

Sectors and Styles Strategy Report

An Investment Strategy Perspective

May 12, 2008

Vinny Catalano, CFA
Global Investment Strategist

Inside this Report

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- Model Growth Portfolio
- Market Monitor
- Key US Economic Indicators

Upcoming Events

Beyond the Sound Bite

May 14: Don Rissmiller
May 21: Art Hogan
May 28: Vitaliy Katsenelson
June 16: Marty Fridson

2008 Market Forecast

Aug. 5: NYSSA
Sept. 18: CFA Society of Nashville

2008 Topical Programs

Oct. 22: CFA Society of South Florida "Hedge Fund Seminar"
Oct. 28 NYC (Bloomberg HQs) "Brazil Day"

2008 Education Programs

Oct. 20 - Nov. 10: NYSSA "Fall Equity Analysis Course"
November 14: New York Institute of Finance "ETF Seminar"

Media Appearances

May 16: BNN TV
May 22: New Delhi TV

Inflection Day Rally Effects – Rotation Underway

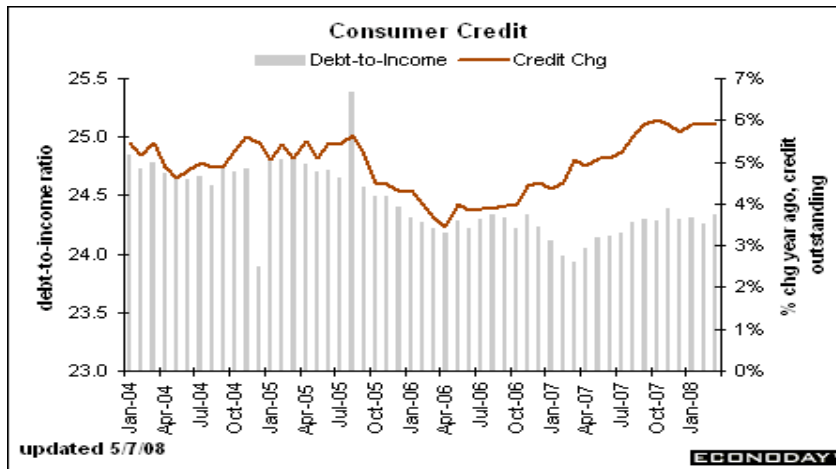
A rotational pattern seems to be emerging in the Inflection Day rally. The recent emerging weakness in Consumer Staples combined with strength in areas such as Consumer Discretionary and Mid Cap Growth suggest a sustainable near term rally in the latter groups is highly probable. Furthermore, it can be assumed that other similar riskier groups (Small Cap Growth, for example) are likely to follow as a summer rally emerges after an expected period of weakness this month.

A catalyst for much of this potential strength is the rebate checks in the mail, the majority of which should be received and spent this quarter, 2Q08.

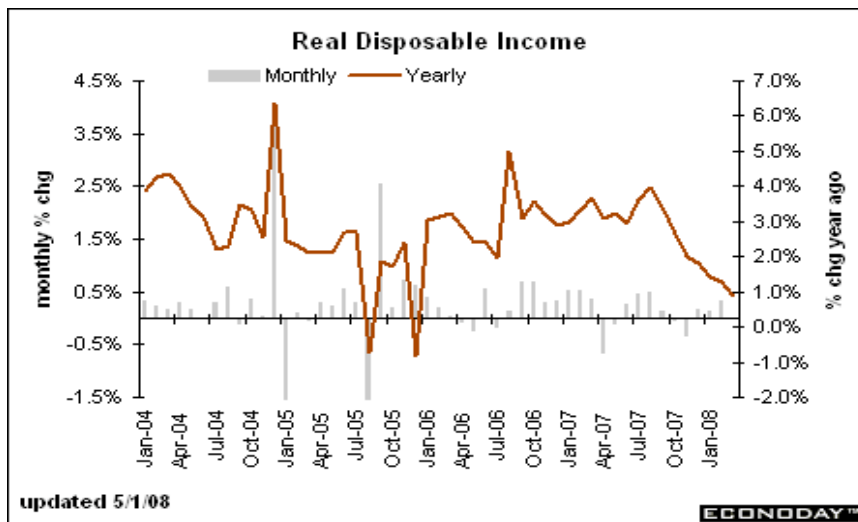
FYI - The economic and valuation effect of the stimulus is noted on page 3 of this report.

