Continuum Global Asset Mgt., LLC

April-May 2016

Newsletter

Our February-March 2016 Newsletter concluded with:

> ***"We continue to believe that this correction presents a good buying opportunity for investors with 12-18 month time horizon. Markets presents opportunities for investors who can bear intermediate term volatility and uncertainty and eventually rewards them with superior returns". February-March 2016.***

If we observe the market from just a gain or loss perspective for the first quarter of 2016, we would think that the quarter was an uneventful one. The truth is obviously far from this. The first quarter was filled with umpteen reasons which created significant volatility and distress in the markets. Even though most major stock market indexes ended the quarter flat to down slightly, most mutual funds and institutional managers underperformed the markets significantly.

It can be seen by the red arrow in the adjacent chart of the S&P 500, that the index lost almost -11%, and then gained 12-13% (black arrow) during the first quarter of 2016.

As mentioned in our previous Newsletter, the major factors behind this decline were the concern about the decelerating Chinese economy, the extremely low commodity prices and the uncertainty of the interest rate direction created by the US Federal Reserve.

It is surprising and somewhat ironic that the importance of these issues was diminished in the minds of investors within a few weeks subsequent to a serious market correction, which resulted in a healthy gain in the US capital markets.

17991 Lost Canyon Rd., Suite 138
Canyon Country, CA 91387

Manu Walia
Email: manuwalia@cgamadvisor.com
www.cgamadvisor.com

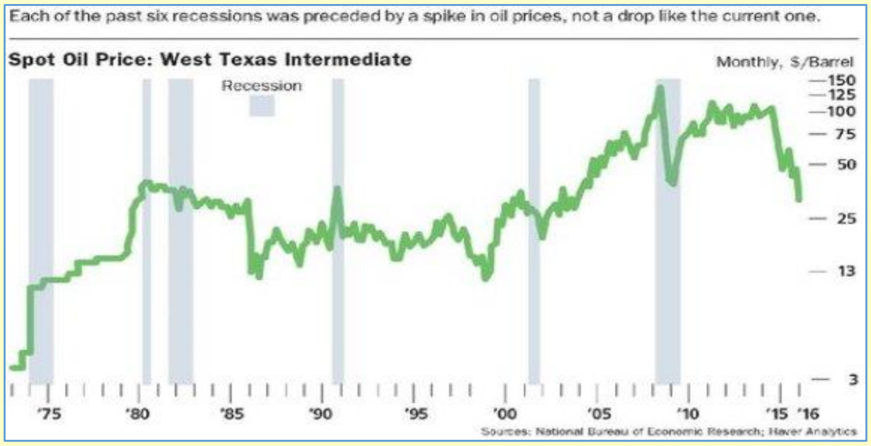
Office: 661-299-1920
Mobile: 661-312-2070

There were certain obvious events that created this V-Shaped turn around. The major factor which created this inflexion was the favorable rhetoric from the Federal Reserve. Janet Yellen (Chairwomen of the Federal Reserve) and Company indicated that the Federal Open Market Committee (FOMC) will be cognizant of not only domestic issues like inflation and unemployment but also global variables that could be affected by their actions pertaining to fiscal and monetary policy.

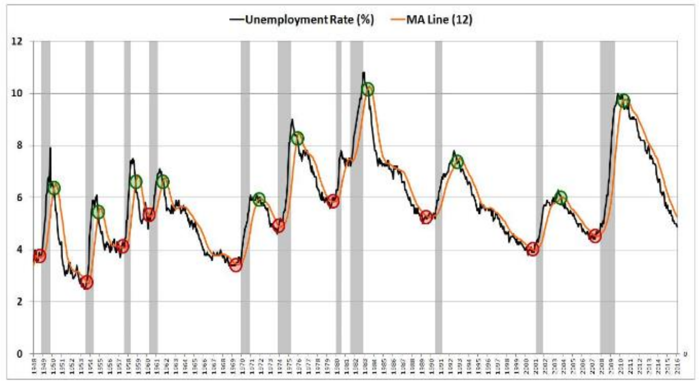
As always, it's not important what has happened in the past but the view of the future. We believe that crucial variables illustrated below will help guide us to the future of markets in the short and intermediate term.

