Continuum Global Asset Mgt., LLC

March-April 2013

Newsletter

Our January-February 2013 newsletter ended with the following… **"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 cycle reverses (rates start to move up), most investors who are heavily invested in bonds will be compelled to liquidate their debt holdings. The alternative investment opportunities 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."**

As we mentioned in the previous issue, we remain bullish on the capital markets primarily due to the Global economy's resilience and the US corporate enterprise's ability to continue to produce earnings growth. Even though investors are generally concerned more with the shorter term volatility, it is prudent to step back and view the markets from a longer term perspective. In other words, how have markets performed over a few decades as opposed to a few quarters. Following are some facts that we have considered in determining where the capital markets could be headed over the next 5-10 years:

It can be observed from Table 1 below that the Dow Jones Industrial Average (Major US broad based index) have doubled every 10 years since 1955. This has happened in tandem with the US GDP growing at about 3% per year.

Table 1[1]

Date	DJIA	Gain/Loss (%)	GDP Growth (%)
2/1/2013	14,009.79	10.71%	2.00%
2/1/2007	12,654.85	84.00%	3.04%
2/3/1997	6,877.74	209.25%	3.15%
2/2/1987	2,223.99	137.50%	3.31%
2/1/1977	936.42	11.56%	3.11%
2/1/1967	839.37	103.79%	4.06%
2/1/1955	411.87		
Average		109.22%	3.34%

The total market value of the US securities that comprise of equities (stocks), mutual funds, exchange traded funds etc., is valued at approximately $13 trillion, which on an average has been close to the US GDP valuation. In other words, the total value of the securities equates to the net production of US corporations. Therefore, as the US corporations add value in the manufaturing and the services sectors, it should naturally increase the value of

[1] Source: www.yahoo.com ***(Dow Jones Average historical data)***

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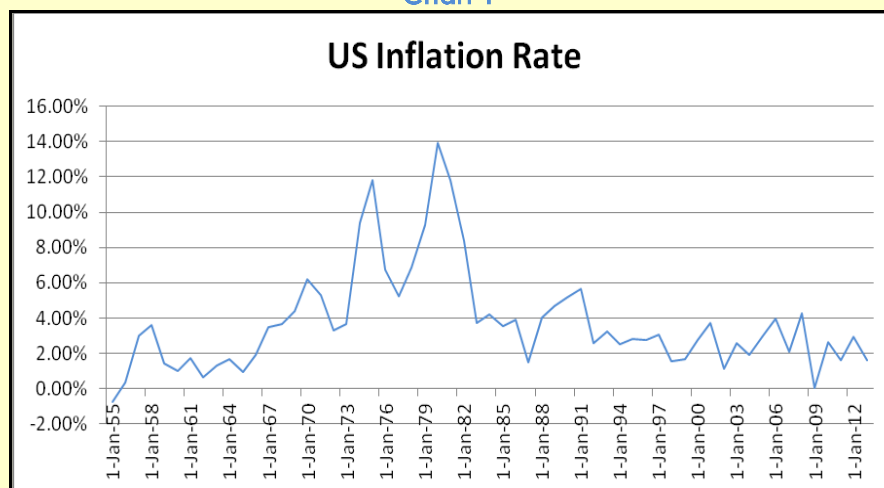
the securities related to the US enterprise.

The US corporations have obviously added enough value every decade since 1955, for investors to believe in this growth. For this phenomenon of an increase in the US broad based indexes to continue, a certain amount of currency needs to be funneled into the capital markets at a steady pace. Since the US real estate and the global financial disaster hit us in 2008, the Federal governments all over the world have inflated their balance sheets by printing money and flooding the capital markets across the globe with liquidity.

Despite the fact that this liquidity infusion by governments across the world has helped bolster markets across the world, there is a downside to this aspect. **Uncontrolled liquidity leads to inflation.** The classic definition of inflation is: "Too much money chasing too few goods". In other words, capitalism is about improving the standard of living of the masses. Inlfation destroys the incentive for entrepreneurs to be creative resulting in fewer good and services for the masses; hence lowering standard of living.

Inflation primarily impacts the Income statement by elevating an organization's Cost of Goods and Wages. Wage inflation is contained due to the emergence of a huge working population in emerging economies like India, China, Brazil, Russia, South-East Asia and Latin America. Cost of raw material/commodities have moved consistently higher over the last decade and should continue this trend due to the rising demand from a worldwide population with increasing disposable income.

Chart 1[2]



It can be observed from Chart 1 above that inflation has been tame for the last decade. In addition, the federal government has a mandate to control inflation. We believe that inflation should remain in check for the foreseeable future allowing the federal government to keep interest rates low.

We would now like to understand the impact of a low interest rate environment along with low inflation on the capital markets.

[2] http://www.multpl.com/inflation/table

Below is CGAM's proprietary Market Direction Model which helps us determine the general direction of the capital markets. This model was based on regressing the data of major market variables for the last three decades. Following are the variables used and our market projection for the following 12 months. Even though we believe that over the next 2-3 years rates will start to move higher, the current rate environment warrents the markets to continue this rally.

Fundamental Variables		**Market Projections**	***As of March 13, 2013***
S&P 500 Earnings (12 month Projections)	$ 115.00	S&P 500 (Projection) = ***Based on the regression equation illustrated below***	1,646.12
S&P 500 Expected PE Ratio	15	S&P 500 (Current) =	1,552.48
10 Treasury Bond Rate (%)	2.50%	***S&P 500 (Gain/Loss) =***	***+6.03%***
Inflation Rate (%)	3.50%	***Standard Error***	**+/- 2.03%**
Volatility (VIX) Index	12.5		
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 from the table above, the variables considered are an amalgum of fundamental (S&P 500 company earnings, 10 yr bond rates etc) and technical variables (Volatility {VIX} Index).

We believe that the US economy is on sound footing and should continue to grow aggregate earnings over the next 12-18 months. Even at a reasonable investor sentiment, which can be measured by the Price to Earnings ratio, we believe that the capital markets can gain another 6-8% over the next 12 months. This does not mean that there wont be any interim corrections between now and the end of the fiscal year.

We believe that the markets should exhibit a bullish trend over the next 4-5 years and gain an average of 12-13% for this period. This is based on the longer term trend of market value doubling every decade along with an average GDP growth of 3%.

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

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