Continuum Global Asset Mgt., LLC

July-August 2011

Newsletter

Our May-June 2011 Newsletter ended with "*…as the market continues to gradually moves higher, it creates bullish attitude which in our view is a self fulfilling bullish activity that ends up being unsustainable and eventually results in market corrections.* ***…"***

We followed up with the Market Development piece in mid-June which ended with, "…we have been waiting for a correction since the end of the first quarter and we believe that we are in the midst of an interim correction within a secular bull market. We continue to stay invested in equities and favor larger companies with consistent dividend paying track record and international exposure…"

We don't claim to be clairvoyant or have Para normal market predictive powers but, do attribute our accurate projections to two aspects. Firstly, we used critical fundamental and technical variables to understand investor behavior. Secondly, we cannot denigrate the market's uncanny ability to fool us and investors with randomness.

That said, we would like to revisit the variables we used in our mid-June Market Update. Even though we believe that we understand the ramification of these variables that impact capital markets, every model is handicapped by the fact that it uses assumptions and variables that may change at any instance. But understanding the areas that impact investor sentiment puts us at a higher level of conviction which we believe helps in the long term to stay disciplined.

Following is a brief description of the variables we used to evaluate markets in our mid-June Market Update:

Table 1

	Variables To Consider	Priority (1-10)	Positive	Negative	Fundamental Variables	Technical Variables	Long Term	Short Term
1	Federal Fiscal Policy-Phase II Ends :June	7		0				χ
2	Consumer Sentiment	6		0		χ		χ
3	Commoditie /Gas Prices	7		0	χ		χ	
4	S&P 5 0 earnings Projections	8	1		χ		χ	
5	GDP Growth (%)	8	1		χ		χ	
6	US Federal Debt	8		0	χ		χ	
7	Global Growth	8	1		χ		χ	
8	European Debt	6		0	χ			χ
9	Emerging Market Growth	6	1		χ		χ	
10	Inflation	6		0	χ		χ	
11	Treasury Yield Vs E rnings Yield	5	1		χ			χ
12	Margin Debt	5		0		χ		χ
13	US Unemployment Rate	7		0	χ		χ	
14	US Worker Productivity	7	1		χ		χ	
15	US Index Movement	5	1			χ		χ
16	Volatility (fear gauge) Index Movement	6		0		χ		χ

Federal Fiscal Policy-Phase II Ended June 30th, 2011

As seen in the Table 1 above, we believe that Federal fiscal and monetary policy is critical but is a short to intermediate term phenomenon. Quantitative easing (Federal Reserve's endeavor to use $600 billion to buy treasuries in order to induce liquidity in the economy) came to an end on June 30th. We believe that the impact of this policy is one of short term. Based in the recent manufacturing and housing data, it seems that the US economy, which went through a soft patch in May and June, should recover during the second half of 2011.

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Consumer Sentiment

Even though Consumer Sentiment is a very important variable, we believe it to be a backward looking variable. It is a short term variable and exhibits how consumers feel currently. Variables like inflation, economic growth, wages and employment impacts consumer sentiment. This variable can change very quickly and hence we do not place a lot of credence to it.

Commodities and Energy Prices

We believe that commodity and energy prices are a critical factor in economic growth. It directly impacts business and individual consumers. The recent directive from President Obama to release US gas reserves to alleviate gas prices is a testimony to this fact. Reasonable energy prices can help fuel not only US but also global growth. Currently, energy prices despite being at elevated levels are not jeopardizing economic growth.

GDP Growth (%)

Even though the US GDP rebounded after the recession of 2008-09 and experienced an average of over 3% gain since, most economists are projecting a subdued GDP growth for the rest of 2011. GDP growth projections in the US range from 2-3.5%. We believe that rebound in global growth coupled with a low dollar value will help the export aspect in the US and will eventually add to the GDP growth. In the interim, the GDP can experience a push in the manufacturing sector from inventory stabilization in Japan.

Global Growth

Global economy seems to have improved considerably since 2008 and is at strong footing to grow at a 4-5% range. Due to global labor competition, wages continue to stay low. In addition, as mentioned above a lower relative value of the dollar will help boost US's competitiveness in the global trading environment. Global growth is the main catalyst going forward and shall help fuel US growth via exports.