The US consumer's desire to spend was evident in last week's consumer credit report, as the chart on the following page shows quite clearly.

...continued on page 2



This appetite to spend, to maintain one's existing lifestyle, occurs despite the fact that real disposable income is under pressure.



Investment Strategy Implications

Consumer sentiment may be at a very low point (next report on this due this Friday) but the need to maintain one's lifestyle still remains an important factor of American life. This will change, however, as time passes. Savings will rise as the obvious consequences of a negative wealth effect alter consumer behavior, particularly among baby boomers whose retirement timeframes come into sharper (and closer) view).

But that is then and this is now. And it is in the now that many investors operate in. Therefore, a counter trend rotational rally will likely unfold this summer with higher risk groups, such as Mid Cap Growth and Consumer Discretionary, outperforming and more defensive areas such as Consumer Staples underperforming. After that, a reversion to their secular trends should resume with a very strong downward tilt for the overall market going into the fall of this year and into 2009.

Expected Return Valuation Model

Valuation Levels								Expected Returns					
bps	Earnings Yield	Est. S&P 500	Oper. Earnings	Earnings			P/E	Earnings Yield	Est. S&P 500	Operating Earnings			
		\$72	\$76	\$82	\$84	\$88			\$72	\$76	\$82	\$84	\$88
-0.60%	3.17%	2271	2397	2587	2650	2776	31.55	3.17%	63.64%	72.73%	86.37%	90.91%	100.00%
-0.40%	3.37%	2136	2255	2433	2493	2611	29.67	3.37%	53.93%	62.48%	75.31%	79.58%	88.13%
-0.20%	3.57%	2017	2129	2297	2353	2465	28.01	3.57%	45.30%	53.38%	65.48%	69.52%	77.59%
0.00%	3.77%	1910	2016	2175	2228	2334	26.53	3.77%	37.59%	45.24%	56.71%	60.53%	68.17%
0.20%	3.97%	1814	1914	2065	2116	2217	25.19	3.97%	30.66%	37.92%	48.81%	52.44%	59.70%
0.40%	4.17%	1727	1823	1966	2014	2110	23.98	4.17%	24.40%	31.31%	41.67%	45.13%	52.04%
0.60%	4.37%	1648	1739	1876	1922	2014	22.88	4.37%	18.70%	25.30%	35.19%	38.49%	45.08%
0.80%	4.57%	1575	1663	1794	1838	1926	21.88	4.57%	13.51%	19.81%	29.27%	32.43%	38.73%
1.00%	4.77%	1509	1593	1719	1761	1845	20.96	4.77%	8.75%	14.79%	23.85%	26.87%	32.92%
1.20%	4.97%	1449	1529	1650	1690	1771	20.12	4.97%	4.37%	10.17%	18.87%	21.77%	27.57%
1.40%	5.17%	1393	1470	1586	1625	1702	19.34	5.17%	0.34%	5.91%	14.27%	17.06%	22.63%
1.60%	5.37%	1341	1415	1527	1564	1639	18.62	5.37%	-3.40%	1.96%	10.01%	12.70%	18.06%
1.80%	5.57%	1293	1364	1472	1508	1580	17.95	5.57%	-6.87%	-1.70%	6.06%	8.65%	13.83%
2.00%	5.77%	1248	1317	1421	1456	1525	17.33	5.77%	-10.10%	-5.10%	2.39%	4.89%	9.88%
2.20%	5.97%	1206	1273	1374	1407	1474	16.75	5.97%	-13.11%	-8.28%	-1.04%	1.37%	6.20%
Current Levels*								Blue Marble Research Est. Fair Value Analysis					
S&P	1388	\$72	13.20%	Deep recession				1618	Ave. FV target (dark blue zone)				
*10 Yr. Tsv	3.77%	\$76	8.40%	Strong recession				1424	12% discount from FV target				
as of May 9, 2008		\$80	3.60%	Moderate recession				36	Diff. between FV level and current level in pts.				
								2.58%	Diff. between FV level and current level in return.				
Key Assumptions								Optimistic Est. Fair Value Analysis					
1 - On any given day the market values itself based on its historical expected return of 12%.								1726 Ave. FV target (dark green zone)					
2 - Risk is dynamic and changes according to credit spreads, volatility, and investor sentiment.								1519 12% discount from FV target					
								131 Diff. between FV level and current level in pts.					
								9.40% Diff. between FV level and current level in return.					
ERVM fair value zones													
Light Blue shaded areas signify zones approximating a 12% expected return.													
Yellow shaded areas signify the fair value levels achieved by adjusting the capitalization factor 120 to 140 basis points over the basic, unadjusted Fed model to reflect current equity market risk (see Fed Model Basics below.)													
Dark Blue shaded area signifies Blue Marble Research estimated fair value and return potential from current levels.													
Dark Green shaded area signifies Optimistic estimated fair value and return potential from current levels.													
How to use the ERVM:													
Step 1 - Determine the fair value for the US stock market (Valuation Levels).													
Step 2 - Determine the 12% expected return ranges (Expected Returns).													
Step 3 - Decide which 12% zones, if any, are realistic.													
Fed Model Basics													
Divide operating earnings estimates by the 10 year US Treasury to derive fair value. This is reflected in the green shaded areas.													

