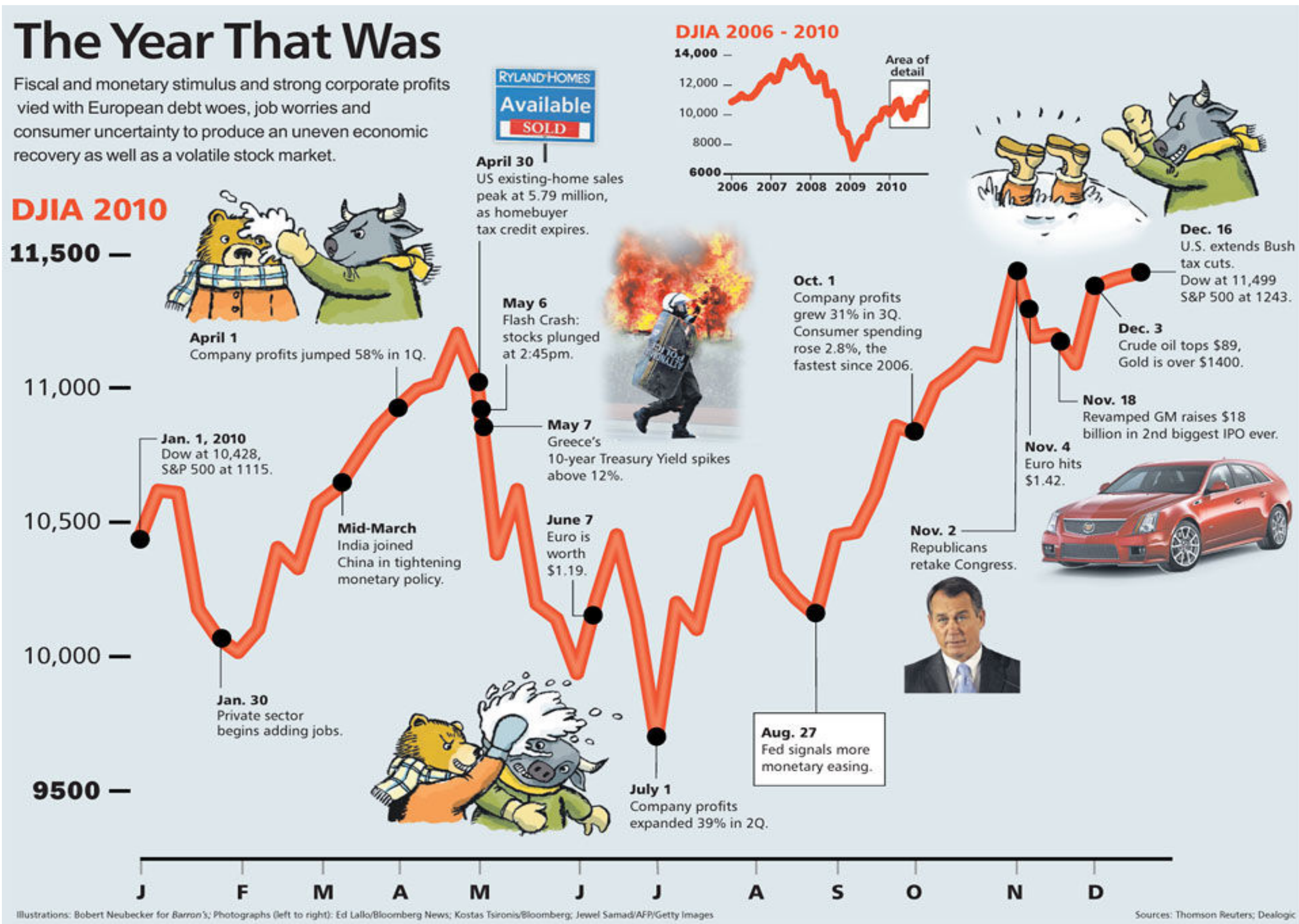
Continuum Global Asset Mgt., LLC

January 2011

Newsletter

A PICTURE SPEAKS LOUDER THAN WORDS!!!



After all said and done, the major market indexes ended up gaining approximately 11-12%. The NASDAQ edged out 17-18% return and Russell 2000 (small company index) returned an eye popping 26% for the year 2010. Despite these impressive returns, the year was filled with drama and uncertainty which is illustrated well with the figure above.

We will all agree that capital markets are a reflection of the economy. Year 2010 and especially the last quarter has projected a genuine turn around in the economic conditions. With an exception of employment situation and the housing sector, major economic indicators are pointing towards US economic recovery. We at CGAM have been proponents of allowing economic indicators show us the market direction. Therefore, the following section illustrates our view and process that determines market valuation and expectations over the next 12 months.

The following Table 1 is a representation of 10 very smart economists (oxymron: smart and economists) and their projections for the S&P 500 corporate earnings, the S&P 500 index expected value and the GDP gains for the Fiscal Year 2011.

Chart Source: www.fidelity.com

In addition, we have provided a table above that provides the variations in these projections. It can be observed that the range is sinificant. For instance, the highest S&P 500 projected value is about 16% higher than the lowest projected value and about 5% above the average projected value.

Max Projected S&P 500 Target Value Projected	1450
Max Projected S&P 500 Profit Value ($)	98
Max Projected GDP Growth Expectation (%)	4.00%
Min Projected S&P 500 Target Value Projected	1250
Min Projected S&P 500 Profit Value ($)	88.5
Min Projected GDP Growth Expectation (%)	2.70%
Average Projected S&P 500 Target Value Projected.	1394
Average Projected S&P 500 Profit Value ($)	93.78571
Average Projected GDP Growth Expectation (%)	3.39%

Readers may remember our S&P 500 earnings projections of $75 for the forward looking 12 months in the **March 2010 Newsletter**[1] issue. In addition we increased our earnings estimate to $85, for the S&P 500 companies for the fiscal year 2011. We also strongly believe that the ***PERCEPTION*** of earnings growth is more important for markets than any other variable. It is true that earnings will follow the GDP growth of an economy, which is also projected to do well over 3% for the next 12 months.

