Continuum Global Asset Mgt., LLC

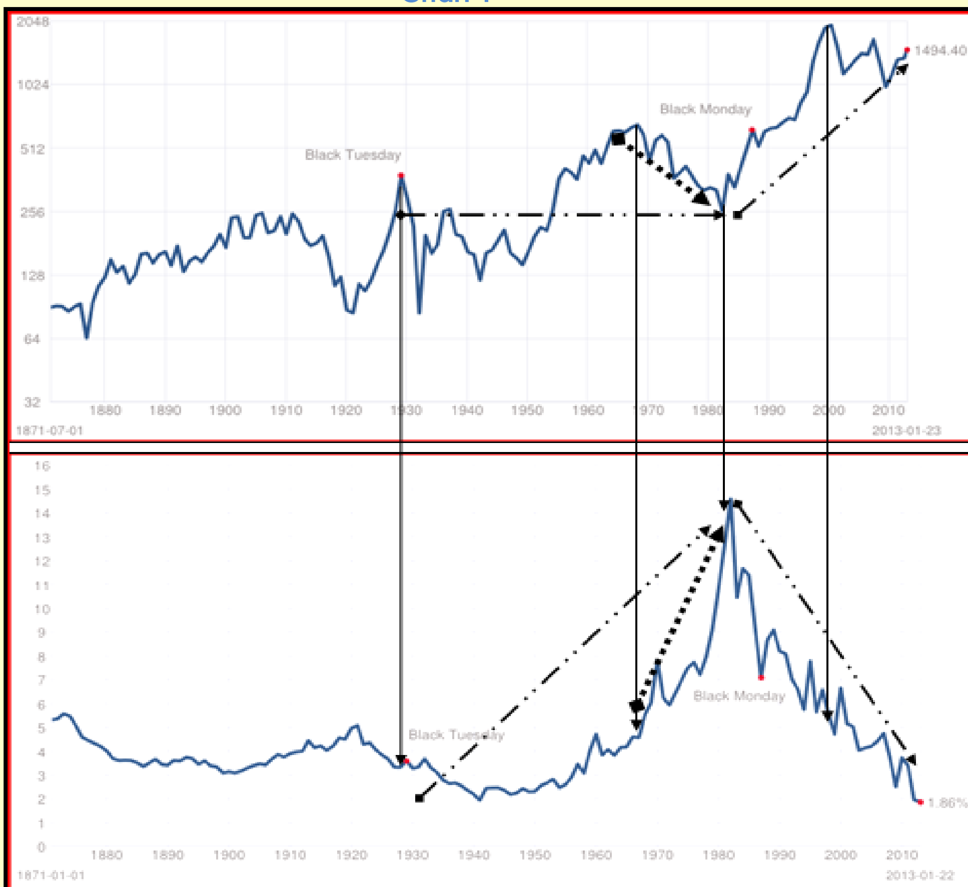
January-February 2013

Newsletter

The capital markets experienced a great 2012, with average broad based indexes gaining double digit returns. This ascent in the capital markets was particularly surprising in light of the European debt issue, the uncertainty due to US Presidential elections and the fiscal policy isses.

The US and global capital markets have experience extreme turbulence and volitility for the last decade. Markets have experience major bullish and bearish periods during this time to end almost flat for since 2000. The value of the S&P 500 index was 1,469 on January 3, 2000 and is currently at 1,494; a gain of 1.70%. Based on these surprising facts, we decided to undertake analysing markets from a longer term perspective and infer how market cycles work.

Chart 1[1]



The adjacent chart is a combination of the S&P 500 index movement (at the top) along with the yield on the 10 year treasury. We have used data dating back to 1871 as we wanted to get a longer term perspective on how markets react to the cost of capital. WE have used the the 10 year treasury as a crucial variable as it is a proxy for the rates that pertain to major dimensions of business; for example rates on mortgages, business loans etc.

