Continuum Global Asset Management, LLC

Earnings, Earnings, Earnings…

It is amusing to watch how the fluctuations in the stock market can completely change the opinions of major economists and pundits in a short span of time. The global capital markets are up at a very healthy rate for the first four months of the year, but not without a rough patch which started on February 27th and reversed in mid March.

Robust returns

The following table illustrates the various indexes and their performance to date. Majority of this growth has been experienced over the last 3-4 weeks. We could infer a healthy annual return of approximately 15-16% for the Dow Jones Industrial average if we were to annualize the return to date.

Index Description	Change since Beginning of 2007	Q1 Returns	Q2 Returns
DOW JONES INDUSTRIAL AVERAGE INDEX	5.40%	-0.87%	6.33%
S&P 500 INDEX	4.79%	0.18%	4.61%
NASDAQ COMPOSITE INDEX	4.81%	0.26%	4.54%
RUSSELL 2000 STOCK INDEX	3.63%	1.66%	1.94%
ISHARES MSCI EAFE FD	8.00%	4.21%	3.64%
LEHMAN CASH COMPOSITE - U.S.	1.63%	1.63%	0.00%

Earnings

The most important element in the growth of a company that hopefully translates to an increase in the company's stock price is; EARNINGS!!!

Inflation & Interest Rates

Earnings of a company are directly related to the operating expenses, in other words INFLATION, and the cost of capital or prevailing INTEREST RATES.

This basic premise of understanding stock valuation consists of variables that have played an important role over the last few months in the market drama. The markets started the year with a focus on US interest rates, and most economists were busy predicting the direction of the US rate movement. The market had a high level of conviction that the Federal government would lower rates. Also, the carry trade, which uses borrowed funds in low interest rate environment like Japan and invests those funds in other international markets to gain higher returns, have been a major factor for excess global liquidity. As the Bank of Japan raised rates to the current level of .50%, it brought worry about a liquidity squeeze.

As wages and commodity prices rose, the markets started to worry about inflation. In addition, investors became nervous about lower GDP growth in the USA that could spread to other markets and decelerate global growth. Another aspect of anxiety is the sub-prime loan industry in the US, which was viewed as a ticking time bomb. All these areas of worry were exacerbated by a 9% slide in the Chinese markets on February 27th that catalyzed a 370 point tumble in the Dow Industrial Average in tandem.

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Market Resilience

So why has the markets rebounded with such resilience? In my view investors started to believe that the Federal government will lower rates as the economy experienced less than robust growth and benign inflation during the first quarter of 2007. As the worry of interest rates abated, the focus moved towards scrutinizing corporate earnings growth. We all know that the US economy has experienced 13-14 quarters of double digit growth. Analysts had recently reduced the earnings expectations to mid single digits for the first quarter 2007.

Following is a table illustrating earnings growth for approximately 1500 US companies so far in Q1, 2007. These companies have experienced an average earnings growth of 10% relative to last year.

No. of cos.		Net on Continuing Operations		
		1st Qtr. 2007	1st Qtr. 2006	% Chg
1505	GRAND TOTAL	170,143,928	155,005,631	+10

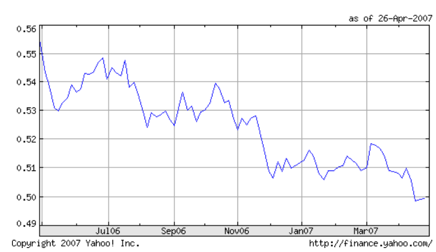
Source: Wall Street Journal

Domestic Growth and…

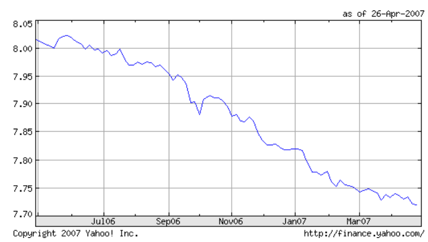
I have to emphasize that the earnings growth in the US companies for Q1, 07 are sound, but the perception has been lifted as earnings have been able to beat the muted guidance set by major analyst and financial professionals.

Chart 1[1]

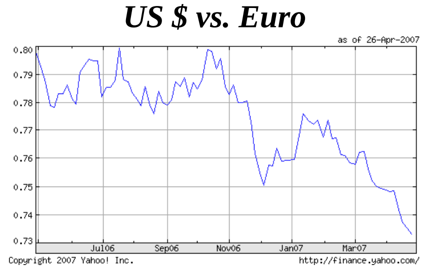
US $ vs. British pound



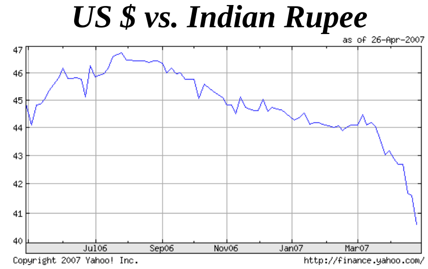
US $ vs. Chinese Yuan



US $ vs. Euro



US $ vs. Indian Rupee



[1] Source: www.yahoo.finance.com

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…Global Growth

Another very important element to consider is the source of the growth American companies are experiencing currently. Early this week Caterpillar and JP Morgan announced their progress for the first quarter of 2007. These companies operate in completely different industries. Caterpillar is a hard core manufacturing company providing tangible earth moving machines. On the other hand JP Morgan is a diversified financial services company. Both these companies had declining sales in the US which were more than offset by the robust growth internationally.

Currency factor

It can be observed in the Chart 1 above that the US dollar has exhibited a common pattern against currencies of its major trading partners. The declining dollar has added to the growth in the US companies that derive revenues in non-dollar currencies.

This is an important phenomenon to consider. As the rest of the world progresses and provides competitive advantage in certain specific areas, it helps keep a lid on inflation in two ways:

1. Wages remain low as the pool of skilled workers across the world rise
   a. This creates a pool of labor that adds value in the services industry without creating wage inflation (at least for the foreseeable future).
2. Even though commodity prices have risen, the value addition primarily in the global manufacturing sector and related industries allows a higher consumption in the industrialized regions of the world.

Conclusion

In conclusion, I believe that the phenomenon of globalization has and continues to provide real growth. One doesn't necessarily need to only invest overseas but can also take advantage by investing in US companies that truly benefit from the global exposure.

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