Continuum Global Asset Mgt., LLC

January-February 2012

Newsletter

2012 has started at a positve note for the capital markets and the gains in broad based indexes for the month of January 2012 are in the range of 4.5-5%. As always, the question remains about the future. Even though markets move based on investor behavior and sentiment, this sentiment is influenced by the fundamentals of the economic variables. Variables which include corporate earnings, inflation, dividends, cost of capital, the unemployment rate etc.

Illustrated below is the market model we have developed and use to project the potential gain or loss in the S&P 500 index over the next 12 months. It can be observed that seven variables have been used to develop this model stated below. We have also illustrated the regression equation developed based on 4 decades of historical data.

Table 1[1]

(Data from September-October 2011 Newsletter)

Fundamental Variables		Market Projections	
S&P 500 Earnings	$ 85.00	**S&P 500 (Projection) =**	**1,267.21**
S&P 500 PE Ratio	14	**S&P 500 (Current) =**	**1,165.00**
S&P 500 Dividend Yield (%)	2.2	***S&P 500 (Gain/Loss) =***	***+8.75%***
Treasury Bond Rate (%)	2		
Inflation Rate (%)	3.1		
VIX Index	35		
Unemployment (%)	9.5		

S&P 500 (Estimate) = 594.83+4.3x(S&P Earnings) +33.55x(S&P PE)-33.63x(S&P Div Yield)-94.89x (Treasury Bond Rate) +20.84x (CPI) +4.13x (VIX Index)-11.55x (Unemployment)

Table 1 was initially illustrated in our September-October 2011 newsletter which projected an approximately 9% gain for a 12 months time horizon. Subsequently, we reiterated our market projection in our December 2011 Markets Write up, which is illustrated below in Table 2. It can be observed that the projections changed slightly despite an increase in the index's value from 1,165 in October to 1,225 in December; a 5% gain.

Table 2

(Data from December 2011 Market Write-Up)

Fundamental Variables		Market Projections	
S&P 500 Earnings	$ 100.00	**S&P 500 (Projection) =**	**1,364.25**
S&P 500 PE Ratio	15	**S&P 500 (Current) =**	**1,225.19**
Treasury Bond Rate (%)	2.5	***S&P 500 (Gain/Loss) =***	***+8.69%***
Inflation Rate (%)	3.2		
Volatility (VIX) Index	25		
Unemployment (%)	8.5		

It is important to note that the assumptions in Table 2 changed as well. It can be observed that the S&P 500 earnings increased from $85 (Table 1) to $100 (Table 2); a 17% increase. Also, the Price / Earnings multiple increased to 15 from 14; a 7% increase. In other words, the market sentiment has improved since the 4th quarter 2011.

[1] Data Source: Various Analyst estimates, CGAM's estimates

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As market forecasters, we have the privilege to fine tune earnings estimates, if we believe that the US economy could continue to improve and the overall investor sentiment improves in tandem. The main reason for the improvement in market sentiment and earnings was pointed out by a respected professional. He reminded me that capital markets can induce a sense of comfort and exuberance in us which could results in a higher level of spending, hence catalyzing economic growth. In other words, an improving market sentiment could be a self fulfilling prophecy.

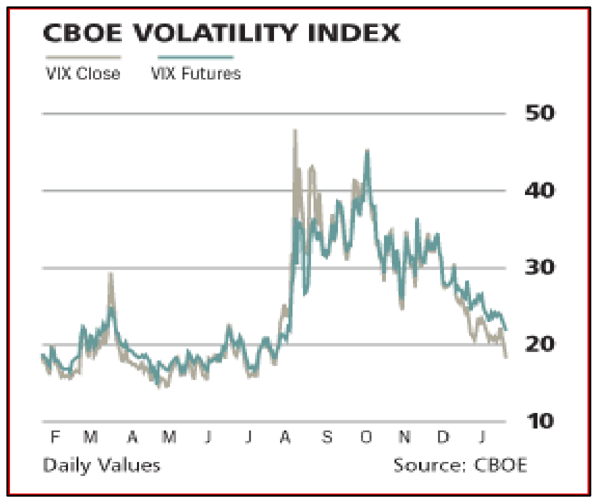
If the economy continues to improve, we believe that the S&P 500 companies can produce earnings of approximately $110 for 2012. At a historical average of 15 Price Earnings ratio, we can expect a gain of approximately 5-6% for the S&P 500 index for the next 12 months. **Despite, our semi bullish outcome of the markets, we remain skeptical** and therefore would like to introduce technical variables that may compel us to consider a not such a bullish scenario for the near term.

