

Churchill Management Group



Market Perspective

September 1, 2009

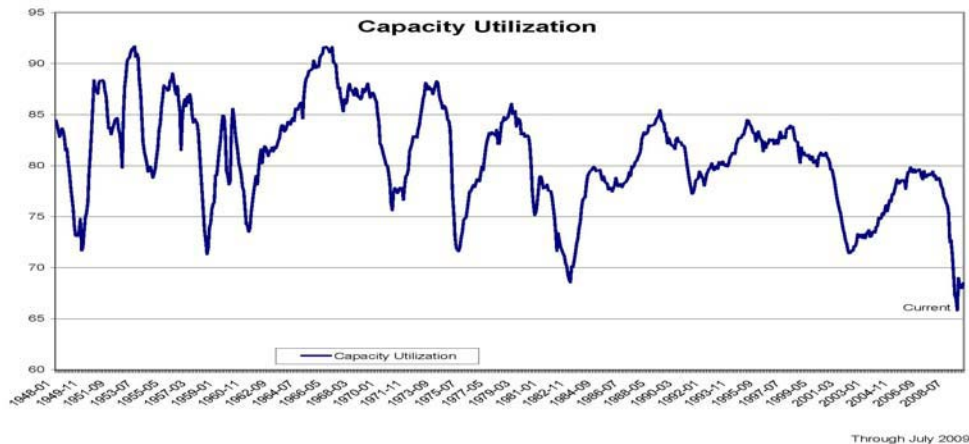
In January of 2000, the investing public reached the height of “Irrational Exuberance” during what is now known as the Tech Bubble. By October of 2002, after the Technology sector had fallen close to 80%, they reached “Irrational Despair.” In October of 2007, the public was back to “Irrational Exuberance.” Though nowhere near the heights it had reached in 2000, the investing public was still overindulgent in optimism. With the financial collapse of 2008, the public was again thrown back into “Irrational Despair.” This emotional flip flop is a classic example of how investor Sentiment works.

Thanks to modern technology, computers, and the like, many of the factors used to analyze the Fundamental and Technical aspects of the stock market and the economy have certainly become more readily available to the public, have been updated, and/or have changed. What has not changed is human psychology, especially as it applies to investing. We know from our Sentiment indicators that when there is a top in the Stock Market that there is also extreme optimism – i.e.: Irrational Exuberance. We also know from our Sentiment Indicators that when there is a bottom in the Stock Market, there is extreme pessimism – i.e.: Irrational Despair. Simply put, when everybody is Bullish, we need to be Bearish and vice versa!!!

Currently, we are in the process (a Bull Market) of *leaving* Irrational Despair, which reached its lows back in March of this year. For good reason, the investing public has become overly concerned with the economy and the market. The key to calling something “irrational” is to say it went to an extreme. It appears that the market fears went to an extreme, thus setting up the current market rebound. As we have expressed in our past letters, we believe the market is currently in the midst of a Cyclical (shorter term) Bull Market against a longer term Secular Bear background. The good news is that it appears we are presently a long way from extreme Irrational Exuberance, which would indicate that this Bull Market still has some room left to run.

However, there are still some very rational reasons to be concerned about the economy and what it might do to the market down the road. At the forefront seems to be concerns over inflation. The U.S. Government is printing an enormous amount of money as are many of the other Central Banks and governments around the world. We believe that the Money Printing Press is likely to continue. Our Chairman of the Central Bank, Ben Bernanke, was recently reappointed and has expressed from his studies of the Great Depression that in battling a potential depression, the liquidity flood gates need to be left open. Additionally, President Obama’s aim for re-election in 2012 favors the Federal Reserve to aggressively print money and bolster government programs to fuel the economy and support his re-election cause. (This is not to imply evil intentions here; it’s the American political game.) We also know that the government already has a second program in place to build infrastructure in the country, similar to what Franklin Roosevelt did in the 1930’s. You can clearly see why the investing public would be concerned about *inflation* fears.

However, a view of the following chart of Capacity Utilization shows the massive excess capacity in the United States and gives an alternative view of the inflation question.



The same is true for the emerging markets; there is massive built up excess capacity in countries such as China and Brazil. This excess capacity is a very severe problem and is likely to keep inflation in check in the near term as it brings in the threat of *deflation*, like the 1930's and Japan's 'Lost Decade' from 1991-2001.

Therefore, it is obvious why the Central Bankers and governments are printing money -- to stop *deflation* before it occurs. Our study of the economic cycles strongly supports that *inflation* is coming; it's only a question of how soon and to what degree. However, our charts and studies of this cycle lead us to believe that the *extreme inflation* won't be here for a number of years. Here are some other immediate concerns that may weigh on the market:

- Concerns over the Dollar and Protectionism. The printing of money has also brought additional concerns over the weakness of the dollar and a shift towards protectionism. As the world has become ever so close, importing and exporting have become critical to the economic survival of many countries, especially the emerging markets. In difficult times, protectionism is a weapon many governments have turned to, often with dire economic outcomes.
- Energy Costs. The prices of commodities, oil and energy in particular, continue to weigh on the consumer. With the price of gasoline up to over three dollars a

gallon in many places again, the average consumer is understandably quite concerned. The investor's concern is that unless the American consumer buys, how can the economy come out of a severe recession?

Thus, it is obvious why Irrational Despair reached an extreme towards the end of 2008 and the first quarter of 2009. Fortunately, when our Sentiment indicators reached such a negative extreme, our Fundamental and Technical indicators were giving us enough positive confirmation that we started investing in our Premier Wealth accounts in early April of 2009 after having an extremely large cash equivalent position for almost a year and a half.

The good news is that we continue to have confirmation from almost all of our indicators that we are now in a Cyclical Bull Market. We would expect to see the market have some type of intermediate correction (greater than 10% but less than 20%) somewhere in this run before a second leg begins in the rally. Because of the Secular Bear background to this rally, we are aware that the up trends will likely be shorter in time and the down trends more volatile when they arrive. Accordingly, we are aware of the importance of protecting profits and not taking too great of a risk.

When will the Cyclical Bull Market End? During past Secular Bear markets, some Cyclical Bull markets have lasted over two and a half years. Of course, this one will play out in its own way. Our strategy will remain simply to look to our indicators to tell us when it is again time to protect capital.

We will keep you informed.

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** 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.