Comment: Based on incoming data, it now appears likely that the tax rebate checks will hit most pronouncedly in 2Q08 thereby producing an economic bounce disproportionately in that quarter. Accordingly, and based on the 1Q08 earnings results (ex Financials), the projected S&P 500 operating earnings for 2008 has been adjusted upward from \$80.20 to \$81.40 (see table below, scenario forecast). Additionally, the adjusted bottom-up estimates (see table below) have been fine tuned to reflect a reduced level of downward adjustment for both 1Q08 and 2Q08. The effect to the adjusted bottom-up estimates increases the full year estimate to \$82.14 (still well below the unadjusted estimate of \$90.94).

The combination of the two forecasts – \$81.40 and \$82.14 – suggests an \$82 S&P 500 operating earnings (up from \$80) is prudent. With that upward adjustment along with last week’s decline in the 10 year US Treasury rate plus the decline in the S&P 500 produces a modestly higher full year fair value target of 1618 and a current fair value target of 1424*.

BMR* Scenario Forecast			Bottom up estimates				Adjusted Bottom up estimates			
S&P 500 Operating Earnings	Scenarios		S&P 500 Operating Earnings	Annual	Rolling 12 months	Rolling 12 mo. yoy** change	S&P 500 Operating Earnings	Annual	Rolling 12 months	Bottom-up forecast adjustment
2008	Scenarios		1Q06A	\$20.75			1Q06A	\$20.75		
\$72	5.0%	\$3.60	2Q06A	\$21.95			2Q06A	\$21.95		
\$76	5.0%	\$3.80	3Q06A	\$23.03			3Q06A	\$23.03		
\$80	25.0%	\$20.00	4Q06A	\$21.99	\$87.72	\$87.72	4Q06A	\$21.99	\$87.72	
\$82	40.0%	\$32.80	1Q07A	\$22.39		\$89.36	1Q07A	\$22.39	\$89.36	
\$84	20.0%	\$16.80	2Q07A	\$24.06		\$91.47	2Q07A	\$24.06	\$91.47	
\$88	5.0%	\$4.40	3Q07A	\$20.87		\$89.31	3Q07A	\$20.87	\$89.31	
	100.0%	\$81.40	4Q07A	\$15.22	\$82.54	-5.91%	4Q07e	\$15.22	\$82.54	
			1Q08e	\$18.37		\$78.52	1Q08e	\$17.45	\$77.60	minus 5%
			2Q08e	\$22.73		\$77.19	2Q08e	\$21.59	\$75.14	minus 5%
			3Q08e	\$24.25		\$80.57	3Q08e	\$21.34	\$75.61	minus 12%
			4Q08e	\$25.59	\$90.94	\$90.94	4Q08e	\$21.75	\$82.14	minus 15%
*Blue Marble Research										
**year over year										

