



# The Sage Capital Newsletter

April-May 2010

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The broad equity markets have continued the current rebound from March 09' lows. The latest economic releases have continued to display stability. While long-term (10 yr treasury yields) yields have been moving up, the equity market has barely taken notice. It is arguable corporate earnings have demonstrated enough strength to suggest the recent rebound does have a foundation.

The only remaining economic caveat is the slow pace of employment. It is difficult to ignore the huge over-hang that is created by the historically low employment numbers.

We still feel the broad-picture holds optimism as retail sales continue to show recent strength and consumer spending looks to have finally bottomed. This is all taking place while the consumer is becoming more spending conscious, Health Care Reform was passed, and as I write this Financial Reform is being discussed.

In this month's newsletter we will look at the characteristics of the broad markets, review the latest economic data, and look at the drivers of the current marketplace.

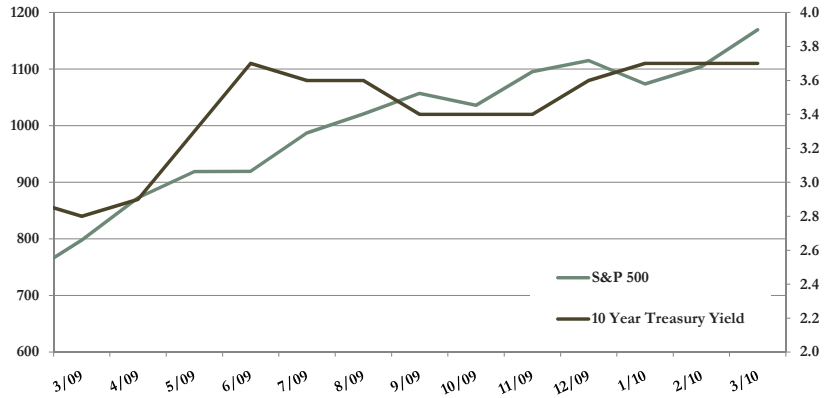


# Sage Capital Market Overview

**Figure 1: S&P 500 VS. 10 YR. TREASURY YIELD**

Data: Thompson Baseline  
(S&P 500 and 10 YR. Treasury Yield, Monthly Closing Value)

One sign of strength is the current rise in the yield of the 10 year treasury, while the broad equity market continues to trend positively. It appears treasuries are losing their luster as a safe-haven investment and investors are accepting greater investment risk for greater anticipated returns.



**Price % Change:**

<b>1 Month Ago</b>	<b>5.9%</b>
<b>3 Months Ago</b>	<b>4.9%</b>
<b>12 Months Ago</b>	<b>46.6%</b>

**Current      5 Yr Avg.**

<b>Forward P/E:</b>	<b>15.1</b>	<b>15.9</b>
<b>Dividend Yield:</b>	<b>1.9%</b>	<b>2.1%</b>
<b>Price to CF:</b>	<b>10.4</b>	<b>10.0</b>
<b>Price to Book:</b>	<b>2.2</b>	<b>2.4</b>

**Figure 2: S&P Performance**

Data: Thompson Baseline  
(March 31, 2010 Data)

**Figure 3: S&P 500 Key Stats**

Data: Thompson Baseline  
(April 27, 2010 Data)



**Figure 4: S&P 500**

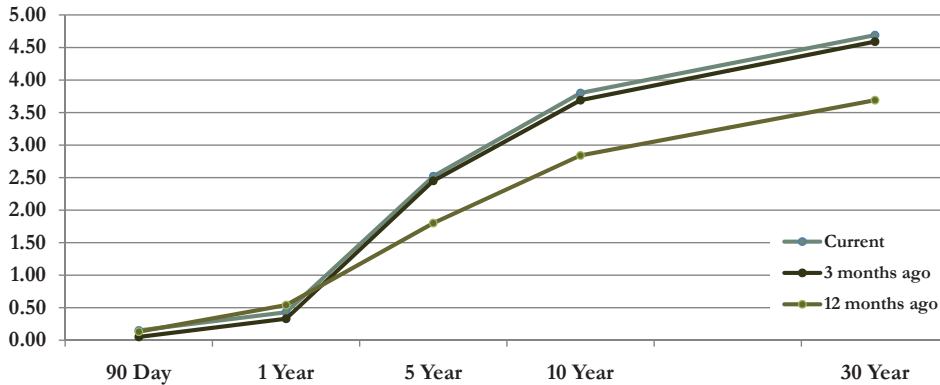
Data: Thompson Baseline  
(S&P 500, Monthly Closing Value)

We are still short of reaching 2008 market levels. Will earnings continue to show validation of recent market levels.

