Churchill Management Group

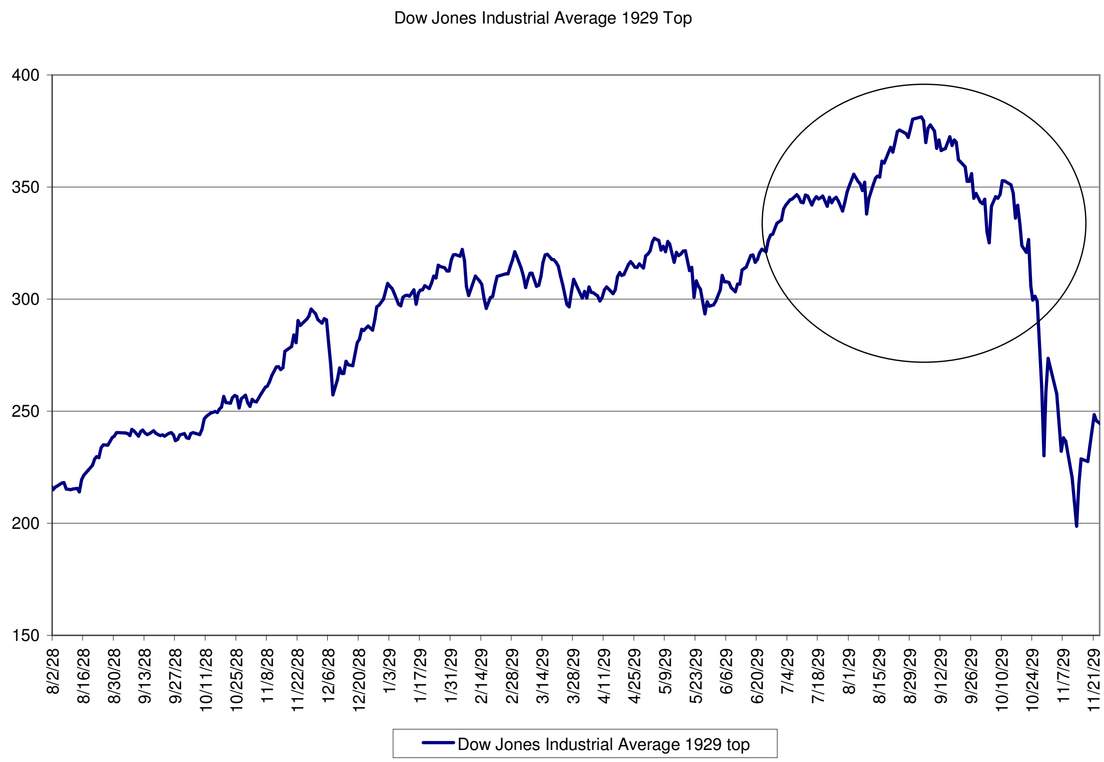
Market Perspective

February 19, 2014

Is the stock market in a topping phase or did it just need to catch its breath before continuing the long Bull Market that began almost five years ago? At present, the answers are not yet clear. While an accommodative Fed has continued to fuel the stock market, recent taper talk combined with international currency worries gave the market brief concerns to start the new year. The market has regained footing since then, although volatility has also increased. This market behavior is fairly normal for an aging Bull Market attempting to maintain its momentum.

We have all been taught that the market goes up and goes down. In stock market terms, it has a Bull Market followed by a Bear Market and then a Bull Market again. But in reality, the process is more of a four-step cycle than a two-step cycle. Our 51 years of experience and our detailed analysis of markets dating back to the early 1920's has taught us that markets go up (Bull Market), have a Topping Phase, then a Bear Market, followed by a Bottoming Process and so on. The following is a chart showing the Top being formed in 1929 prior to the Bear Market that led to the Great Depression.

