



The Sage Capital Newsletter

October 2010

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As the third quarter earnings season approaches, we remain optimistic. The past several quarters have displayed the flexibility and proactive management of American companies. We expect to see continued corporate cost-cutting as the country moves forward from the latest recession.

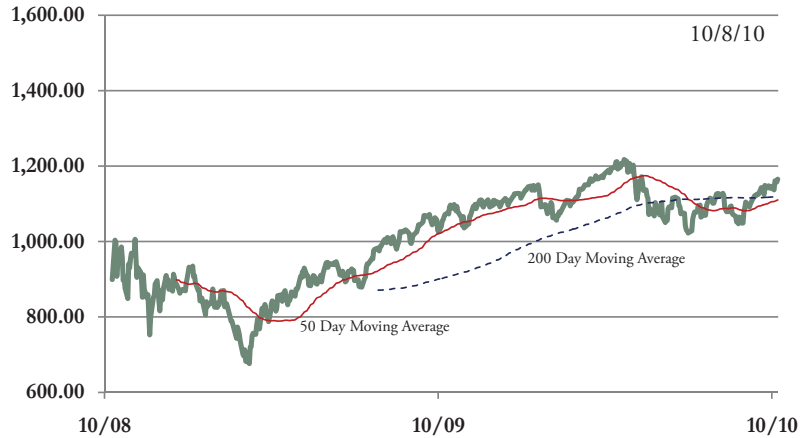
After plunging downward in unison over the previous few months, many economic indicators have shown a stabilizing trend. We shall examine trends in the production of expensive goods in search of the direction and magnitude of overall economic growth.

On a global scale, the International Monetary Fund (IMF) has called for international cooperation in an effort to get worldwide economic growth back on track. We will look at some of the key areas that the IMF states are critical for a sustained global economic recovery.



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	8.80%
3 Months Ago	10.70%
12 Months Ago	8.00%

Table 1: S&P Performance

Data: Thomson Baseline
(Sept. 30, 2010 Data)

	<u>Current</u>	<u>5 Yr Avg.</u>
P/E (LTM):	15.3	15.7
Dividend Yield:	1.9%	2.1%
Price to CF*:	9.5	10.0
Price to Book:	2.2	2.4

Table 2: S&P 500 Key Stats

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

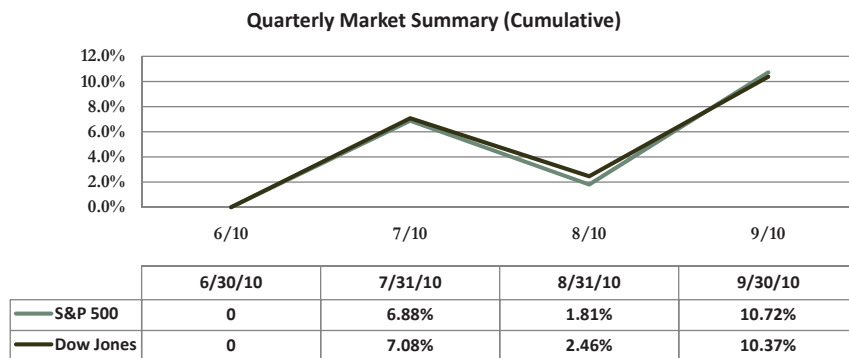


Figure 2: QUARTERLY MARKET SUMMARY

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

* Price to Cash Flow

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Market Analysis

Bond Analysis:

