

Market Perspective

May 4, 2010

The significant investment decision of the moment is to not allow the “Secular” to overwhelm the “Cyclical” and turn you from a “Bull” to a “Bear” when investing in the current market. While the economic news coming from the popular financial press continues to be bleak, in April the United States stock market was up for the twelfth time in the past fourteen months. How can that be? For a number of years we have communicated our research studies on two types of Stock Market cycles that impact the risks for investors, the “Secular” (longer term, 30 to 40 years) and the “Cyclical” (shorter term, 3 to 5 years).

Right now, the negative “Secular” news surrounding the world wide economic de-leveraging is overwhelming the air waves. However, we believe a critical investment strategy is not to confuse the short term investment making process by combining the fundamental and emotional background of the “Secular” with the “Cyclical” stock market trend. The shorter term “Cyclical” stock market moves need to be evaluated on their own. While they, of course, need to be evaluated within the “Secular” context, we know there are often good money making opportunities to be found within each “Secular” market decline. The trick is to not let all of the negative “Secular” news cloud your view of the opportunities when they present themselves. Today, we believe the financial world is overreacting to that confusion.

It is true that the fundamental background of the current “Secular” environment is quite concerning. The modern economic world is going through two dramatic changes. The first one is the de-leveraging process. For many decades consumers pushed the envelope and borrowed too much money and are now having to pare back their budgets. The second is world wide excess capacity in most economic sectors. The internet and the cell phone have helped bring millions of people around the world into the benefits of modern world capitalism. Beginning with the Tech Bubble of the early 2000s, to the recent housing bubble, there has been massive excess capacity created around the world. We now have most of the governments in the world (the Capitalistic world and the

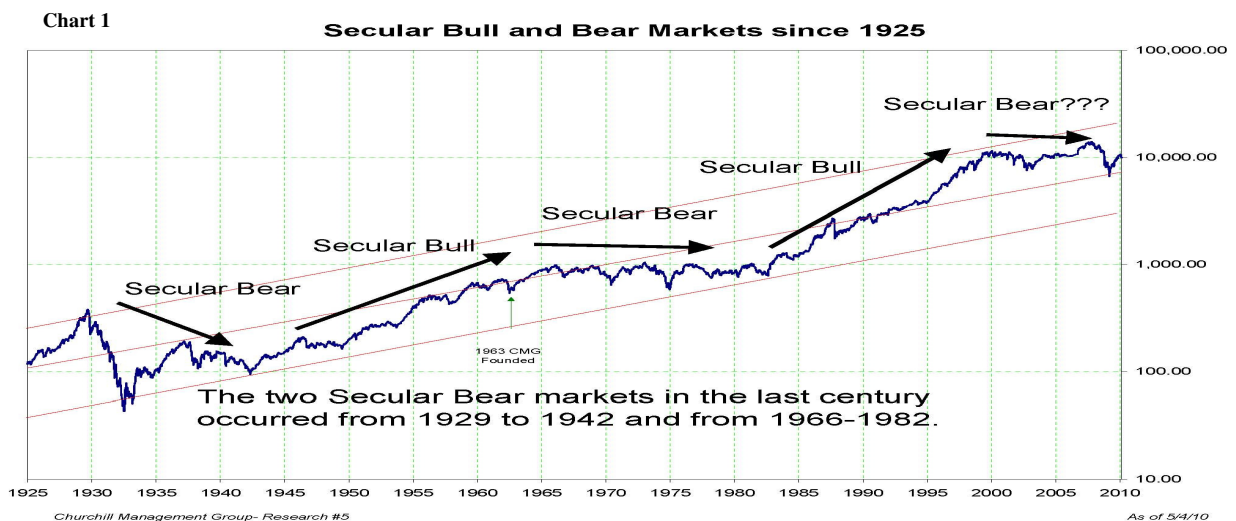
Socialistic world) forced into trying to create demand from the consumer in an effort to stop the deflation that is caused by supply overwhelming demand. As a result of the economic trends, these governments have been trapped into carrying massive debt. With poor looking balance sheets, many countries with major debt around the world will soon have to join in the de-leveraging process, if they haven't already.

Globally, Europe is in a much worse financial position than the U.S. Greece demanded aid from the European Union and the IMF. This will have devastating effects on that country, forcing budget cuts and the rescheduling of debt. In addition to the small countries of Greece and Portugal, the much larger economies of England, Italy and Spain face the same critical outlook.

Fortunately, the emerging countries of Asia are not yet directly caught up in this crisis. The Communist Government of China, through its Central Bank, has just tightened credit again trying to be proactive to stop inflation and asset bubbles, especially in the Real Estate Market.

In the United States, the background to the investment world is similarly pretty scary. Unemployment rates have soared and U.S. households have embarked on a multi year period of credit restraint which has put a significant cut on consumer spending. The Federal government, working with the Federal Reserve (central bank), has triggered massive spending plans to fill the gap leading to worries over future inflation, tax increases, and federal, state, and local government fiscal crisis.