Churchill Management Group ▪ 5900 Wilshire Blvd., Suite 400 ▪ Los Angeles, CA 90036
Phone: 877-937-7110 ▪ Fax: 323-937- 0408



All of the Bull Markets since 1929 have had some sort of a Topping formation at their conclusion. In our Premier Wealth tactical strategy, we use the indicators in our Chart Room from a Fundamental, Technical, and Sentiment perspective to help warn us when a Top may be forming.

Fundamentally, the current Bull Market began on March 10, 2009 and is just under five years old. Since 1922, there have been sixteen Bull/Bear market cycles, and only three that are longer than the current one. Two of the Bull Markets lasted a little over eight years and one lasted a little over seven and a half years. The remaining Bull Markets lasted five years or less before encountering a Bear Market (where the major indices drop twenty percent or more). Needless to say, this Bull Market is getting mature.

Many times in a Bull Market run the market will become extremely over-valued before a Bear Market Top begins. While the current Bull Market is slightly over-valued, it is not extremely over-valued from a historical perspective.

One of the classic patterns in Wall Street is that Bull Market Tops are formed after the Federal Reserve raises the Discount Interest Rate three times. Currently, interest rates are dirt cheap because of the stimulating efforts from Central Banks across the globe to stop the likelihood of deflation caused by the massive excess capacity in a world that has become so close. The commencement of the Fed "Taper"—the reduction of monetary stimulus added to the economy—is a worry. Is the tapering akin to a rate hike? Some in the financial world fear it could be perceived that way, and certainly the market had a negative initial reaction. Either way, it is early in the tapering process and the Federal Reserve is still signaling a very accommodative stance going forward.

Technically, there was a brief divergence in the fourth quarter of last year where the breadth of the market (the advance/decline line) was not making new highs even though the market indices were. A breadth divergence has been a "smoke signal" if you will, of potential trouble to come. However, the divergence has since cleared up. Those with a good recollection of market history know that there was a breadth divergence that emerged in 1986, cleared up, and then re-emerged as one of the signals prior to the 1987 crash. A divergence remains in the number of stocks hitting new highs as that indicator has not yet confirmed the market's peak. While this divergence is not a terribly ominous sign on its own, it is something for us to keep our eye on.

Finally, our Sentiment indicators have been signaling an extremely Bullish outlook from investors for some time, which can be a concern. In particular, the use of margin to purchase stocks has soared, which implies that much of the fuel that helps propel markets upward has been used. In our last letter, we discussed a possible Bubble forming, and that does remain a possibility. In sum, the market has shown some signs that it could be in the preliminary stages of forming a top. Accordingly, and consistent with our 51 years of experience, we have taken a cautionary first step in our tactical strategies to reduce exposure even though our portfolio of individual stocks and ETFs looks excellent both Fundamentally and Technically.

When taking a partial step back to reduce exposure like we have just done, WE KNOW WE ARE ALWAYS WRONG. If the Market goes up, we shouldn't have reduced exposure at all and if the Market goes down, we know we should have gotten out completely. However, in a practical sense, it is the discipline referred to above that keeps the power of compounding going "Making it and keeping it" is what investing is all about.

We know that even if this is the beginning of a topping formation, the process can take a long time to form and the market can rally during this time. We are also aware that these initial signs of risk may clear themselves rapidly and set the stage for another leg up in this long Bull Market. Either way, we will be keeping a close eye on our indicators and will act accordingly.

WE WILL KEEP YOU INFORMED.

CHURCHILL MANAGEMENT GROUP

** This report is meant to inform the reader of our current market opinion, which we, as professional money managers, use in our decision-making. It should be noted that stock market and bond market data are subject to varying interpretations and any one interpretation will not necessarily guarantee investment success. The information obtained from the sources specified herein and used as basis for our current market opinion is believed reliable, but we do not guarantee the accuracy of such information.
**CMG may purchase significant positions in foreign securities in all of its investment strategies depending on perceived market conditions, often through the use of Exchange Traded Funds.

Churchill Management Group ▪ 5900 Wilshire Blvd., Suite 400 ▪ Los Angeles, CA 90036
Phone: 877-937-7110 ▪ Fax: 323-937- 0408