Our October 2019 Newsletter concluded with the following inference:

Conclusion: *"Even though things can change quickly rendering even the most sophisticated models useless, we believe that achieving greater than 6-7% earnings growth will be difficult for the US enterprise. Currently, a prudent risk reward inference compels us to be cautious and therefore suggest raising cash in growth portfolios."*

We are in the midst of experiencing a correction in the US and global markets. As of February 25th, 2020, we have already experienced an average of approximately -6% decline in major market indexes.

As always, we believe in studying the relationship between macro economic fundamentals and the technical parameters, which we believe are psychological factors impacting majority of investors. Following are some observations that helps illustrate the prevalent macro economic fundamentals for the US economy:

US Macro Economic Scenario[1]

Wells Fargo U.S. Economic Forecast

	Actual 2019				Forecast 2020				Actual			Forecast	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	2017	2018	2019	2020	2021
Real Gross Domestic Product [1]	3.1	2.0	2.1	2.1	1.5	2.4	2.4	2.3	2.5	2.9	2.3	2.0	2.3
Personal Consumption	1.1	4.6	3.1	1.8	2.5	2.0	1.9	1.9	3.0	3.0	2.6	2.4	2.0
Inflation Indicators [2]													
PCE Deflator	1.4	1.4	1.4	1.5	1.8	1.7	1.8	1.9	1.5	2.1	1.4	1.8	1.9
Consumer Price Index	1.6	1.8	1.8	2.0	2.3	2.0	2.1	2.0	1.6	2.4	1.8	2.1	1.8
Industrial Production [1]	-1.9	-2.3	1.2	-0.5	-5.7	1.1	2.0	2.5	3.1	3.9	0.8	-0.9	1.8
Corporate Profits Before Taxes [2]	-2.2	1.3	-1.2	-2.0	1.0	3.0	2.8	2.5	5.4	3.4	-1.0	2.3	2.2
Trade Weighted Dollar Index [3]	109.8	109.7	111.0	109.9	110.8	110.0	109.0	107.8	93.4	106.4	110.1	109.4	105.8
Unemployment Rate	3.9	3.6	3.6	3.5	3.6	3.5	3.6	3.6	6.2	3.9	3.7	3.6	3.6
Housing Starts [4]	1.21	1.26	1.28	1.44	1.35	1.35	1.35	1.35	1.00	1.25	1.29	1.35	1.36
Quarter-End Interest Rates [5]													
Federal Funds Target Rate	2.50	2.50	2.00	1.75	1.75	1.75	1.75	1.75	0.25	1.96	2.25	1.75	1.75
Conventional Mortgage Rate	4.28	3.80	3.61	3.72	3.60	3.70	3.80	3.80	4.17	4.54	3.94	3.73	3.98
10 Year Note	2.41	2.00	1.68	1.92	1.80	1.95	2.05	2.10	2.54	2.91	2.14	1.98	2.28

Forecast as of: February 12, 2020
[1] Compound Annual Growth Rate Quarter-over-Quarter
[2] Year-over-Year Percentage Change
[3] Federal Reserve Advanced Foreign Economies Index, 2006=100 - Quarter End
[4] Millions of Units
[5] Annual Numbers Respresent Averages

- **US GDP is expected to grow over 2% on an average for FY 2020.**
- **Inflation remains tame at around 2%. This would help rates to remain at a favorable level. We believe that the Federal Funds Target Rates, which command the cost of capital is expected to stay at around 1.75%-2% level. In other words, interest rates in the markets should stay low due to benign inflation.**
- **US Corporate earnings are expected to grow at 2-2.5% for the next 2 years.**
- **Unemployment rate is expected to remain benign at 3.5-3.6% for the next 12-18 months.**

[1] Source: https://www.wellsfargo.com/insights Chart Source: Wells Fargo Weekly Insights.

