Continuum Global Asset Mgt., LLC

July 2014

Newsletter

Our June 2014 Newsletter concluded with, *"We believe that as the US economy continues to show resilience, the FOMC will gravitate towards unwinding its accommodative policy. Once this becomes the market perception, a reasonably significant number of bond investors will start to liquidate their holdings. Under these circumstances, this newly released asset base will start to gravitate towards the equity markets. Based on this paradigm, we believe that the equities are a favorable area to be invested in currently."*

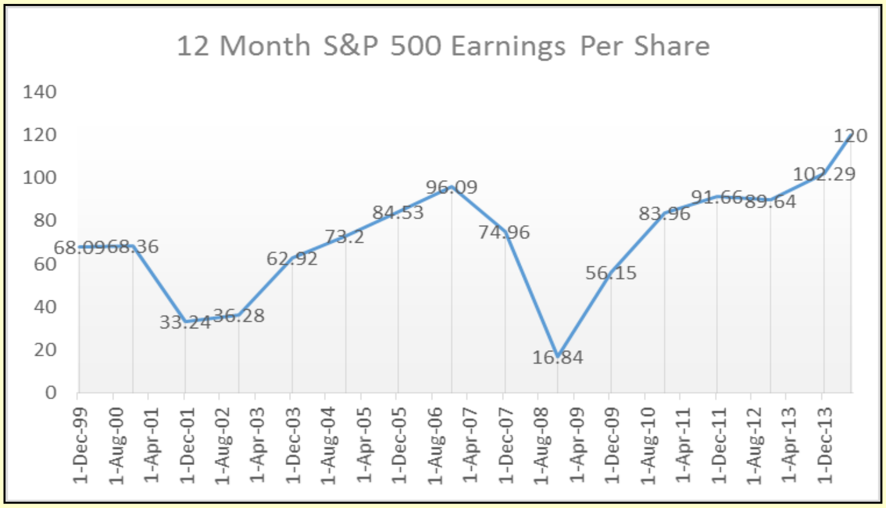
Since we published the June Newsletter, the broad based markets have gained approximately 3%. Capital markets seem to have built an unfazed momentum and continue to make new highs. Most market mavens are expecting this market to continue this trend. Even though we believe that the US economy is in a recovery mode along with improving employment, housing and consumer sentiment, we at CGAM are contrarian investors and cannot afford to be complacent and / or euphoric. We have illustrated 7 crucial fundamental and technical variables that we believe will play a major role in guiding the markets in the near and intermediate term.

Following are the variables used:

1. S&P 500 (Corporate) Earnings: Neutral
2. Interest Rates or Cost of Capital: Bullish
3. Unemployment Rate: Bullish
4. Inflation: Neutral to Bullish
5. Housing Recovery: Neutral
6. Investor Sentiment: Contrarian Indicator: Bearish
7. Margin Debt: Contrarian Indicator: Bearish

S&P 500 (Corporate) earnings[1]: Neutral:

It can be observed from the adjacent chart that the corporate earnings *(represented by the blue line)* have been growing since the the major recession the US experienced in 2008-09.



Earnings is a forward looking / leading indicator for the capital markets. Broader indexes follow the growth or deceleration of corporate earnings. Even though the economy

