Continuum Global Asset Mgt., LLC **October 2019**

Our August 2019 Newsletter concluded with the following inference: Conclusion: We believe that this market correction is an opportunity we have been waiting for. We also believe that the US economic fundmentals do not indicate an imminent recession or a prolonged period of economic deceleration. Again, a technical correction is a natural market phenomenon and it would be prudent to gradually add to current positions in the area or Technology, Financial and Healthcare for growth oriented investors.

As of August 2019, US market indexes have gained +5% to +6%[1]. We have mentioned umpteen times in our Newsletters that predicting the market is a fool's errand. Like the great Chinese poet Lao Szu said, "Those who have the knowledge don't predict. Those who predict don't have the knowledge." Having said that, I am reminded of a market research article I wrote in 2007. The heading was, ***"DOW 26,000: Can it happen?" (Please click to access the article)***.

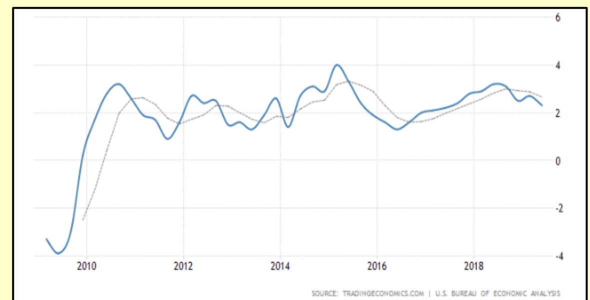
It has been 12 years since that article was published on our website. The Dow Jones Industrial Average (DOW) was at 12,460 at the beginning of FY 2007. The article argued that the DOW has doubled every decade on an average since the beginning of the century. The one variable that was crucial in this phenomenon was an average annual 3% US GDP growth.

A decade later the DOW closed at about 19,872; a 60% growth (January 2017). By January 2018, which was 12 months later, the DOW had reached 24,809. This was a 100% gain from the beginning of 2007. ***So, the DOW doubled in 11 years instead of 10***, reinforcing empirical evidence. Naturally, the question now is whether the DOW can reach 50,000 by 2027???

Again, it's easy to say and infer that history will repeat itself; but it's not always the case. We have illustrated data below which shows how the US economic fundamentals have evolved over the last decade and whether the trend can be sustained to experience similar market returns.

GDP Annual Growth (%)[2]

- US GDP has grown over 2% on an average since 2010.
- The law of large numbers states that it's difficult for a $21 trillion economy to consistently grow over 3% annually.
- We believe that the US GDP can sustain a 1.5-2% annual growth rate.



[1] Data Source: www.finance.yahoo.com
[2] Source: https://tradingeconomics.com/united-states/gdp *(All charts are sourced from tradingeconomics.com)*

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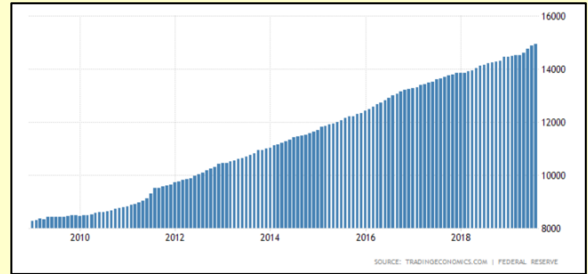
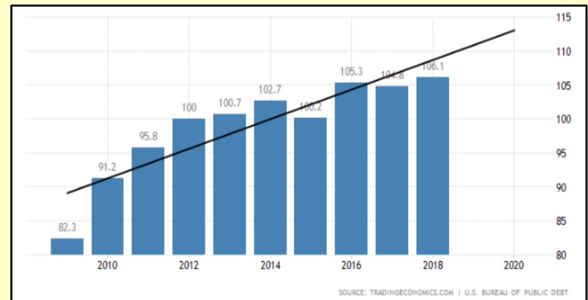
Money Supply (M2)

- Money Supply has consistently grown over the last 10 years.
- Consistent US economic productivity gains can keep inflation in control. Therefore, a higher money supply helps the economy as opposed to creating inflation.



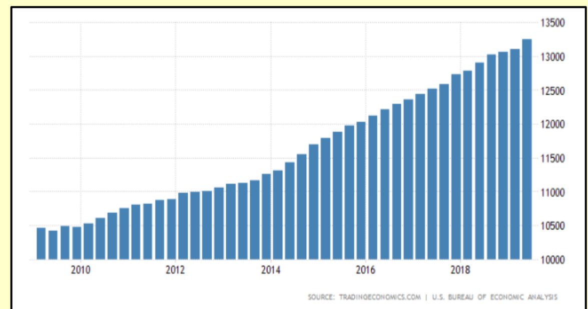
US Government Debt to GDP

- US Government debt started to increase after the 2008-09 recession.
- The US government's quantitative program fueled this phenomenon and the trend is worrisome.