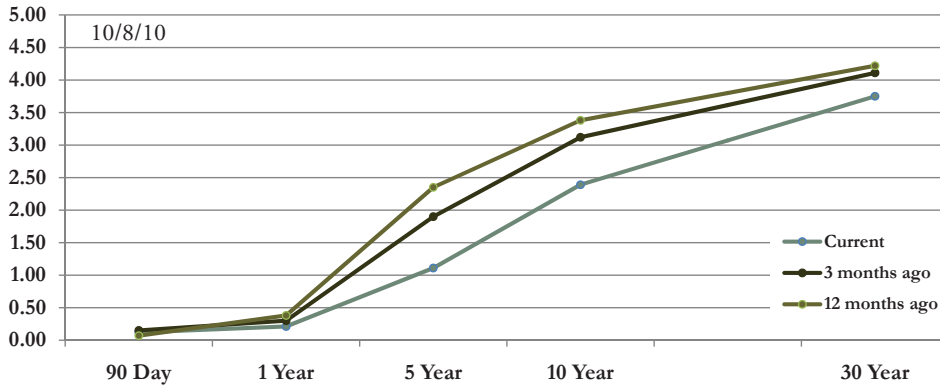


Figure 3:
TREASURY YIELDS

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

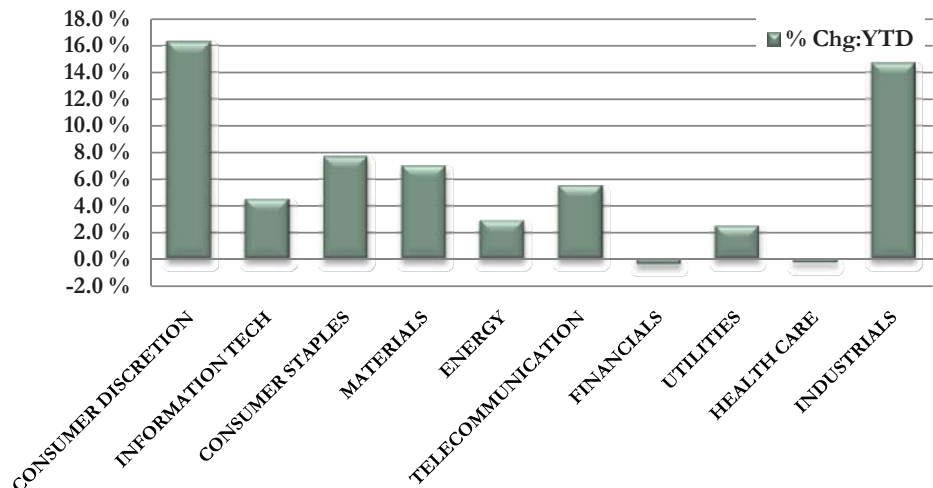
Given the current slope of the yield curve, we feel a laddered portfolio approach is most favorable. The yield of a 5 year bond has dropped significantly over the last 3 months. On an absolute basis, it is hard to get excited about current yields because companies provide dividend income with higher yields.

Sector Analysis:

Interestingly enough, the cyclical pro-growth sectors have been the best performing sectors this year. This would imply that the market feels true economic growth is upon us in the next several months. Financials have likely underperformed due to the mounting questions still remaining on their financial health, the mortgage / foreclosure debacle, the flattening slope of the yield curve, and whether or not they will be able to enjoy the easy money they have realized going forward.

Figure 4: % CHANGE: YTD BY SECTOR

Data: Thomson Baseline (% Change by Sector from December 31, 2009 to September 30, 2010)



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The Economy

Housing:

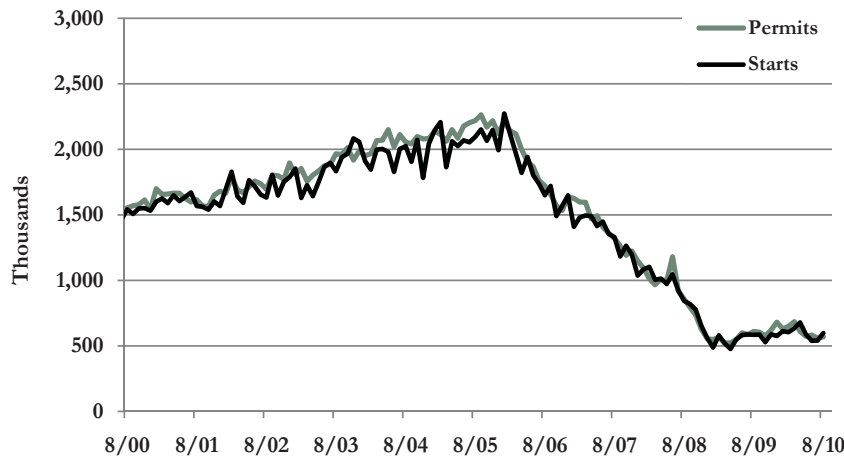


Figure 5:
NEW RESIDENTIAL CONSTRUCTION
Data: Census Bureau (Building Permits, Housing Starts, Monthly values, as of 10/1/2010)

New Housing Permits declined by 24,000 and increased by 10,000 during the past two months continuing a slightly negative overall trend. It has declined 6.7% year over year.