It can be clearly observed that the markets have an inverse relationship with

[1] Data Source: www.multpl.com

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the movement of the 10 year yield. There are certain blatant patterns that can be observed in this chart. We would like to bring the reader's attention to the time horizon that ranges between 1930 and the current year. The interest rates in the 1930s were at approximately the same level that they are now. From 1930s to early 1980s the rates continually moved in an upwards direction. Even though there were prolonged periods that the markets gained significantly, ultimately the markets ended flat (inflation adjusted) for the period of 1930-1980. Subsequently, rates started to decline. The 10 year treasury yield declined from a high of approximately 14% to a current yield of 1.7-1.8%. during this time, the S&P 500 index gained 1,200%. If we analysed this concept on a shorter time horizon, we will find periods that buck this trend. For instance, even though rates have been declining since the year 2001, the markets have been primarily flat for the last decade. We believe that the cost of capital or the prevailing interest rates are very important in understanding the state of the economic cycle.

We have used our proprietary model to gauge the direction and the magnitude gain or loss we believe the markets could experience over the following 12 months. This model was based on regressing the data of major market variables for the last three decades. Based on the observations of the regression analysis we derived the most important variables consistently impacting the movement of the index.

Fundamental Variables		**Market Projections**	
S&P 500 Earnings (12 month Projections)	$ 105.00	S&P 500 (Projection) = ***Based on the regression equation illustrated below***	1,584.34
S&P 500 Expected PE Ratio	16	S&P 500 (Current) =	1,495.00
10 Treasury Bond Rate (%)	2.00%	***S&P 500 (Gain/Loss) =***	***+6.06%***
Inflation Rate (%)	3.0%		
VIX Index	12		
Unemployment (%)	7.5%		

CGAM Market Model Equation

S&P 500 ***(12 Month Estimate) =*** ***927.80+10.77 x (S&P Earnings)+20.68 x (S&P Price Earnings Ratio)-35.90 x (Treasury Bond Rate{10 yr})-44.68 x (Consumer Price Index)- 9.89 x (VIX; Volatility Index)-95.77 x (Unemployment Rate)+St. Error***

It can be observed that we have used the 10 year Bond Rate as one of the variable in projecting the S&P 500. Even though we believe that over the next 2-3 years rates will start to move higher, the current rate warrents the markets to continue this rally.

In addition to the fundamental variables like the 10 year treasury, we have also incorporated a technical variable known as the Volatility index (VIX Index). The VIX index is a gauge of fear in the market in layman's terminology. Another technical variable that shows whether the markets are overbought or oversold is known as Stochastics. We are revisiting this variable below in cotext to the broad based indexes.

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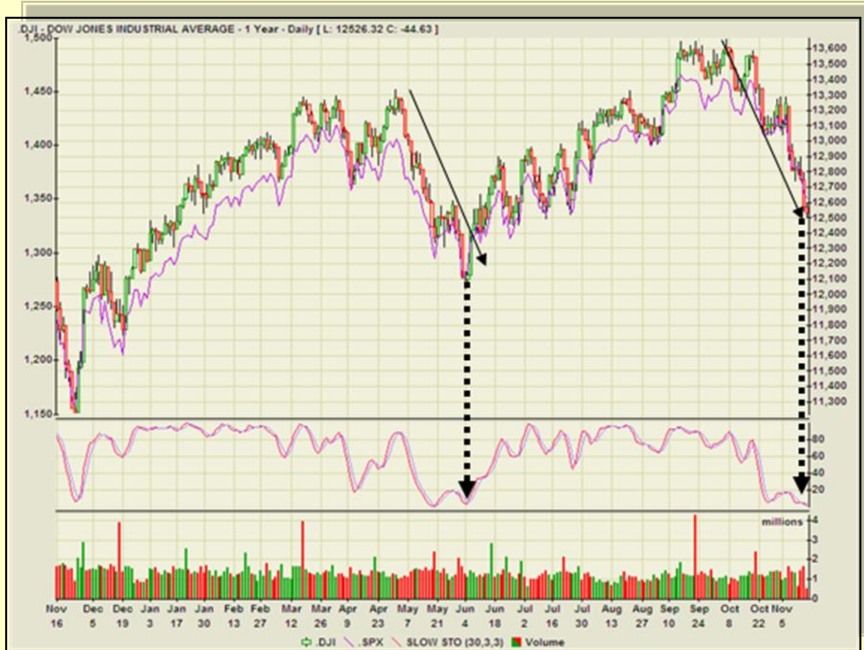
Chart 2[2]