Following are crucial technical variables that we have considered in addition to the fundamental variables mentioned above, to gauge current investor behavior:

1. Volatility Index (VIX)
2. PUT / CALL Ratio
3. Short Positions
4. Prevailing Bullish Sentiment

1. Volatility Index (VIX):

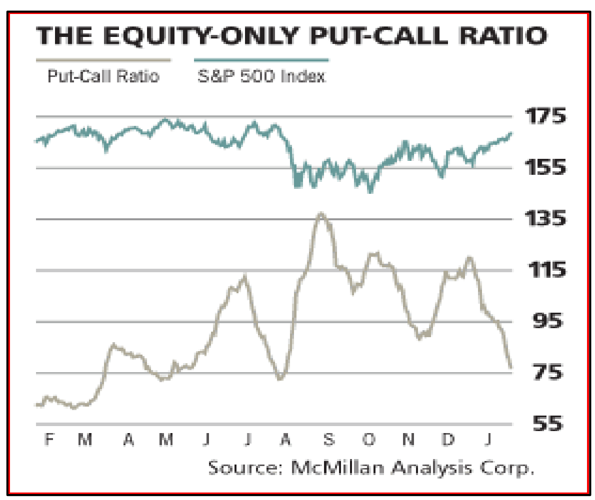
The CBOE volatility index was developed to gauge investor fear or complacency. The index is calculated using Puts (Protection in case markets decline) and Calls (bullish contracts) on the S&P 500 index. As the markets rise and investors exhibit bullish sentiment, fewer Puts are bought for portfolio protection and vice verse more Calls are bought. Bullish behavior lowers the volatility and vice verse. It can be observed that the VIX index is trading at relatively low levels historically. We believe that the VIX is a contrarian indicator and hence is showing complacency in the market sentiment. Markets can continue their accent but corrections happen invariably even during long bull markets. We therefore believe that the VIX index is indicating a short term correction.



2. PUT / CALL Ratio:

The PUT/CALL ratio exhibits the bullish or bearish sentiment of the investing population. The adjacent Equity Put-Call Ratio chart clearly shows that this ratio is inversely correlated to the S&P 500 index. It can be observed that the Put/Call ratio was at a relatively high level at the beginning of 2012; a bullish contrarian indicator. Since then, the markets have gained approximately 5%. During this period, the Put/Call ratio has plummeted to relatively low levels; a bearish contrarian indicator.

We therefore believe that the markets are ready for an interim correction based on increased complacency in the market.



3. **Short Positions:**

The concept of shorting comprises of borrowing shares of a company from a broker and then selling the stock in the open markets. The borrower of the stock keeps the cash from the sale but is also responsible for returning the borrowed stock to the owner. The borrower is hoping that the borrowed stock price will decline so that the stock can be purchased at a lower price and returned, profiting from the difference between the initial sale (higher) price and the purchase (lower) price.

Currently, the aggregate short positions in the markets are at relatively low levels. In other words the recent rally could have been aided by significant short covering. Again, as a contrarian indicator, we believe that bears can start to increase their short positions which could derail the market momentum in the short term.

4. **Prevailing Bullish Sentiment:**

The adjacent table illustrates the current consumer sentiment in terms of how bullish or bearish, individual and institutional investors feel. It can be observed that Consensus Index and the AAII Index (American Association of Individual Investors) shows higher percentage of bullish sentiment on a relative basis. In other words, as the market indexes gain value, the average investor starts to feel more bullish. As more investors feel bullish, they tend to invest more in risky assets like stocks. As this sentiment grows fewer investors are left to continue to invest in the markets. Therefore, we believe that a higher percentage of bullish sentiment is a contrarian indicator and could be a prelude to an interim correction.

INVESTOR SENTIMENT READINGS

High bullish readings in the Consensus stock index or in the Market Vane stock index usually are signs of Market tops; low ones, market bottoms.

	Last Week	2 Weeks Ago.	3 Weeks Ago
Consensus Index			
Consensus Bullish Sentiment	71%	69%	68%

Source: Consensus Inc., P.O. Box 520526,Independence, Mo.
Historical data available at (800) 383-1441. editor@consensus-inc.com

	Last Week	2 Weeks Ago.	3 Weeks Ago
AAII Index			
Bullish	48.4%	47.2%	49.1%
Bearish	18.9	23.6	17.2
Neutral	32.7	29.2	33.7

Source: American Association of Individual Investors,
625 N. Michigan Ave., Chicago, Ill. 60611 (312) 280-0170.

We have changed our bullish stance to one more cautious for the short to medium term. We believe that the market has already discounted a reasonable growth in US corporate earnings. Despite the improving economic indicators, we believe that the markets could correct in the near term as the markets have made a significant run up since the beginning of 2012. Despite our short term outlook, we believe that the broad based indexes could gain 8-9% over the next 12 months.

To summarize, despite being bullish over the next 12-18 months, we think that it would be prudent to wait for an interim correction to initiate fresh investment positions. It is reasonable to say that during a correction, stocks with high beta (higher volatility) can loose 2 to 3 times the market loss. In other words, an interim correction can hurt an average portfolio significantly more than the average market loss. It would be therefore prudent to raise cash in order to take advantage of an opportune time to rebuild a portfolio.

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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