There is no change to the risk adjustment range of 120 to 140 basis points** as various indicators of the tightness in the credit markets (credit freeze) remain at elevated levels (credit spreads, senior loan officers survey, for example).

*The upward changes in operating earnings estimates is fairly modest and not terribly different from the April 8, 2008 blog posting “Fair Value Target for S&P 500: 1420.

*Note: pre credit crisis, the risk adjustment range was 80 to 100 basis points.

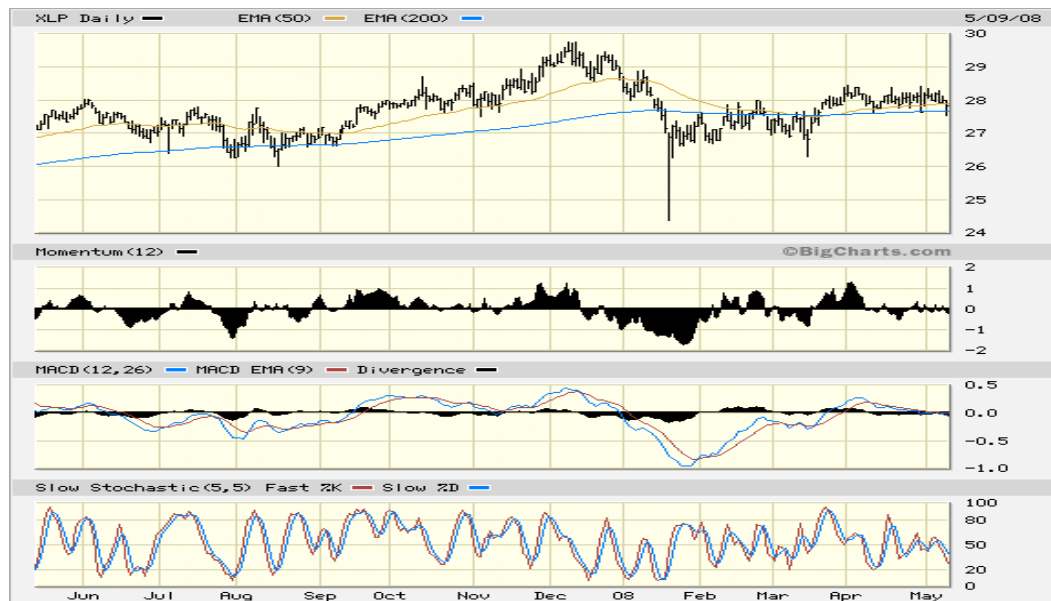
Moving Averages Scorecard

Moving Averages Scorecard				
Category		as of 5-9-08		
US Economic Sectors	SYM	Mega Trend	Near Term Direction	% Bullish
Consumer Discretionary	XLY	Bearish	Improving	
Consumer Staples	XLP	Bullish	Weakening	
Energy	XLE	Bullish	Intact	
Financials	XLF	Bearish	Intact	
Healthcare	XLV	Bearish	Intact	
Industrials	XLI	Neutral	Improving	
Basic Materials	XLB	Bullish	Intact	
Info Tech & Telecom*	XLK	Neutral	Improving	
Utilities	XLU	Neutral	Improving	
sub total	9	4 1/2		50.00%
Telecom**	IYZ	Bearish	Improving	
Styles: Size				
Mega cap	OEF	Bearish	Neutral	
Large cap	SPY	Bearish	Neutral	
Mid cap	MDY	Neutral	Improving	
Small cap	IJR	Bearish	Neutral	
Micro cap	IWC	Bearish	Intact	
sub total	5	1/2		10.00%
Global				
Developed Economies				
EAFE	EFA	Neutral	Improving	
Europe 350	IEV	Neutral	Improving	
Japan	EWJ	Neutral	Neutral	
Emerging Economies				
Emerging Markets	EEM	Bullish	Intact	
Latin America 40	ILF	Bullish	Intact	
Chindia	FNI	Neutral	Neutral	
sub total	6	4		66.67%
Total	20	9		45.00%
*Include both S&P 500 sectors				
**Includes non S&P 500 mid cap issues and is shown for informational purposes only				

