Continuum Global Asset Mgt., LLC

April 2008

Newsletter

Market Commentary

The Newsletter dated January 2008 started with the report card for the world stock indexes. By the end of January the major US broad based stock indexes had lost value by a magnitude of 7-10%. Surprisingly, emerging markets like India, China and Russia had lost only about 2-3% during early January 2008. At that time the buzzword being chanted was "decoupling"; decoupling of emerging market's economy with that of the industrialized nations like the US and Europe. That did not last long and for the first quarter of this year, the emerging world has lost significantly more value relatively to the capital markets in the US.

The dismal performance of the hottest emerging markets like China, India, Turkey etc, can be observed clearly from Table 1. The concept of decoupling lasted a few weeks. As the good old fear took hold, investors world wide started to unload asset classes across the board.

Table 1[1]

Country-by-Country Derby

First-quarter stock-market performance, based on the Dow Jones Global Indexes in U.S.-dollar and local-currency terms ranked by U.S.-dollar performance

Country	U.S. dollar	Local currency	Country	U.S. dollar	Local currency
Morocco	**24.4%**	16.1%	Austria	**−8.6%**	−15.7%
Peru	**14.5**	4.8	Colombia	**−8.7**	−17.1
Slovakia	**10.7**	−1.3	Russia	**−8.9**	−12.9
Pakistan	**8.5**	10.3	U.S.	**−10.0**	−10.0
Mexico	**8.3**	5.9	Finland	**−10.1**	−17.0
Chile	**8.3**	−4.9	Norway	**−10.2**	−15.9
Taiwan	**8.0**	1.2	Singapore	**−10.4**	−14.2
Egypt	**6.2**	4.9	Estonia	**−10.9**	−17.8
Thailand	**1.6**	−5.1	Malaysia	**−11.2**	−14.1
Jordan	**−2.0**	−2.0	U.K.	**−11.2**	−11.1
Czech Republic	**−2.1**	−14.4	Italy	**−11.5**	−18.4
Switzerland	**−2.2**	−14.6	Germany	**−11.6**	−18.4
Denmark	**−2.3**	−9.9	Portugal	**−12.7**	−19.5
Sweden	**−2.4**	−10.5	Australia	**−12.8**	−16.2
Latvia	**−2.9**	−10.2	Hungary	**−14.3**	−18.6
Belgium	**−3.0**	−10.5	South Korea	**−14.7**	−9.7
Malta	**−3.4**	−10.8	New Zealand	**−14.8**	−16.6
Ireland	**−3.7**	−11.1	Greece	**−15.5**	−22.0
Poland	**−4.8**	−14.1	South Africa	**−17.7**	−2.1
Lithuania	**−5.2**	−12.6	Slovenia	**−17.9**	−24.2
Spain	**−5.4**	−12.7	Bulgaria	**−18.5**	−24.8
Netherlands	**−5.7**	−12.9	Philippines	**−19.2**	−18.2
Brazil	**−5.7**	−7.3	Hong Kong	**−20.1**	−20.3
Argentina	**−6.4**	−5.9	Romania	**−24.2**	−27.3
Israel	**−7.5**	−15.1	China	**−26.8**	−27.0
Japan	**−7.7**	−17.8	India	**−29.2**	−27.9
Canada	**−7.8**	−4.2	Iceland	**−33.8**	−20.1
Indonesia	**−8.3**	−10.1	Cyprus	**−35.0**	−40.0
France	**−8.5**	−15.6	Turkey	**−37.2**	−28.5

Source: Dow Jones Indexes

Mr. Barton Biggs, auther of the book "Hedge Hogging" and a successful hedge fund manager mentioned that booms and busts take place when majority of investors take one side of the market. This concept was clearly exhibited during the recent housing market boom (2003-2006), as buyers with access to abundant liquidity believed that investing in real estate was a sure thing. Greed, one of the main ingredients of capitalism, incented the corporate world to develop creative financing and hence fueling the mania further.

