Our April 2017 Newsletter concluded with:

"Markets have an uncanny ability to surprise us constantly. We were surprised when Mr. Trump was elected as our President, despite the predictions from most polls against it. We were further surprised as the markets made new highs despite the predictions of market corrections in case Donald Trump became president.

We believe that it is prudent to harness history and not get carried away with the investing herd in believing that everything will be all right. Based on empirical evidence and estimations by our Market Direction Model, we believe that it is prudent to be cautious currently. We have been proponents of maintaining a reasonable level of cash reserves in portfolios since the beginning of the year. We believe that capital markets will provide patient investors with an opportunity to invest at better values, during interim market corrections". ***April 2017.***

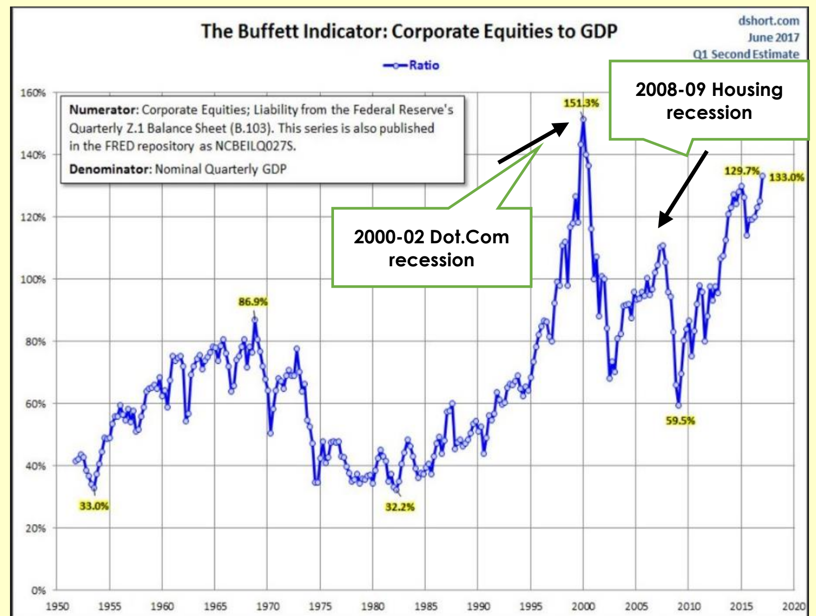
The broadest US stock market index, the S&P 500 index has gained approximately 4% since April 2017. Other major indexes, like the Dow Jones Industrial Average and the Nasdaq have also gained substantially since the beginning of the year.

At the same time, the **Volatility Index (VIX)** has moved from 12.40 in mid-April 2017, to approximately 9.5 as of July 15th, 2017. As mentioned in our previous issues, the Volatility Index is a fear gauge for the markets. It is calculated using PUTs and CALL options on the S&P 500 index and indicates how concerned investors are in the short to intermediate term about the market volatility. The correlation between the VIX and the S&P 500 is of great value when analyzing investor sentiment and the direction of the markets.

The adjacent chart illustrates the correlation between the S&P 500 and the VIX for the last 10 years. It can be clearly observed that VIX and the S&P 500 index (solid red line) have a negative correlation. The noticeable spike in the center of the chart was during the

peak of the 2008-09 recession. All major market indexes had lost 30-40% in value during the height of the recession, but the VIX had spiked to levels never seen before. In other words, investors were not scared; they had panicked. We believe that low level of VIX indicates complacency in the market, which is a contrarian indicator. Currently, the low level of the VIX clearly shows how complacent investors are, which leads us to believe that markets could be headed for an interim correction.

The Buffett Indicator: Another market valuation indicator followed by many is popularly known as the Buffett indicator. It is a simple ratio that divides the US Equity Market Value by the US Gross Domestic Product (GDP). This ratio illustrates how much the markets are trading above or below the current production of the US economy. Obviously, the higher the number the more overvalued the markets.



It can be seen in the adjacent chart that the black arrows signify an elevated level of this indicator. These levels were followed by two of the most severe recessions (dot.com bust in 2000-02 and housing recession in 2008-09) the US has encountered over the last 50 years. The bad news is that we are currently experiencing a significantly elevated level in this indicator, which is something to consider seriously.

So far, we have shared variables that show the bearish or bleak side of the markets. The variables stated above are important but are technical in nature.

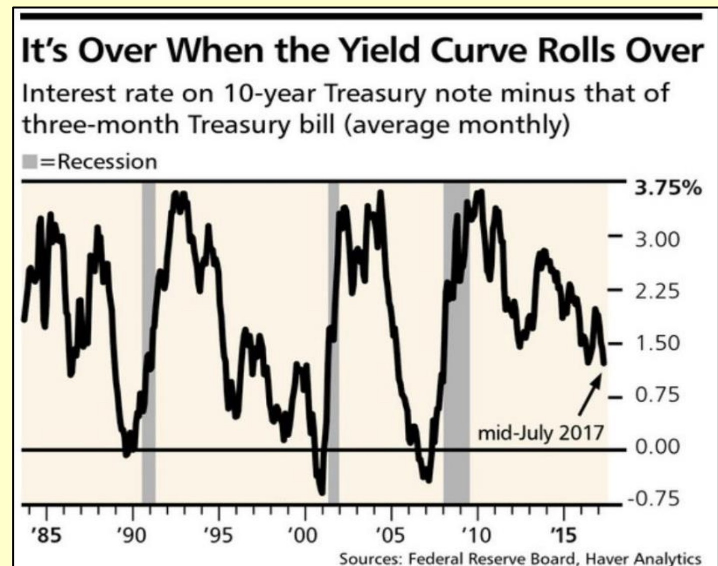
We would like to share a fundamental variable that has been empirically significant in recognizing imminent recessions. A very important parameter in propelling an economy are the interest rates or the cost of capital. As interest rates rise, the cost of capital rises, making it more expensive for companies to borrow money for expansion and/or growth.