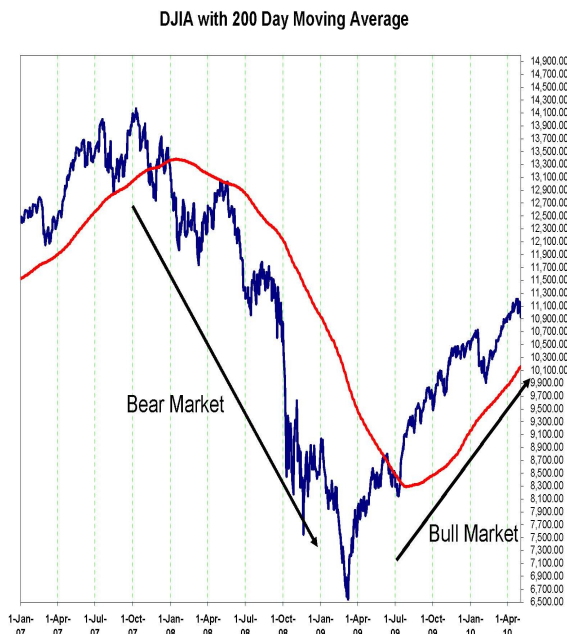
The good news is that even against alarming "Secular" Bear trends there are "Cyclical" Bull Markets where good money could be made without taking undue risk. Chart 1 shows the "Secular" stock market trends going back to the early 1900s. You can see that we believe we are now in the third "Secular" Bear (that began January 14, 2000) since that time. Within the context of one "Secular" Bear move, there are generally four or five "Cyclical" Bull moves, where the market will rally for many months before finally selling off and giving way to the Secular trend. Of course, the key to making money in a "Cyclical" Bull market against a "Secular" Bear background is to have a soundly based investment philosophy to make sure you don't give back the profits when the shorter term trend runs out of steam.



We at Churchill know the critical importance of keeping the background to the “Secular” Bear period separate from the day-to-day management of stock market investments. It needs to be strongly considered, as we know that “Cyclical” Bull Markets will be shorter and “Cyclical” Bear markets more troubling during “Secular” Bear declines. However, the emphasis needs to be on the direction of the “Cyclical” move.

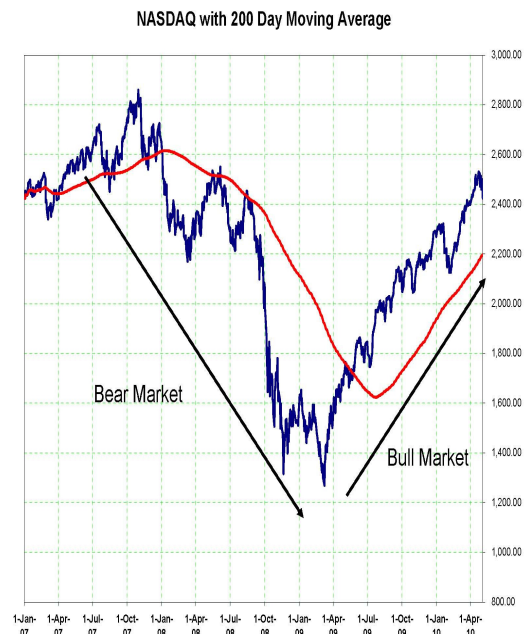
Chart 2

Chart 3



2007 - Current

Current up to 5/4



2007 - Current

Current up to 5/4/10

Charts 2 and 3 above show, in technical terms, that both the Dow Jones Industrial Average and the NASDAQ remain in powerful up trends – a “Cyclical” Bull market. This is a period when good money can be made. Our top-down processes helped us to identify the beginning of this run back in the spring of 2009. We continue to use our Sentiment, Fundamental, and Technical Factors to define the low risk opportunities. Our bottom-up process this time led us to invest in the leadership from technology, internet retail, and emerging markets!

We know it will remain critical to stick to our disciplines in order to anticipate the next time we will need to take a defensive posture. Currently, this “Cyclical” Bull market is just short of 14 months old. The first two “Cyclical” Bulls against the “Secular” Bear periods, in the 1960’s and 1970’s, were 27 months and 32 months long. Currently, our top-down and bottom-up process do not indicate that the current markets

correctionary phase is the beginning of a Bear market. However, we have taken some defensive moves during a volatile period by paring off some positions that appeared to be at risk.

As we mentioned in our last letter, it would not be surprising to see an intermediate correction, where the market averages fall over 10% but not over the 20% Bear market definition, creating a second great buying opportunity – in our terms a “buy zone” for the second leg of the Bull market. The critical fact is for clients to know that while the press and politicians in America and around the world cause trauma we must stick to our disciplines. Our experience tells us that the returns we desire can be made.

We like to remind people that when we look at the charts in our Chartroom (that go back to 1922 on a daily basis): What do the charts of the market show us? The Markets go up and down – like life. True, the “Secular” background is very concerning. However, as our economy has in the past, we are confident that it will get through it. But for investing, the key is to recognize the cycles and take advantage of them as much as possible. We will look to make our share when the opportunity presents itself, but be mindful when the risks increase as the “Secular” Bear market runs its course!

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