Moving Averages Principle
Application of the Moving Averages Principle (MAP) is as follows:
* Price relative to the 50 and 200 day moving averages.
* 50 day moving average relative to the 200 day moving average.
* Slope of the 50 moving average and 200 day moving average.
Example – Bullish mega trend:
* Price above 200 day
* 50 above 200 day
* 50 and 200 day sloped upwardly

Comment: Last week's market pullback produced some weakening in the near term direction for most US economic sectors. There were, however, two interesting developments. Consumer Staples produced an interesting decline in its near term direction (see chart below). Contrarily, Mid Cap has improved sufficiently to warrant closer monitoring as it suggests broader market strength.

Focus: Consumer Staples



Comment: Sideways action for months coupled with weak momentum and MACD data implies mediocre price performance over the near term.

Performance Data

Model Growth Portfolio: Weekly Results

MGP: -1.31% S&P 500: +1.81% Net Relative Performance: +0.50%

Week ending May 9, 2008				Weekly Results			Relative Performance MGP wgt. vs. Mkt wgt.*
	Mkt. Wgt.*	MGP Wgt.*	Sym.	Wkly Return	Mkt. Wgt.	MGP Wgt.	
US Sectors & Industries							
Consumer Discretionary	8.69%	6.00%	XLY	-2.98%	-0.26%	-0.18%	0.08%
Consumer Staples	10.36%	6.00%	XLP	-0.97%	-0.10%	-0.06%	0.02%
Global Consumer Staples		3.00%	KXI	-0.85%	n/a	-0.03%	n/a
Energy	13.63%	9.00%	XLE	4.05%	0.55%	0.36%	-0.19%
Financials	17.49%	10.00%	XLF	-6.21%	-1.09%	-0.62%	0.28%
Insurance		3.00%	IAK	-6.05%	n/a	-0.18%	n/a
Healthcare	11.33%	5.50%	XLV	-1.81%	-0.21%	-0.10%	0.05%
Biotech		2.00%	IBB	-2.25%	n/a	-0.04%	n/a
Medical Devices		2.00%	IHI	-0.30%	n/a	-0.01%	n/a
Industrials	11.76%	9.00%	XLI	-1.70%	-0.20%	-0.15%	0.02%
Defense		2.00%	ITA	-1.09%	n/a	-0.02%	n/a
Basic Materials	3.54%	3.50%	XLB	2.38%	0.08%	0.08%	0.00%
Info Tech & Telecom***	19.59%	21.00%	XLK	-1.17%	-0.23%	-0.25%	-0.02%
Utilities	3.63%	2.50%	XLU	-2.39%	-0.09%	-0.06%	0.03%
Sub Total	100.00%	84.50%			-1.53%	-1.25%	0.28%
Size & Styles							ETF return vs. S&P 500
Mid Cap Growth		2.00%	IJK	1.27%		0.03%	3.08%
Small Cap Growth		3.00%	IJT	-1.67%		-0.05%	0.14%
Global Markets							
EAFE		2.00%	EFA	-0.78%		-0.02%	1.03%
Brazil		3.00%	EWZ	-0.56%		-0.02%	1.26%
Other							
Gold		2.00%	GLD	3.36%		0.07%	5.17%
Blackstone (private eq.)		1.00%	BX	-7.02%		-0.07%	-5.21%
Sub Total		13.00%				-0.06%	
Total		97.50%					
Performance Comparisons					S&P 500	MGP	Net
S&P 500 vs. Model Growth Portfolio					-1.81%	-1.31%	0.50%
* Beginning Asset Mix as of May 5, 2008		** Includes Industry and/or other positions					
***The Market weight for Info Tech & Telecom are combined							
Note: Economic sector weightings listed exclude the sector effects of other positions (size & styles, Global, and Other).							