1. **Interest Rates:** Interest rates are at historically low levels. This easy monetary policy has helped the economy recover from the major recession we faced in 2008-09. The Federal Reserve is cognizant of the support this accommodative policy has provided to the economic growth. In addition, inflation is contained and therefore the Federal Reserve is in no hurry to raise rates.

2. **Energy and its impact on Markets**[1]: The adjacent chart is self-explanatory. It clearly shows that the past 6 recessions in the US happened in conjunction with relatively higher oil prices. **This is not the case currently**. We believe that low gas and energy prices have resulted in higher disposable income for US consumers, which would propel the US growth over the next 12-18 months.

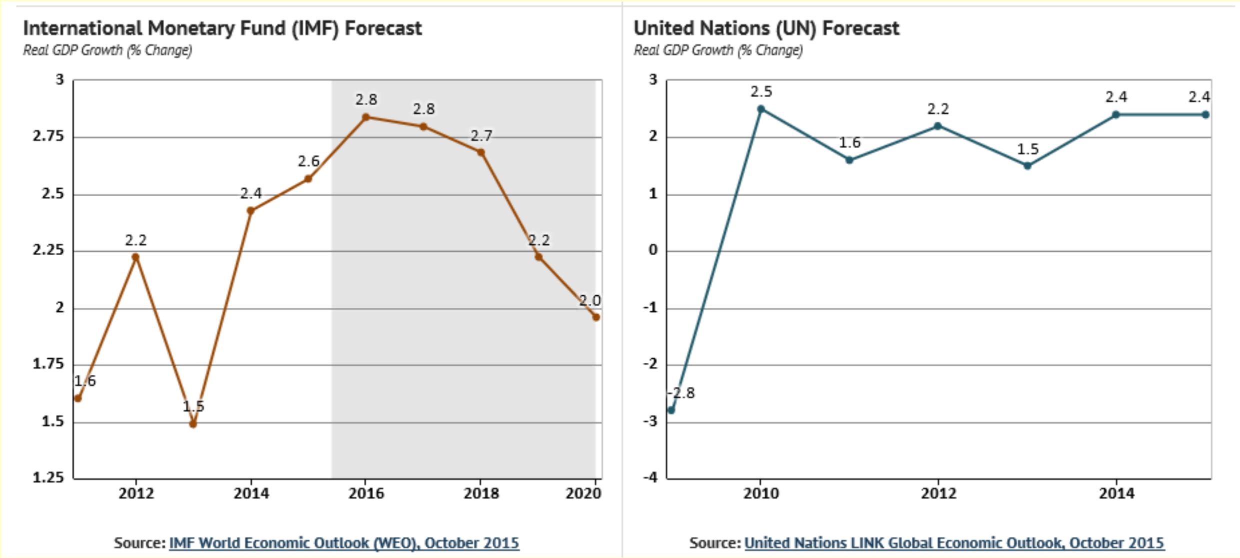


3. **Low US Unemployment Rate:** [2] The current unemployment rate in the US is 4.9%. In other words, we have created approximately 12 million jobs since the 2008-09 recession. In addition, we are experiencing increasing wages which would help increase the disposable income of US consumer. We need to remember that 2/3rd of the US economy is propelled by the retail consumer; who seems to be in healthy shape currently.



[1] Source: http://www.calamos.com/campaign/2015/Q1/outlook
[2] Source: http://www.philosophicaleconomics.com/2016/02/uetrend/

4. **US GDP:** The International Monetary Fund (IMF) and the United Nations expects the



global growth to be in the 2-2.4% range respectively. We believe that the US economy should grow at about 2.2-2.3% for the next 12 months as well. This would be a great accomplishment considering that the US is approximately $16 trillion. In addition, most other economies including the high growth emerging economies are showing signs of decelerating growth. This makes the US a favorable destination from a global investment perspective.

5. **The Dow Jones average has doubled approximately every 10 years** since the great depression of 1929. This was accomplished in tandem to an average yearly US GDP growth of approximately 3%. Even though we are below the 3% mark, the US GDP grew at about 2.1% in 2015 and is expected to grow between 2-2.5% for the next 12 months. If we used the Dow Jones Industrial Average (DJI) value since April 1996 (approx. 5,600: 20 years ago), we should value the DJI today in excess of 22,000, a 22% increase from the current levels. I am not recommending that we start investing based on this empirical valuation method only, but it does paint a bullish picture based on data spanning over 90 years.

