



The Sage Capital Newsletter

November 2010

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In this issue, we will focus on the broad asset classes. A few current events have appeared to disconnect the normal correlations between the various markets.

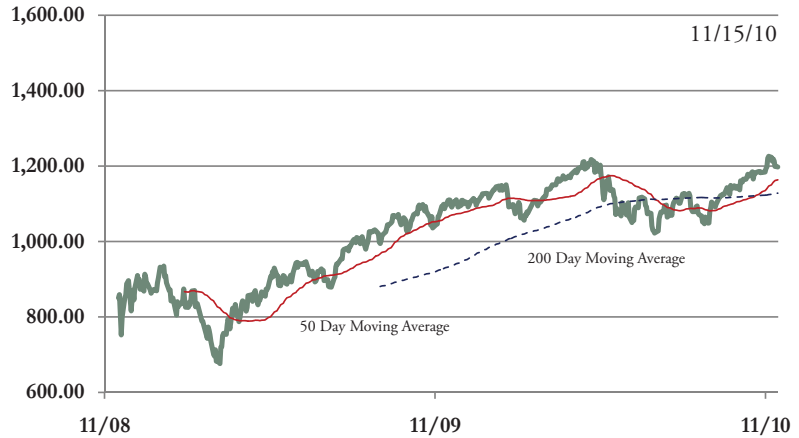
The stock market continues to surge as the federal reserve announced a plan to purchase \$600 billion worth of longer term treasuries over the course of the next 8 months (the second round of quantitative easing or QE2). We will look into the central bank's view of the economy and why they think an additional stimulus package was necessary given the current state of our economy.

Economic indicators have generally been positive over the past month. However, unemployment remains an issue and there seems to be very little wage inflation. The Federal Reserve (or the Fed) is attempting to improve these two issues through QE2. We will focus on these two economic areas as we look deeper into where our economy is headed.



Sage Capital Market Overview

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



<u>Price % Change:</u>	
1 Month Ago	3.70%
3 Months Ago	7.40%
12 Months Ago	14.20%

Table 1: S&P Performance

Data: Thomson Baseline
(Oct. 31, 2010 Data)

	<u>Current</u>	<u>5 Yr Avg.</u>
P/E (LTM):	14.6	15.7
Dividend Yield:	1.9%	2.1%
Price to CF*:	9.4	10.0
Price to Book:	2.2	2.4

Table 2: S&P 500 Key Stats

Data: Thomson Baseline
(Nov. 15, 2010 Data)

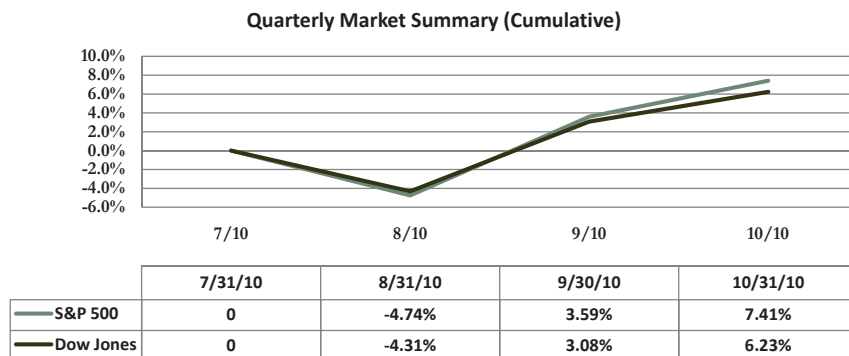


Figure 2: QUARTERLY MARKET SUMMARY

Data: Thomson Baseline
(S&P 500 and Dow Jones
Monthly Closing Values)

* Price to Cash Flow

Sage Capital Market Analysis

Bond Analysis:

