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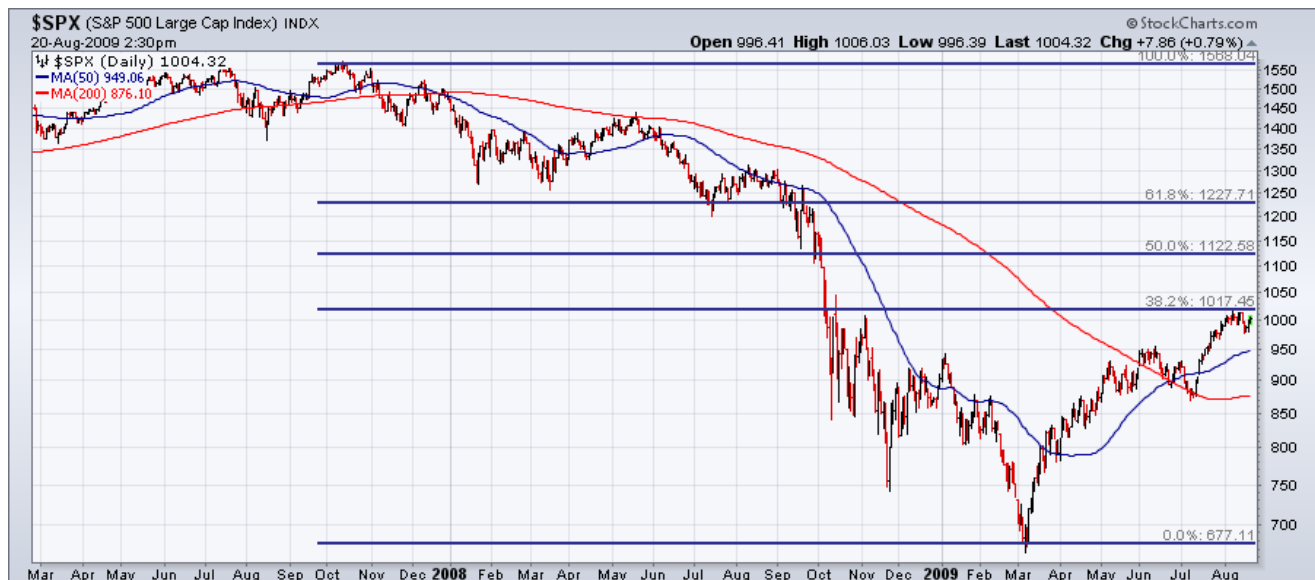
Alternative Investment Strategies

Summer Rally

At the depths of the March deluge few would have predicted that the US markets would rally back with such ferocity and for such a long time. In July, markets extended their rallies to levels not seen since late 2008. Technology continues to lead the way with the NASDAQ Composite up 25.46% year to date after gaining 7.82% in July. The Dow Jones Industrial Average remains the laggard of the major indices with a year to date return of 4.50%, but was particularly strong in July gaining 8.58%, as large cap companies, especially financials, have proven to be market leaders after better-than-expected earnings results. The S&P 500 finished the month up 7.56%, bringing its year-to-date return to 10.97%. More significantly, the index has gained over 50% from its March lows and has not had a 30 point correction in over a month. As we enter the summer months and most investors, traders and financial professionals go on vacation, it is worth taking a look at the technical levels of the S&P 500. As you may know, many of CMG's absolute return strategies utilize the S&P 500 index as an investment vehicle. Furthermore, technical analysis is woven into the fabric of many of our trader's models.

Technical analysis has been derived from hundreds of years of observation of financial markets with its most fundamental principle being that a market's price reflects all relevant information about an asset. One of the oldest

known examples of technical analysis was founded by Homma Munehisa, an 18th century Japanese rice trader, when he developed candlestick charts to help predict the future price of rice. The charts allowed Homma to visually represent the open, high, low, and closing market prices for rice and helped him to identify market trends. The method was adopted in the US by Charles Dow, co-founder of the Dow Jones Company and founder of the Wall Street Journal, in the early 1900's and has been popular with traders since. Since then, many indicators, overlays and technical strategies have been developed that help traders identify price trends that may give them an edge. Technical analysis proves to be particularly useful in markets like the present, where company and economic fundamentals take a backseat to momentum and liquidity forces. The recent rally, much like the waterfall selloff early in the year, have been driven primarily by fund flows: investors looking to get out because their pain level has been hit (March) or investors looking to get on board because they are missing out on relative performance (July). In both cases, markets are pushed to extreme levels where prices do not reflect rational levels of risk and reward. While markets were extremely oversold in March, the recent rally in July has brought the markets into overbought levels, indicating a high probability for a correction. In terms of technical analysis, let's take a look at what Leonardo Fibonacci is telling us.



Leonardo Fibonacci was a 13th century mathematician, whose claim to fame is the number sequence that bears his name. The sequence, which is created by adding the previous two numbers of the series together (i.e. 0,1,1,2,3,5,8,13...etc), is used as a tool to determine probable retracement levels for investments and indices, like the S&P 500. There are three major retracement levels, 38.2%, 50% and 61.8%. The 38.2% ratio is found by dividing one number in the series by the number that is found two places to the right (i.e. 5/13). The 61.8% retracement, which is also referred to as the "golden ratio" is found by dividing one number in the series by the number that follows it (i.e. 8/13). Applying the Fibonacci retracements to the S&P 500 shows some interesting technical levels that point to a ceiling on the current bull market rally. The closing high for S&P 500 was on October 9, 2007 at 1565.15 while the corresponding closing low since then was 676.53 on March 9, 2009. Applying the Fibonacci ratios to the difference between the high and low point for the S&P gives the Fibonacci retracement levels on the chart above. The current bull rally has fizzled right around the 38.2% retracement level of 1016. The golden ratio of 61.8% is at 1225 on the S&P, which also corresponds to a support level that was broken during the October 2008 sell-off. Both of these numbers represent key technical levels that help traders navigate markets with unpredictable fundamental readings. While there is no concrete evidence that the Fibonacci retracement levels in themselves provide the Holy Grail to trading, they are used as signposts for traders looking to increase trading probabilities and are often used in tandem with other indicators, such as candlestick reversals.

In addition to technical indicators that point to a market top, there are a number of fundamental factors that indicate the summer bull market may be coming to a close. The markets are entering what has historically been the worst month statistically, September. The summer rally has made investors complacent with market volatility indices at their lowest levels since September 2008. Although the recent rally lifted off after better than expected news from the financial sector, the earnings reports of many banks do not indicate strong growth nor do they support the case for significant stock upside at these levels. Just like mark-to-market accounting was blamed for the erosion of bank balance sheets and share prices earlier in the year, recent earnings were inflated at many companies, most notably AIG, as those same assets were now marked up significantly as market liquidity has returned. Consumer spending remains weak and will slow the market recovery moving forward. Home prices are bottoming and first time home buyers took advantage of tax credits and low interest rates. However, as rates have ticked up over the past couple months, sales have slowed. The commercial real estate sector could be the next landmine for banks holding CMBS (Commercial Mortgage Backed Securities). Stocks have staged a dramatic rally from their lows in March, but momentum is waning. Technical indicators show the market is facing resistance at these levels, while the fundamentals are not bullish enough to support a strong thrust higher. It may be time for this rally to pause. For investors, it is time to take some profits and lower exposures as markets are due for a correction.