ALTERNATIVE PERSPECTIVES

Macro Strategy & Research

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Monthly Strategy Update

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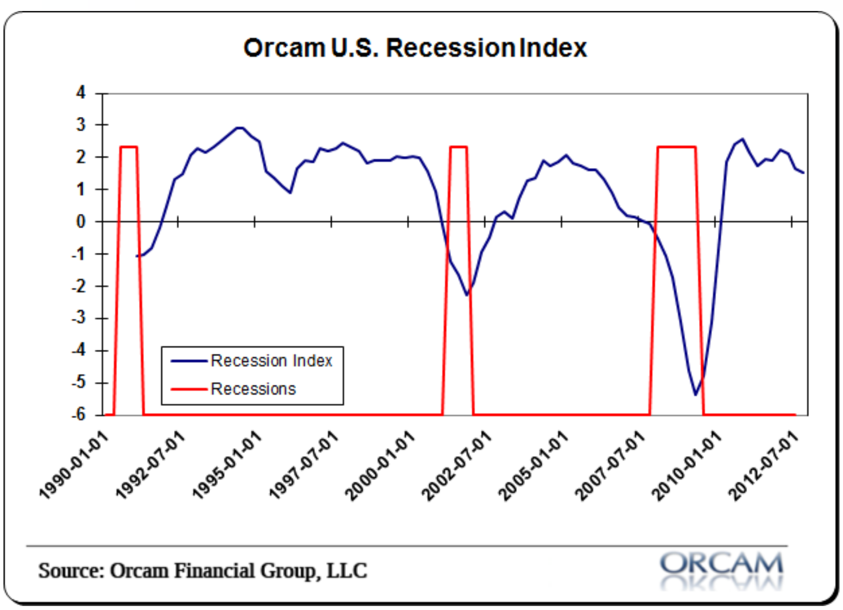
This update will include many of our macro outlooks for specific asset classes across various timeframes. As with all of our research we hope you'll use it as a guidepost and not as a holy grail.

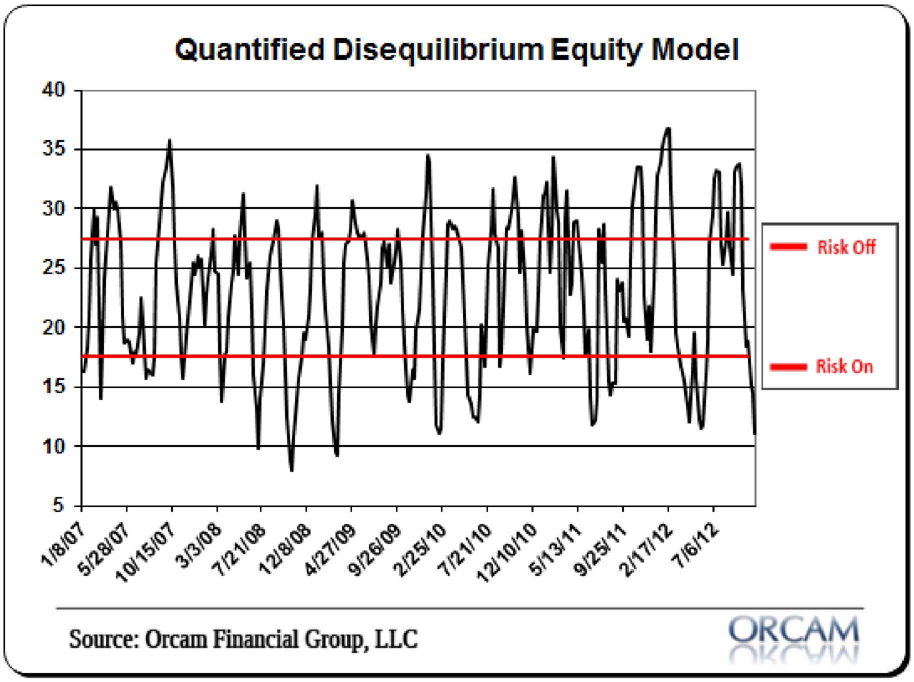
Equity Outlook

Our top down approach attempts to identify strategic risks across the business cycle. From a core strategic position, we have long held the position that there is low recession risk in the USA. Based on our research, this is pertinent in that the most damaging market declines tend to occur within economic contractions. Currently, from a long-term strategic position, we are equity bulls based on our recession model which is consistent with low growth in the USA.