The yield curve, which is comprised of short, medium and long-term interest rates is a good indication of the way the banking system lends money to borrowers. It is in the economic interest of a bank to borrow at low rates (short term rates) and lend at higher (long term rates) rates. As long as the yield curve is upward sloping (lower short-

17991 Lost Canyon Rd., Suite 138 *Manu Walia* *Office: 661-299-1920*
Canyon Country, CA 91387 *Email: manuwalia@cgamadvisor.com* *Mobile: 661-312-2070*
www.cgamadvisor.com

term rates and higher long-term rates) banks have an incentive to continue to lend profitably.

On the other hand, during phases when the yield curve starts to flatten and/or starts to become inverted, banks cannot operate profitably. An inverted yield curve has empirically been a prelude to a recession.



The adjacent chart has been developed by using the difference between the 10-year treasury bond rate and the 3-month Treasury Bill. It can be clearly observed that the delta of 10-year Treasury – 3-month T-Bill (black line) is at a low before each recession (signified by a grey line). It can also be observed that the difference between the long-short rates breached 0% or became negative before each recession (the yield curve was inverted; difference between the short and long-term). Even though the yield curve is on a decline currently, it is far from levels that can choke lending and subsequently threaten the US economy.

In addition, the members of the Federal Open Market Committee (FOMC), which decides the future of interest rates, have mentioned that they will be extremely cautious in context of raising rates. No one can predict the trajectory of rates in the future, but we believe that the FOMC has enough empirical evidence to recognize the importance of moving gradually and cautiously in terms of adjusting rate.

CGAM's Proprietary Market Model:

Following is our proprietary Market Model, that we use to guide us in understanding the direction of the market. We have used the S&P 500 index as the proxy for the US broad based markets. Our proprietary model was developed on the belief that investor behavior repeats itself based on a combination of fundamental parameters of the economy and human psychology. The model constantly reviews the change in the index based on the changes in statistically significant economic variables.

Fundamental Variables		**Market Projections**	***As of: July 17th, 2017***
S&P 500 Earnings	$145.00	S&P 500 (12 Month Projection) =	2,440.00
S&P 500 Expected PE Ratio	17.00	S&P 500 (July 17th, *2017*) =	2,459.00
10 Treasury Bond Rate (%)	2.50%	***S&P 500 Estimated (Gain/Loss) =***	***-0.77%***
Inflation Rate (%)	1.70%	***Standard Error***	**+/- 5.72%**
Volatility (VIX) Index	10.00		
Unemployment (%)	4.60%		

17991 Lost Canyon Rd., Suite 138 *Manu Walia* *Office: 661-299-1920*
Canyon Country, CA 91387 *Email: manuwalia@cgamadvisor.com* *Mobile: 661-312-2070*
www.cgamadvisor.com

The objective of the model is to quantify these variables into a regression equation using four decades of historical data. The combination of these variables statistically explains 93-94% movement in the S&P 500 index.

We believe that the impact of the Trump tax reform could enhance US corporate earnings. We had incorporated the best possible scenario of corporate tax reduction and increased the earnings projections of the S&P 500 companies from $140 to $145 in our previous issue. We have not changed the earnings projections since.

In addition to earnings projections, we are using a Price Earnings (PE) ratio of 17, which is approximately 15% above the average PE for the last three decades. Also, the Volatility Index (VIX) has declined from approximately 16 to 10 currently. This illustrates complacency in the markets.

The 12 month market projection derived from our model is luke warm at best. Our model indicates that markets are fairly valued at current corporte earnings and other valuation measures.

Conclusion:

We believe that markets remain in an overvalued situation. Most investors seem to like the new administration, despite the slow progress in some key issues like healthcare and tax reform. On the other hand, corporate earnings are rising at a brisk pace. If corporate earnings and guidance is healthy, the markets can continue their assent for sometime. We still believe and recommend having 15-20% of one's portfolio in cash. This would provide an opportunity to invest during interim market corrections.

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

17991 Lost Canyon Rd., Suite 138
Canyon Country, CA 91387

Manu Walia
Email: manuwalia@cgamadvisor.com
www.cgamadvisor.com

Office: 661-299-1920
Mobile: 661-312-2070

This page is left blank intentionally

Please review the following disclaimer

This Newsletter has been prepared by Continuum Global Asset Management, LLC (CGAM), an independent Registered Investment Advisor. CGAM believes that the data contained is from reliable sources but cannot guarantee the accuracy of the data. None of the information provided constitutes a recommendation or solicitation of an offer to buy or sell any particular security. The investment strategies and or securities may not be suitable to all investors and past performance is not indicative, nor a guarantee, of future results. It should not be assumed that recommendations made in this Newsletter and in the future will be profitable or will equal the performance of the securities mentioned in this or previous Newsletters.

17991 Lost Canyon Rd., Suite 138
Canyon Country, CA 91387

Manu Walia
Email: manuwalia@cgamadvisor.com
www.cgamadvisor.com

Office: 661-299-1920
Mobile: 661-312-2070