

## Client Conference Call Script July 2010

Good morning everyone, this is Christopher Pelley - hope everyone is enjoying what is shaping up to be a beautiful Colorado summer.

I'd like to begin by thanking all of you who have joined us today – this is our third Quarterly Client and Market Update call. As usual, in order to keep to the time allotted, we will begin with commentary on the macro economic picture, and then Chad will lead in with an update on CIMCO portfolios. We are unable to comment on any client specifically, so please call us directly with any questions relating to your personal accounts.

It's summer, and the heat is on...

The last quarter was not kind to the US equity markets, an observation that has been covered at length by the media. Nearly every sector of the market (39 out of 40) lost ground as the new highs of April gave way to volatile months of May and June. In the end, it was one of the worst quarters of the past decade and this naturally leads to the question of whether turning the page on our wall calendar is enough to truly change anything in the market, or whether last quarter was simply foreshadowing things to come. In other words, was last quarter a pullback for a positively trending market that will continue to be just that, or was it instead the beginning of a new negative trend for US equities?

That is an important question, and while not the type that lends itself to a succinct answer today, identifying changes in trend are far more manageable than trying to call exact tops or exact bottoms. We can adapt to trend, we can invest in trends, and we can identify them. However, exact market tops and market bottoms are events that pass quickly, hardly with confidence, often quietly, and are quite frankly not something we find any tool particularly adept at finding with any accuracy...

Trends, however, are different. We can say that the S&P 500 has been in a positive trend since last April, and that trend is now roughly 5.6% from changing for the worse. We can say this objectively and we can say this in a concerned manner because we know that historically markets in negative trends behave differently than those in a positive trend. In large part, markets in negative trends behave much as we've seen for the past few months. Surely there have been rallies, but those rallies *have fallen short of the one before it*. Certainly there have been declines, and those have rather clearly *not subsided until reaching lower levels* than the decline before it. That is, essentially, how a negative trend is defined. The picture is grim, and time will tell if we reach that turn where the trend becomes negative.

Let's take a look at Domestic economic health:

All kinds of May economic data seemed to point to a slowdown, and some of it even indicated deflation.

The spirit in the real estate market has been pretty low after the release of May home sales data – it seemed to hint that the housing rebound of the last few months was very much reliant on federal stimulus measures. New home sales sank a jarring 32.7% according to the Commerce Department. The National Association of Realtors also reported that existing home sales slipped another 2.2%. At the end of June, mortgages had become almost as cheap as they were during the 1950s – a good trend, in light of all the bad.

Housing market malaise aside, factory orders were down 1.4% for May, and durable goods orders diminished by 0.6%. June's jobless rate was down to 9.5%, but as an effect of the U.S. Census layoffs, you had just 83,000 jobs added and 125,000 jobs shed.

Not surprisingly, given the aforementioned pressures and the continued turmoil in Europe, the Federal Reserve made no changes in its monetary policy stance, and maintained its commitment to keep rates exceptionally low for an extended period. In fact, this recent "soft patch" in economic data and recovery, has led to a greater concern for deflation, rather than inflation. Deflation occurs when consumers believe that prices could be lower in the future, thereby providing little reason to consume or invest today, and delaying economic activity. Lower demand results in a drop in production, job cuts, and wage decreases – resulting in a reinforcing and detrimental cycle.

This leads us to widen the view a bit and take a look at Global economic health:

Tensions over European debt and banking-system health have plagued the already tenuous recovery. Europe started the quarter off with the continuation of the debt crisis, and as June drew to a close, the big news item was not from Europe but from Asia. China's benchmark manufacturing index registered down from May – the second straight month of decline. PMI indices in India, Taiwan, South Korea, and Australia dipped as well, adding to concerns about a global slowdown.

We did see successful government debt auctions (notably in Spain and Portugal), and the 750 billion euro bailout package. The European central bank also extended liquidity provisions for euro-zone banks beyond June and announced the release of individual bank level stress tests in late July. Liquidity remains problematic, with yields rising as maturities come into view. While debt may be issued, the question is at what "price," or interest rate. Over time, tensions in the credit markets may ease if governments follow through on deficit-reduction measures. However, austerity measures and the need to adjust for lack of labor competitiveness are likely to depress growth in the euro-zone.

As we get into July, we have a number of things on our minds – the strength of the recovery, the concern about economies in Asia and Europe slowing down or struggling with debt, the apparent fragility of the housing market... Looking at barometers like consumer spending and the ISM indices, the economy is still growing. The question is, can it grow fast enough or strongly enough to please the investor? We recognize the headwinds as we go forward, and now as much as ever, we proceed with caution.

Chad will now take a minute to discuss the markets in more detail, as well as CIMCO's portfolio positioning and outlook.

**(Chad)**

Thanks, Chris, and thanks again to all of you attending the call. I will start by briefly commenting on the increased volatility in the market and how it impacts our investment strategies, then I will walk you through main changes to our models, and finally, I will comment on our view of the market going forward.