"Failure to prepare is preparing to fail."
-Coach John Wooden

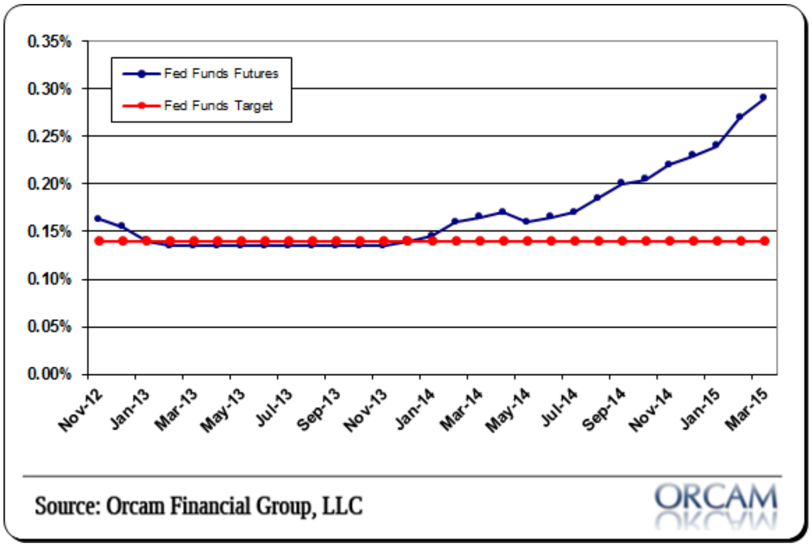
From a tactical (short-term) perspective we have turned much more constructive on the market after having been bearish since the 1475 peak in the S&P 500 inSeptember. Current readings in our primary trading model are consistent with a market that is now favorable from the long side with regards to risk/reward. We expect this model to output an official buy signal this week based on historical evidence.



US Government Bond Outlook

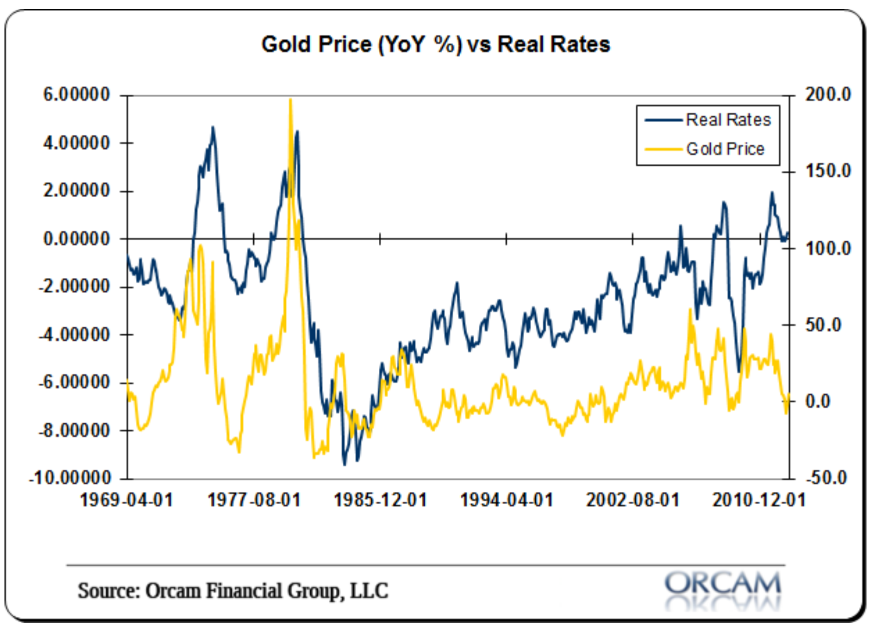
We remain strategic bulls regarding US government bonds. Our thesis here is rather simple: don't fight the Fed. While this axiom is often applied to the equity markets we believe it is even more applicable to the bond market. The Fed essentially controls the yield curve as the monopolist on bank reserves. As a result, long bond yields are a function of short yields which are a function of the Fed's perception of the economy. The Fed has been abundantly clear about their policy forecast. They will keep rates low until 2015. That gives us a clear view into the future of US government bond yields—they are very likely to remain low during this period.

