



## Continuum Global Asset Management, LLC

### Market Direction June 8<sup>th</sup>, 2011

**Objective:** To develop an understanding of the longer term market direction based on fundamental and technical variables.

Gordon Gekko turns to Bud Fox in the award winning 1987 movie “Wall Street”, and says **“...the illusion has become a reality...”**.

The current behavior of investors reminds me of this blatant behavior of the herd mentality. After a strong recovery in the US and global recovery, investors seem to be worried about Debacle 2; a repeat of the 2008-09 market turmoil. There is no question in our mind that capital markets are driven by investor sentiment. That said there are various fundamental and technical variables that constantly weigh on investor sentiment. We have used 16 variables listed in Table 1 below.

The primary endeavor with this exercise is to understand the major factors that may help maintain or derail the recent bullish sentiment of the market. Table 1 categorizes these variables using their importance, whether these variables are positive or negative for the market, and whether they have a long term or a short term impact.

Table 1								
	Variables To Consider	Priority (1-10)	Positive	Negative	Fundamental Variables	Technical Variables	Long Term	Short Term
1	Federal Fiscal Policy-Phase II Ends :June	7		0				χ
2	Consumer Sentiment	6		0		χ		χ
3	Commodities/Gas Prices	7		0	χ		χ	
4	S&P 500 earnings Projections	8	1		χ		χ	
5	GDP Growth (%)	8	1		χ		χ	
6	US Federal Debt	8		0	χ		χ	
7	Global Growth	8	1		χ		χ	
8	European Debt	6		0	χ			χ
9	Emerging Market Growth	6	1		χ		χ	
10	Inflation	6		0	χ		χ	
11	Treasury Yield Vs Earnings Yield	5	1		χ			χ
12	Margin Debt	5		0		χ		χ
13	US Unemployment Rate	7		0	χ		χ	
14	US Worker Productivity	7	1		χ		χ	
15	US Index Movement	5	1			χ		χ
16	Volatility (fear gauge) Index Movement	6		0		χ		χ

*Priority: 1 through 10, 1 being most important, Positive = 1; Negative = 0*

It can be observed the following:

1. 12 out of 16 variables are of the fundamental nature.
2. Almost 60% of the variables have long term impact on the markets.
3. Negative and positive variables are approximately evenly split.
4. More than 80% of the variables have fairly high to high priority.

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Even though it is difficult to form a strong opinion about the direction of the markets by looking at this table, there is no variable that is pointing towards a double dip recession. In addition, the crucial fundamental variables like US corporate earnings, global growth, the difference between the US Treasury return vs. the US Corporate earnings return are all pointing towards a longer term economic recovery and improvement.

We believe that earnings are the most important element driving the markets. We have evaluated a reasonable conservative estimate of 2012 S&P 500 companies' earnings estimate which is provided in Table 2.

It can be observed in Table 2 that even at a conservative P/E of approximately 16, the markets can experience a gain of approximately 10% over the next 12 months. At an average P/E of 17 we can expect the markets to gain 17%.

S&P 500 Earnings (2011)	\$87.00	
S&P 500 Earnings 2012 (Estimate)	\$95.70 <sup>1</sup>	
S&P 500 Index Value as of April 30 <sup>th</sup> , 2011	1,363.61	
	P/E Minimum	P/E Average
Average P/E	15.8	17
Projected S&P 500 Valuation	1,512.06	1,626.90
Expected %age Gain based on projected earnings	9.82%	16.18%

We have been waiting for a correction since the ending of the first quarter and we believe that we are in the midst of an interim correction within a secular bull market. We continue stay invested in equities and favor larger companies with higher dividend records and international exposure.

The following section is an analysis of a portfolio derived by randomly selected dividend paying stocks and a comparison of its results with that of the S&P 500 since March 30<sup>th</sup>, 2008. The objective of this exercise is observing the importance of dividends in the net returns of an actively managed portfolio during one of the most challenging times in capital markets.