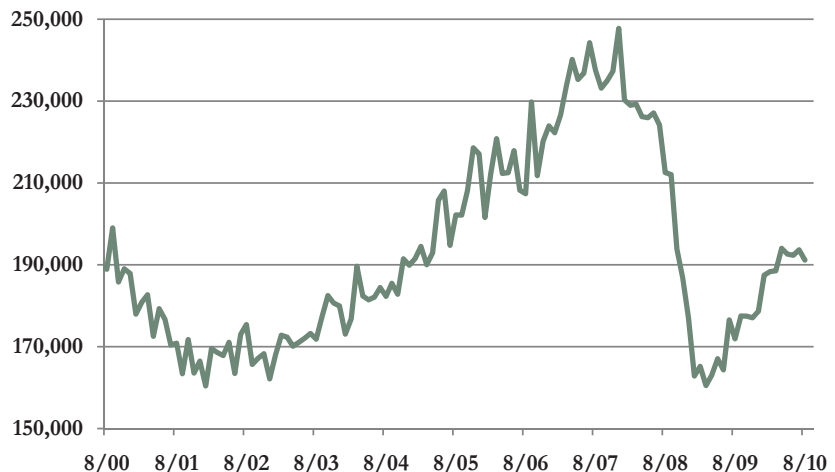
After many of the housing indicators plummeted last month, this month's reports, including new housing starts (figure 5), show a stabilizing trend. While sales of both existing and new home sales are still near record low levels due to the expiration of the housing credit, a relatively stable number of permits suggests that we are at a bottom. However, there is very little to suggest any large upward advance in the near future.

Durable Goods:

Many indicators that measure economic output have stopped growing during this year after showing signs of a steady recovery in 2009. This includes new durable goods orders (figure 6) which is generally a leading economic indicator because households tend to spend less money on more expensive goods when they are on tighter budgets.

Figure 6:
NEW DURABLE GOODS ORDERS
Data: Census Bureau (Durable Goods: New Orders, Monthly values, as of 10/1/2010)

New Durable Goods Orders increased by \$1.3 billion and decreased by \$2.5 billion during the past two months continuing a relatively flat recent trend. It has increased 9.7% year over year.



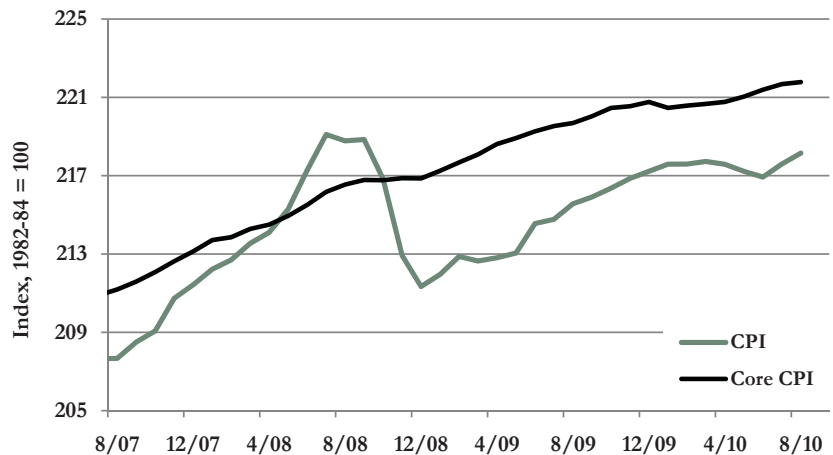
The Economy

Inflation:

Figure 7:
CONSUMER PRICE INDEX

Data: Bureau of Labor Statistics
(All items, All items less food
and energy, monthly values, as of
10/1/2010)

The Consumer Price Index has advanced 0.3% during the past two months recovering from four consecutive months of decline. It has grown 1.3% year over year.



One of the major topics of discussion among economic policy makers is the direction inflation is headed in. Even within the Federal Reserve, there has been disagreement. With a general slowdown in the recovery over many sectors of the economy along with stagnant price indices (figure 7, 8) over the past couple of months, there is very little to suggest that inflation is a threat in the immediate future.

With very little to suggest that inflation is on the horizon, there is much speculation that a new economic stimulus package is right around the corner. As the amount of domestic currency in the economy has continued to increase at a rapid rate along with speculation that this is expected to continue, the dollar has weakened against many major foreign currencies. More currency in circulation leads to a weaker currency because if there is more money to buy the same amount of goods, it is going to take more money to buy the good.

