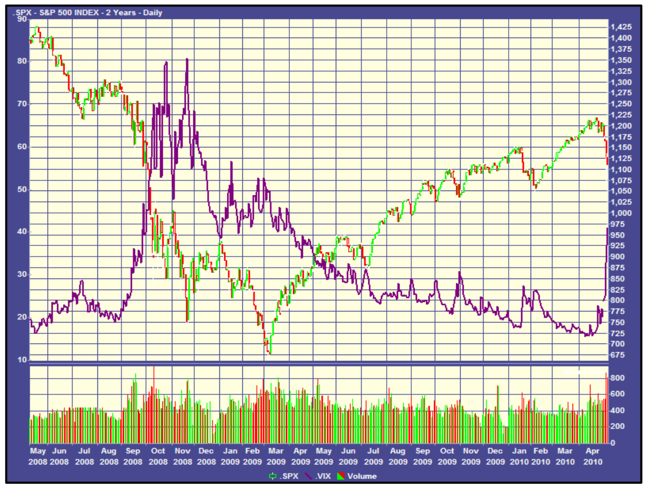
Continuum Global Asset Management, LLC

Market Commentary: May 7th, 2010: 5:40 pm (PST). Posted by Manu Walia

Every market correction has its own sets of variables that justify it in hind site. Most market pundits articulate the event, after it has occurred. We would like to focus on certain factors that will provide some clarity, despite prevailing fear which is usually preceded and followed by greed.

Following are four variables that encompass fundamental and technicals that drive investor sentiment.

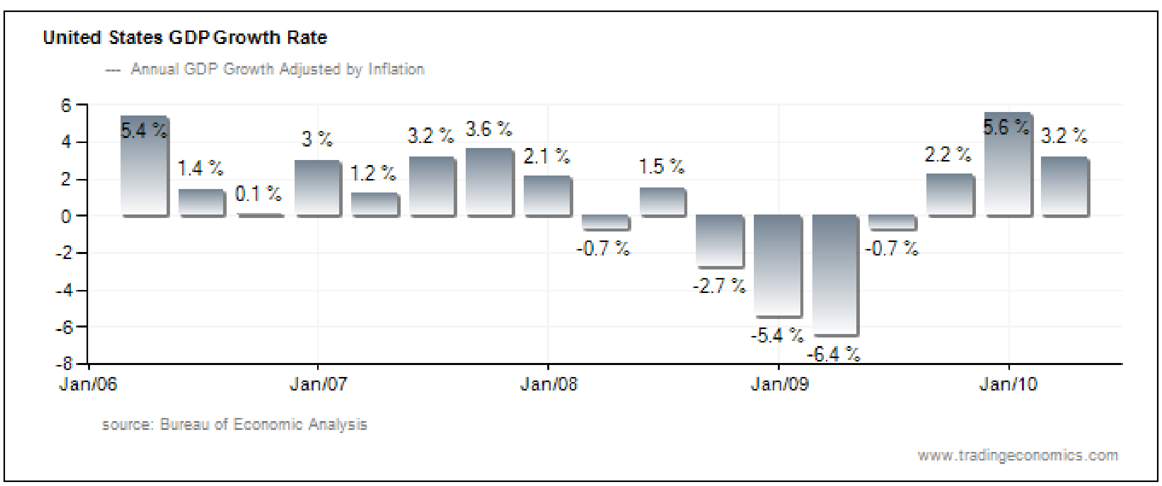
<u>Volatility Index:</u>



The Chart below is a representation of the Dow Jones Industrial Average (DJI) and the Volatility index (VIX; in purple). The VIX index is calculated by the option activity in the market and in essence gauges the fear in the market.

It can be observed that the VIX index rose from a level of 20 on September 2nd, 2008 to 79 on October 24th, 2008, a 260% gain. During that time the DJI dropped -27%. The recent market decline of 8-9% has experienced the VIX index move from a low of 16 on April 21st to 41 on May 7th, a 156% increase in about 2 weeks. More importantly, majority of the increase was experienced in the last three days. As contrarians, we believe that the VIX is suggesting extreme fear which started with the European debt crisis, but was fueled by the May 6th technical glitch on the US exchanges which sent the DJI down more than 1,000 points for a few seconds. Following are crucial variables that should describe how the US economy is positioned fundamentally going forward.

<u>The US Economic Growth:</u>



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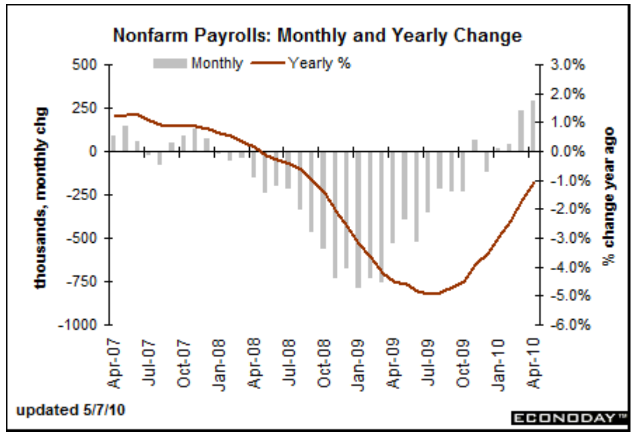
The US Gross Domestic Product (GDP) contracted at about 3-5% from September through November of 2008 and carried into the first quarter of 2009. It can be clearly observed from the GDP chart above that the US economy has been growing at an average of 3.6% over the last three quarters. This reversal from the late 2008 and early 2009 is favorable for capital markets as the US economy experiences an expansionary phase.