6. **The propensity of our Society to spend:** Humans have certain inherent characteristics that govern the way we live and move forward in life. I promise that this is not a lecture on human philosophy but an understanding of how these innate qualities impact capital markets. I believe that the economy of any country, continent or geographic region is fueled by the consuming habits of its population. The more we consume, the more there is incentive for industry to innovate and produce and in the process improve the standard of living of its inhabitants. It seems to me that the era we live in is marked by not only satisfying our basic food, shelter and clothing needs but also a strong desire that characterizes us appropriately;" Keeping up with the Jones". Philosophy aside, this phenomenon has propelled the US economy to approximately $16 trillion today.

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www.cgamadvisor.com
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Mobile: 661-312-2070

That's good for the markets. The problem is that our society of "CONSUMED" is based largely on debt, which we all know can last for only so long. An average American has -$15,762[3] on credit card debt as of the end of 2015. I believe that the US population is blinded by media that continues to instill insecurity in us compelling a need to fill that with material things that we may or may not need. In any event, this is good for the markets. Combined with low energy prices, low interest rates and a will to spend, I believe that the US consumer will continue to spend and worry about their debts later.

CGAM's Proprietary Market Model:

We now turn towards CGAM's proprietary market model that has been developed to project the S&P 500 index over the next 12 months. The model is based on the concept that investor behavior repeats itself based on certain 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. The objective is to quantify these variables into a regression equation based on four decades of historical data. The combination of these variables explains almost 93-94% movement in the S&P 500 index.

Fundamental Variables (12 month Projections)		**Market Projections** ***Based on the regression equation illustrated below***	***As of: April 15th, 2016***
S&P 500 Earnings	$127.00	S&P 500 (12 Month Projection) =	2,200.00
S&P 500 Expected PE Ratio	17.00	S&P 500 (April 15th, 2016) =	2,081.00
10 Treasury Bond Rate (%)	1.80%	***S&P 500 Expected (Gain/Loss) =***	**+5.69%**
Inflation Rate (%)	2.10%	***Standard Error***	**+/- 5.82%**
Volatility (VIX) Index	14.00		
Unemployment (%)	4.90%		

S&P 500 (12 Month Estimate) = 888.017+11.34 x (S&P Earnings) +21.18 x (S&P Price Earnings Ratio)-32.98 x (Treasury Bond Rate{10 yr})-47.60 x (Consumer Price Index)+9.50 x (VIX; Volatility Index)-94.50 x (Unemployment Rate)+St. Error.

Following are the changes and the inference of our model based on the recent developments in the capital markets:

1. 12 month earnings expectation for the S&P 500 companies is $127[4]. We have factored deceleration in earnings primarily due to the result of the ailing energy

[3] Source: https://www.nerdwallet.com/
[4] Source: CGAM, LLC estimates.

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sector. The S&P 500 earnings would have grown at about 4.5% rate, year over year, excluding energy.

2. The Volatility Index (VIX) is a fear gauge for the markets. It is calculated using PUTs and CALLs on the S&P 500 index and indicates how concerned investors are in the short to intermediate term about the market volatility. VIX has declined from about 25 during the hight of the market correction to about 14 currently. Our model has shown increasing negative correlation of the market indexes with the VIX. In addition, empirical evidence shows that the VIX level of 25 and above indicates a buying signal and sell signals below 11-12, from a contrarian perspective.
3. Our projections guide us to believe that markets could gain another 5-6% over the next 12 months with an error rate of 5-6% for our model. No one is perfect!!!

CONCLUSION

Markets have recovered impressively since the 10%+ correction experienced in January-February this year. We believe that the markets are still in a bullish mode and could continue their assent if corporate earnings show promise. Having said that, the volatility index is indicating complacency in the markets. CGAM's proprietary model is projecting a 5-6% gains over the next 12 months if earnings grow by 5-7%. The US economic growth may well accomplish this task, but the contrarian fabric in us at CGAM believes that this is not the time to buy. We would be inclined to raise cash in growth portfolios to approximately 10% and continue to hold onto quality companies. Investors will be served well by waiting for an interim correction to add to their portfolios.

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

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Please review the following disclaimer

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