

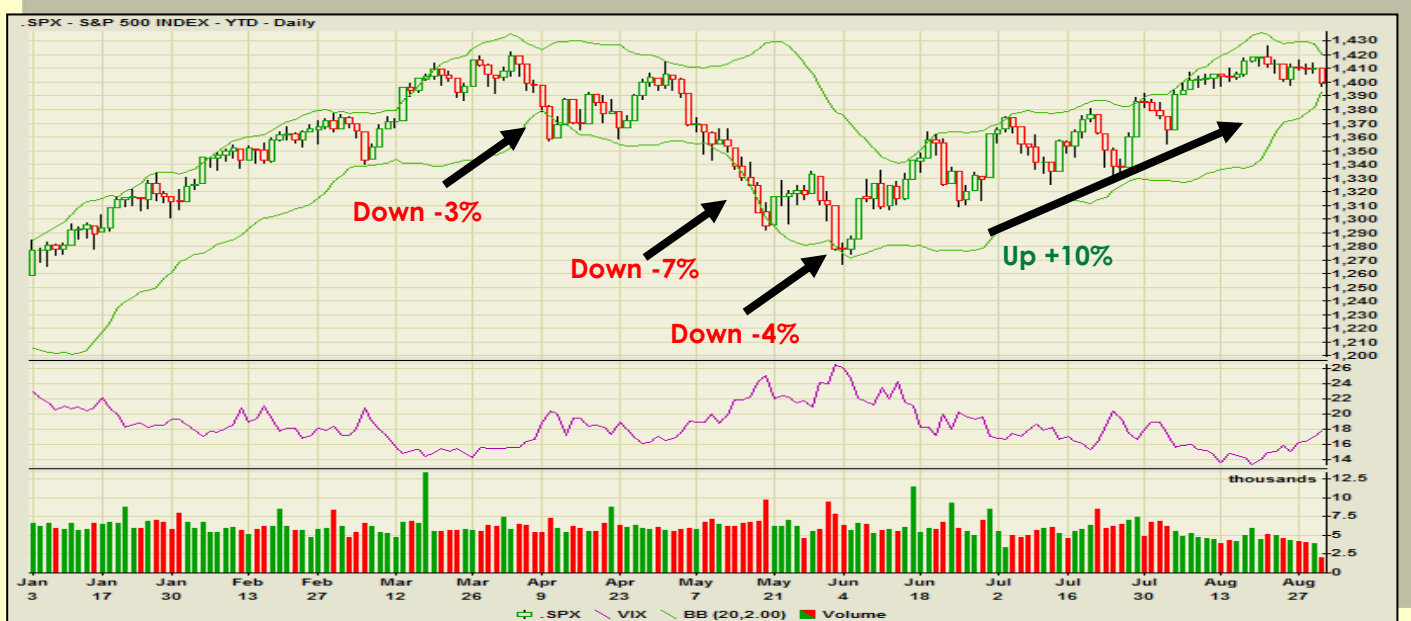
Newsletter-Follow on

We started our September-October 2012 Newsletter with...

“Our May-June 2012 Newsletter concluded with, “Based on our market model illustrated on page 2 and our macro thought process, we are bullish on the US equity markets over the next 12-18 months. We believe that this interim correction is a good point to initiate fresh investment positions or add to existing companies...”

Since, the broader markets have gained approximately 7, 10 and 12% for the Dow Jones Industrial Average, S&P 500 and the Nasdaq respectively. Following is the extension of the chart to date that we had initially illustrated in the May-june 2012 Newsletter.

Chart 1¹



Its crucial and important to understand the actual reasons behind this recent market action; in this case a 10% broad-based rally. We believe that despite the improving global and especially US economic fundamentals, the primary reason behind this rally was the initial speech by Mr. Mario Draghi, Chairman of the European Central Bank, on July 26th. In essence, Mr. Draghi stated that the European Central Bank will do whatever it takes to support the European Union. Markets have rallied almost 10 % since that speech, which was later supported by our own Mr. Ben Bernanke, Chairman of the Federal Reserve Bank.

¹ Data Source: www.fidelity.com, CGAM's estimates

We believe that the markets were catalysed more by the belief that both the European and US Federal government is ready to provide liquidity in one form or another to help the economic recovery. In our view this market action seems to be based on make believe and speculation of added monies being funnelled into the economy. **This is not sustainable and sooner rather than later, the investing community will start to focus on economic fundamentals which include corporate earnings, unemployment and retail activity...**

Even though the US economy has experienced positive developments on the corporate earning's front and the housing market, we can not ignore certain technical variables (pertaining to investor sentiment and behavior) that are clearly signaling an interim correction..."

