Continuum Global Asset Mgt., LLC

MAY-JUNE 2015

Newsletter

Our March-April 2015 Newsletter ended with…

"We continue to believe that the current economic conditions, especially in the United States are strong and continue to improve. Improving economic conditions, low unemployment and low inflation should bode well for the capital markets for the next few years. Having said that, we believe that the markets could and will experience a technical correction (5-7%) in the short term. We recommend that investors raise 10-15% cash in order to position themselves to take advantage of any short term correction we may encounter."

Sell In May and Go Away? A Cliché or a phenomenon with serious empirical evidence.

Even though there is empirical evidence in the statement "Sell in May…", it is also true that history doesn't always repeat itself. We at CGAM believe that it's important to gauge investor sentiment based on their perception of the macroeconomic and specific sector/company fundamentals. Therefore, we would like to focus on these fundamentals as opposed to just depending upon technical analysis and empirical evidence. Following are certain variables that we believe highlight the most pressing issues concerning the markets currently:

1. Market Valuation: Whether markets are over or under valued?
2. US Corporate Earnings.
3. Future of Interest Rates: Cost of Capital.

Market Valuation: This is always the $64 million question: Whether the market is overvalued?

Chart 1[1]

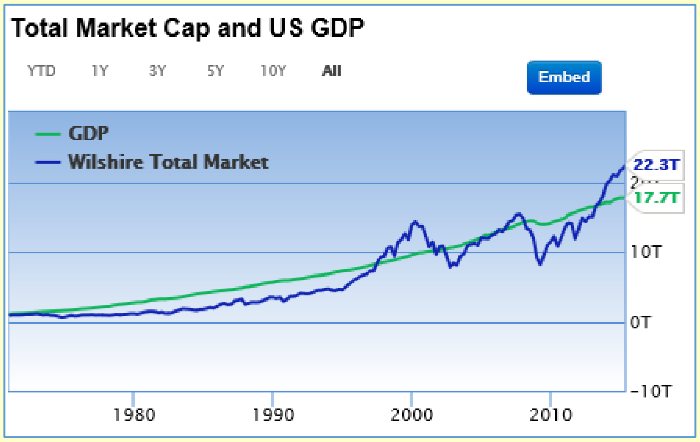

Chart 2

[1] Source: http://www.gurufocus.com/stock-market-valuations.php

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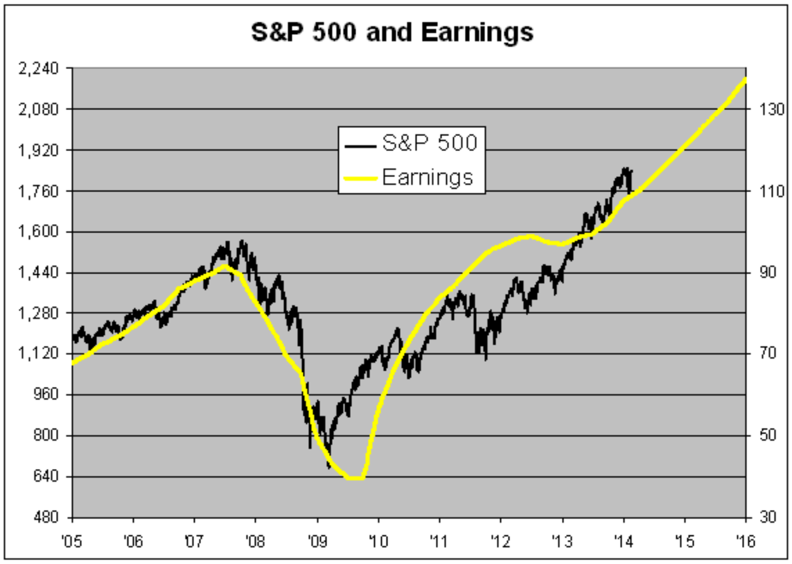
We have all heard, learned and revered one of the best investors in history. Without question, that person in my opinion is Mr. Warren Buffett. Without describing the umpteem qualities this gentleman posesses, I would like to share a variable that he considers extremely important when gauging whether the markets are under or overvalued.

This variable is the comparison of the total market value (Equities, Mutual Fund, Exchange Traded Funds etc) to the Gross Domestic Product of a country. Chart 1 and 2 on page 1 illustrate the comparison of the Total Market Capitalization (TMC) to the US GDP for almost 5 decades. The most discernable phenomenon in Chart 1 is that major corrections have occurred when the TMC has risen significantly above the GDP. The major market decline experienced in 2000-2002 and 2008-09 were preceeded by high ratios of TMC/GDP. In 2000, this ratio had touched a 150% level. In other words, the TMC was 1.5 times the GDP. Similarly, 2008 experienced almost 120% TMC/GDP ratio.

We can clearly observe in Chart 2 that the current US total market value is over 125% of the GDP. Based primarily on empirical evidence, we can conclude that we are in an overvalued market condition. On the other hand, inertia can move markets further and an overextended variable can continue to stay extended. One can not be definitive about the markets based on one variable, but we believe that this is a compelling variable and should be considered seriously.

US Corporate Earnings: We believe that ultimately, the markets are driven by corporate earnings and the future perception of earnings.

Chart 3[2]



It can be observed from Chart 3, that US corporate earnings have grown significantly since 2008-09 economic recession. Major market indexes have also gained value in tandem to the growth in earnings.

The yellow line projects S&P 500 earnings till FY 2016. The data is based on the aggregate expectations of various analysts. One can observe that this line becomes a straight line and starts to ascend in a parabolic fashion.

