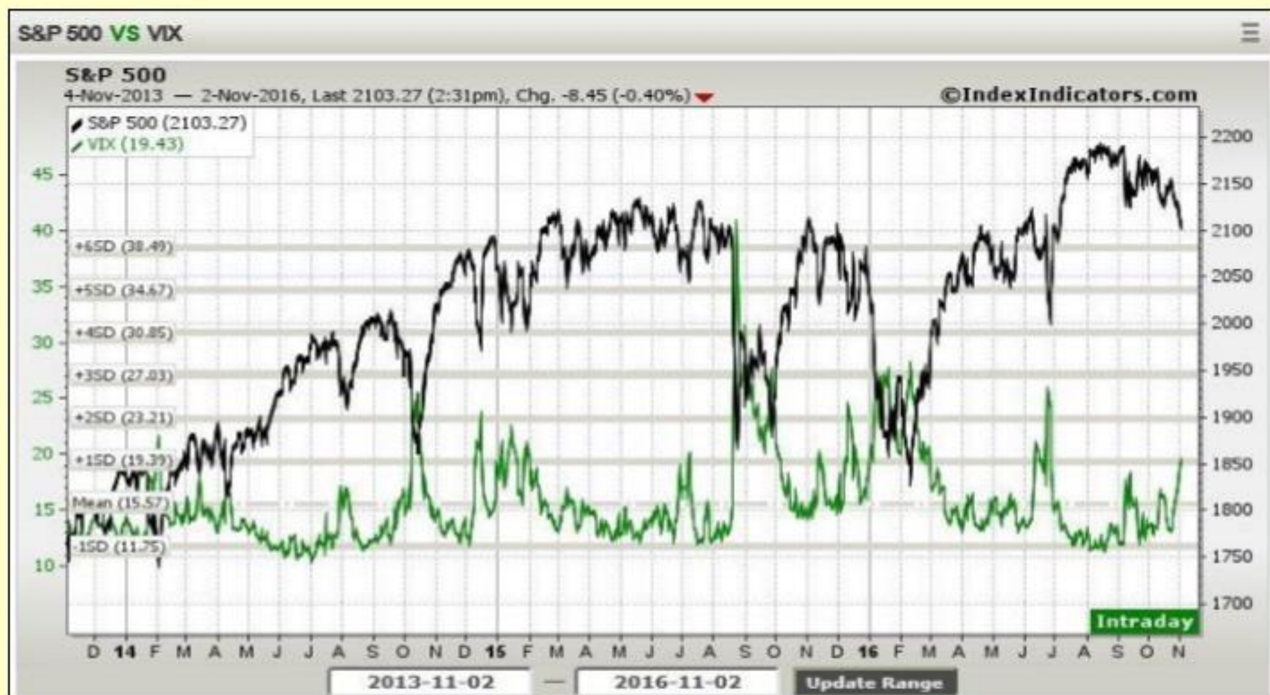
Our March 2017 Newsletter concluded with:

"We still believe that the markets are currently overvalued and euphoric. Despite strong economic fundamentals and high consumer confidence, markets could correct in the short and intermediate term by 5-7% on a technical basis. We would reiterate by recommending that investors prepare for a correction by raising cash. We are not recommending selling everything and bury our heads in the ground but be aware of risk return that the markets currently offer. The downside of having a reasonable level of cash in a portfolio will prohibit from capturing 100% of the upside but it will definitely provide investors with a better opportunity to invest during a correction." ***March 2017.***

The broadest US stock market index, the S&P 500 index has lost almost 2.6% of its value from it's high on March 1st, 2017. At the same time the **Volatility Index (VIX)** had moved from 12.50 to approximately 16 on April 13, 2017, a 27-28% gain. The Volatility Index is a fear gauge for the markets. It is calculated using PUTs and CALL options on the S&P 500 index and indicates how concerned investors are in the short to intermediate term about the market volatility. The correlation between the VIX and the S&P 500 is of great value when analyzing investor sentiment and the direction of the markets.



