



# The Sage Capital Newsletter

April-May 2011

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Earnings Season is well underway and with few exceptions, companies across all sectors have provided strong earnings and positive tones to the global economic recovery.

Yet, just as things look to be improving and discussions made to add some fiscal responsibility to our over-bloated balance sheet; The Standard and Poor's rating agency elected to downgrade the outlook of the US to Negative. While this is not necessarily wrong, I wonder where this analytical work was while the mortgage market was blowing up. Mortgage securities the rating agencies had as AAA rated.

This month we will continue to look at the broad market valuations, and try to make sense of the current levels of the US Dollar along with the recent run in commodities.

Without question a great deal of the financial markets focus has been on the inflation frontier. It is no longer possible to ignore rising commodity prices across the board coupled with our weak US Dollar. With the exception of housing and wages, inflation has become a prominent news item. The Federal Open Market Committee (April 2011) stated that; Inflation is still somewhat low (wage inflation and high unemployment).

With this insight we will try to walk you through our perceived thought process of the US Treasury and the Federal Reserve.

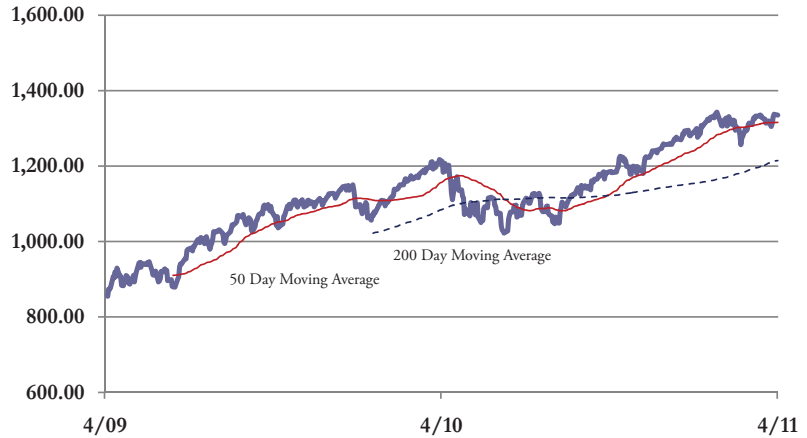


# Sage Capital Market Overview

**Figure 1: S&P 500**

Data: Thomson Baseline  
(S&P 500, Daily Closing Value,  
50 and 200 day  
moving averages)  
4/25/11

It would appear the equity markets are enjoying the weak domestic dollar (easy money) policy. The question that begs to be answered is how the expected tightening from the government is going to affect performance going forward.



<u>Price % Change:</u>	
<b>1 Month Ago</b>	<b>-0.10%</b>
<b>3 Months Ago</b>	<b>5.40%</b>
<b>12 Months Ago</b>	<b>13.4%</b>

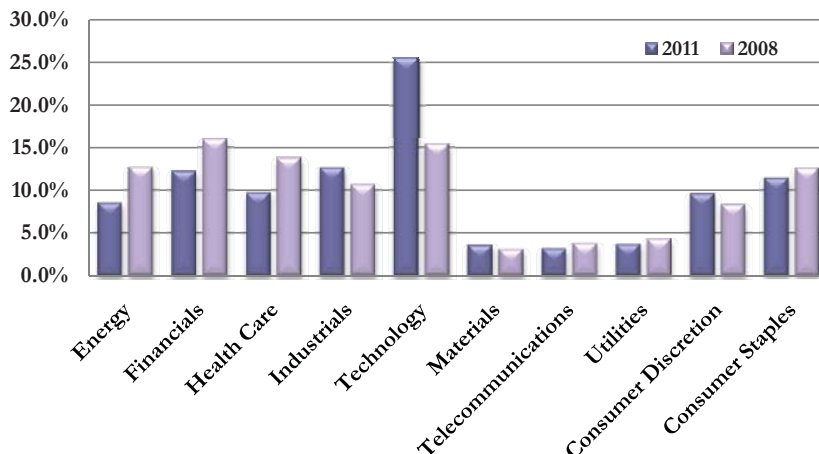
**Table 1: S&P Performance**

Data: Thomson Baseline  
(Mar. 31, 2011 Data)

	<u>Current</u>	<u>5 Yr Avg.</u>
<b>Forward P/E:</b>	<b>14.0</b>	<b>15.5</b>
<b>Dividend Yield:</b>	<b>1.8%</b>	<b>2.1%</b>
<b>Price to CF*:</b>	<b>10.0</b>	<b>9.6</b>
<b>Price to Book:</b>	<b>2.3</b>	<b>2.3</b>

**Table 2: S&P 500 Key Stats**

Data: Thomson Baseline  
(April 25, 2011 Data)