Comment: For the second week in a row, the combination of the occasional pricing discrepancy between the S&P 500 and the individual economic sectors (-1.81% vs. -1.53%) this time coupled with last week's overall reduction in equities plus the good move in Gold produced an excellent 50 basis points of outperformance for the MGP. Also of note is the unusually strong performance by Mid Cap Growth. Combined with the emerging weakness in Consumer Staples, a rotation into higher growth stories may be underway.

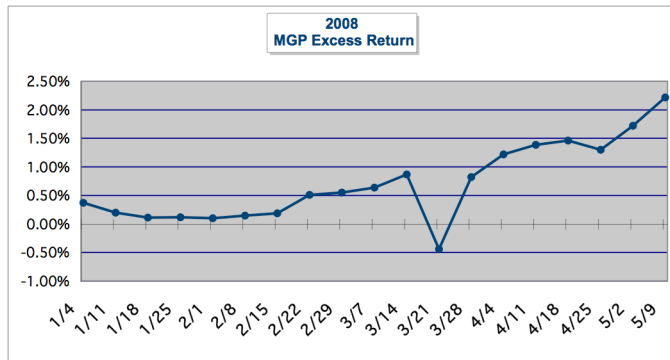
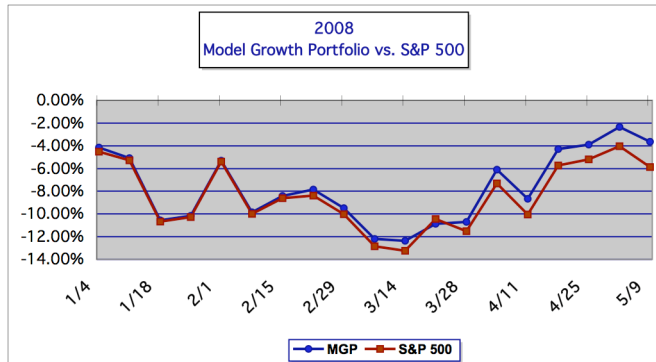
Model Growth Portfolio: Re-balancing

While there is some concern re the recent weakness in Consumer Staples (see Moving Averages Scorecard on previous page) as well as the non-confirmation in Energy stocks (XLE), there are no recommended changes being made to the MGP at this time.

Model Growth Portfolio: Year to date Results

MGP: -3.64% S&P 500: -5.86% Net Relative Performance: +2.22%

2008 Period End.	MGP		S&P 500		Relative Performance		
	Actual	YTD	Actual	YTD	Weekly	QTD	YTD
1Q08	-10.69%	-10.69%	-11.51%	-11.51%	n/a	0.82%	0.82%
4/4/08	4.60%	-6.09%	4.20%	-7.31%	0.40%	1.22%	1.22%
4/11/08	-2.57%	-8.66%	-2.74%	-10.05%	0.17%	1.39%	1.39%
4/18/08	4.38%	-4.28%	4.31%	-5.74%	0.07%	1.46%	1.46%
4/25/08	0.38%	-3.90%	0.54%	-5.20%	-0.16%	1.30%	1.30%
5/2/08	1.57%	-2.33%	1.15%	-4.05%	0.42%	1.72%	1.72%
5/9/08	-1.31%	-3.64%	-1.81%	-5.86%	0.50%	2.22%	2.22%