There was no better investment opportunity like real estate. Then in mid 2007 the tide turned and real estate took a turn for the worst. Most financial and mortgage companies started to loose value in their mortgage portfolio holdings, compelling them to take hefty wrtie downs. Domestic and international financial corporations have taken write downs of over $200 billion so far. The deteriorating financial health of these institutions has investors doubting their ongoing existence. A major financial services company, Bear Sterns, announced the demise of two of it's mortgage backed hedge funds in the middle of 2007. Its financial condition kept deteriorating and it finally ended up being sold to JP Morgan for a mere $10 per share by mid March 2008, even though it's stock had traded as high as $150 during early 2007. This transaction was consumated by the blessing and initiation of the Federal governmet in order to mitigate further sentiment deterioration, which could have been devastating for the worldwide capital markets.

As the greed of real estate investing turned to the fear of sub-prime impact, market sentiment turned into

[1] ***Source: Wall Street Journal** www.wsj.com*

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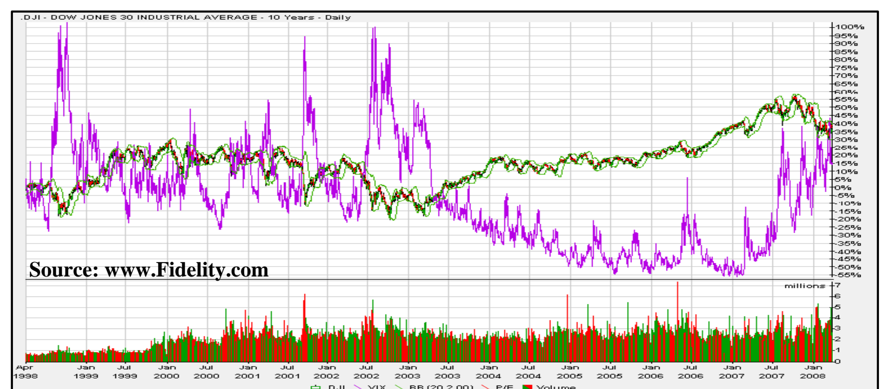
panic. Investors started to realize the extent of real estate associated holdings in money market funds held at major financial institutions, the lack of liquidity and unclear valuations of these products. The initial worry regarding the economic slow down turned into a major concern as investors questioned the sustainability of the US financial infrastructure. The culmination of these factors has left the market with fear and uncertainty during the first quarter of 2008.

As we move into the second quarter of 2008, an evaluation of the changing economic and business environment becomes a crucial endeavor in the aspect of investing. Even though no one knows what the future holds, I will attempt to present an ensemble of fundamental and technical variables which should provide conviction and guidance for the markets going forward.

1. **Federal Fed Rates:** The Federal government uses monetary policy to control the cost of borrowing by proactively setting the Federal Fund Rates. The Federal Open Market Committee has lowered the Fed Fund rates six times since September 2007, to enhance liquidity and in turn help the economy circumvent a severe downturn. In addition, the Federal government has used fiscal policy to help the deteriorating conditions of the sub-prime and Alt-A housing category. Also, President Bush has authorized an economic stimulus package worth $160 billion, which is expected to provide a boost in consumption and economic growth, starting May 2008.
2. **Money Market Balance:** Currently, the fear within the investor community has resulted in significant liquidations in the capital markets from both, the retail and institutional investors. This has resulted in accumulation of over $3.5 trillion in money market assets, which is approximately 25% of the total stock market value in the US. Under normal business and economic circumstances, money market funds range between $15-1.7 trillion. Institutional investors which include mutual funds, have a mandate to be invested in their respective asset classes and styles. At some point when markets stabilize, a major part of the money markets assets will be invested back in the market. This would not only help lift the market but also catalyze a change in overall investor sentiment.
3. **Fed Model:** Any rational investor would compare the opportunity cost of investing in growth oriented riskier equities as opposed to safer bonds. As these two asset classes behave differently and have separate risks associated to them, a rational comparison would be to measure the earnings yield for each security. The 10 year treasury (a universal proxy for bonds) is currently yielding approximately 3.45%. This means that a $1,000 bond provides approximately $34.50 in annual earnings to its investor. In other words, the Price ($1,000) divided by earnings ($34.50) provides the Price Earnings multiple of 28.98. Currently, the Dow Jones Industrial Average is trading at a 13.14 Price to Earnings and S&P 500 is trading at about 17. In other words a lower PE multiple is a sign of value. It can be observed by the relatively low PE multiple of a broad based index like the S&P 500 that there is relative value with an assumption that the US economy will not go through a severe slowdown.
4. **Short Positions:** The short interest on NASDAQ is at high levels on a relative basis. Currently, 9.77 billion shares are shorted as opposed to 4.06 billion in March 2003. This high relative short position in the market during 2003 was experienced just before the market staged a major rally. (Investors short or sell borrowed stock to benefit during declining markets).
5. **Volatility Index (VIX):** The VIX index is a measure of implied volatility in the market, calculated by using the ratio of bearish and bullish options. It can be observed from the adjacent chart that the VIX index (illustrated in Pink) experienced abnormal volatility over the last two quarters. Once again, the uncertainty whether the US economy will experience a slowdown or recession has the VIX gyrating vehemently. In comparison, the green line on the chart represents the Dow Jones