Even though it seems plausible to achieve a sustained growth in earnings, especially if the US economy keeps growing at approximately 3% per annum, we are not sure that the markets will continue a parabolic move upward. Our thoughts and inferences are based on our primary belief of the phenomenon of REVERSION TO MEAN.

[2] Source: http://www.crossingwallstreet.com/archives/2014/02/2015-sp-500-earnings-estimate-137.html

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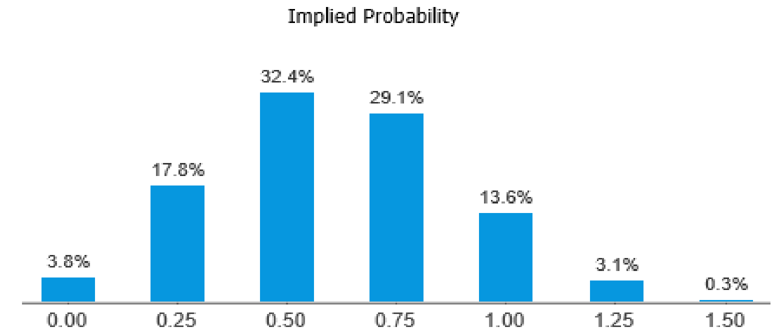
We believe that as valuations of a major market index or specific stock price move away from a reasonable level, the probability of a reversion continues to increase. This phenomenon holds true in both the bullish and bearish phases.

Future of Interest Rates: One of the most anticipated and analyzed topic has been and continues to be the future of Interest Rates. This is with good reason as interest rates command the cost of capital which directly and indirectly impacts the consumer in our economy. Why is that important; because the consumer comprises of almost 75% of our economy.

Chart 4[3]

Meeting Date: Wednesday, January 27, 2016
Futures Expiry: January 2016
Futures Price: 99.5750
Probability of Rate Hike: 78%

Previous Day
Volume: 7,605
Open Interest: 46,312



Target Rate %	Current Probability %	Previous Day Probability %	Previous Month Probability %
0.00	3.78	4.20	10.82
0.25	17.79	19.01	30.96
0.50	32.36	33.07	34.09
0.75	29.09	28.30	18.39
1.00	13.60	12.53	5.06
1.25	3.11	2.69	0.65
1.50	0.26	0.21	0.03

Chart 4 is an illustration of the Implied Probability of Fed Fund futures for the next 12 months. In other words, this chart shows the economist's expectations of interest rates in the future. It can be observed that most economists are expecting the rates to move between 0.25% to 1% within the next 12 months. If we narrow that band, we observe that there is a 60% chance that rates will be between 0.50-0.75% over the next 12 months. Therefore, its safe to say that most economists expect rates to start to increase sooner rather than later.

Some of the crucial variables that impact rates are related to inflation. The Federal government has a mandate to contain inflation in addition to being cognizant about prudent monetary policy and adequate fiscal liquidity for the benefit of the economy. If wages start to grow quickly or price of commodities (oil, gas, food etc) decline beyond reasonable levels, it puts upward pressure on inflation. In other words, higher wages and lower commodity prices puts too much money in the economy pushing inflation up. In the longer run, higher inflation pushes prices up which is ultimately a drag on the economy.

Currently, we believe that both variables (wages and commodity prices) are at tame levels and the Federal government has indicated their patience in regards to raising interest rates. When rates start to rise and they will, it will initially put pressure on debt instruments. That is because there is an inverse relationship of bond prices with interest rates. If the market

[3] Source: http://www.cmegroup.com

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expects an extended period of increasing rate environment, bond funds will experience withdrawals. This phenomenon will be negtive for the debt securities but could actually benefit equities. Overall, higher rates are not a positive sign for the economy as it increases the cost of capital. On the same token, rates are at such low levels that even if Fed Fund rate (Rates at which major banks borrow from the Federal Government) rises to 1%, (currently 0%-0.18%) it will be 2-2.5% below is long term historical average.

We now turn towards CGAM's proprietary market model that has been developed to project the S&P 500 index over the next 12 months. The model is based on the concept that investor's behavior repeats itself based on certain fundamental parameters of the economy and human sentiment. The model constantly reviews the change in the index based on the changes in statistically significant economic variables. We have attempted to quantify these variables into a regression equation developed based on four decades of historical data. The combination of these variables explains almost 93-94% movement in the S&P 500 index.

Table 5[4]

Fundamental Variables (12 month Projections)		**Market Projections** ***Based on the regression equation illustrated below***	***As of May 5th, 2015***
S&P 500 Earnings	$135.00	S&P 500 (12 Month Projection) =	2,183.00
S&P 500 Expected PE Ratio	18.00	S&P 500 (**May 5th, 2015**) =	2,095.00
10 Treasury Bond Rate (%)	2.00%	***S&P 500 (Gain/Loss) =***	***+4.18%***
Inflation Rate (%)	2.50%	***Standard Error***	**+/- 6.13%**
Volatility (VIX) Index	14.00		
Unemployment (%)	5.50%		

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

We still believe that the S&P 500 companies will earn approximately $135.00 (aggregate per share) over the next 12 months. In addition to a favorable earnings environment, we have used the Price/Earnings ratio of 18 (P/E: a gauge of how much investors are willing to pay for earnings). It can be observed that the model infers a gain of approximately 4% in the S&P 500 index for the next 12 months.

Improving economic conditions, which includes a low interest rate environment, decent corporate earnings and a growing GDP should be favorable for the capital markets for the next few years. Having said that, we still believe that the markets could and will experience a technical correction (5-7%) in the short term. As mentioned in our previous Newsletter, we recommend that investors raise 10-15% cash in order to position themselves to take advantage of any short term correction we may encounter.

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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