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# Market Analysis

## Bond Analysis:



**Figure 5: BOND YIELDS**

Data: Thompson Baseline (90 Day, 1 Year, 5 Year, 10 Year and 30 Year, Daily Values)

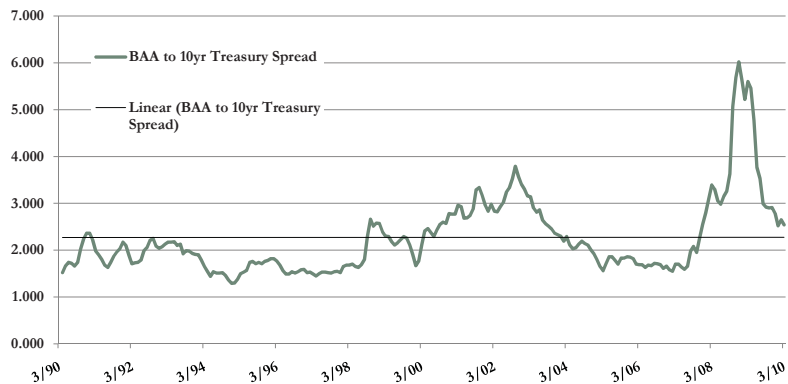
The yield curve is positively sloping with historically low short-term rates.

Observing the yield curve, it appears the greatest slope is near the 5 yr area. We continue to feel the greatest value remains in this general area. While the Fed still maintains a very accommodative monetary policy, recent appreciation in long-term yields have given us reason to believe the economy is stabilizing which would give us pause investing in long-duration strategies. As we experience an overall rising rate environment, we would find greater value in premium bonds (which offer higher current income) over discount bonds (which provide greater opportunity when rates decline). We feel the only remaining factor keeping short-term rates low continues to be the over-hang in the unemployment numbers. As far as quality is concerned, there still appears to be value in the corporate bond market vs. the treasury market. We currently feel much more comfortable with the industrial debt that is funding growth rather than funding working capital.

**Figure 6: CORPORATE BAA SPREAD TO 10 YR. TREASURY YIELD**

Data: Thompson Baseline (Corporate BAA and 10 Yr. Treasury Yield; Monthly Data)

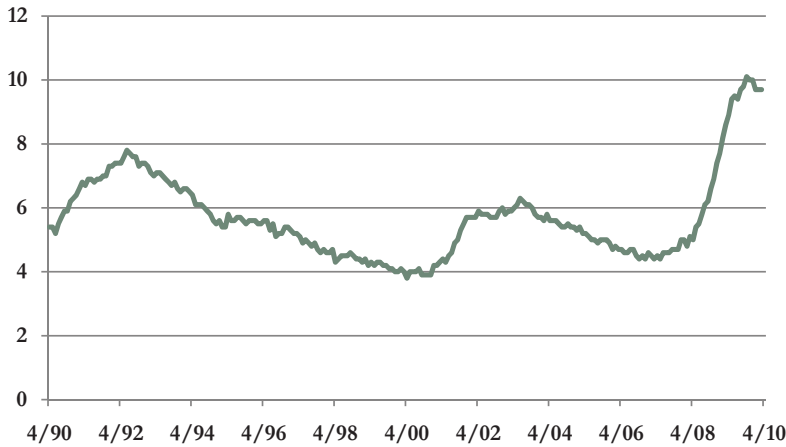
The spread on corporate high yield debt is still wider than long-term averages and we expect this to revert to historical levels.



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# The Economy

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**Figure 7: UNEMPLOYMENT RATE** Data: Thompson Baseline (Unemployment Rate; Monthly Values)

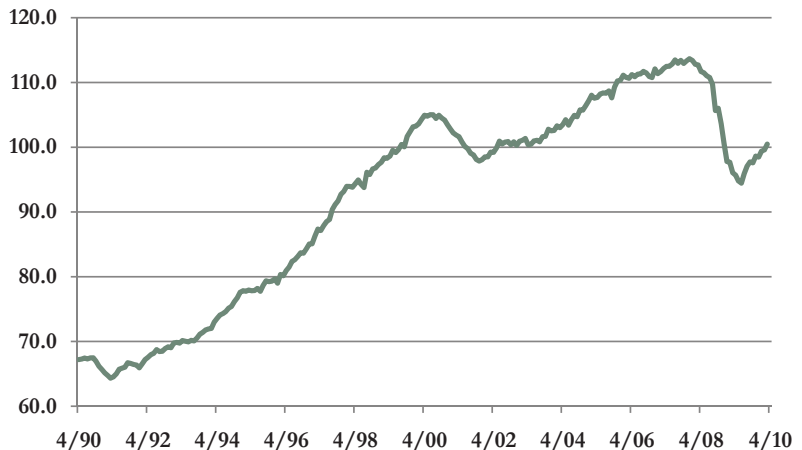
Are we heading for lower levels or will the current employment situation continue.