Unemployment Rate:

One of the most important factors for the US economic growth is employment as 70%+ of the US GDP is driven by the consumers.

The employment situation has been improving since the beginning of 2010 and over 500,000 jobs were added to the economy over the last two months. Despite the fact that the unemployment rate is at approximately 9.7%, the reversal in the trend suggests further improvement in job creation which should lead to higher spending and hence catalyzing the US economy.

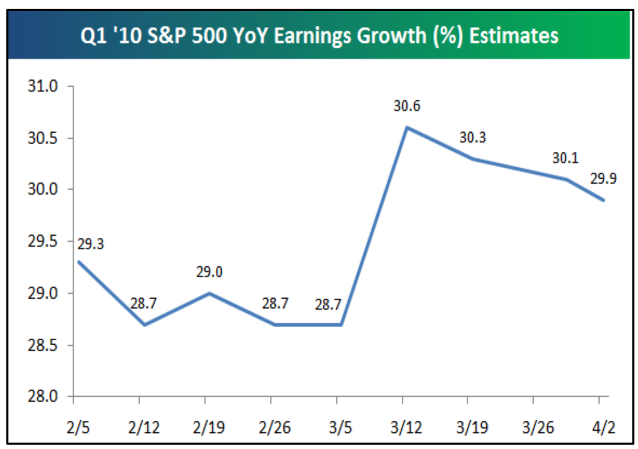


US Corporate Earnings:

In addition to unemployment, US corporate earnings play a crucial role in valuing the future of the markets.

Below is a table which illustrates the S&P 500 company earnings projections for the year 2010. The adjacent chart shows the earnings growth expectations before the Q1, 2010 earnings release.

We believe that earnings should continue to rise for the next 2 quarters. Using a low P/E of 15 (80 year average), we can expect a 21% growth in the S&P 500 over the next 12-18 months.



CHANGING ESTIMATES	Q4 2009 ESTIMATES AS OF:			2009 ESTIMATES AS OF:			2010 ESTIMATES AS OF:		
	6/30/2009	**9/30/2009**	**CURRENT**	**6/30/2009**	**9/30/2009**	**CURRENT**	**6/30/2009**	**9/30/2009**	**CURRENT**
S&P 500	17553.57%	17167.74%	17997.59%	12.19%	10.38%	13.57%	33.28%	34.85%	33.38%
Consumer Discretionary	794.80%	871.28%	928.79%	42.54%	62.94%	80.99%	72.81%	57.36%	44.88%
Consumer Staples	9.86%	9.88%	9.59%	1.19%	2.66%	4.60%	10.06%	9.95%	8.54%
Energy	35.34%	40.45%	51.12%	-67.22%	-66.74%	-64.99%	90.19%	90.49%	87.54%
Financials	118.93%	114.84%	118.17%	133.92%	124.21%	124.63%	84.45%	132.03%	131.57%
Health Care	17.33%	15.84%	16.69%	8.28%	7.78%	9.04%	9.50%	9.71%	11.99%
Industrials	-15.32%	-18.15%	-22.05%	-32.73%	-33.19%	-35.48%	9.49%	8.27%	10.67%
Information Technology	76.60%	81.35%	97.13%	-7.51%	-3.98%	1.77%	32.65%	32.87%	28.95%
Materials	132.94%	128.96%	138.38%	-41.40%	-37.11%	-16.77%	112.52%	105.50%	72.14%
Telecommunication Services	13.55%	14.64%	2.39%	1.81%	-2.52%	-8.62%	1.22%	4.86%	7.54%
Utilities	12.42%	8.02%	5.94%	-2.48%	-4.87%	-4.62%	9.85%	11.18%	9.60%
S&P 500 EPS	**$16.31**	**$15.95**	**$16.73**	**$55.54**	**$54.64**	**$56.22**	**$74.02**	**$73.69**	**$74.99**

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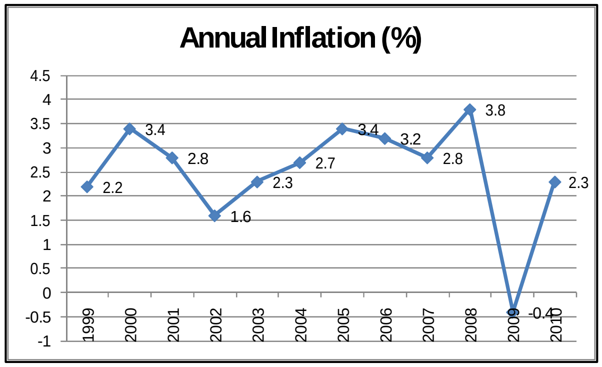
<u>Inflation and Interest Rates:</u>



Interest rates are at a historic low and inflation is under control. Even though we believe that the Federal government will start to raise rates over the next 6-12 months, their current rhetoric suggests that rates will stay at current low levels for the foreseeable future. Low interest rates mean low cost of capital for the US corporate enterprise helping their profit margins and earnings growth.

Despite the favorable market variables explained above, one can not underestimate the ramifications of the crisis Europe is facing currently. The worry is that the European banking system may suffer a complete lack of customer sentiment as experienced in the US during 2008. The European Central Bank has a mandate and we share the Article 2 from it as follows:

<u>"Article 2 Of the EU Treaty states that the EU aims to promote "economic and social progress and a high level of employment and to achieve a balanced and sustainable development."</u>

We believe that after experiencing especially the recent turmoil, the ECB will not risk a repeat of the financial crisis in the European Union. Providing more liquidity may not be the most effective long term remedy but it sure will provide the instant relief for investors to take a breather and reassess the entire situation. We also believe that the fundamentals of the global economic recovery will prevail and help keep the earnings story intact.