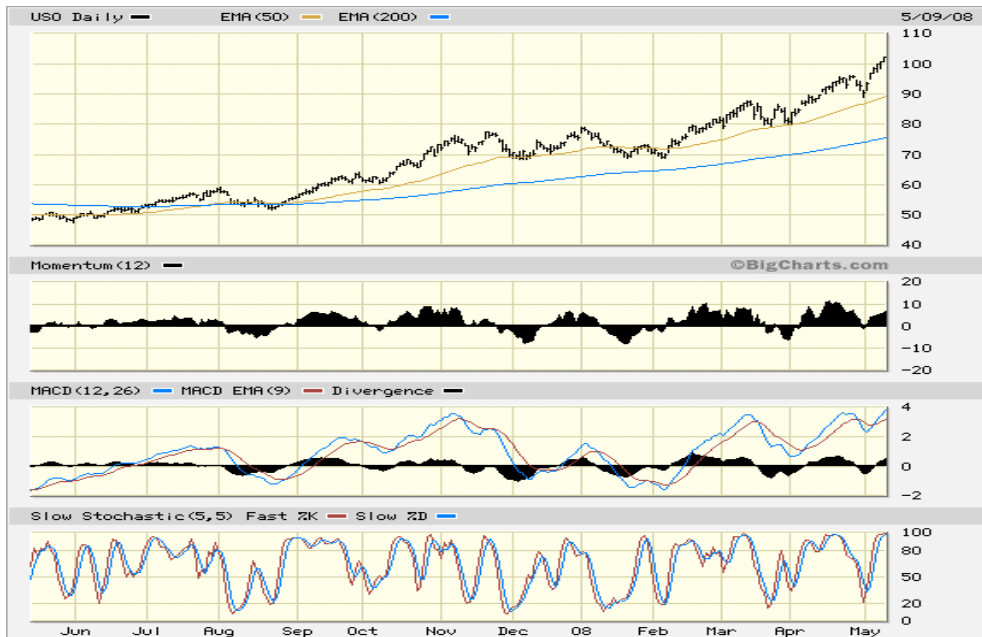


Comment: Yet another strong relative performance week for the MGP (that makes it 6 out of the last 7, 12 out of the last 14, and 14 out of 19 for the year) puts the year-to-date relative performance results at another yearly high: +2.22%.

Note: Year to date performance results are based on price change only and are chain linked on a weekly basis. For more information regarding the performance results see the final page of this report.