**Figure 2: S&P 500  
SECTOR WEIGHTINGS**

Data: Thomson Baseline  
(S&P 500 Sector Weightings  
2011 (May 2, 2011) and  
2008 values)

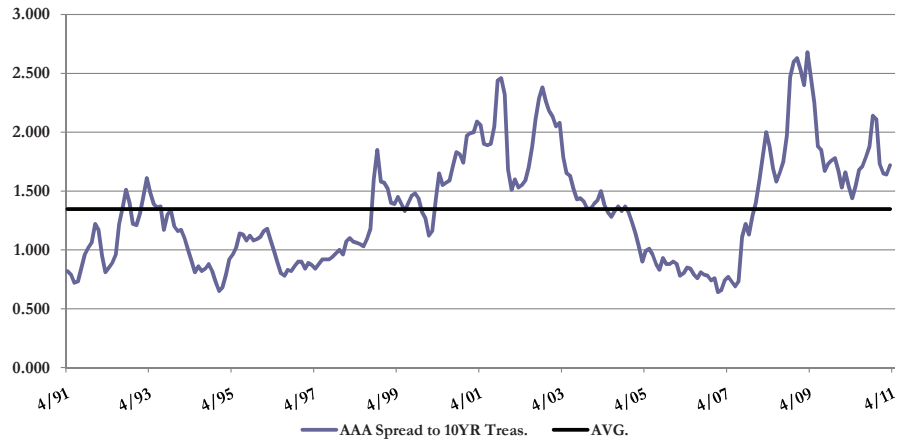
Based on 5 year historical averages current market valuations for the S&P 500 appear to be priced at fair levels. In context with bond yields and our economic growth it could be argued equities still provide much greater value.

\* Price to Cash Flow

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# Market Analysis

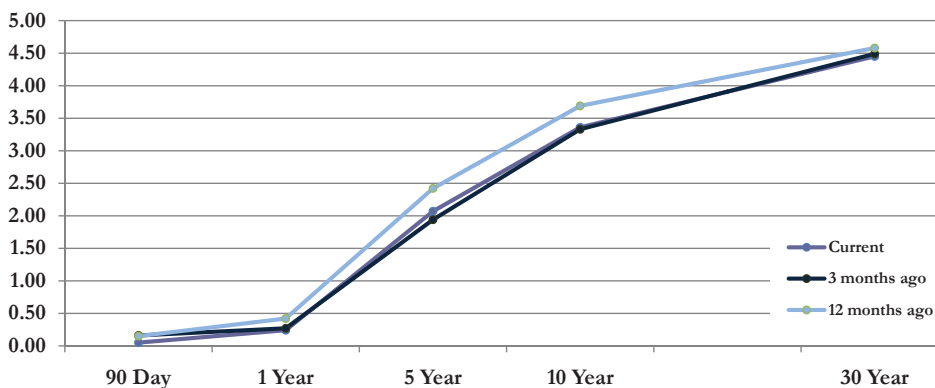
**Figure 2:**  
**AAA SPREAD**  
**TO 10YR. TREASURY**  
 Data: Thomson Baseline  
 (AAA and 10YR. Treasury  
 Monthly Values.)



While rates are low across the board and provide virtually no real perceived value, on a relative basis it would appear that corporate bonds continue to hold the most value.

Something I found interesting was the way the treasury market behaved the day S&P announced the negative ratings watch on US Debt. Interest rates were actually lower indicating a higher price while the paper was effectively downgraded. A flight to safety due to the negative views of the various securities being purchased for safety.

An upward sloping yield curve continues to favor a short duration (1-5yrs), laddered strategy. We would still favor industrials over financial offerings.

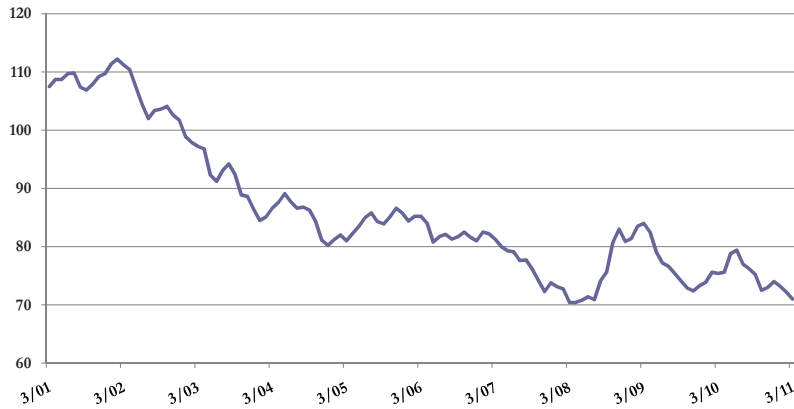


**Figure 3:**  
**TREASURY YIELDS**  
 Data: Thomson Baseline  
 (90 Day, 1 Year, 5 Year,  
 10 Year and 30 Year,  
 Daily Values.)  
 4/25/11