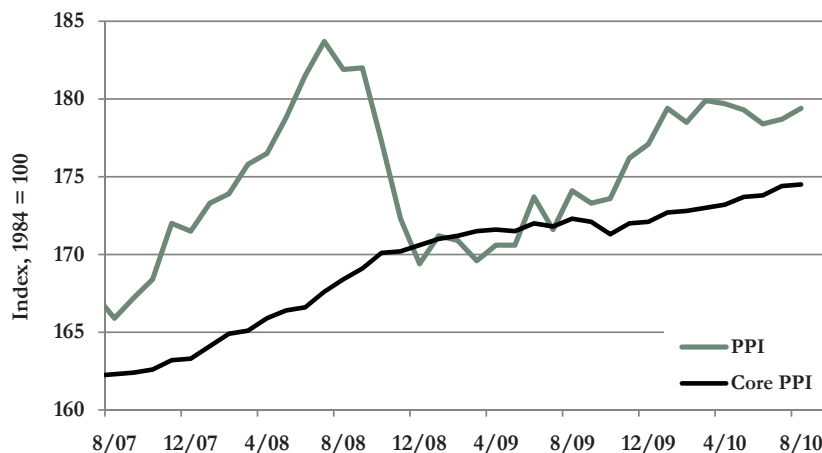


Figure 8:
PRODUCER PRICE INDEX

Data: Bureau of Labor Statistics
(Finished goods, Finished goods less
food and energy, monthly values, as
of 10/1/2010)

The Producer Price Index has advanced 0.2% and 0.4% during the past two months recovering from three consecutive months of decline. It has grown 3.1% year over year.

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News of Note

International Monetary Fund (IMF):

The IMF has stated that a worldwide economic recovery is underway but that it is “fragile and uneven.” Growth has been sluggish in many advanced economies and a continued slowdown may hinder the more rapid growth of emerging countries. This can be seen in the IMF’s projection of 2.7% and 2.2% growth for advanced countries in the next two years compared to 7.1% and 6.4% growth for emerging countries in the next two years. If growth in advanced countries wanes, emerging countries will be forced to look for domestic demand to sustain high levels of growth. A major reason emerging markets have been hit less is due to the lack of a financial bubble before the meltdown. Reforming the structure of the financial sector remains an important part of the recovery today.

The IMF outlined four key areas that need to be addressed for there to be a sustained global economic recovery. The first is sovereign debt. Countries with high levels of debt, especially several in Europe, may need policies to boost their country’s demand, but debt levels need to be monitored for medium to long term growth. The second is employment. Much of the recovery has been driven by productivity growth resulting in continued high levels of unemployment. A long term recovery is not complete while the unemployment rate remains high. The third is financial sector reform. There need to be policies in place so that another financial bubble collapse does not result in a global economic meltdown. The fourth and final area is global cooperation, especially on a currency basis. Exchange rates have been extremely volatile during the recovery leading to a lot more growth in some countries more than others. Within the many areas that need to be addressed, the IMF focused on these areas for a global economic recovery.

* Source: International Monetary Fund

Mortgage and Foreclosures:

The latest issue involving the housing market is whether or not foreclosure documents were improperly signed by “robosigners” leading to foreclosures that should never have taken place. The validity of these foreclosures is in question because there is confusion over who actually owns the mortgages that allow these foreclosures to take place which led to the creation of these documents.

All 50 states have launched an investigation into whether or not improperly handled foreclosures took place and several financial institutions have temporarily halted foreclosures. Many bank stocks have continued to tumble on increased uncertainty over how much this will cost the banks.



Thoughts

The last several months have shown how much confusion remains in both the domestic and global economic recoveries. While one side fears inflation, the other expects deflation to undermine the current recovery. The markets have also demonstrated how much confusion remains in the system. Gold prices continue to climb and given the lack of inflationary evidence, it appears fear still drives the yellow metal prices higher. On the flip side, both bond and stock prices have been rising, raising more questions. Without wages rising, it is hard to follow the inflation hawks, yet with all the money our country has been pumping into the economy, one can only assume it will show face at some point down the road we are heading. Bond prices seem to be rising due more to government intervention than true market demand. I would hesitate to venture a guess as to when reality will hit this particular asset class.

Earnings season has begun and we will provide our take on the 3rd quarter next month. Until then, don't hesitate to call or email any questions you may have.

Best,



Matt



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