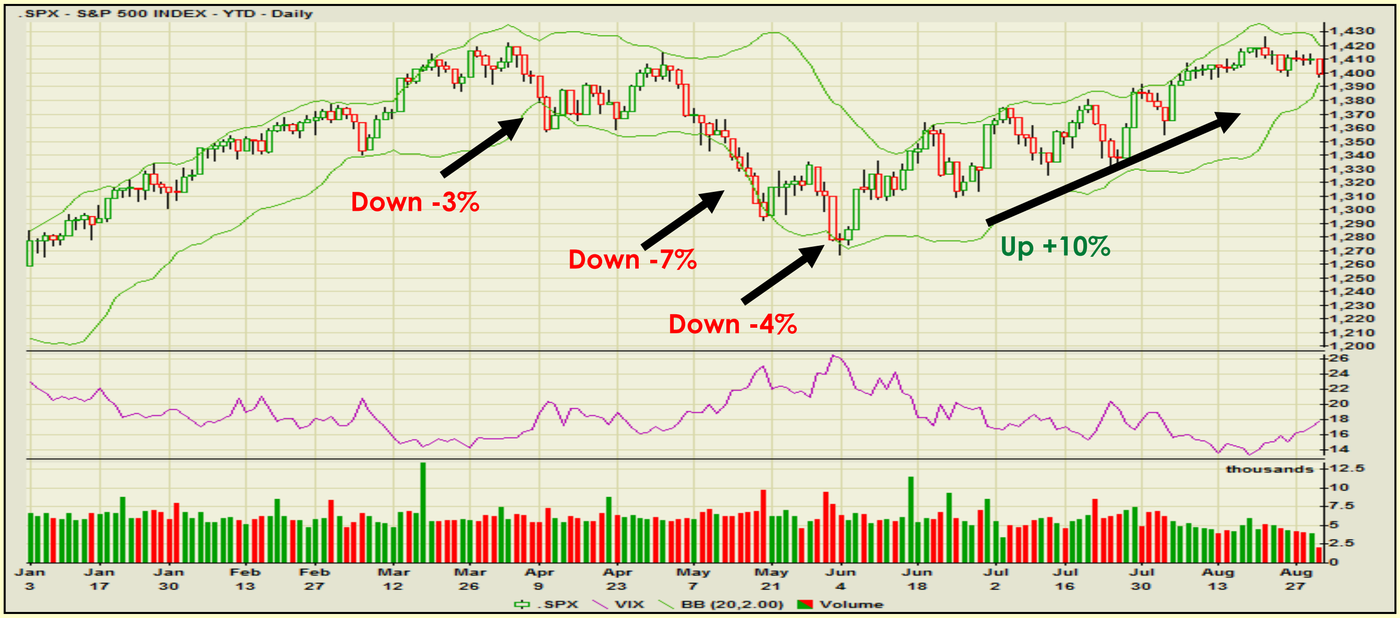
Newsletter

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 Industriual Averga, 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 1[1]



It is 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 is 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

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We believe that the markets were catalyzed 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. In our view, 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 signaling caution.

Following are important variables that we would like to share with our readers:

1. ***Volatility Index (VIX)***
2. ***Insider Buying / Selling Activity***
3. ***European Debt Issue***
4. ***Upcoming US Presidential Elections***

Before we start to elaborate on the technical aspect of the market equation, we would like to revisit our market projection model which is based on historical data spanning back four decades. As you can observe, this model is predicting a 10% gain from current levels on the broad based market indeces based on a reasonably strong US corporate earnings and an average historical PE (investor sentiment) ratio of 15. We haven't changed the unemployment or the inflation rate from our previous analysis. This means that in case the US corporate earnings continue to grow at a reasoble rate and there are no major unknown disruptions in the market, we should see decent gains in the market.

Table 2[2]

Fundamental Variables		**Market Projections**	
S&P 500 Earnings (12 month Projections)	$ 105.00	S&P 500 (Projection) = ***Based on the regression equation illustrated below***	1,548.00
S&P 500 Expected PE Ratio	15	S&P 500 (Current) =	1,369.00
Treasury Bond Rate (%)	2.00	***S&P 500 (Gain/Loss) =***	***+10.64%***
Inflation Rate (%)	3.1		
VIX Index	15		
Unemployment (%)	8.1		

S&P 500 **(12 Month Estimate) =**	584.008+4.22 x (S&P Earnings)+34.54 x (S&P Price Earnings Ratio)-95.57 x (Treasury Bond Rate{10 yr})+9.69 x (Consumer Price Index)-21.304 x (VIX; Volatility Index)+4.47 x (Unemployment Rate)+St. Error