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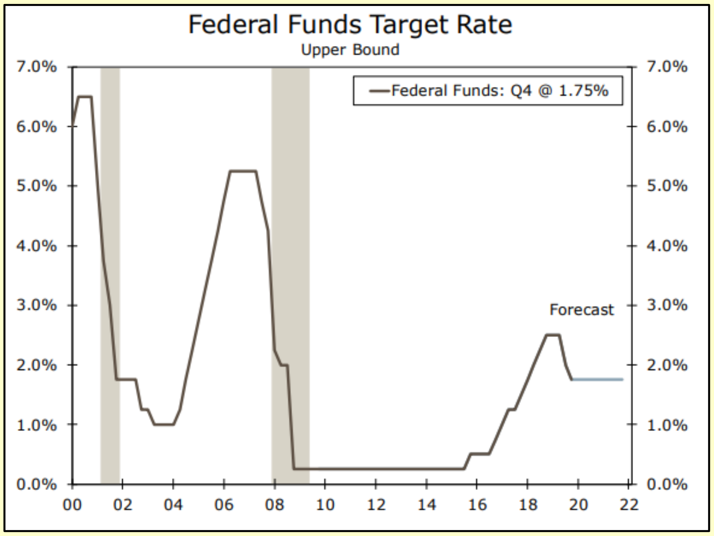
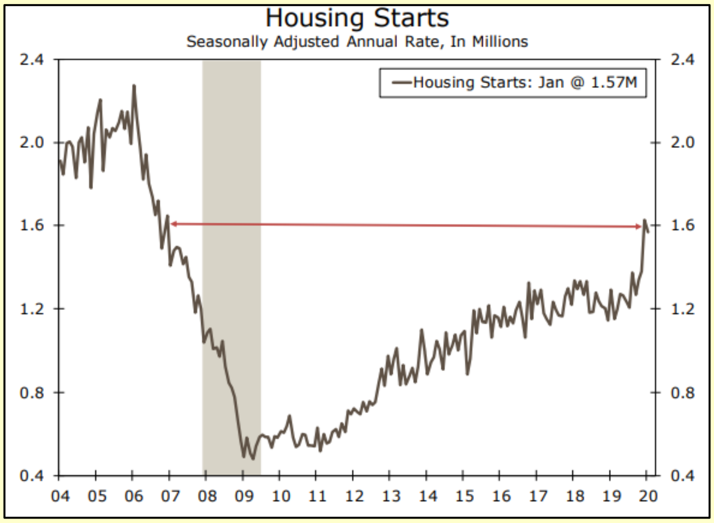
Fed Fund Target Rate

- The Federal Funds Rate refers to the interest rate that the Federal Reserve charges other banks for overnight lending.
- The Fed Fund Rates are at historically low levels and are expected to stay in this range for the foreseeable future. This is FAVORABLE.



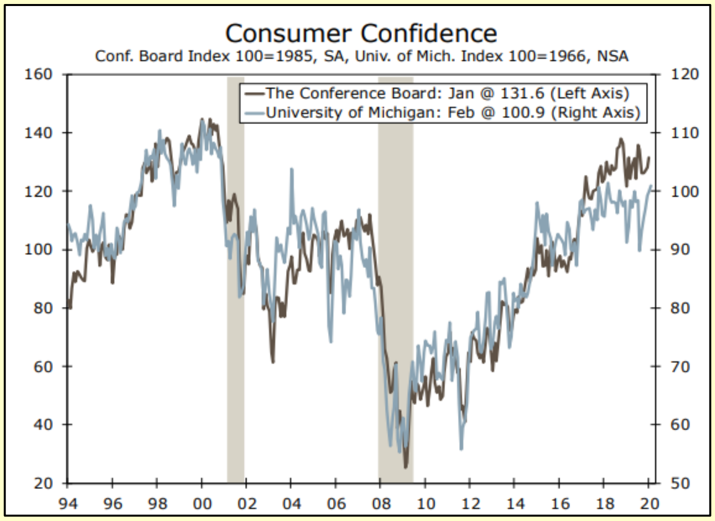
Housing Starts

- Housing Starts is the number of new single or multi-family housing units, as determined from number of permits issued for construction of residential buildings.
- It can be observed from the adjacent chart that housing has been improving consistently since the 2008-09 recession. This is a fundamentally FAVORABLE indication.



Consumer Confidence

- Consumer confidence is a statistical measure of consumer's feelings about current and future economic conditions.
- It can be seen from the adjacent chart that consumers (that comprise of 3/4th of the US economy) are confident in the US economic future; a FAVORABLE indicator.



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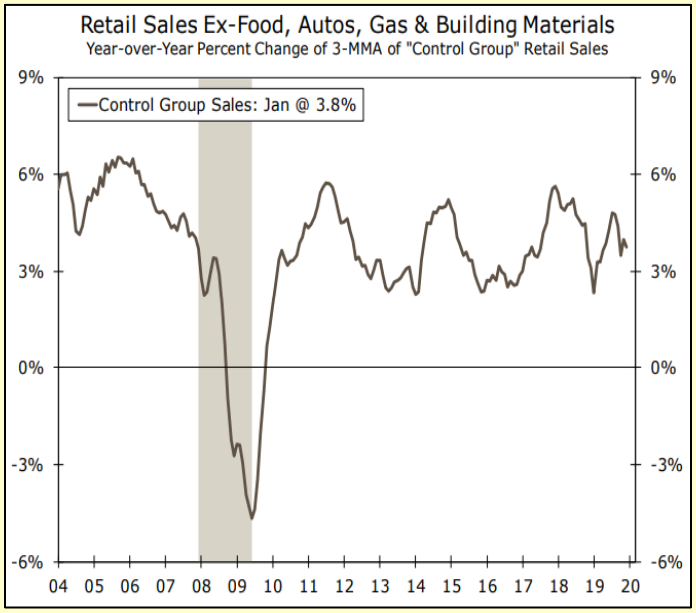
Retail Sales

- Retail sales is the purchase of finished goods and services by consumers and businesses.
- The adjacent chart clearly shows that the US consumer has been spending consistently since the 2008-09 recession. US consumers are 3/4th of the US GDP. A healthy consumer translates to healthy US corporate earnings.