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# The Economy

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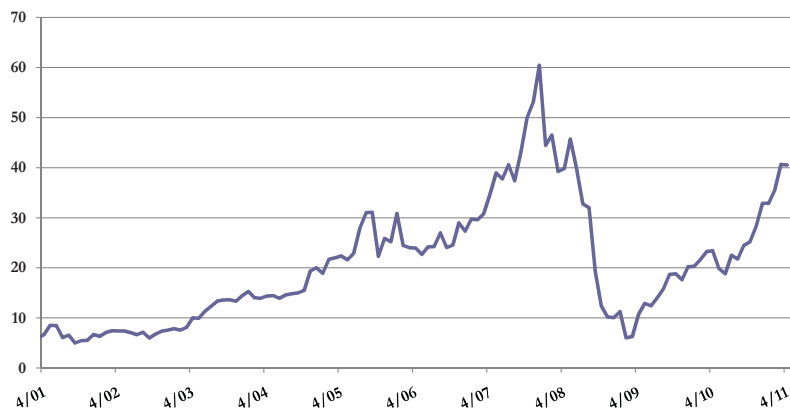
**Figure 5:**  
**US DOLLAR**  
Data: Thomson Baseline  
(US Dollar, Monthly Closing Values.)

The investing public has continued to be skeptical of the government's ability and or desire to bring down spending. The US Dollar has continued to fall versus foreign currencies even though it could be argued we are more fundamentally sound than some of our counterparts. The one area of the market that has benefited from this view is the commodity markets. Be it prices at the pump, precious metals, or small grains, commodity prices have continued to increase.

In normal markets this would indicate one of two things; either the economy is growing and providing strong end user demand, or the weak US Dollar is effectively driving up the prices for tangible assets. While the Federal Reserve has stated its lack of concern over inflation the only answer would be the investing public is in inflation protection mode.

**Figure 6:**  
**COMMODITY INDEX**  
Data: Thomson Baseline  
(CBI, Monthly Closing Values.)

Domestic commodity prices are seemingly in a perfect storm with growing global demand coupled with a weak US Dollar. The question remains; how long will this trend continue.



# The Economy

## Inflation:

Inflation is frequently misunderstood by many. You and I go to the grocery store and notice the rise in prices; we know as fact our dollar isn't going as far as it did a few years ago. The cost of gas has gone up almost daily and we don't need anybody to tell us there is inflation. Our purchasing power is going down. Enough said.

However, the academic version of inflation that our government and many economists employ is markedly different than the version you and I utilize. The only true measure of inflation in the eyes off the powers that be is wage inflation; and it doesn't take much of an imagination to realize that there are absolutely no signs of wage inflation currently in this country.

With the weak US dollar policies continuing real estate should be robust, yet banks haven't figured out how to navigate the foreclosure markets. Talks have taken place in Washington to remove the mortgage interest tax deduction. It appears housing could be the key to a jobs recovery and our economic growth.



**Figure 7:**  
**EX. HOME PRICES VS**  
**TRADE WEIGHTED**  
**DOLLAR**

Data: Thomson Baseline  
(Ex. Home Prices and Trade  
Weighted Dollar, Monthly Closing  
Values.)



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# News of Note

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## News:

### Bermanke:

Chairman Bermanke gave the first ever Q&A after a Federal Reserve committee meeting last week. The Fed's viewpoint is based on housing and wage inflation finding low levels of inflation. Chairman Bermanke also mentioned that although the bond purchase program will be ending at the end of the 2nd Quarter, the Fed would continue to maintain the bond portfolio and re-invest maturing securities.

### Debt Limit:

The coming weeks could experience volatility as Washington will be discussing raising the current debt limit.



## Thoughts

The recent run-up in commodity prices with somewhat slow growth provides reason to maintain some caution. It is apparent that the investment markets are finding solace in tangible assets as the US Dollar remains weak.

Recent political in-fighting has left many apprehensive on the ability of our government to reduce spending in a meaningful way. While both sides seem to understand the seriousness of our growing debt problem, solutions seem distant.

The one area of the economy that may hold the key to our economic turnaround is housing. A housing recovery would do wonders for employment as well as consumer confidence.

Until we see real change on fiscal and monetary policies that push the government to tightening mode we expect the savers to continue to be punished for good behavior. Interest rates are likely to remain low for a continued period, likely until the housing and job markets display sustainable growth.

Best wishes,



Matt

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