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The Chart above (**For detailed analysis: CGAM November 2016 Newsletter**) clearly illustrates a negative correlation, the VIX index and the S&P 500 displays. In other words, as investors uneasiness about market volatility grows, they start buying insurance on their portfolios in the form of S&P 500 index Put Options. When this occurs, the VIX index rises which is usually accompanied by declining market indexes. Again, the rise in VIX is a byproduct of market decline, which compels investors to take cover or buy S&P 500 put options to protect their portfolios. The recent accent in the VIX shows growing concerns of investors regarding market performance.

Despite our analysis of the technical variables in the markets, we cannot forget certain positives in the US economy. We list certain crucial parameters that we believe would help the markets in the long-term:

1. **Interest Rates:** Rates are still at attractive levels and the Federal government should raise rates at a prudent and manageable rate.
2. **GDP growth:** GDP should grow at a reasonable rate; not robust but sustainable.
3. **Corporate Earnings:** This is the brightest area helping the upwards trend of the major capital markets. Growth in US corporate earnings is expected to be in the range of 6-8% which in our view is robust if achieved.
4. **Inflation:** Despite a slight increase in overall inflation over the last two quarters, we believe that currently inflation is contained.
5. **Consumers:** Consumer sentiment is at robust levels.
6. **Unemployment:** Employment and wages are at favorable levels for the economy to grow consistently.

CGAM's Proprietary Market Model:

Following is our proprietary Market Model, that we use to guide us in understanding the direction of the major market index; S&P 500. Our proprietary model was developed on the concept that investor behavior repeats itself based on a combination of fundamental parameters of the economy and human psychology. The model constantly reviews the change in the index based on the changes in statistically significant economic variables.

Fundamental Variables		Market Projections	*As of: April 14th, 2017*
S&P 500 Earnings	$145.00	S&P 500 (12 Month Projection) =	2,389.00
S&P 500 Expected PE Ratio	17.00	S&P 500 (*April 14th, 2017*) =	2,329.00
10 Treasury Bond Rate (%)	2.50%	***S&P 500 Estimated (Gain/Loss) =***	**+2.58%**
Inflation Rate (%)	1.70%	***Standard Error***	**+/- 5.80%**
Volatility (VIX) Index	16.00		
Unemployment (%)	4.60%		

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The objective of the model is to quantify these variables into a regression equation using four decades of historical data. The combination of these variables statistically explains 93-94% movement in the S&P 500 index.

As mentioned before in our previous issues, the major impact of the Trump tax reform would enhance US corporate earnings. We have incorporated the best possible scenario of corporate tax reduction and therefore increased the earnings projections of the S&P 500 companies from $140 to $145 in our model. This is almost 10-15% greater than the S&P 500 earnings since the Presidential Election in 2016.

In addition to earnings projections, we are using a PE ratio of 17 which is approximately 15% above the average PE for the last three decades. The rest of the variables haven't changed.

The inference this model makes are not very inspiring. The point we are trying to make is that despite increasing earnings and ebullient investor sentimet, we believe that the markets are overvalued. In case of any dissapointments from the Trump admnistation to move forward with some policy reforms or geopolitical uncertainties, the markets could correct and correct quickly.

Conclusion:

"Markets have an uncanny ability to surprise us constantly. We were surprised when Mr. Trump was elected as our President, despite the predictions from most polls against it. We were further surprised as the markets made new highs despite the predictions of market corrections in case Donald Trump became president.

We believe that it is prudent to harness history and not get carried away with the investing herd in believing that everything will be all right. Based on empirical evidence and estimations by our Market Direction Model, we believe that it is prudent to be cautious currently. We have been proponents of maintaining a reasonable level of cash reserves in portfolios since the beginning of the year. We believe that capital markets will provide patient investors with an opportunity to invest at better values, during interim market corrections".

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

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