The Sage Capital

Newsletter

December 2010

IN THIS ISSUE:

The consumer sector has shown some life over the past month. However, this trend follows a long period of pessimism and must continue over several months before we reach the point where consumer spending has a notable positive impact on the economy. We will examine the consumer from various perspectives in this issue.

Several international events over the course of the past month have impacted the financial markets. In this issue, we will take a closer look at the spreading bailout situation in Europe, namely Ireland, and the threat of war by North Korea.

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Market Overview

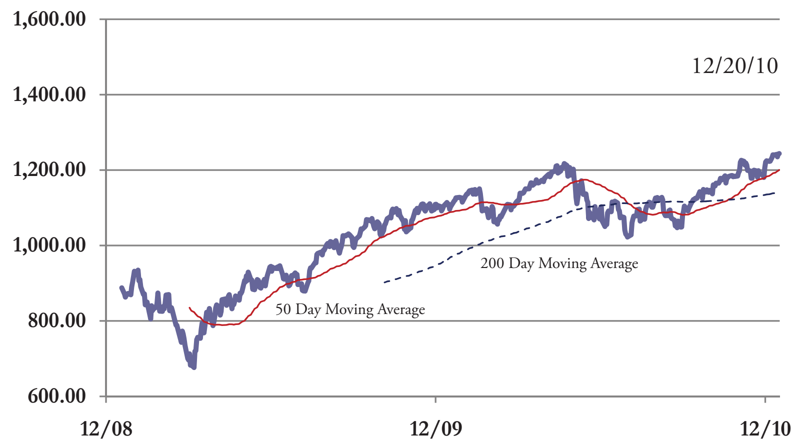


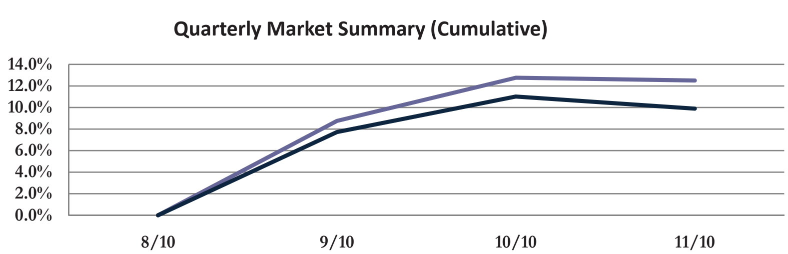
Figure 1: **S&P 500**
Data: Thomson Baseline
(S&P 500, Daily Closing Value, 50 and 200 day moving averages)

Price % Change:	
1 Month Ago	-0.20%
3 Months Ago	12.50%
12 Months Ago	7.8%

Table 1: **S&P Performance**
Data: Thomson Baseline
(Nov. 30, 2010 Data)

	Current	5 Yr Avg.
Forward P/E:	13.8	15.7
Dividend Yield:	1.8%	2.1%
Price to CF*:	9.5	10.0
Price to Book:	2.3	2.4

Table 2: **S&P 500 Key Stats**
Data: Thomson Baseline
(Dec. 20, 2010 Data)



	8/31/10	9/30/10	10/31/10	11/30/10
S&P 500	0	8.76%	12.76%	12.51%
Dow Jones	0	7.72%	11.02%	9.90%

Figure 2: **QUARTERLY MARKET SUMMARY**
Data: Thomson Baseline
(S&P 500 and Dow Jones Monthly Closing Values)

* Price to Cash Flow

Bond Analysis:

