Continuum Global Asset Mgt., LLC

November 2010

Newsletter

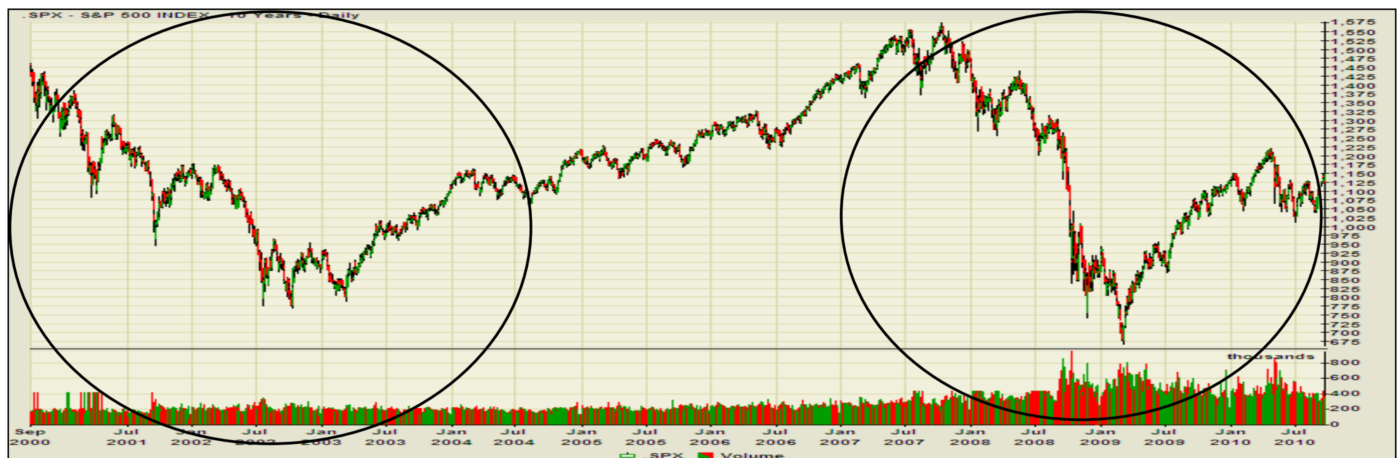
The previous issue of our Newsletter started with ***"After a lackluster first eight months of 2010, the US and most global capital markets markets were bestowed with a pleasantly surprising September. We emphasise the word "pleasantly" because historically September has been a dismal month as far as US capital market performance is concerned. The month of September experienced approximately 9% gain in major indexes."***

The issue ended with ***"It can be observed that based on investor sentiment, which can be illustrated by an array of P/E multiples, we have different values of the S&P 500 exhibited in the table above. In other words, at a reasonable P/E ratio of approximately 16-17, we can expect the S&P 500 to appreciate by 14-15% respectively for the next 12 months with $83 in corporate earnings."***

The October issue also discussed the similarities between the two major recessions the US experienced over the last decade and the inferences we drew from them. At the end of the day, we believed that the markets were poised to do well. So far the hypothesis has come to fruition for most of the variables considered.

Following are two charts showing the broad based index (S&P 500) movement over the last decade followed by the year to date chart. The S&P 500 has gained over 14% over the last two months, a significant move in our view. The following section will discuss the major factors behind this move and our view of the markets going forward.

Chart 1



According to our analysis the most important variables in the recent market movement have been:

1. US Corporate earnings growth.
2. Accommodative fiscal and monetary policy by the Federal government.
3. Mid-term elections and the ramifications of Republicans gaining the House.

