Our June-July 2016 Newsletter concluded with:

> **"We believe that the markets are attempting to find a direction under the presence of improving US economic fundamentals. Fortunately, the markets have experienced great gains over the last 7 years since the great recession of 2008-09. We believe that the markets should break out on the upside and reward patient investors. We do not see an interim correction based on the parameters described in this Newsletter and would encourage investors to maintain their portfolio positions; especially in the Financial and energy sectors."** ***June-July 2016.***

At CGAM we believe that investor psychology is as important as the economic fundamentals in evaluating the direction of Capital Markets. Below is a chart[1] that clearly illustrates the major gyrations the S&P 500 index has experienced over the last 2 years.

The chart may not show the extent of the significant fluctuation the markets experienced over the last two-three weeks since Britain's referendum, resulting in a vote to exit the European Union. The markets lost over 6% in two days and then gained approximately 8% over the next 2 weeks (June 14th-July 7th, 2016). This 13-14% net fluctuation was a result of uncertainty created by investor sentiment and not necessarily any changes in global or domestic fundamentals.

[1] Source: www.yahoofinance.com

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As mentioned in our previous Newsletters, we believe that the Volatility Index (VIX), a measure of the fear in the markets, is a reliable contrarian indicator. The VIX Index, a fear gauge for the markets, is calculated using PUTs and CALLs being bought on the S&P 500 index. If investors buy more Puts than Calls then the Fear gauge moves up and vice verse. It indicates how concerned investors are in the short to intermediate term about the market volatility.

In addition to the chart illustrating the US major stock index, below is a chart[2] exhibiting the Volatility index (VIX), for a span of previous 2 years. It can be seen that the VIX index has fluctuated between a band of 12-12.5 on the lower end and 24-25 on the upper end.

The VIX index moved to the higher end (approximately 25 level) after British vote to exit the European Union. This was in unison to the market losses of over 6% in two days. Subsequently, as mentioned above, the markets recuperated all its losses and went on to make new highs. This was coupled with the VIX index declining to a current level of approximately 13, which is closer to the lower end.

We do not believe that the VIX index is the only technical variable to be considered in evaluating the direction of the markets but definitely a crucial one. As we believe VIX to be a contrarian indicator; a low value indicates investor complacency whereas a higher value points to irrational and undue fear based on emotions. We have quantified the VIX index as one of the six important variables in our proprietary model described below.

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 a combination of 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.

[2] Source: www.yahoofinance.com

The objective of the model is to quantify these variables into a regression equation based on four decades of historical data. The combination of these variables statistically explains 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: July 14th, 2016***
S&P 500 Earnings	$127.00	S&P 500 (12 Month Projection) =	2,228.00
S&P 500 Expected PE Ratio	17.00	S&P 500 (July 14th, 2016) =	2,168.00
10 Treasury Bond Rate (%)	1.50%	***S&P 500 Estimated (Gain/Loss) =***	**+2.50%**
Inflation Rate (%)	1.70%	***Standard Error***	**+/- 5.74%**
Volatility (VIX) Index	13.00		
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 has been reduced by approximately 2-3% to $127[3]. Even though we believe that the energy and financial sectors will benefit the entire index from an earnings perspective, the overall S&P 500 companies have experienced a deceleration in earnings growth.
2. VIX has declined from about 25 during the hight of the market correction (subsequent to the Britain referendum to exit the Euopean Union: June 24th, 2016) to about 13.5 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 2-3% over the next 12 months with an error rate of 5-6% for our model.

CONCLUSION: We believe that the United States is one of the strongest economic regions in the world currently. With the US GDP expected to grow at approximately 2%, unemployment at 4.6-4.7% and wages rising, we are in a sound economic position. Having said that, US market indexes have moved up significantly in a short period of time. Market do not go up of down in a strainght line. From a technical perspective, we believe that investors should raise cash with a perspective to wait for an interim technical correction which would then be an opportunity to invest at lower values.

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

[3] Source: CGAM, LLC estimates.

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