectives.**

<sup>7</sup> Source: CGAM, LLC

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