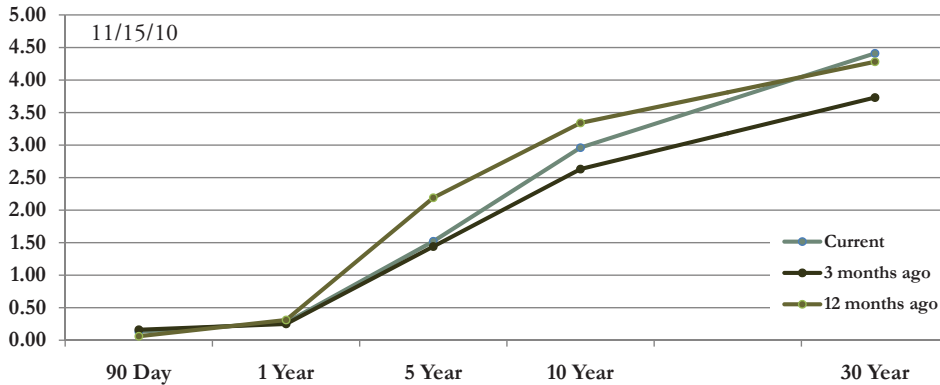


Figure 3:
TREASURY YIELDS

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

The yield curve is upward sloping with the 10 year bond displaying the sharpest slope. We would recommend a laddered bond portfolio with a 5 to 10 year duration.

It is difficult to find a great deal of upside to the overall bond market. While the Fed is buying bonds to maintain a low interest rate pro-growth business environment, we would still be cautious as the yield curve is displaying a rising interest rate environment. High yield corporate bonds currently look the most attractive to us as states are dealing with low tax revenues and the Fed is busy raising the price of treasuries to bubble levels.

When we experience stronger growth, interest rates should rise regardless of the Fed's posture. Inflation has never been kind to bonds and the greatest fear in the bond market is decidedly inflation.



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The Economy

Employment:

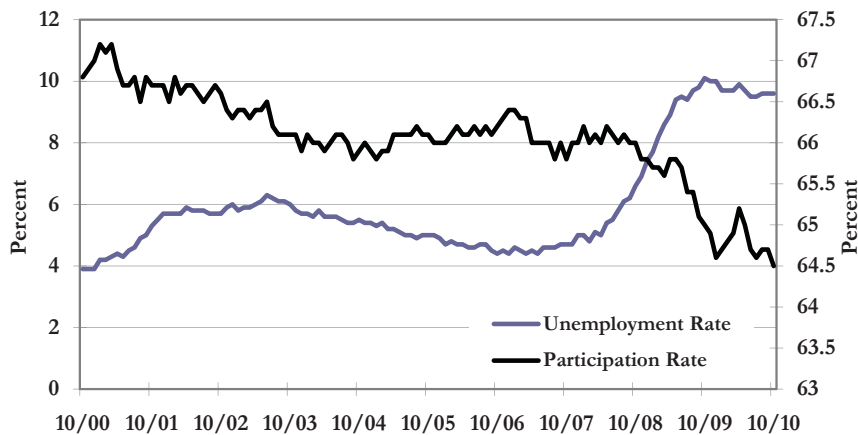


Figure 4:
EMPLOYMENT SITUATION

Data: Bureau of Labor Statistics (Unemployment Rate and Participation Rate, Monthly values, as of 11/5/2010)

The unemployment rate has continued to linger at 9.6% while the participation rate keeps declining as job growth has not been greater than the growth rate of the population work force.