[1] Source: CGAM, LLC and S&P IQ

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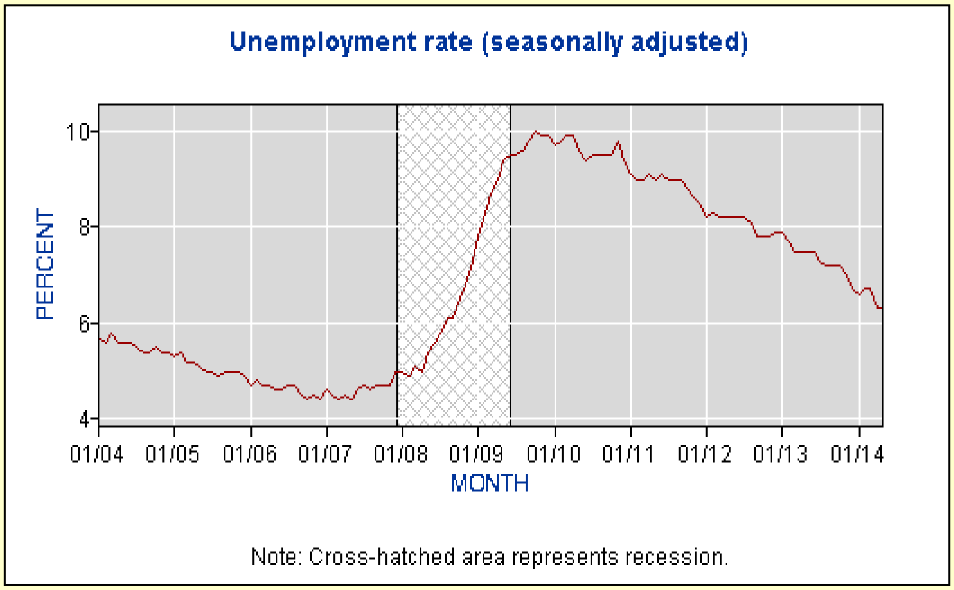
has been growing for the last 5-6 years, we do believe that earnings will be a result of consumer spending which has been decelerating a bit. The deceleration in consumer spending patterns has brought caution in our evaluation of market's fair value. We at CGAM have gravitated to a nuetral stance on earnings from being bullish over the last few years.

Interest Rates or Cost of Capital[2]: Bullish: One of most important factor in corporate growth is the cost it pays for it's capital. In other words, the prevailing interest rates that the federal government charges major banks command the rates they use to lend money to companies, individuals etc.

It can be seen from the adjacent chart that rates (10 year treasury yield; the proxy for rates) are at historical lows. In addition, the Federal government has reiterated their accommodative stance with fiscal and monetary policy till the time unemployment settles at a sub 6% level (currently at 6.2%) as long as inflation remains tame. We believe that rates will remain low for another 12-15 months which is bullish for economic growth and hence capital markets.

Unemployment Rate[3]: Bullish
One of the most important fundamental variable that supports an improving economy is consumer spending. As employment improves, disposable income for the aggregate population improves, resulting in increased spending which fuels economic growth.



It can be clearly observed in the adjacent chart that the unemployment rate has improved from approximately 10% in mid 2009 to about 6.1-6.2% currently. This improvement instills a lot of confidence in markets. We believe that this fundamental improvement in employment is a bullish sign for the economy and the markets.

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[2] *Source:* **http://finance.yahoo.com/**
[3] *Source:Bureau of Labor Statistics, Current Population Survey*

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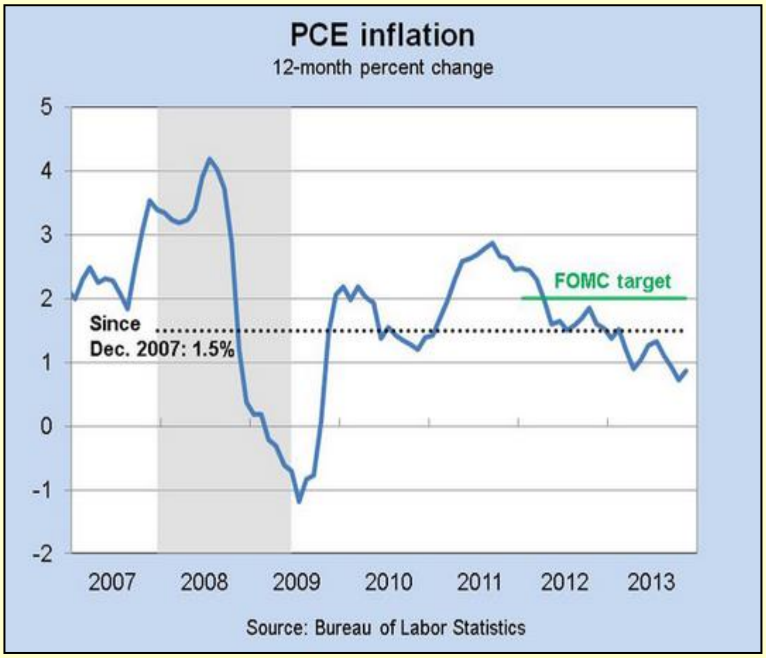
Inflation: Neutral to Bullish; The classic definition of Inflation is, "Too much money chasing too few goods…".



We all know that the US Federal government has infused trillions of dollars in the US economy using the bond buying program since the recession of 2008-2009. In other words the federal government performed a crucial role in stabilizing the mortgage securities market that was threatening to debase the US and global financial infrastructure.