I look forward to the month when employment or lack thereof, is no longer a topic of discussion. While numerous economic indicators point to recovery, or at least signaling the worst is behind, the jobs situation remains the final hurdle for confirmation. While corporate earnings have strengthened, we are left wondering, when businesses will increase hiring. While analyzing both sides to the current labor situation, we find a couple different viewpoints. On one side the unemployment rate appears to have turned over and is stabilizing at current levels. Temporary hiring continues to show positive signs which could indicate future full-time positions. Manufacturing inventories have appeared to climb from the lows; retail sales continue to show strength, all this while the consumer is in the midst of massive de-leveraging.

**Figure 8: INVENTORY PRODUCTION - MANUFACTURING**

Data: Thompson Baseline (Inventory Production - Manufacturing; Monthly Values)

With wage cost growth slowing at lower than recent average levels and production appearing to have started to trend up, will the jobs market benefit.

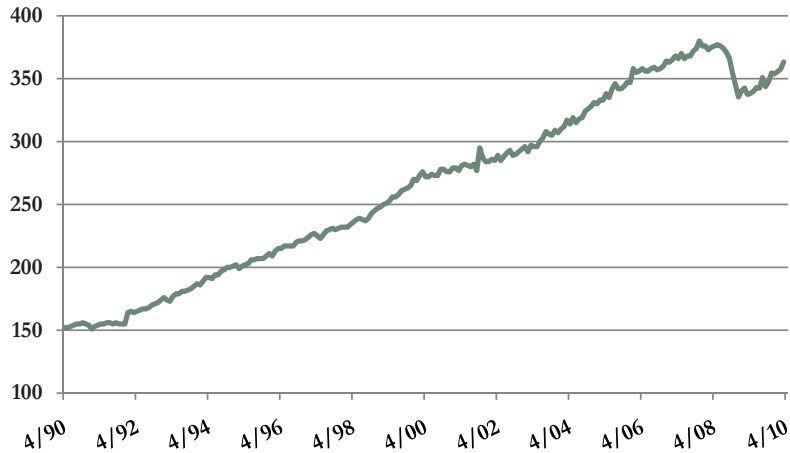


# The Economy

**Figure 9: RETAIL SALES**

Data: Thompson Baseline  
(Retail Sales; Monthly Values)

Retail sales have continued to surprise on the upside as the consumer has been de-leveraging and high unemployment; when will this translate to jobs.



As mortgage rates stay at historic lows for the time being, the stimulus expiration did bring an increase in Mortgage applications for March. Housing prices remain flat from one year ago and overall median prices are slightly changed. Improvement in Housing may have spillover effects into an improved construction sector.



**Figure 10:  
EXISTING SINGLE FAMILY  
HOME PRICES**

Data: Thompson Baseline  
(Existing Single Family Home  
Prices; Monthly Values)

5 yr. existing single family homes. Real estate investment is slowing its decline, will we finally start to see growth.

# News of Note

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## In the News:

The U.S. Treasury announced a pre-set sales plan to sell its 7.7 billion of Citigroup common shares. The Government has engaged Morgan Stanley to sell the shares into the market utilizing a “pre-arranged written trading plan” in an at the market offering, per a Treasury statement. The Government acquired the shares at \$3.25 per share, during bailouts of 2008 and 2009 and this unraveling comes as shares of Citigroup have risen with broader markets, creating a potential profit for the Treasury over their \$25 billion in cost. Citigroup received a total of \$45 Billion in Government bailouts, at the end of last year Citigroup repaid \$20 Billion in TARP funds.

Congress had a hearing claiming unethical practices with Goldman Sachs, apparently more posturing for votes on the upcoming financial reform vote.

And Euro-zone has rebounded after recent downgrades on Greek sovereign debt by the major credit rating agencies. These are the same rating agencies that rated piles of sub-prime mortgages investment grade.



## Thoughts

In this month's newsletter we have examined the current characteristics of the broad markets. The yield curve is still sharply upward sloping, giving us reason to believe the recovery could continue. We feel broadly that given the recent volatility in the bond market we would remain cautious. The equity market is currently pricing on the higher end of its 5 year average valuation ratios. However, it appears earnings are providing validation. The dollar is showing continued strength, as the euro is falling prey to Greece.

Commodity prices appear to be trading at more sustainable levels finding balance with the dollar and current demand. We would expect volatility to increase as earnings season has begun. Lastly, the looming question remains concerning the employment picture and when it will improve.

Until next time,



Matt



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