ORCAM
ALTERNATIVE PERSPECTIVES

Macro Strategy & Research

November 8, 2012

Equity Strategy Update

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The recent slide in S&P 500 brings the total decline to -7% from the September highs. The S&P 500 has declined almost –4% in just the last 2 trading sessions.

Let's Not Overreact...

The fiscal cliff fears are certainly not unwarranted, but we are beginning to think that investors are overreacting to the recent election and fears over the cliff outcome. We think it's important to step back, consider the big picture and then react accordingly.

First of all, it's highly unlikely that the fiscal cliff is going to amount to much. Our estimate remains for something in the low $100B range in total as Congress is likely to compromise on many of the policy changes. The risk to this is certainly to the upside, but we think it's important to note how these policies would actually play out. Most of the tax increases would be very gradually felt. So, if we're right about our "fiscal bump" then the bump is actually more like a slide. That $100B+ is not going to hit the economy all at once. So the description as a "fiscal cliff" is misleading in many ways and likely leading to some overreaction.

Long Story Short—The "Fiscal Cliff" worries are likely getting overdone….

What The Indicators Say

To help put this all into perspective it might help to step back and review a few key equity market indicators that we like to review for our tactical (short-term) perspective.

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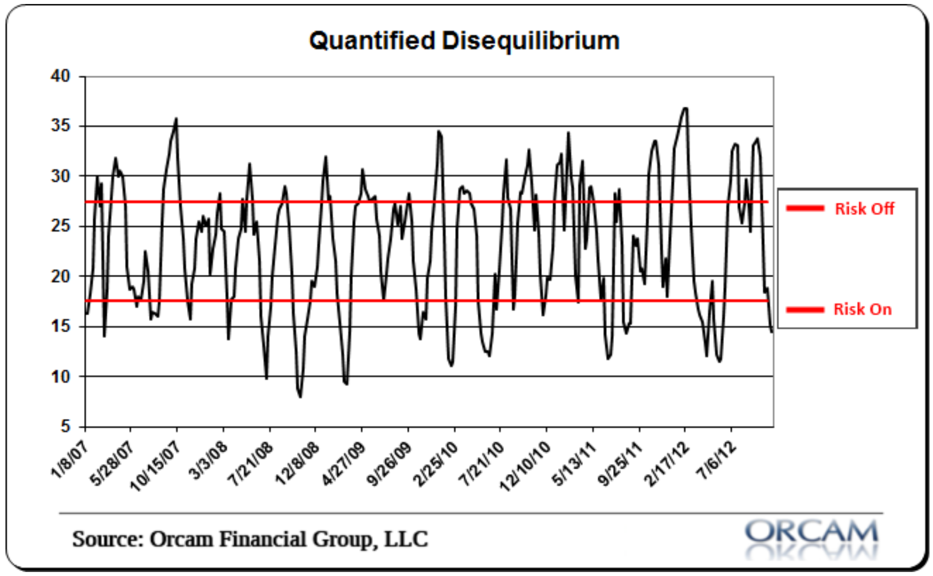
Our key equity indicator, which measures market risks at particular junctures has moved into a far more constructive range this week.

This indicator is a summation indicator of many of the proprietary indicators we use and serves as the key indicator for our tactical trading.



The recent readings are consistent with a market environment that is much more conducive to buying than selling. We have yet to see a definitive buy signal in the indicator (we find that the optimal buying opportunities tend to occur when the indicator reverses downside momentum), but we are more inclined to buy than sell at these levels. Remember, this indicator is a risk management metric and not a timing holy grail. Timing holy grails do not exist in the world of investing and we don't want readers to come under the impression this is one.

We remain of the opinion that the US economy is not headed for recession. So our strategic (longer-term) bias remains bullish. However, as we've noted over the last few weeks our tactical approach remains cautious, but quickly turning more bullish. We think the markets are likely to find their footing before year-end and stage their typical "Santa Claus rally". But the key to timing this is knowing when the politicians will resolve the fiscal cliff matters. I presume the uncertainty will continue to weigh on the markets in the coming weeks and we could see a sentiment "wash out" fairly soon.

We've sidestepped a rather significant slide at this juncture so from a risk management position we've already won the battle even if we're in the midst of a war (a true bear market beginning). Again, we would emphasize that, given the lack of a true recessionary environment the odds of a –20% decline (a true bear market decline) are low. This means the odds are beginning to substantially favor trading from the long side. We will be inclined to be buyers of dips in the coming weeks looking for an eventual resolution to the "fiscal cliff" and the likelihood for the market to realize that there has been a bit of an overreaction to the news.

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