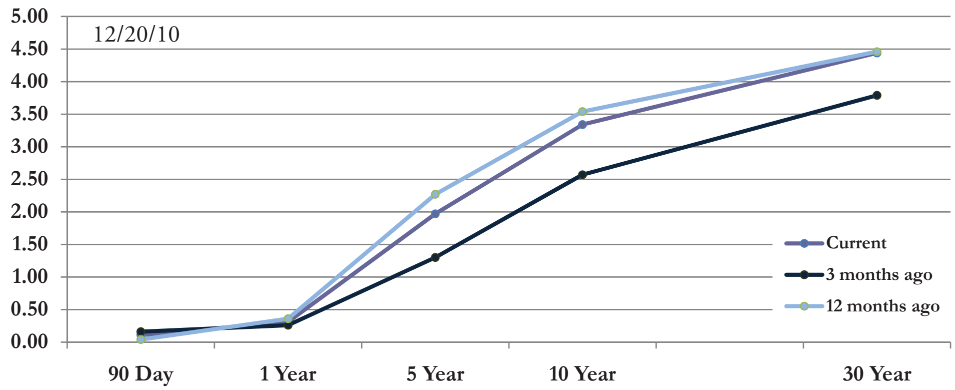


Figure 3:
TREASURY YIELDS
Data: Thomson Baseline (90 Day, 1 Year, 5 Year, 10 Year and 30 Year, Daily Values.

We continue to favor the 5 year range of the yield curve. A recent news article on a widely viewed website has made note of the problems of the escalating pension obligations in the municipal sector. Much like General Motors we feel the municipal market is on shaky legs and remain cautious of investment in municipal debt. Currently we are finding some value in the lower credit quality sectors which are typically small to mid-size companies that we feel are under-rated by the credit agencies.

And then there was QE2:

While the Fed has been busy buying bonds, the market has been busy selling them. Yields have been fighting the Fed on the mid to long range of the yield curve. We view this as a positive effect as the savers of this country have been getting punished for nearly a decade as our Fed has been taking the easy money approach. Fiscal responsibility should be rewarded with a strong dollar and stable long-term interest rates.

Consumer Confidence:

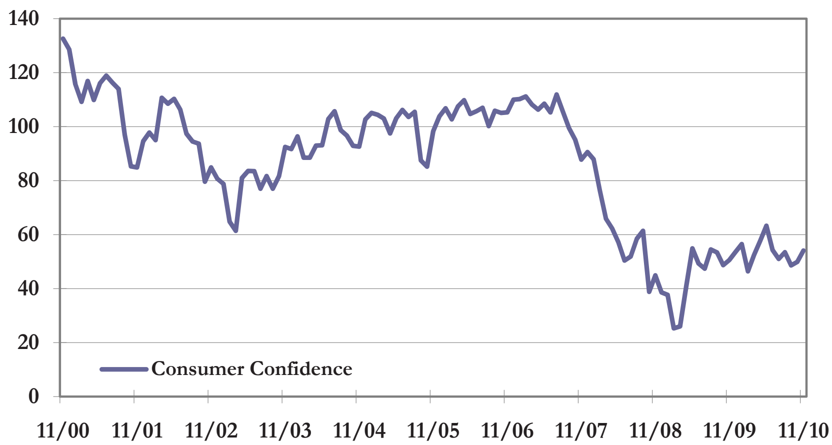


Figure 4:
CONSUMER CONFIDENCE
Data: The Conference Board (Consumer Confidence Index, Monthly values, as of 12/6/2010)

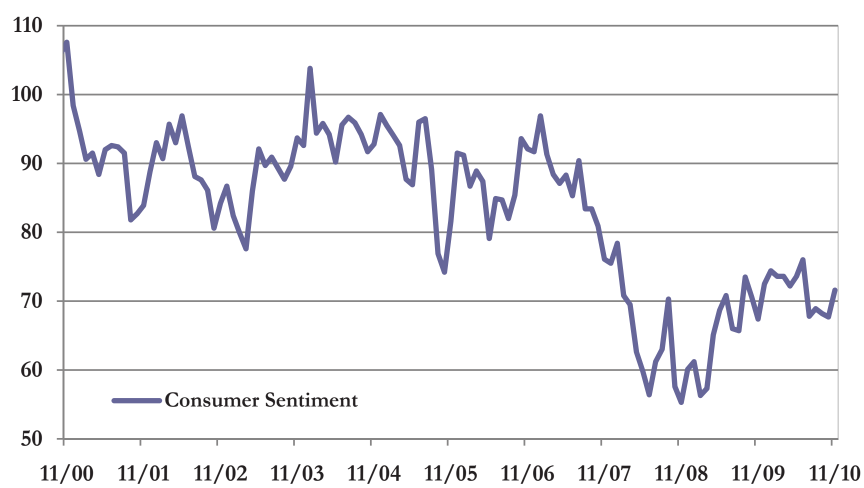
Consumer Confidence rebounded slightly over the past month but has continued to linger around 50 for almost a year and a half.

