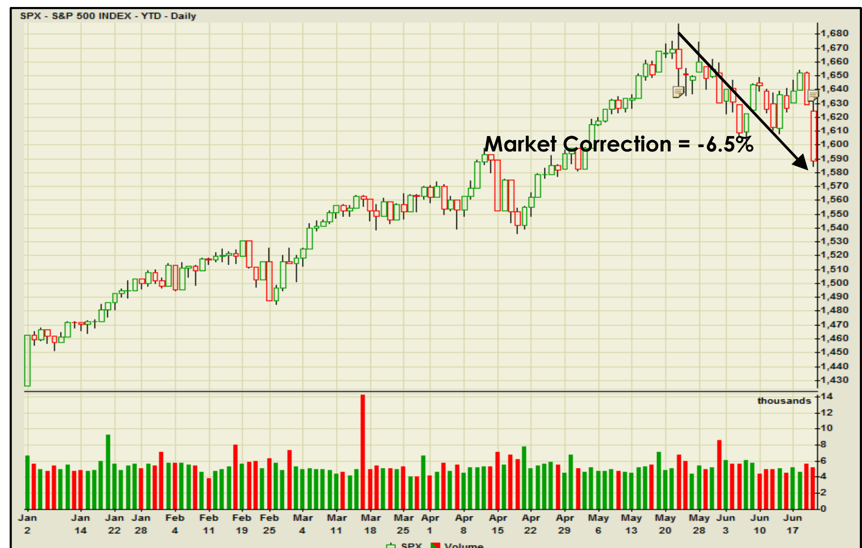
Newsletter

Our May-June 2013 Newsletter ended with **"Despite our longer term bullish projections, we recommend raising between 20-25% cash in respective portfolios to take advantage of an interim technical correction of 5-7% during the summer months this year…"**

It can be observed from Chart 1 that the markets have experienced a correction of approximately 6.5%, since the May 22nd highs.

Chart 1



1. **Cause of current market correction:** The major cause of the market downturn is the rhetoric from Mr. Ben Bernanke, the Chairman of the Federal Reserve. The Federal Reserve has been pumping blood in the veins of the US economy in the form of favorable monetary and fiscal policy. To be more precise, Mr. Bernanke has lowered the borrowing rates virtually to zero and have been buying approximately $85 billion in US mortgage securities per month for the last year or so.
   Wednesday, June 19th was the second time that Mr. Bernanke indicated in a press conference that the era of easy money from the Federal government will likely be diminished and eventually be stopped.

2. **Bernanke Revelation:**
   Dr. Ben Bernanke has done a great job of infusing life into the US economy that was going through convulsions which started in mid 2008. Whether we are pro-Keynesian or not, the monetary and fiscal policy undertaken by the Federal government has worked so far. Unfortunately, the Federal government's printing press cannot continue to print money forever without side effects. The markets have reacted adversely to the recent rhetoric from Dr. Bernanke, which indicated a deceleration, not reversal in the easy monetary policy. In our opinion, it is prudent for the federal government to consider easing up on the rather lenient monetary and fiscal policy. The main endeavor of this policy was to alleviate the economic trauma and stabilize confidence in the economy. Now that that is coming to fruition, we believe that the US economy should and can stand on its own feet and sustain a reasonable level of growth going forward.

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3. Fundamental Facet:

As always we believe that at the end of the day, economic fundamentals drive market sentiment. We at Continuum have developed a market model based on regressing data of major market variables spanning over three decades. Following are the variables used and our market projection for the following 12 months:

Fundamental Variables		Market Projections	*As of June 22nd, 2013*
S&P 500 Earnings (12 month Projections)	$115.00	S&P 500 (Projection) = *Based on the regression equation illustrated below*	1,745.10
S&P 500 Expected PE Ratio	16	S&P 500 (Current) =	1,608.69
10 Treasury Bond Rate (%)	2.50%	**S&P 500 (Gain/Loss) =**	**+8.50%**
Inflation Rate (%)	3.50%	***Standard Error***	**+/- 2.85%**
Volatility (VIX) Index	20		
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***

4. Technical Aspect:

A major change in the parameters considered in the market model above is the spike in the Volatility Index (VIX), during the recent market correction. We believe that this variable is crucial in understanding aggregate market sentiment. This sentiment can fluctuate violently in the short term as fear or greed supersedes fundamentals. The VIX increased from a low of approximately 12 (May 22nd, 2013) to 20 (67% increase) on June 20th, 2013.

Chart 2

We believe that the US economy is on sound footing and should continue to experience earnings growth over the next 12-18 months. Even at a reasonable investor sentiment, which can be measured by the Price to Earnings ratio (approximately 16-17), we believe that the capital markets can gain another 8-10% over the next 12 months.

We believe that the recent market correction and hightened investor fear provides a great entry point from a contrarian perspective for growth oriented investors.

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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