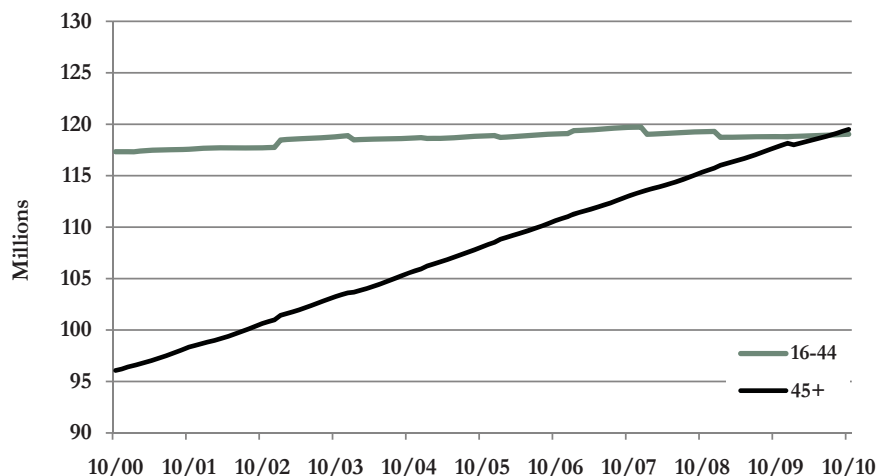
Both the unemployment rate and participation rate (Figure 4) have continued to linger at their post recession rates. While additional jobs have been created this year, it has only matched the overall population growth which results in a lack of improvement in the aforementioned rates. The positive news is that part of the lack of job growth is because government jobs have been declining meaning that private job growth does exist though not at the rate one would hope for during post recession times.

The change in number of jobs has varied widely by sector. Education and health services (+4.5 million) and leisure and hospitality (+1.3 million) have added the most jobs over the past 10 years while manufacturing (-5.5 million) and trade, transportation, and utilities (-1.4 million) have lost the most jobs. The rapid rise in population of people over the age of 45 (Figure 5) could be a large factor in the rise of health care jobs.

Figure 5:
POPULATION BY AGE GROUP

Data: Bureau of Labor Statistics (Civilian Noninstitutional Population by Age, Monthly values, as of 11/5/2010)

The average age of the American worker has gradually been rising, especially the proportion of people above the age of 45.



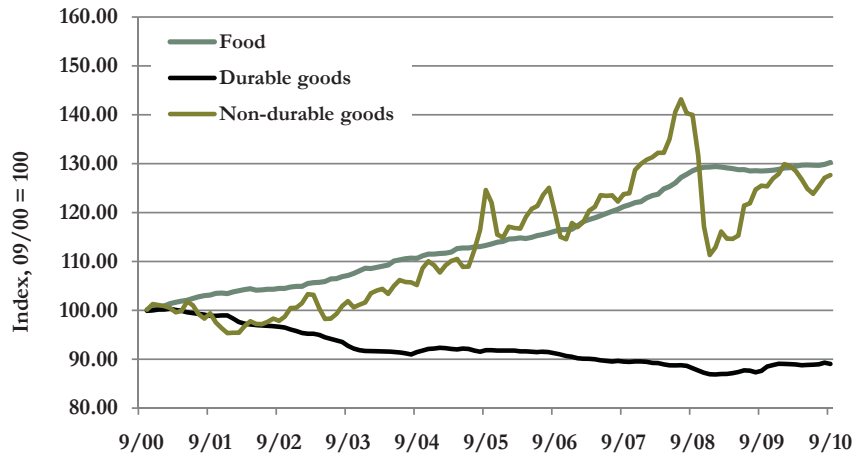
The Economy

Inflation:

Figure 6:
CPI BY COMMODITY

Data: Bureau of Labor Statistics
(Select CPI Values, Monthly values,
as of 11/5/2010)

All commodity components of CPI have been largely stagnant the last two years except the energy component of non-durables. Services make up the remaining 60% of the indicator but has shown similarly stagnant price movements.



The consumer price index (CPI) has grown at a crawling 1.89% annualized rate after hitting a bottom during the recession in December of 2008. Core CPI has grown an annualized 1.29% during the same time period. Both were below the 10 year annualized averages of 2.32% and 1.98% respectively which include the price decline during the recession, and well below the 25 year annualized averages of 2.85% and 2.84%. This lack of inflation is a large part of why the Fed issued a new round of quantitative easing by increasing the amount of money in circulation.