The most important concept to understand is that earnings growth is a comparitive measure and market participants are continually comparing them to last quarter and the prior year. It is natural that momentum in earnings growth cannot continue for ever and at some point the actual corporate earnings should diminish. Once this happens, markets should correct based on the deceleration of earnings growth for the forseeable future.

Following is our endeavor to project the S&P 500 for the next 12 months:

Earnings Growth and S&P 500 valuation based on historical Price Earnings multiple

S&P 500 Earnings (2008)	$49.51
S&P 500 Earnings 2011 (Estimate)	$94.00[2]
S&P 500 Index Value as of Dec 31st, 2010	1256.77

	82 Year Average	50 Year Average	25 Year Average
Average P/E	16.00 (rounded up)	17.00	21.00
Projected S&P 500 Valuation	**1,504.00**	**1,581.00**	**1,953.00**

1. Our model uses the average Price to Earnings multiple, usually used to value the market indexes.
2. Price to Earnings Ratio data derived from www.ndr.com. This data is taken for the last 82, 50 and 25 years for illustrating the range of the S&P 500 index valuation.

[1] *Source: http://cgamadvisor.com/wp-content/uploads/2009/06/CGAM-Newsletter-March-20101.pdf*
[2] *Source: Average Projected S&P 500 earnings based on Figure 1, www.Barrons.com*

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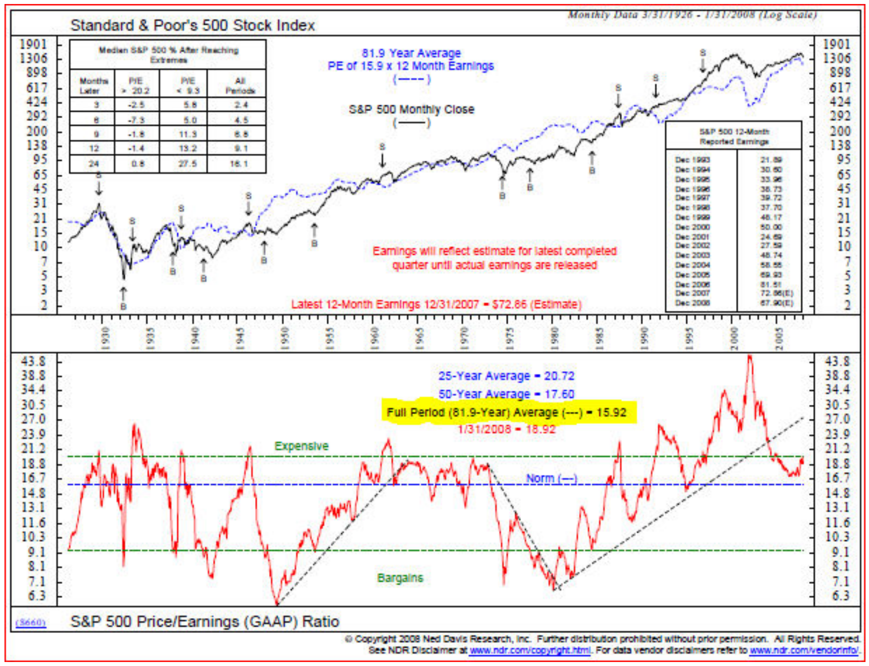
Figure 1[3]



It can be observed in the adjacent Figure 1, that based on investor sentiment *(which translates into different P/E multiple)* we have different values of the S&P 500 index exhibited in the table above (Pg 2 of 4). In other words, at a reasonable P/E ratio of approximately 16-17, we can expect the S&P 500 **to appreciate by 19-25% respectively for the next 12 months with $94 in corporate earnings estimate.**

This seems great, but the basic problem with statistics is that it is based on assumptions. Assumptions can always be rationalized based on human behavious; optimism and pessimism.

At this stage of the economic recovery one can twist and turn, squeeze and churn statistics to prove ones case. But we can not forget the importance of negative events, and their emergence at the most unexpected times.

The problem with projections is that a lot of variable have to fall in place for the projections to come to fruition. Therefore, projecting a market value 12 months in advance is like rolling the dice. There are so many factors which include, political, geo-political, natural calamities, currency fluctuations, weather conditions etc that impact any economy.

If we consider major economic indicators like GDP growth, the stock markets movement, Corporate earnings growth, inflation, interest rates (cost of capital) etc., we will realize that there is pertinence in believing in the economic recovery. Having said that, we should not forget that earnings growth (the primary driver of US economy) can not and will not grow infinitely. Therefore, if we discount the 2011 earnings and project their growth at 10% per annum, we will derive $80-85 earnings for the S&P 500 companies. If we use a conservative estimate of 16-17 times corporate earnings, we derive 1280-1360 for the S&P 500 index for the Fiscal Year 2011. ***In other words, the market could be fairly valued at actual $80 in earnings for FY 2011 and may have another 7-8% gain if earnings can achieve an $85 level.***

We encourage investors to pay attention to valuation on specific securities and be prepared to harness profits in case the economy faces headwinds in 2011. Areas we favor include: Healthcare, Financials and Industrials. We would also recommend that aggressive investors consider hedging their portfolio with Treasury Inflation Protection Securities (TIPS), and reduce exposure to US bonds.

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

[3] *Source:* www.ndr.com

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