[2] Data Source: Various Analyst estimates, CGAM's estimates

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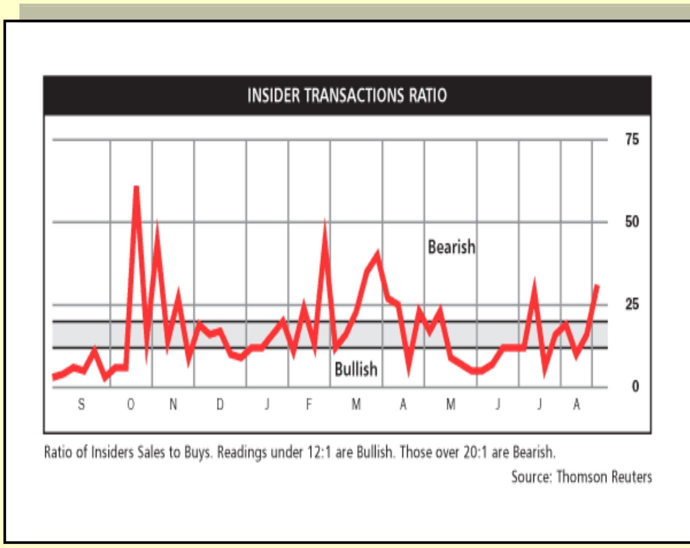
We now focus our attention to the technical variables stated above:

Volatility Index (VIX)[3] : Contratian Indicator pointing to a correction!!!

The Volatility Index is calculated using Puts and Call activity on the S&P 500 Index. In laymen terminology, it's the fear gauge of the market. If investors are worried about the direction of the markets and decide to buy protection in the form of Put options, it drives the VIX index up and vice verse.

In our view, the VIX index is a contrarian indicator. It can be observed in the adjacent chart that there is a clear negative relationship of the VIX with the S&P 500 (Purple line). If investors feel complacent and extremely bullish, the volatility index shows this behavior by being at very low levels. It is not difficult to observe that the VIX index is currently trading at extremely low levels. We believe that the recent market rally has brought in more than justifiable bullishness and complacency within investors. Any sign of negativity can induce a market correction.

Insider Buying / Selling Activity[4]: Hightened Insider Selling!!!



Ratio of Insiders Sales to Buys. Readings under 12:1 are Bullish. Those over 20:1 are Bearish.
Source: Thomson Reuters

Insiders comprise of management, directors and any employee that has access to material information of a company. The adjacent chart attempts to gauge insider sentiment by the buying or selling activity of insiders.

This is also a contrarian indicator in our view. As insider's selling activity picks up momentum, it may be an indication of market tops and vice verse. We can observe from the adjacent chart that there has been increased selling activity by insiders recently. In other words, majority of insiders may believe that the markets (especially their own company stocks) are already in or moving into overbought territory. This is a clear indication that the market may have moved ahead of itself based on higher expectations of economic stimulus and

[3] Source: www.Fidelity.com
[4] Source: www.Barronsonline.com

quantitative easing by the Federal government in the US and Europe.

European Debt Issue:

European debt and banking problems have been a major issue not only for Europe but for the rest of the world as Europe is the biggest economy in the world. Significant bail out plans and support from the European union and the International Monetary Fund (IMF) has been coordinated to help support the deteriorating conditions in this region. The financial support to various countries which include Greece, Portugal, Italy and Spain have been based on austerity plan specific to these countries. In other words, the financial support (bail-out plan) is based on following cost cutting plans designed to reduce federal debt and bring their financial house in order. In simple words, these measures obviously hurt public workers in terms of salary and benefit cuts and markets in terms of increased taxes. These bail out plans, which have been developed and approved by major countries like France and Germany are now in jeopardy, primarily due to the change in French government which has a socialist slant and may not agree with the previous regime's thought process.

Upcoming US Presidential Elections

We believe that the November 2012 Presidential election is a major event inducing uncertainty in the markets. This is not a new phenomenon, nevertheless a real one. Two major aspects that include Healthcare and Taxes (especially on Dividends and Capital Gains) are the source of uncertainty in this election. The Bush dividend and capital gains tax rate of 15% is in jeoprady for people with incomes of over $250,000.00 if President Obama is re-elected. On the other hand, some entitlement issues are casue of concern if the Republican Presidential nominee, Governer Mitt Romney takes office. Either way, US corporations and investors seem to be on hold before the elections.

We believe that despite the improving fundamentals in the global economy, one can not completely ignore the behavioral 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 the magnitude of an expected correction 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 experience 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 tolerance and wait for an opportune time to re-enter the markets.

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

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