<sup>1</sup> Source: Average Projected S&P 500 earnings based on CGAM projections. Information gathered from various analyst's projections



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### Dividend Portfolio Comparison to S&P 500 since March 30<sup>th</sup>, 2008

	Return From March 30 <sup>th</sup> , 2008- Dec 31 <sup>st</sup> , 2008	Return From March 30 <sup>th</sup> , 2008- April 1 <sup>st</sup> , 2009	Return From March 30 <sup>th</sup> 2008-June 7 <sup>th</sup> , 2011	Div (%)	Div for 3 years
<b>S&amp;P 500</b>	-31.32%	-38.33%	-2.30%	1.30%	3.90%
<b>Dividend Portfolio</b>	-23.75%	-28.00%	-7.61%	5.71%	17.14%
<b>S&amp;P 500 performance (Including Dividends)</b>			<b>1.60%</b>		
<b>Dividend Portfolio Performance (Including Dividends)</b>			<b>9.53%</b>		

	Symbol	Return From March 30- Dec 31 2008	Return From March 30- April 1 2009	Return From March 30- June 7 2011	Div / Year (%)	Div for 3 years
Telecom Italia ADR	TI	28.11%	29.88%	46.16%	5.90%	17.70%
Annaly Capital Mgt Inc	NLY	-1.17%	-8.16%	19.52%	13.70%	41.10%
Banco Santander ADR	STD	-60.68%	-54.11%	-41.88%	7.26%	21.78%
Eli Lilly And Co	LLY	-21.94%	-36.19%	-27.66%	5.10%	15.30%
SK Telecom ADR	SKM	-24.34%	-27.49%	-16.06%	8.60%	25.80%
AT&T Inc	TI	-35.72%	-33.11%	-20.63%	5.50%	16.50%
France Telecom ADR	FTE	-33.09%	-34.31%	-36.69%	10.40%	31.20%
Exelon Corp	EXC	-33.28%	-43.24%	-48.94%	5.10%	15.30%
Nokia ADR	NOK	-61.45%	-55.58%	-79.45%	6.50%	19.50%
PPL Corp	PPL	-33.23%	-34.86%	-39.70%	5.10%	15.30%
CenturyLink Inc	CTL	-18.35%	-18.32%	21.54%	7.10%	21.30%
American Electric Power	AEP	-24.69%	-36.63%	-9.63%	5.00%	15.00%
Johnson & Johnson	JNJ	-11.07%	-19.28%	1.14%	3.48%	10.44%
Progress Energy Inc	PGN	-7.15%	-18.18%	11.99%	5.18%	15.54%
Duke Energy Corp	DUK	-15.13%	-22.63%	3.14%	5.12%	15.36%
Pfizer Inc	PFE	-30.34%	-36.17%	-0.67%	4.25%	12.75%
FirstEnergy Corp	FE	-27.15%	-40.40%	-36.72%	5.00%	15.00%
Toyota Motor ADR Rep	TM	-37.05%	-24.51%	-19.05%	1.52%	4.56%
Pepco Holdings Inc	POM	-27.95%	-51.66%	-21.12%	5.44%	16.32%
Costco Wholesale Corp.	COST	-30.50%	-24.99%	21.28%	1.10%	3.30%
Verizon Comm Inc	VZ	-18.05%	-16.76%	-2.69%	5.29%	15.87%
Enterprise Products LP	EPD	-26.06%	-20.57%	36.60%	5.80%	17.40%
Kinder Morgan Energy LP	KMP	-9.40%	-12.67%	32.13%	6.30%	18.90%
Glaxosmithkline ADR	GSK	-16.90%	-27.50%	1.06%	4.95%	14.85%
Merck & Co Inc	MRK	-24.77%	-36.13%	-6.01%	4.27%	12.81%
Health Care REIT Inc	HCN	-16.22%	-24.51%	14.38%	5.59%	16.77%
<b>Average</b>		<b>-23.75%</b>	<b>-28.00%</b>	<b>-7.61%</b>	<b>5.71%</b>	<b>17.14%</b>
<b>S&amp;P 500</b>		<b>-31.32%</b>	<b>-38.33%</b>	<b>-2.30%</b>		

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