Consumer Confidence and Consumer Sentiment are the two main economic indicators that track the consumer's opinion towards the present and future economy. Both indicators have rebounded from the bottom towards the end of 2008 to the beginning of 2009 (Figure 4, 5). However, the current levels remain far away from pre-recession levels and within the indicators, there is a distinct lack of optimism towards the future.

Consumer behavior is essential because it is consumer spending that ultimately drives the economy and the financial markets. If the consumer does not have confidence in the current environment, they will save more and spend less because there will be more uncertainty regarding future sources of income. Once the economy picks up, jobs will become more plentiful, people can be more confident in future sources of income, they will spend more, and economic growth will pick up speed.

Figure 5:
CONSUMER SENTIMENT
Data: Thomson Reuters (Sentiment Index, Monthly values, as of 12/6/2010)

Consumer Sentiment has rebounded slightly over the past month but has continued to linger around 70 for almost a year and a half.



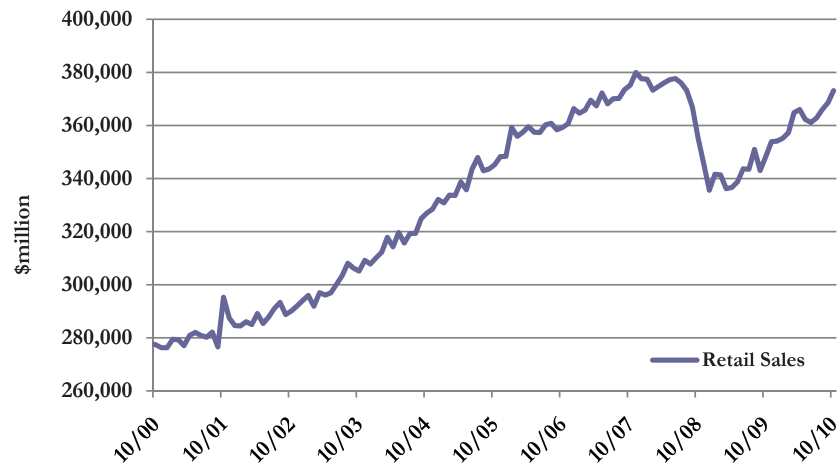
Consumer Spending:

Figure 6:

RETAIL SALES

Data: Census Bureau
(Retail and Food Services total,
Monthly values, as of 12/6/2010)

Retail sales has shown relatively steady growth over the past year. However, it has yet to recover to the point of reaching pre-recession levels.



Retail Sales and Personal Outlay growth (Figure 6, 7) has begun to pick up some momentum over the past few months perhaps hinting at increasing consumer optimism towards the future. Both retail sales and personal outlays have increased after the huge drop at the beginning of the recession. However, because these values are in absolute terms and because the overall population is increasing, amount of spending per person may not necessarily be increasing. Therefore, it is possible that consumer spending is increasing but consumer confidence is decreasing.

A closer look at the indicators shows that there is reason to believe that consumer spending is recovering but that consumer spending habits are still cautious. Increases in spending have been led by increased spending in autos but spending increases can be observed over a variety of sectors and product types. One area of concern is that the personal savings rate rose to roughly 5.5% at the time of the financial market crash and has remained relatively unchanged to date.

