Our August 2016 Newsletter concluded with:

"**CONCLUSION: We believe that the United States is one of the strongest economic regions in the world currently. With the US GDP expected to grow at approximately 2%, unemployment at 4.6-4.7% and wages rising, we are in a sound economic position. Having said that, US market indexes have moved up significantly in a short period of time. Market do not go up of down in a strainght line. From a technical perspective, we believe that investors should raise cash with a perspective to wait for an interim technical correction which would then be an opportunity to invest at lower values.**"
August 2016.

Once again markets have not disappointed us in proving that most valuations revert to their mean eventually. Obviously, we are referring to the brief market correction that we have encountered during the first week of September. The markets lost approximately 3% over three days, which in reality is hardly noticeable. But the more important aspect to consider is the reason markets reacted to.

Major indexes experienced this decline primarily due to the rhetoric from the Federal Open Market Committee (FOMC), indicating the imminent probability of increase in interest rates. The FOMC has been sharing their thoughts on rates all year and markets have been reacting by exhibiting a heightened volatility. The importance of rates has to do with two aspects. One; the beginning of the end of the easy money in the markets and two; is the US economy strong enough to withstand a rising rate environment.

Timing the market's highs and lows is one of the most difficult tasks anyone can undertake. Despite this statement, we continue to use our Market Direction Model to see into the future. We believe that this model has provided a reasonably logical vision into the future based primarily on variables, that have proven to be empirically significant effective.

CGAM's Proprietary Market Model:

Our proprietary model was developed on the concept that investor behavior repeats itself based on a combination of fundamental parameters of the economy and human psychology. The model constantly reviews the change in the index based on the changes in statistically significant economic variables.

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The objective of the model is to quantify these variables into a regression equation using four decades of historical data. The combination of these variables statistically explains 93-94% movement in the S&P 500 index.

Fundamental Variables (12 month Projections)		**Market Projections** ***Based on the regression equation illustrated below***	***As of: September 12th, 2016***
S&P 500 Earnings	$130.00	S&P 500 (12 Month Projection) =	2,293.00
S&P 500 Expected PE Ratio	17.00	S&P 500 (Sep 12th, 2016) =	2,135.00
10 Treasury Bond Rate (%)	1.70%	***S&P 500 Estimated (Gain/Loss) =***	***+7.50%***
Inflation Rate (%)	1.70%	***Standard Error***	**+/- 5.60%**
Volatility (VIX) Index	17.00		
Unemployment (%)	4.80%		

<u>S&P 500 (12 Month Estimate) =</u> 888.017+11.34 x (S&P Earnings) +21.18 x (S&P Price Earnings Ratio)-32.98 x (Treasury Bond Rate {10 yr.})-47.60 x (Consumer Price Index)+9.50 x (VIX; Volatility Index)-94.50 x (Unemployment Rate)+St. Error.

As mentioned umpteen times in our previous Newsletters, we believe that fundamental variables like S&P 500 earnings, interest rates, inflation and unemployment ultimately drives the longer term value of the markets. Having said that, we at CGAM also believe that one can not diminish the importance of investor sentiment. Followin we have emphasized the factors impacting each of these varaibles and the ramifications on our expectations on the markets.

1. **<u>S&P 500 Earnings:</u>** Most economists expect a better second half of 2016 for the US GDP growth. On an average, economists are expecting 2-2.5% GDP growth for Q3 and Q4 of 2016. Unemployment and wage growth have improved significantly over the last few years as well. We do not put a significant ammount of credibility in the GDP growth expectations at this time. We therefore have used $130 for the S&P 500 companie's earnings for the next 12 months. This is consistent with the figures we have used since the beginning of the year.
2. **<u>S&P Price/Earnings (P/E) Ratio:</u>** The S&P 500 is trading at approximately 16-17 times next years projected earnings. This ratio, a measure of investor sentiment, has averaged at about 15 over the last 4 decades. We do not believe that the S&P 500's P/E ratio exhibits overbought levels in the capital markets currently. Further we feel that the P/E ratio can expand and help fuel the markets further, if the markets experience better earnings growth.
3. **<u>Inflation Rate:</u>** Commodity and energy prices are at favorable levels for economic growth. Lower Inflation levels should help bolster markets going forward.
4. **<u>Unemployment Rate:</u>** We are currently experiencing 4.8-4.9% unemployment rate in the US. This number has been a subject of controversy. Many experts in this area believe that most of the jobs created are part time, in addition to a significant number of people exiting the job market. We believe that a more crucial variable is the wage growth that has been experienced over the last few quarters. A

combination of improving job market along with higher wages should help boost the economy. One needs to recognize that $3/4^{th}$ of the US economy is supported by the US retail investor.

5. **Volatility Index (VIX):** We believe that the Volatility Index (VIX), a measure of the fear in the markets, is a reliable contrarian indicator. The VIX Index, a fear gauge for the markets, is calculated using PUTs and CALLs being bought on the S&P 500 index. If investors buy more Puts than Calls, the Fear gauge moves up and vice verse. It indicates how concerned investors are in the short to intermediate term about the market volatility. The VIX index rose from a low of 11-12 to approximately 18 during the second week of September; a 50% increase. We believe that the difference pre and post FOMC rhetoric is only in market sentiment. We would be comfortable investing into the market at VIX levels north of mid 20s.

It can be infered from our Market Direction Model above that the S&P 500 could gain approximately 7-8% over the next 12 months. We believe that this is primarily due to the earning power of the mid to large US companies and the opportunity that the markets are creating with the current market correction.

CONCLUSION: We had suggested in our August Newsletter that it would be prudent for investors to wait for a market correction to start reinvesting at better equity values. In addition, we had recommended raising cash in portfolios for protection and to be positioned for better market opportunity. We believe that the recent correction is the beginning of a market opportunity we should see in the near term. We can never be exact but we believe that VIX levels of over 20 and a 5-7% market correction should be an opportune time to start reinvesting in the US markets.

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

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