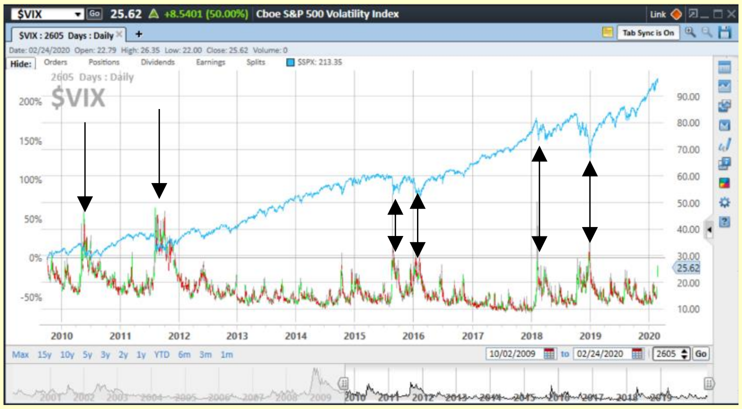


An important Technical Indicator: VIX

The Fear gauge (VIX): The Volatility Index is a fear gauge for the markets. It is calculated using PUTs and CALL options on the S&P 500 index and indicates how concerned investors are in the short to intermediate term about the market volatility. The correlation between the VIX and the S&P 500 is of great value when analyzing investor sentiment and the direction of the markets.

Chart 1 illustrates the correlation between the S&P 500 index and the VIX for the last 10 years. It can be clearly observed that VIX and the S&P 500 index (solid light blue line) have a statistically significant negative correlation. This is illustrated by arrows pointing to the times when the S&P 500 index corrected by more than 5%, along with a spike in the VIX.

Chart 1[2]



We believe that low level of VIX indicates complacency in the market and vice versa. The VIX, according to our analysis is a contrarian indicator. This index has increased over 100% over the last week (Feb 17th – Feb 25th, 2020). According to our proprietary model, this is an indication for investors to start considering opportunities created during this correction.

[2] Source: www.streetsmartpro.com (Charles Schwab & Co.)

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Market Valuation…

CGAM's Proprietary Market Model:

We have developed our proprietary Market model, which has helped guide us in understanding the direction of the broader markets. We have used the S&P 500 index as the proxy for the US broad based markets. The model was developed on the belief that investor behavior repeats itself based on a combination of fundamentals of the economy and variables relating to investor psychology. The model is dynamic as it constantly reviews the change in the index based on the changes in statistically significant economic variables.

The table below is an illustration of the variables used to project the 12 month target on the S&P 500. Our regression model uses six variables (shown on the extreme left column), which attributes to 93% of the movement in the S&P 500.

Fundamental Variables	**FY 2020 (Estimate)**	**Market Projections**	***As of Feb 24th, 2020***
S&P 500 Earnings	$185.00	S&P 500 (12 Month Projection) =	3,3376.90
S&P 500 Expected PE Ratio	18.00	S&P 500 (Sep 23rd, 2019) =	3,160.00
10 Treasury Bond Rate (%)	1.32%	***S&P 500 Estimated (Gain/Loss) =***	***+6.80%***
Inflation Rate (%)	2.00%	***Standard Error***	**+/- 4.13%**
Volatility (VIX) Index	27.00		
Unemployment (%)	3.60%		

It can be observed in the table above that the model projects a slightly undervalued S&P 500 index currently. We have used fundamental and technical variables that we believe have a high probability of occurring over the next 12 months. Certain variables like the volatility Index (VIX) have the propensity to be significantly more volatile than the rest of the fundamental variables. Even though it's nearly impossible to time the markets, factoring the VIX in our proprietary Market Direction model gives us opportunities to gravitate from being defensive to being relatively aggressive.

Conclusion…

The recent decline of -6% to -7% in the broad-based indexes is a technical correction according to our model. We believe that this correction provides growth-oriented investors with an opportunity to add or increase growth-oriented investment exposure to their respective portfolios. We believe that it would be appropriate to reduce cash exposure by half and use it to add and increase equity growth exposure.

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

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Please review the following disclaimer

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