European Debt

The most important aspect about the problems with Europe is the perceived value of the impact. It is a fact that countries like Greece, Portugal, Italy, Ireland and Spain are over leveraged. The truth is that if a single country defaults on its loan, it will have crippling domino effect on the rest of the world. Therefore, it is in everyone's interest to avoid a major financial disaster analogous to the one we experienced in the US in 2008-09. In addition, these countries should be held accountable and monitored in regards to their respective adherence to debt reduction austerity plans. The International Monetary Fund is already helping these respective countries and we believe that the situation will be controlled as the future of the European Union is at stake.

US Federal Debt

The debt circus has now moved its focus to the US Federal debt after enough drama regarding high debt ratios in European countries, especially in Greece. It seems that Congress is in gridlock regarding raising the debt ceiling and avoiding a default. We believe that the Democrats and the Republicans will come to some consensus before August 2nd, the deadline for increasing the debt ceiling for a smooth functioning of the government.

Inflation

We believe that there is a high probability of inflation showing its ugly head in the near future, primarily due to the major infusion of capital by most governments in the world. The silver lining is that wage inflation should be contained due to global competitiveness in regards to skilled or unskilled labor. We also believe that the US Federal government, comprised of Mr. Bernanke's team is under a lot of pressure to maintain a balance between the cost of capital and inflation. We do believe that the Federal government will keep the cost of capital low (interest rates) to bolster the economic recovery while keeping a close eye on inflation.

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Treasury Yield Vs Earnings Yield

Currently, the 10 year US Treasury bond yields approximately 3.2%. In other words, if we used $32 (3.2% of $1000 Bond) as the earnings for this bond, we would get a price to earnings multiple of ($1000/32) 31.25. Compare this with the S&P 500 company average price to earnings multiple of 16.5, we can infer that US stocks are relatively cheap compared to US bonds. In addition, interest rates set by the US Federal government should stay at lower levels for the next 2-4 quarters. The inference here is that stocks are considerably cheap compared to the safety of US debt. This is a positive sign in favor of investing in equities as opposed to fixed income products.

US Unemployment Rate

The US unemployment is currently at an extremely high rate historically speaking. There is no question that creating employment is one of the most important and critical components attributable to the sustained growth of the US economy. This is because over 70% of the US economy is fueled by consumer spending. We believe that the US will have to struggle with a high rate of unemployment till the average wage in various US industries approaches parity with those in the high growth emerging economies like China, India, Latin America, Russia and other parts of South-East Asia. Till this happens, most US global corporations will continue to hire skilled and unskilled labor abroad.

S&P 500 earnings Projections (THE MOTHER OF ALL VARIABLES)

The US economy has been improving since the market lows of March 2008. In tandem, the US Corporate earnings have grown by almost 50% during this time frame. We believe that earnings are the single most important element in gauging capital market valuation. We also believe that US corporate earnings should continue to grow at a decent pace over the next 12-18 months, primarily driven by global growth and international trade.

We have used the average earnings estimate of the S&P 500 companies based on major economist projections. It can be clearly observed in the Table 2 below that the S&P 500 has potential to grow handsomely over the next 12 months if these earnings estimates come to fruition. In addition, it is critical for major US companies to provide robust future projections in order for markets to maintain momentum.

Table 2[1]

S&P 500 Earnings (2011)	**$87.00**
S&P 500 Earnings 2012 (Estimate)	**$95.70**[2]
S&P 500 Index Value as of July 5th, 2011	**1,337.88**

	P/E Minimum	P/E Average
Average P/E	**15.8**	**17**
Projected S&P 500 Valuation	**1,512.06**	**1,626.90**
Expected %age Gain based on projected earnings	**13.00%**	**21.60%**

It can be observed in Table 2 that even at a conservative price to earnings ratio of approximately 16, the markets can experience a gain of approximately 13% over the next 12 months. At an average P/E of 17 we can expect the markets to gain 21%. These projections seem great but the problem with assumptions is that they are just assumptions.

We remain bullish for the rest of the year based on the aggregate inference derived from the variables illustrated above. As usual, all investors should be cognizant of the interim corrections but focus on the long term fundamentals of the economy and their respective holdings.

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

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

[2] *Source: Average Projected S&P 500 earnings based on CGAM projections. Information gathered from various analyst's projections*

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