Our July-August 2017 Newsletter concluded with:

"We believe that markets remain in an overvalued situation. Most investors seem to like the new administration, despite the slow progress in some key issues like healthcare and tax reform. On the other hand, corporate earnings are rising at a brisk pace. If corporate earnings and guidance is healthy, the markets can continue their assent for sometime. We still believe and recommend having 15-20% of one's portfolio in cash. This would provide an opportunity to invest during interim market corrections". ***July-August 2017.***

The broadest US stock market index, the S&P 500 index has gained approximately (2,526 to 2,870) +13% and corrected (2,870 down to 2,700) -6% since we published the August 2017 issue. Other major indexes, like the Dow Jones Industrial Average and the Nasdaq have also gained and corrected similarly for the same time horizon.

The Fear gauge: Chart 1, which was published initially in our previous Newsletter, illustrates the correlation between the S&P 500 index and the VIX for the last 10 years. It can be clearly observed that VIX and the S&P 500 index (solid red line) have a negative correlation. The noticeable spike in the center of the chart was during the peak of the 2008-09 recession.

Chart 1[1]

We believe that low level of VIX indicates complacency in the market, which is a contrarian indicator. The low level of the VIX index guided us to believe that investors were complacent and led us to believe that markets could be headed for an interim correction.

The week of January 29th – February 2nd, 2018 has experienced a 3-3.5% market correction. Chart 2, presented on page 2, exhibits the VIX level currently. It can be

[1] Source: www.yahoofinance.com

observed that the VIX has spiked from a low of approximately 9 during the beginning of the year to approximately 24 currently (February 5th, 2018); a 160% gain.

Chart 2[2]

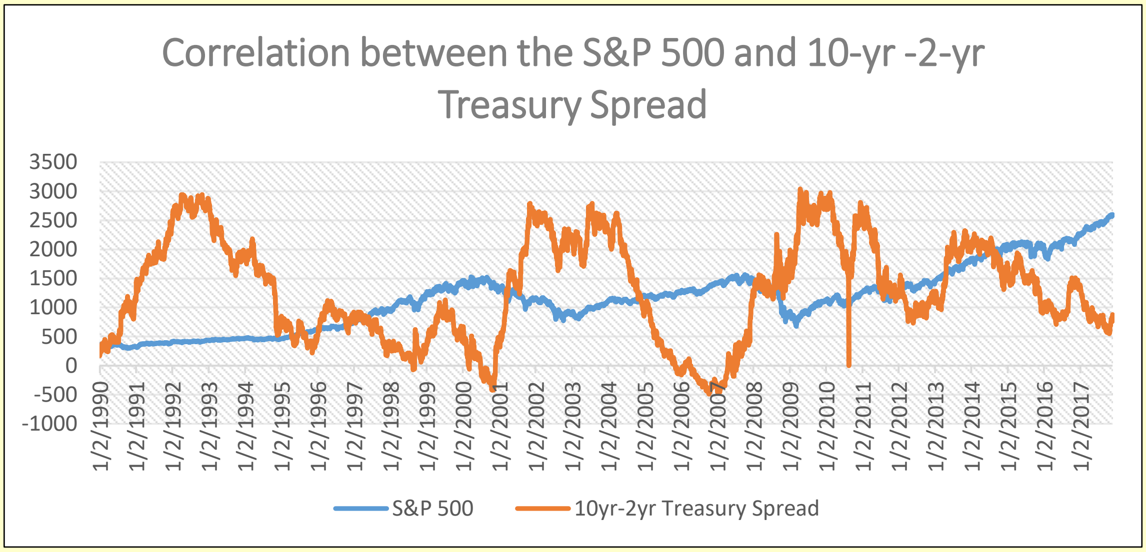
Earnings and Revenues: So far, approximately half the companies in the S&P 500 have reported financial results for the first quarter of 2018. Earnings and Revenues grew 15% and 8% respectively year over year. This is a great accomplishment for the economy as corporate earnings are the mother's milk for the capital markets. I believe that the fundamental reason for earnings growth has been the accommodative monetary and fiscal policy by the Federal Government, that was initiated after the 2008-09 housing and financial crisis the and the rest of the world faced. In addition, we also believe that the tax reform implemented by the Trump administration has created an optimism on Wall Street. We believe that the impact of corporate tax cuts and repatriation of capital for US companies would increase earnings by approximately 10-15%. We have incorporated the earnings expectations into our proprietary market direction model below.