We then concluded the Newsletter with the following inference:

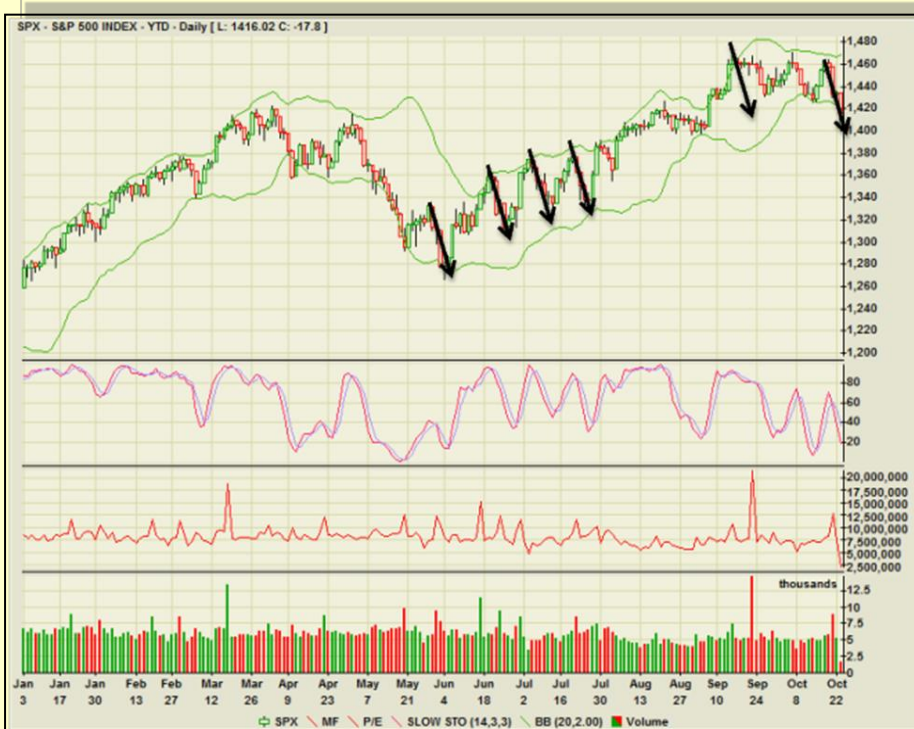
We believe that despite the improving fundamentals in the global economy, one can not completely ignore the behavioural side of the investor sentiment. We therefore believe that the broader markets could experience an interim correction in the magnitude of 5-7%. One of our team members emphasized the importance of understanding magnitude of an expected corrections within the framework of our market model. The exact downside in an interim correction can not be accurately predicted. A correction is expected primarily due to profit taking and emergence of caution in case the markets experiences negative news and hightened uncertainty from Europe, deceleration of growth in emerging economies and also US upcoming Presidential elections. Therefore, we would like to emphasize more conceptually on our belief of a correction in the near term rather than a specific number that the markets can correct.

We therefore believe that based on the discussion mentioned above, it would be prudent to raise cash based on individual risk stances and wait for an opportune time to re-enter the markets.

Since the release of this information, the markets have lost approximately -3.5%. This may have been a coincidence but it reinforces our belief in the herd mentality and fickleness of aggregate investor sentiment.

We would therefore like to illustrate the importance of mean reversion and the importance of technicals (in other words; investor sentiment) in the movement of the overall capital markets. Following is our brief discussion on the basic reason for the correction and whether its an opportune time to start buying into this market.

Chart 2²



The adjacent Chart 2 is an extension of Chart 1, which was initially exhibited in the September-October 2012 Newsletter.

We would like the reader to concentrate on the down arrows. Our intent is to show the volatility of the S&P 500 index, despite a relatively longer term bullish trend. It is crucial to understand two points :

- 1.)
- 2.) 1.) While the broader index has lost 3-4%, majority of the stocks could loose 2-3 times.

Change in S&P 500	Change in Stochastic (Fast-Slow) since Oct 5 th , 2012 ³	Change in PE Ratio
-3.24%	228.36%	-2.90%

2.) As the markets gain value, the possibility of a correction continues to rise due to the possibility of random and unforeseen variables. But the most important point to consider is that the impact of even the slightest negative news increases significantly as the markets reach higher highs.

As mentioned it in our previous issue we believe that this is a technical correction under the guise of fundamental issues. Even though markets are loosing value primarily due to dissapointing earnings from US companies, we believe that earnings continue to be reasonably sound on a global basis and the US corporate enterprise remains strong.

Illustrated is a table with the change in the S&P 500 since the market high on October 5th. We have used a technical parameter known as the Fast-Slow Stochastic, that attempts to understand the price movement of any security on a relative time horizon basis. It compares the movement of the security on the short and relatively longer term. The table clearly shows that the downward movement in the S&P 500 index has been accompanied by very significant movement in the stochastic variable over the last few days. This signifies a relatively higher and quick movement of the index over the short term relative to the last four weeks. Even though this is not an exact science, it exhibits our belief that the market has given more than deserved share to earnings that didn't meet expectations.

² Data Source: www.fidelity.com ,

³ Source: CGAM's estimates

We believe that the capital markets are in the mode of taking profits under the guise of a perception that US corporate environment may not be as robust and is being projected in lowered earnings expectations. We are of the belief that the markets could lose another 2-3 % due to this negative sentiment. We recommend that investors be prepared to start investing in companies that have shown strong earnings and are in favored sectors.

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

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