As mentioned, one of the danger of infusing such a significant amount of dollars in the economy is inflation. Despite the liquidity glut, we can observe in the adjacent chart that inflation is currently contained and well below the federal government's mandated level.

The Federal Open Market Committee (FOMC) watches inflation closely and have reiterated their comfort with leaving rates at lower levels. We at CGAM believe that inflation should stay at lower levels due to global competition, especially from a wage inflation perspective. As long as we have low inflation, the cost of capital should stay at levels that fuels economic recovery. Therefore, we believe that the current inflation levels are bullish for the markets.

Housing recovery: Nuetral

Housing market plays a major role in many dimensions of the economy. For instance; raw material, construction, manufacturing, consumer durables like furniture and appliances. All these aspects help the economy to a very large extent.

Despite a slow down in residential sales (observed in the adjacent chart; solid blue line) over the last few months, the longer term trend is positive. In addition, as the financial sector improves, access to mortgages eases. With the low mortgage rates and access to mortgage finance, we believe that the housing markets should stay positive for the foreseeable future.

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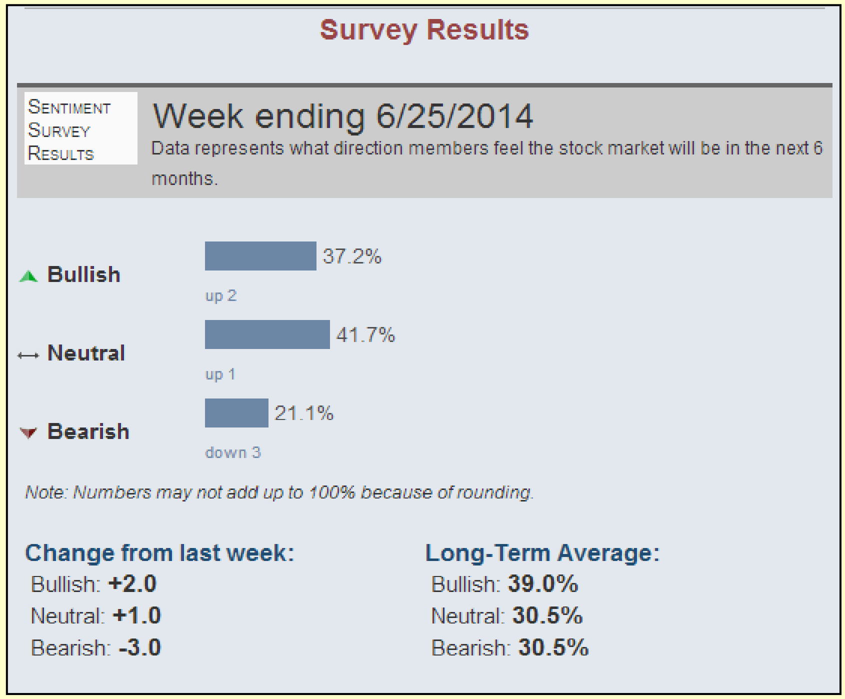
Investor Sentiment: Contrarian Indicator: Slightly Bearish

We at CGAM believe that market participants exhibit herd mentality. It is natural to follow momentum, whether it's up or down. Historically, it has been observed that masses generally invest vehemently at the later stages of bull runs and liquidate assets closer to the bottom of bear markets.