By looking at the commodity components of both CPI and PPI (Figure 6, 7), we can observe that the PPI components have been rising more rapidly than their CPI counterparts. If producers have to buy the goods at higher prices and are unable to sell goods at equivalently higher prices, they will be working with a smaller profit margin that will reduce their overall profitability. Companies have adjusted to this by reducing human labor costs and replacing them with machines. However, in the long run, there is a need for consumer demand to rise which would lead to faster consumer price growth.

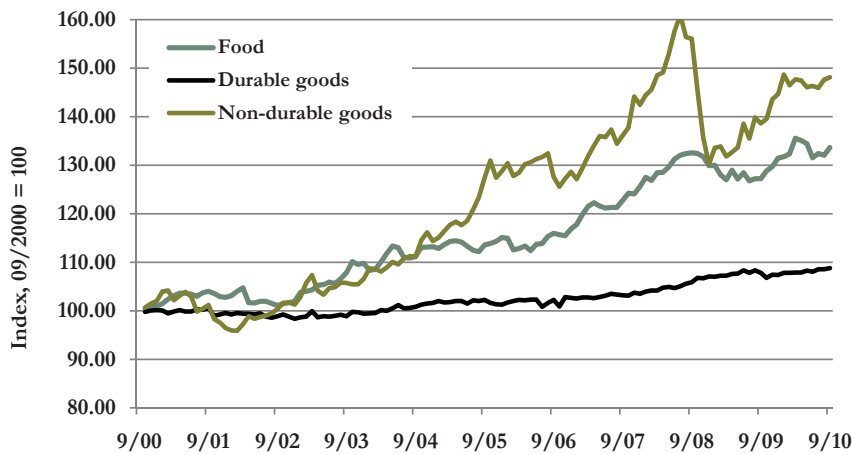


Figure 7:
PPI BY COMMODITY

Data: Bureau of Labor Statistics
(Select PPI Values, Monthly values,
as of 11/5/2010)

All commodity components of PPI have been largely stagnant over the last two years except the energy component of non-durables. Capital equipment makes up the remaining 26% of the indicator but has shown price movements even more stagnant than commodities.

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News of Note

Inflation / Deflation:

Based on economic indicator releases, we simply do not have enough vibrant economic growth to support real inflation. Many economists argue that the true measurement of inflation is wage inflation. Given our lackadaisical employment situation, it is difficult at best to find inflationary factors. However when looking at the price of commodities (oil, metals, and food) it would seem economic growth is taking a back seat to fear and the weak dollar.

The US Dollar:

The Fed is buying bonds adding a great deal of liquidity to the economy thereby lowering interest rates and weakening the dollar. In time, as we begin to see both stronger economic growth and higher employment, we hope the Fed will unwind their bond position and let the market determine interest rates by supply and demand. One stabilizing theme to the dollar may be the relative weakness of the other major currencies, especially the Euro.

Real Estate:

It appears the main purpose of QE2 is to stabilize housing by intervening in the treasury market. It is unlikely that the housing market will see true growth until the foreclosure issues have worked themselves out. With rates at such low levels, it is appealing to lock into fixed rate mortgages. Again, we would be hesitant to overweight real estate until economic growth has stabilized.

Stocks:

With the coming QE2 it is hard not to see the potential for inflation. This bodes well for equities as inflation should also provide revenue growth. If we fail to see growth and rates remain low, tangible assets should continue to find higher valuations.



Sage Capital Last Word

Thoughts

Equities are trading in line with earnings during the 3rd quarter. Although earnings were healthy, it again appeared to be a result of expense management rather than true revenue growth that saved the day.

The Fed seems to be worried enough about employment and housing that it is willing to overlook its other two objectives; namely maintaining a stable dollar, and stable longer term interest rates. If managed correctly, We are not about to question whether the Fed is capable of pulling off this plan. We will continue to monitor the indicators and will keep you all informed of what we see.

Best,



Matt



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