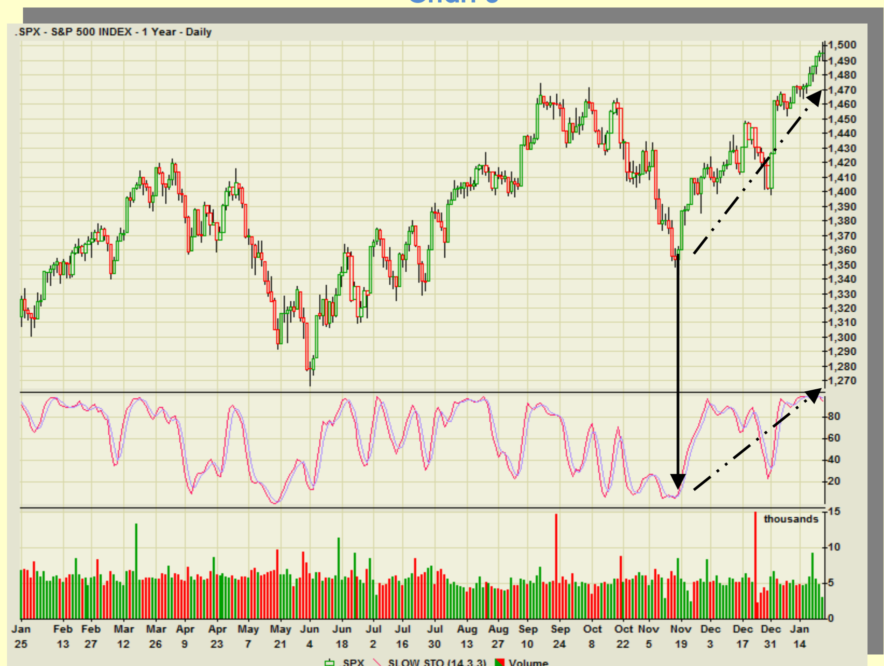
The adjacent Chart 2 was initially exhibited in the September-October 2012 Newsletter.

This was intended with a focus on the arrows that illustrate the two main corrections during 2012. In adition the dotted arrows pointing down towards the variable known as Stochastic; the pink line which exhibit whether the marets are over bought or oversold. This variable suggested that the markets were OVERSOLD based on Table 1 below, and we suggested that that was a great time to start re investing in the capital markets.

Table 1[3]

Change in S&P 500	*Change in Stochastic (Fast-Slow) since Oct 5th, 2012*[3]
-6.670%	*-93%*

Chart 3



Since, the markets have gained approximately 10.5%. This has been a significant move even under the anticipation of earnings and political uncertainty caused by the gridlock between our two main political parties.

If we revisit the Stochastic variable, we see that with the market, this variable has also gained significantly and clearly exhibits that the markets are in an OVERBOUGHT territory. Again, this is one variable that we believe is a great gauge of investor behaviour.

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[2] Data Source: www.fidelity.com ,

[3] Source: CGAM's estimates

Despite the recent healthy gains in major broad based indexes, we remain bullish on the US domestic capital markets. We believe that the markets are currently going through an asset class rotation. In other words, we believe that as and when the interest rate cycles reverses (rates start to move up), most investors who are heavily invested in bonds will be compelled to liquidate their debt holdings. The alternatives for these investors are US and global equities. We would also like to add that international equities are a natural hedge against the falling value of the US dollar in case inflation starts to show its ugly head.

We recommend that investors consider the following sectors both in the US and global regions; Healthcare, Energy, Financials, and Technology sector. We at CGAM believe that these sectors are poised to outperform the broader markets over the next 12-18 months.

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

Please review the following disclaimer

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