As Chris mentioned earlier, second quarter 2010 has been one of extreme volatility and uncertainty. Although April started well, with the continued positive momentum from Q1 leading the S&P500 to the highest level for the year, this faded quickly during the week of May 6<sup>th</sup>, when the 1-day "flash crash" marked the beginning of a significant bear market correction. Let me take a moment and give you an idea of the volatility we have seen.

After a market rally through most of April, highlighted by the S&P 500 making a new high for the year on April 17<sup>th</sup>, the market fell more than 7% in the week of May 6<sup>th</sup>. Over the three days following, the market rallied about 5%, before it dropped another 8% in mid-May. Over the next couple of weeks the market came back with a 3% gain, before it finished May with yet another loss. June kicked off with a 5% drop in the S&P500; it then bounced back more than 6% during the middle of the month, but gave it all back in the last two weeks when it dropped close to 8%. Over the nine weeks covering May and June we have seen 5 down-weeks of more than 2%, but we have also seen 3 up-weeks of more than 2%, and in no particular order. Further, of the 63 trading days in the second quarter of 2010, the Dow has seen intraday swings of 200 points 35 times, and swings of 100 points or more 62 out of 63 times!

With such extreme volatility and high intraday- and intraweek swings, any trading model will experience heightened probability of being whipsawed. This is something that CIMCO also has to face, but in times like these, we find it particularly important to remember that our investment horizon is the longer term, and that we believe that in the aggregate, our investment philosophy will perform in line with our, and your, expectations. It is therefore more important than ever to stick to the plan – it is a well known fact that although the equity market over the longer term will yield on average about 6% annually, the average investor will only yield about 3%, with this discrepancy

being due “chasing returns” instead of having the discipline and patience to stay with a chosen strategy.

As far as trading goes, the increased volatility led to increased trading activity on our behalf. A 7% drop in the S&P500 in the week of May 6<sup>th</sup> triggered a sell signal in equities and high yield. Along with a significant weakening in global equities, this led us to reduce our international exposure in our 50/50 models, as well as adding bear positions in the 50/50 model and the Momentum 2 model. Following this, a six percent increase in the S&P500 in 6 trading days led us to drop the hedge and go long on June 16<sup>th</sup>. Unfortunately, this was a short-lived rally. The market continued to correct down, and on July 1<sup>st</sup> we put the hedge back on. Currently, the 50/50 model has a close to 50% short position; the Momentum 1 has a 20% short position, and the Momentum 2 has a 30% short position.

As far as holdings go, we are currently concentrated in domestic equities, as the US market has held up better than most international markets, particularly Europe. We did, however, see increasing strength in emerging markets during June, and have added back some equity exposure to our models in this area.

Going forward, we think there are many issues that need to be resolved before the market can return to normal. Although the frustration in Europe seems more muted, nothing is changed and the economy will be troubled for a long time. It seems that the recovery is slowing domestically as well. Unemployment is still hovering around 9.5-10%, spending seems limited, and the real-estate market is in trouble. With the expiration of government-sponsored stimulus programs, and the eventual need for the Obama administration to start taking austerity measures, there is a good chance that the economy will slow further. Historically, July, August, and September have been troubled months for the market, and this gives us additional reason to be cautious

There is no denying that several key charts are flashing technical caution. Whether near key retracement levels, or flirting with major topping formations, we are in a state of renewed turbulence in the markets.

### **(Back to Chris)**

With all of that said – what does this mean for you, our clients? Continued uneasiness on Wall Street, and globally, could lead to some extended range-bound trading during the remaining summer months, perhaps longer. In order to endure this volatility, make sure your risk tolerance is in alignment with your portfolio; and even more importantly, make sure you understand what is a **normal range of return expectation** for that risk profile. Asset allocation and diversification remain paramount. These types of markets test our resolve in the most difficult ways, and having an educated sense of where your portfolio can go is crucial. Being an equity investor requires time to weather such conditions, and clients must be in communication with their advisors, and vice versa, to make sure everyone is in alignment.

Before finishing up today, we'd like to make mention of another event that took place over the quarter. We are just wrapping up a transition to a new broker/dealer, First Allied Securities. Due to the number of questions that have come in, we wanted to clarify what this change means. Our previous broker/dealer was Securities Service Network, and any broker/dealer's role is really to provide compliance and regulation over us as a firm. Think of them as a back-office, support entity. We did not sell or merge with anyone – First Allied provides regulation, as well as a greater partnership in terms of research, marketing, and investment solutions. Members of the team, including myself, attended their National Conference in San Diego last month, and we are very excited for the tools they are able to provide, and the alliance, we are confident, will be a successful one.

To wrap things up, we wish everyone a wonderful, and safe, remainder of the summer. Our next call will be in October, so keep an eye out for that notification. In the meantime, please feel free to contact us with any questions, concerns, comments.

Thank you!

Securities offered through First Allied Securities, member FINRA/SIPC.