This view is confirmed by the Fed Funds Futures curve. We've overlaid the forecasted target rate with the current curve. We believe expectations on the long end are likely to come down from their current levels as we progress forward. This will depress the entire curve (or at the very minimum keeps upward pressure on yields at a minimum).



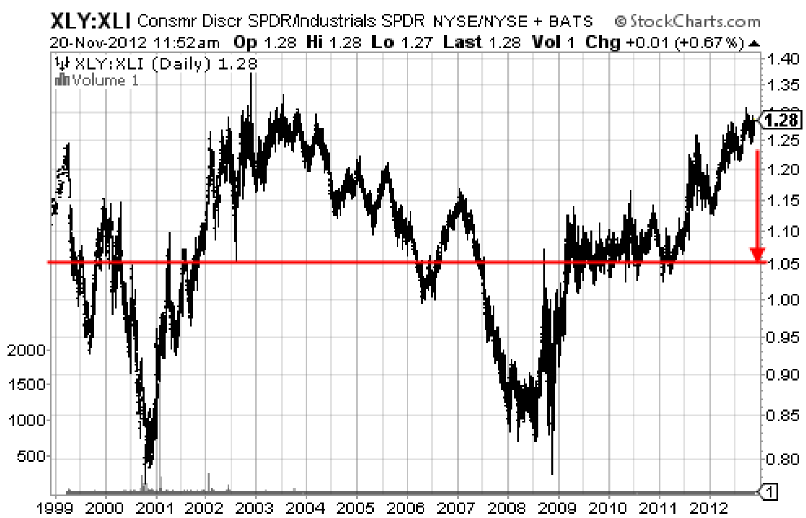
Gold Price Outlook

Similar dynamics are influencing the price of gold. As outlined several weeks ago, real interest rates are the primary driver of gold prices in the current environment. The Fed's current posturing has depressed real rates to levels that are likely to keep inflation fears relatively high. Although these fears are unfounded we believe gold serves as a natural hedge against the fixed income portion of a portfolio that is essentially a bet that the Fed will be right about low inflation moving forward. But this doesn't mean both positions can't ultimately be winners. As we've seen over the course of the last 10 years, bonds and gold can both perform well in a relatively low inflation environment. Instead, what is driving government bond yields lower is the expectation of accommodative Fed policy, which, interestingly, keeps the gold bulls in a frenzy reaching for ever higher prices.