The Yield Spread: The adjacent Chart 3 has been developed by the Federal Reserve, using the difference between the 10-year treasury bond rate and the 2-year Treasury Bill. It can be observed that this spread has preceded to narrow before recessions.

Chart 3

[2] Source: www.yahoofinance.com

Currently (Feb 5th, 2018), this spread is approximately 0.62%. This yield has come down from a delta of 1.20% down to 0.62%. It's important to recognize that there is a reason for this yield to narrow. Both the 2-year and the 10-year bond has experienced an increase in their respective yields (this happens when investors expect the federal government to increase rates and therefore sell their long bonds with current yields in hope to buy bonds with higher yields). It is important to recognize that even



though the yield of both the 2-year and the 10-year bond have increased, it's the 2-year bond that has seen a relatively higher yield increase than the 10-year bond. It may be early to make a definitive inference, but this trend should not be taken lightly. We are not predicting a recession but are pointing to this important observation and will continue to monitor it for further developments in regard to the US economic growth.

CGAM's Proprietary Market Model:

Our proprietary Market model helps to guide us in understanding the direction of the market. We have used the S&P 500 index as the proxy for the US broad based markets. Our proprietary model was developed on the belief that investor behavior repeats itself based on a combination of fundamental parameters of the economy and human psychology. The model is dynamic as it constantly reviews the change in the index based on the changes in statistically significant economic variables.

Fundamental Variables		**Market Projections**	***As of: Feb 2nd, 2018***
S&P 500 Earnings	$160.00	S&P 500 (12 Month Projection) =	2,704.00
S&P 500 Expected PE Ratio	18.00	S&P 500 (Feb 2nd, 2018) =	2,712.00
10 Treasury Bond Rate (%)	2.80%	***S&P 500 Estimated (Gain/Loss) =***	***-0.29%***
Inflation Rate (%)	1.50%	***Standard Error***	**+/- 5.27%**
Volatility (VIX) Index	24.00		
Unemployment (%)	4.20%		

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

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.

We believe that the impact of the Trump tax reform could enhance US corporate earnings for the next 18-24 months. We have incorporated the best possible scenario of corporate tax reduction and increased the earnings projections of the S&P 500 companies from $140 to $160 (an approximately 10-15% earnings growth).

In addition to earnings projections, we are using a Price Earnings (PE) ratio of 18, which is approximately 15-17% above the average PE for the last three decades. In addition, the Volatility Index (VIX) has increased from approximately 9-10 during the month of September 2017 to 24 currently. In our view this illustrates growing fear (at 52 week high) which go hand in hand with technical corrections in the markets. As mentioned before, we believe that during bullish market phases, a level of 20-25 on the VIX is a good contrarion indicator for investors to start considering opportunities in the equity markets.

The 12 month market projection derived from our model doesn't instill confidence. Accordinng to our model, markets are a bit over-valued at 2018 projected corporte earnings and other valuation parameters. As we have mentioned before, finance is not an exact science as human sentiment trumps every model.

Conclusion:

Markets have corrected by approximately 6% as of Feb 5th, 2018, from its highs. We have believed that markets have been due for a correction since mid-2017. The delimma remains whether the corporate earnings will continue to bolster the bullish market trend or the increasing rates will debilitate the markets and results in a recession. As mentioned before, the Federal government is cognizant and sensitive to this phenomenon. We believe that a technical correction of 5-7% (another 1-2% correction) provides a good opportunity and its prudent to start investing gradually in equities for investors who have had 15-20% cash as recommended in our previous Newsletters. We would still allow approximately 10% cash in a growth portfolio for further corrections later this year.

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

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

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Please review the following disclaimer

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