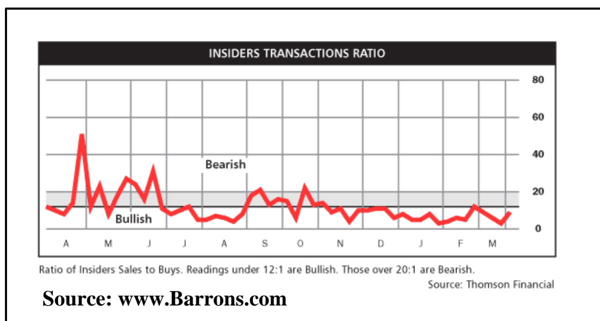


Industrial Average, which moves inversely to the movement of the VIX index. Even though the Dow Jones Average has not experienced losses comparable to those experienced during 2000-2002 dot.com bust, we can clearly see that the volatility index has been trading at above average levels. As a contrarian indicator, above average volatility is followed by a bull run as investors start to unwind their bearish positions.

6. **The mighty Dollar:** The US dollar is the main currency of trade in the international commodities market. In other words, major commodities like oil and precious metals are traded in US dollars. It can be observed by the chart on the right that the dollar index has depreciated (against major currencies like the Euro, English Pound and the Japanese Yen) over the last few years. US Federal deficit has increased significantly over the last 5-7 years as well as the balance of payments that gauge the difference between exports and imports. The silver lining for a declining dollar is that a relatively weaker currency promotes exports as goods produced in the US become cheaper for our trading partners. On the flip side, a declining currency also catalyzes inflation. I believe that the Federal government is close to the end of rate reduction, which should bolster the dollar. In addition, the enhanced export activity from the US will counter the domestic economic slow down to a great extent. The Dow Jones Average contains 30 US compaies, off of which, 25 derive major portion of their revenues from overseas. The growth in these respective company's revenue should be a result of increasing global consumption and the declining dollar.

Source: www.ino.com

7. **Insider Buying:** A major gauge of corporate activity is to review insider trading. Insiders comprise of the upper management and employees of a company. The chart below signifies the buying and selling patterns of insiders. A reading below 12 signifies bullishness and above 20 bearishness. In other words a ratio of sales to buys can gauge the insider sentiment regarding their own company's growth and performance.



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

It is apparent that on average corporate insiders are confident regarding the growth of their businesses and hence the future performance of their respective company stocks.

Even though the culmination of variables effecting the markets stated above present a bullish projection for the capital markets, one can not forget that the impact of the housing decline can and will effect the economy in ways we may not be able to foresee. It will be important to continue to monitor the US housing situation and how deeply it impacts consumption patterns and in turn broad based corporate earnings.

Despite the uncertainty with economic growth, rising commodity prices and deceleration in domestic consumption, I am confident that the resilience of capitalism and human behavior to find solutions and move forward will bring us out of this slump and into a renewed bullish phase. To conclude, I believe that long term investors could start building investment positions in strategic sectors like industrials, technology and the controversial financial services. We can not accurately pick stock market bottoms, but can gain superior results by being patient and skillfully contrarian.

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