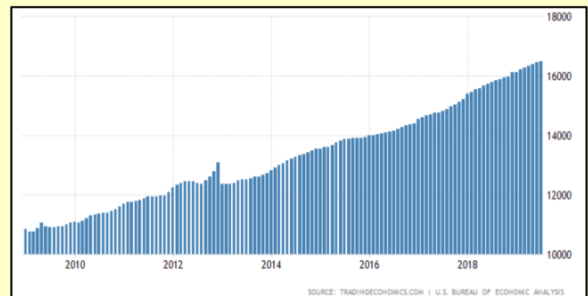
Consumer Spending

- The US GDP is primarily comprised and fueled by consumer spending.
- The retail consumer has been the silver lining in the US economy.



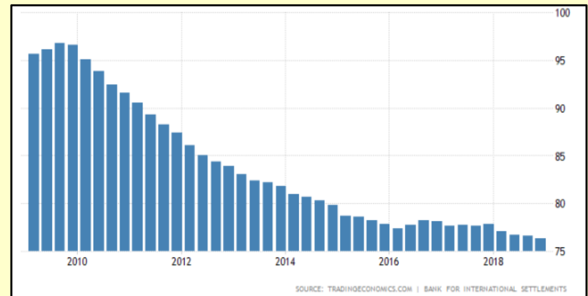
US Disposable Personal Income

- Disposable income has kept up with inflation and hence providing US consumer the buying power to satiate its ever-increasing need to consume.



US Household Debt to GDP

- Post 2008-09 recession, US household debt to GDP has declined considerably (see adjacent chart).
- This trend clearly shows that the US population is gravitating towards savings as opposed to investing in conventional assets classes like the Capital markets or Real Estate.



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Market Valuation…

CGAM's Proprietary Market Model:

We have developed our proprietary Market model, which has helped guide us in understanding the direction of the broader markets. We have used the S&P 500 index as the proxy for the US broad based markets. The model was developed on the belief that investor behavior repeats itself based on a combination of fundamentals of the economy and variables relating to investor psychology. The model is dynamic as it constantly reviews the change in the index based on the changes in statistically significant economic variables.

The table below is an illustration of the variables used to project the 12 month target on the S&P 500. Our regression model uses six variables (shown on the extreme left column), which attributes to 93% of the movement in the S&P 500.

Fundamental Variables	FY 2020 (Estimate)	Market Projections	*As of Sep 23rd, 2019*
S&P 500 Earnings	$182.00	S&P 500 (12 Month Projection) =	2,885.00
S&P 500 Expected PE Ratio	17.00	S&P 500 (Sep 23rd, 2019) =	2,995.00
10 Treasury Bond Rate (%)	1.54%	***S&P 500 Estimated (Gain/Loss) =***	***-3.70%***
Inflation Rate (%)	2.00%	***Standard Error***	**+/- 4.84%**
Volatility (VIX) Index	15.00		
Unemployment (%)	3.7%		

Conclusion…near to intermediate term…

It can be observed in the table above that the model projects a fully valued S&P 500 index currently. In other words, the model indicates a negligible return projection for the next 12 months. The model factors a 6-7% increase in the earning's of the companies comprising the S&P 500 index, for 2020 and a P/E ratio of 17 (average P/E for the last 3 decades is approximately 15). The model also suggests an error of approximately 5%, which if factored in will only move the index in the positive range by about 1-2%.

Even though things can change quickly rendering even the most sophisticated models useless, we believe that achieving greater than 6-7% earnings growth will be difficult for the US enterprise. Currently, a prudent risk reward inference compels us to be cautious and therefore suggest raising cash in growth portfolios.

Conclusion…10 years from today…

On the longer term however, things look different. If we use a 5-6% earnings gain per year on the S&P 500 companies and an average price to earnings ratio of 16-17 over the next decade, we can see below how the equation develops:

Fundamental Variables	FY 2029 (Estimate)	Market Projections	*As of Sep 23rd, 2019*
S&P 500 Earnings	$315.00	S&P 500 (10 Year Projection: 2029) =	4,462.00
S&P 500 Expected PE Ratio	16.00	S&P 500 (Sep 23rd, 2019) =	2,995.00
10 Treasury Bond Rate (%)	2.50%	***S&P 500 Estimated (Gain/Loss) =***	***+48.97%***
Inflation Rate (%)	2.50%	***Standard Error***	**+/- 3.31%**
Volatility (VIX) Index	13-15		
Unemployment (%)	3.7%		

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One can always argue the validity and the values of the variables undertaken. However, if we believe that the US economy can grow at a reasonable rate of 2-3% per year over the next decade and earnings in tandem can grow at 5-6%, then we can see a healthy gain in the S&P 500 index. The gains do not include the dividend provided by the companies in the index. If we incorporate the dividends, we can add another 18-20% over the same time period. In other words, the model shows that the index may not double from where we are, but it can come close to it. There are obviously a lot of moving parts in this equation, and they dynamics change constantly.

Even though no one can say with any certainty what the markets will do over the next decade, if history is to rhyme in the future, we can be confident with our investments in the US economic fundamentals.

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

Please review the following disclaimer

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