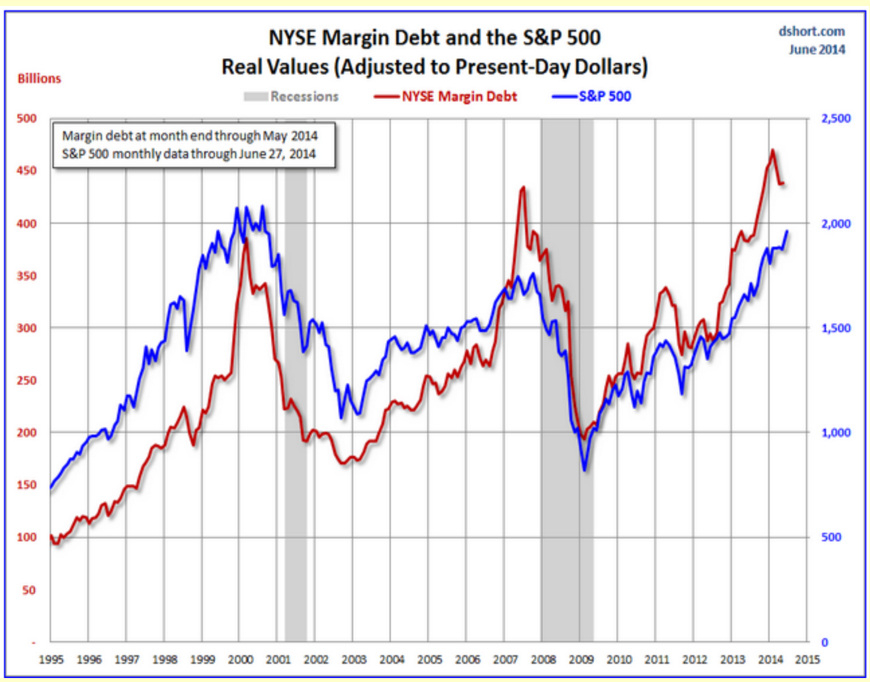
In other words, the aggregate sentiment exhibited by the masses is usually ill-timed. The adjacent table is a representation of the result of a survey conducted by the American Association of Individual Investors. This survey is conducted weekly to gauge the sentiment of individual investors.



It can be seen that the bullish level is at 37% which is close to the long term average of about 39%; nothing unusual here. On the other hand, the bearish sentiment is approximately 21% relative to the average of 30%. In other words, the sample of individual investors are exhibiting complacency. We believe that from a contrarian perspective this is slightly bearish for the capital markets.

Margin Debt: Contrarian Indicator: Bearish

Margin debt is the loan an investor can avail of by pledging their securities held by a broker. As markets experience higher returns, they instill confidence in investors encouraging them to borrow more and use those assets to invest.



It can be observed from the adjacent chart that there is a positive correlation between the margin debt level and the movement of the major index; in this case the S&P 500. It can also be clearly observed that the margin levels were extremely high before both major market corrections that took place in 2000-2002 and 2008-2009.

We believe that margin debt level can be used as a contrarian indicator. As debt level rises, the possibility of a correction rises and vice verse. At CGAM, we believe that currently, margin debt level is at precarious level and is casue for worry. In other words, the markets maybe too euphoric. Any negative news could be magnified and could trigger a correction.

Illustrated below is CGAM's proprietary market model which has been developed to project the potential gain or loss in the S&P 500 index over the next 12 months. The model uses fundamental growth and strength of the economy to project the market movement. We have also illustrated the regression equation developed based on 4 decades of historical data.

Table 14

Fundamental Variables (12 month Projections)		**Market Projections** *Based on the regression equation illustrated below*	*As of June 2nd, 2014*
S&P 500 Earnings	$125.00	S&P 500 (12 Month Projection) =	2,006.00
S&P 500 Expected PE Ratio	17.00	S&P 500 (**Current, July 2, 2014**) =	1,920.00
10 Treasury Bond Rate (%)	2.30%	***S&P 500 (Gain/Loss) =***	***+1.59%***
Inflation Rate (%)	2.50%	***Standard Error***	**+/- 6.60%**
Volatility (VIX) Index	11.00		
Unemployment (%)	6.00%		

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

The major change in the model has been the gain in the broader index. In addition, we have kept the 12 month S&P 500 companies earnings at the higher end; $125. Also, the Volitility index has been trading at very subdued levels since February of this year. The price earnings ratio (a measure of investor sentiment) is trading at 17 which is about 9% above the long term average of approximately 15.50.

It can be observed that the model infers a gain of approximately 1-2% in the S&P 500 index with an error rate of about 5-6% for the next 12 months. The total return expectation has been decreased from 6% down to 1-2% (Since June Newsletter) due to the recent accent in the markets.

Despite a very accommodative policy from the Federal government and a recovery in the economic fundmanetals we are convinced that any negative event which could include geopolitical tensions, change in Federal government's rhetoric or deceleration in economic fundamentals, would trigger a technical correction of 5-7%.

Based on the observations illustrated above and the guidance based on our proprietary market direction model, we recommend raising cash (upto 20-25% of the total portfolio). The endeavor is to be preemtive and be prepared to take advantage of an interim technical correction.

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

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

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