Cross Asset Class Correlation Ideas

Consumer Discretionary Relative to Industrials

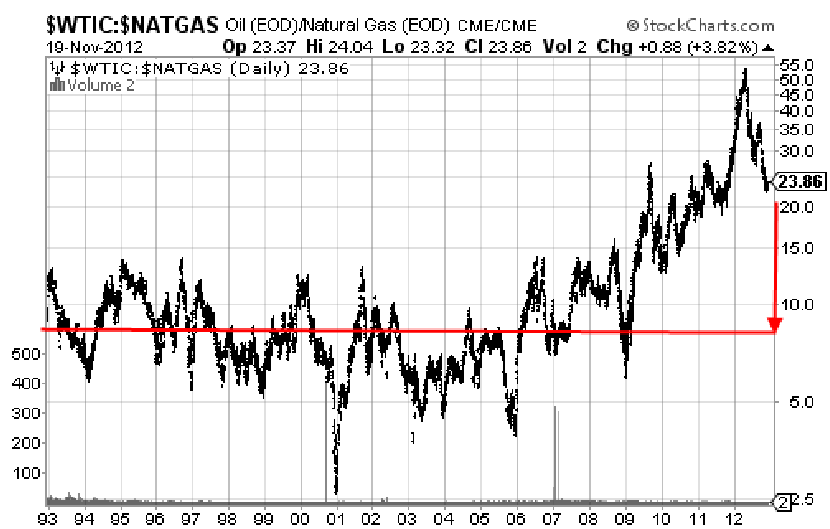


Source: Orcam Financial Group, LLC

At this point in the business cycle we would favor industrials over consumer discretionary stocks. As you can see in the chart to the left, consumer discretionary names have been substantial outperformers relative to their industrial counterparts. If history is any guide this trend is unlikely to persist in relative terms.

Natural gas has been a long-time underperformer relative to oil prices. This trend appears to have reached a peak in early 2012 as natural gas prices fell to new lows. This trend has only just started to reverse and is likely to revert back to the long-term mean.

Texas Crude Relative to Natural Gas

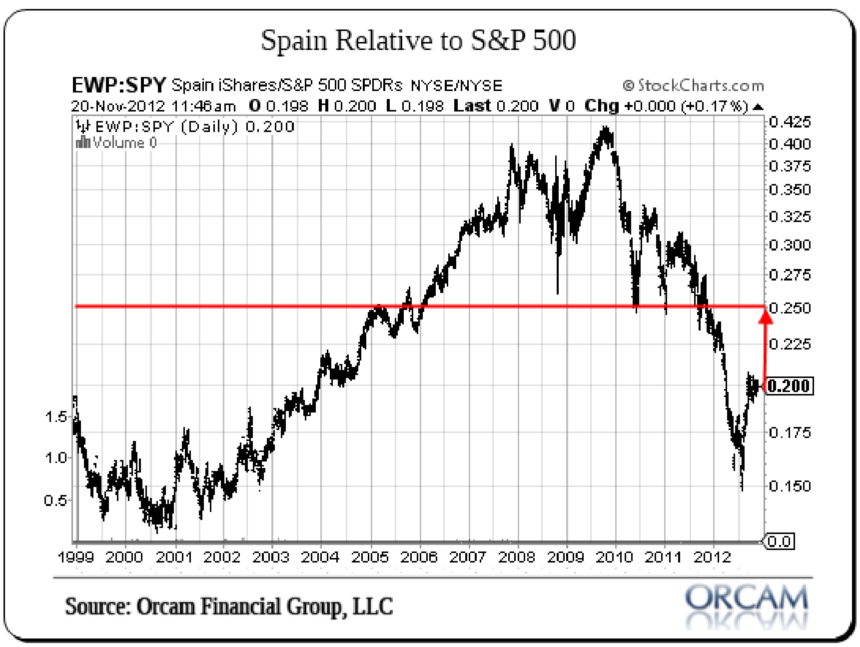


Source: Orcam Financial Group, LLC

Banking shares have been big underperformers in recent years during the de-leveraging cycle. As we begin to see demand for credit increase and real estate improve in the USA we believe this underperformance is unlikely to persist.

We're certainly not technology bears, but this chart provides some perspective regarding relative performance.

This idea is not for the faint of heart as Orcam doesn't see an end to the Euro crisis any time soon, but those looking for a bit of beta in their portfolio might look to some of the more depressed European nations. Stock markets like Spain have been obliterated over the last 5 years and could serve as long-term value propositions for the investor who is truly looking to "invest" in a portfolio of equities.



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