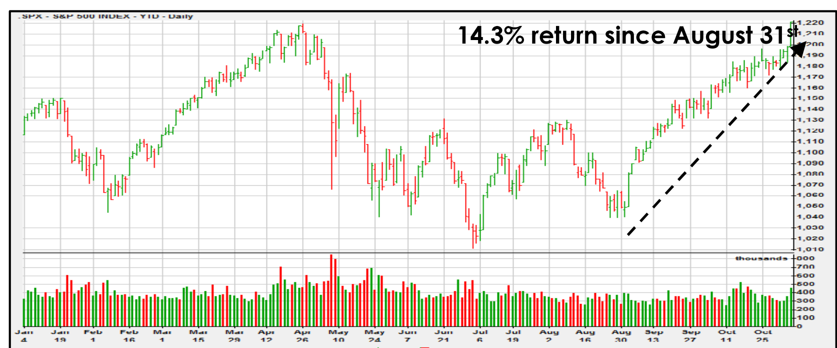
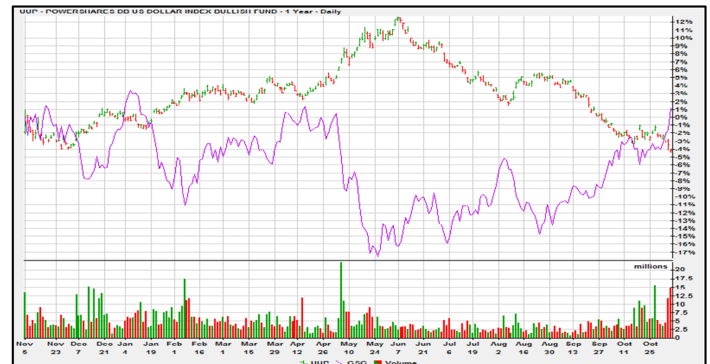


 Chart Source: www.fidelity.com

1. **Corporate earnings growth:** US corporate earnings have been growing at a respectable pace since the recession which began in 2008 and seemed to have bottomed during the first quarter of 2009. Subsequently, corporate earnings grew at 13% net in 2009, with major growth coming during the second half of the year. In addition, fiscal year 2010 has experienced over 33% earnings growth so far.

   We mentioned in our previous issue that the US corporate earnings could reach $83 (cummulatively) for the S&P 500 companies. This would be a 9% growth over the 2010 earnings, a reasonable rate based on the economic recovery we have been experiencing. One of the major deterrent to the earnings growth could be the emergence of inflation which we will discuss below. Despite the uncertainty and a real probability of inflation we still believe that the makret could gain another 10-12% over the next 12 months based on the fundamental economic growth and sustained earnings.

2. **Accommodative fiscal and monetary policy by the Federal government:** Mr. Ben Bernanke, Chairman of Federal Open Market Committee (FOMC), is a student of the great depression this country experienced in the 1920s. In addition, Mr. Bernanke has studied periods of prolonged economic slowdown in regions like Japan and its ramifications.



   Mr. Bernanke and company have done a good job of dragging the US economy out of its dismal state since 2008. The major endeavor undertaken was the reduction in cost of borrowing in terms of monetary policy. After reducing the interest rates (which impacts the overall borrowing rate) to virtually zero, FOMC is now concentrating on fiscal policy, which is popularly known as quantitative easing. This is being accomplished by the government purchasing treasury bonds in the open market, which results in increased liquidity in the capital markets.

   We believe that despite the successful initial intended purpose if this policy, the probability of inflation is now high. As a global economy, we will most likely not experience wage inflation. On the other hand most commodities are dollar denominated (in other words, most commodities are traded in dollars in the international markets), and hence will continue to experience inflation if the dollar continues to lose value. This can be observed by the adjacent chart which clearly shows a negative relation between the value of the US dollar and the commodities index represented by a commodities exchange traded fund.

3. **Mid-term elections and their ramifications:**
   The November mid term elections have resulted in the Republicns gaining majority in the House. This has been perceived as a positive. Conservative policies are pro markets. Current market perception is that the grid lock between the Democrats and the Republicans is going to bolster pro market policies. For instance, President Obama has already mentioned that he would be open to discussing extending Bush tax cuts comprising of lower tax rates on dividends and long term capital gains. Despite the positve slant to this election results, we believe that the long term impact is not as significant as the market perceives it to be.

We believe that the Federal government has done a great job of putting band-aids on the severe recessionary wounds experienced by the US economy in 2008. The most important aspect of a turn around is to be able to do the rights things and not merely things right. Most emerging markets have experienced significant growth based primarily on exports over the past two to three decades. The major shift will have to come in the form of domestic consumption from export orientation if these economies need to sustain their economic growth.

Therefore, we believe that international companies in the Financial, Technology, Healthcare and Materials sector will do particularly well as they cater to the basic need of the burgeoning global middle class.

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