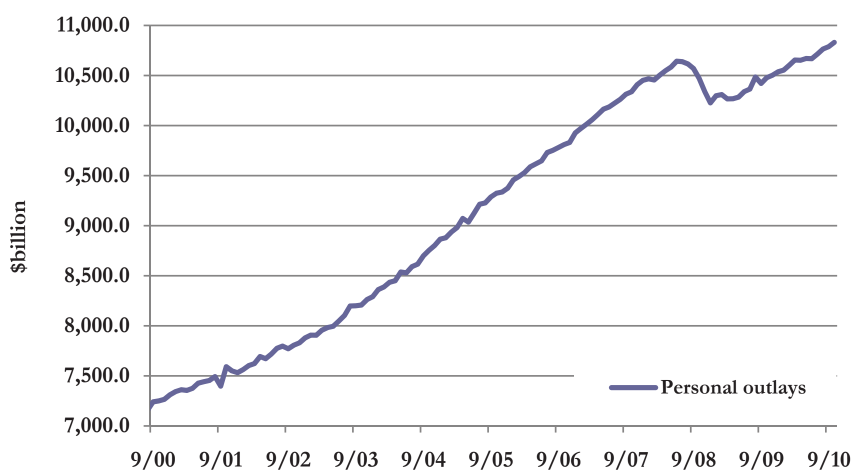


Figure 7:

PERSONAL OUTLAYS

Data: Bureau of Economic Analysis
(Personal Outlays, Monthly values,
as of 12/6/2010)

Overall personal outlays have shown consistent growth. However, the pace is not at what one would hope following a recession.

Eastern Asia:

North Korea bombarded a small South Korean island killing 2 soldiers and civilians. This follows an incident earlier this year in which North Korea sunk a South Korean warship. In both incidents, both sides have blamed the other as to who initiated the action.

This is significant not only because of the threat of war but because it affects the relationship between the United States and China who is North Korea's closest ally. The recent topic of interest between the United States and China has been the manipulation of the exchange rate between the US dollar and the Chinese Yuan. While the currency pair is no longer pegged like it used to be, it is still being manipulated highlighted by China's ownership of US debt.

Bailout in Europe:

An 85 billion Euro bailout package for Ireland is imminent. After Greece required a bailout earlier this year, Ireland's bailout looks like a sure thing. The bailout package is likely to be a joint package between the IMF and the European Union.

Ireland's situation looks similar to that of other recent economically troubled nations in that reckless bank lending led to a property bubble. Additional European nations also look like they are in trouble as there is speculation that Portugal is next in line to seek a bailout.

Oil Prices:

We have been experiencing a recent run in oil prices. This has gained a great deal of attention. Is this due to the strengthening economy, the weak US dollar, or the consumption in China? With forecasts pointing to oil topping $100 per barrel, it is our hope that it doesn't lead to a further drag on the economy.

Thoughts

We appear to be slowly getting through the recent economic down-turn. The private sector is once again stabilizing from 2008 and earnings have been meeting expectations. However, nervousness continues across all sectors as political unrest fails to cease. It is our opinion that without more concrete parameters of the looming tax situation, healthcare overhaul, and pension issues, we will continue to see nervousness in the markets. We don't want to see more extensions to the problems. This country demands solutions as witnessed in the recent elections, yet just last week a lame-duck vote took place that went entirely against recent elections. We must find a middle ground in this country where everyone has an opportunity for prosperity. Currently no planning can take place as countless policies are temporarily in place.

We have extended unemployment benefits yet again. It is our view that many without jobs are reaping nothing more than an extended vacation paid for by the taxpayer. This is not to say as a nation we shouldn't help our fellow man. However, I am reminded of the often used quote "give a man a fish he can eat for a day, teach that man to fish he can eat for a lifetime".

We remain positive that going into the New Year, we as a country are heading in the right direction. Recent elections have demonstrated that the people of this country have started to pay attention to the problems that exist.

Best,

Matt

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