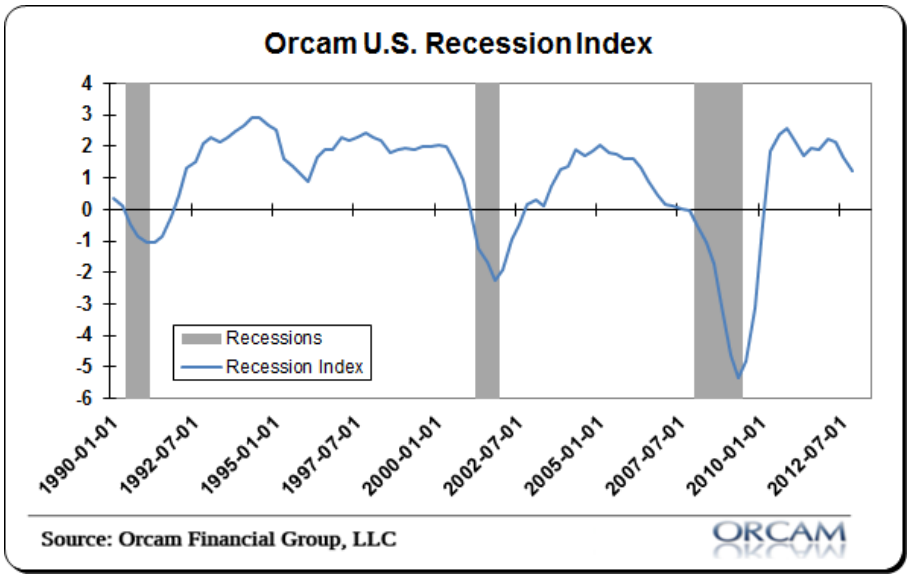
Four For Friday

Cullen O. Roche
Founder
Orcam Financial Group, LLC
cullenroche@orcamgroup.com

The US Economy Still Looks OKAY

The key to understanding the plight of the US economy has been the balance sheet recession and the de-leveraging cycle. Investors who understood these issues had a substantial advantage over those who misunderstood this. Fortunately, the balance sheet recession's impact is waning, but still remains with us. So, the economy remains fragile, but is still bolstered by improvement in private investment and a sizable government budget deficit. All this has led to modest growth. That trend is still well intact. As the Orcam US Recession Index shows, the risk of recession is still very low. This is a big positive, particularly from a more cyclical perspective.



"Risk comes from not knowing what you're doing. "
-Warren Buffett

China Update—Is It Now Overdone on the Upside?

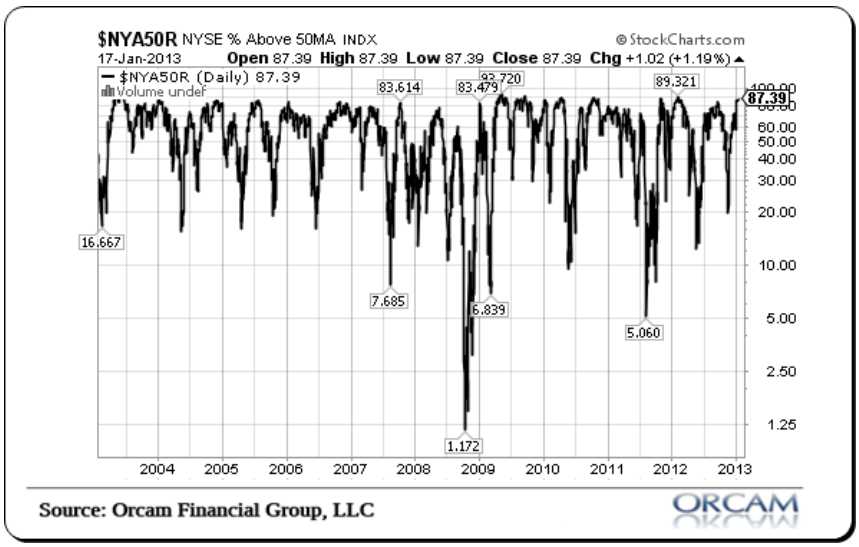
On November 30th, two days before the Chinese Shanghai Index bottomed and then subsequently rallied 20%, I said:

"Like the Spanish equities idea, this is not for the faint of heart as Chinese equities can be extremely volatile. But given the recent recovery in Chinese PMI and overall economic data I have to wonder if the 18 month 27% slide in the Shanghai Composite isn't a bit overdone?"

This trend has now reached the other end of the spectrum. In general, I am cautious about the equity markets at this level. Markets like China that have rallied substantially are increasingly risky. High beta benefited most from the bullish stance I highlighted back in November. With risk assets reaching riskier levels here high beta is most at risk.

Further Signs of Stretched Equities?

There are growing signs of stretched equity prices. One in particular is the % of stocks above the 50 day moving average. The current reading of 87% is an unusual reading that has occurred just 4 times in the last 3 years. 3 of the 4 instances were followed by 5%+ sell-offs.



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A Yen Hedge?

As you know from the cyclical view, I am not extremely bearish here, but I am definitely cautious from a tactical (near-term) perspective. Given that caution, some hedging and risk management is prudent. The Yen has sold-off over 10% versus the USD over the course of the recent equity market rally. This traditional safehaven currency could experience a reversal if a sell-off were to occur. It's a lower risk way to gain exposure to market protection than a pure short position in equity markets. It's worth pondering.

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