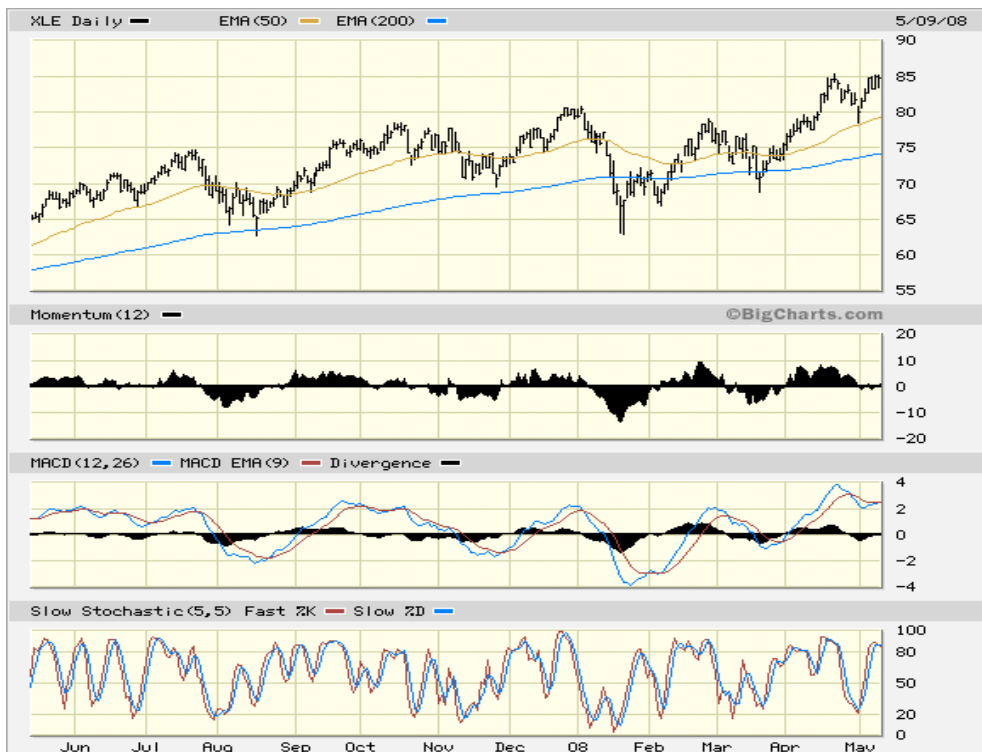
Other: Oil

Potential serious overbought as Slow Stochastics and weakness in Momentum offset the positive (but suspiciously looking overbought) MACD.



Sectors: Energy

Similar technical conditions exist here. Also, any news re political rumblings in the US of a windfall profits tax is likely to put added pressure to the group. Lastly, Slow Stochastics is in overbought territory (80+) at the same time that Momentum and MACD are not confirming the current rally.



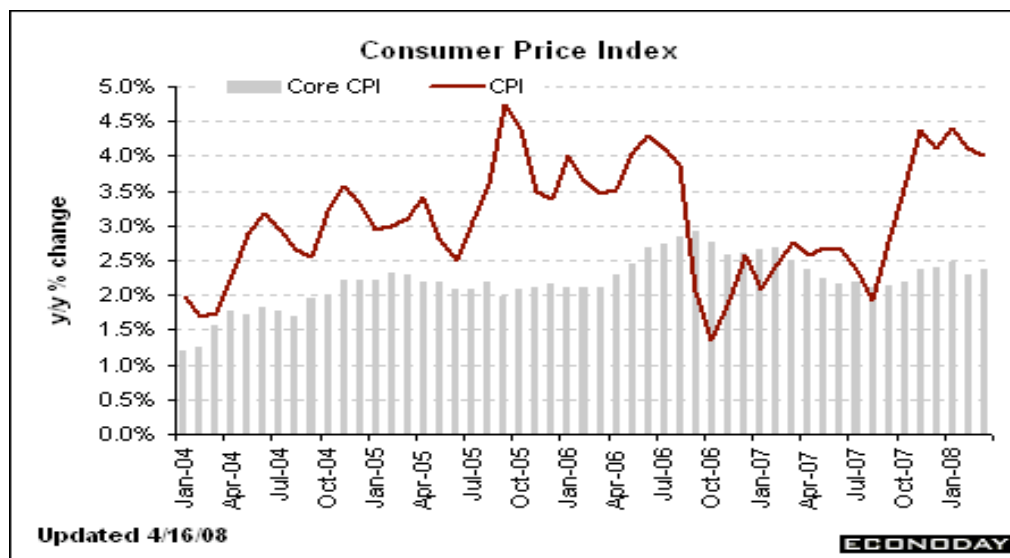
Key US Economic Indicators

The Economic Week Ahead: May 5 – May 9, 2008	Last Week: May 5 – May 9, 2008
Monday, May 12, 2008	Monday, May 5, 2008
2:00p.m. Apr US Budget Balance. WSJ Exp. -\$160B. Previous: -\$48.4B.	10:00a.m. Apr ISM Non-Manufacturing Composite Index: 52.0. Consensus 49.3. Previous: 49.6.
Tuesday, May 13, 2008	Tuesday, May 6, 2008
8:30a.m. Apr Import Prices. Consensus: +1.7% Previous: +2.8%.	No major economic indicators are expected.
8:30a.m. Apr Retail & Food Sales. Consensus: -0.1%. Previous: +0.2%.	Wednesday, May 7, 2008
8:30a.m. Apr Retail & Food Sales, Ex-Autos. Expected: +0.3%. Previous: +0.1%.	8:30a.m. 1Q Productivity, Prelim.: +2.2%. Consensus: +1.7%. Previous: +1.9%.
10:00a.m. Mar Business Inventories. Consensus: +0.5%. Previous: +0.6%.	8:30a.m. 1Q Unit Labor Costs, Prelim.: +2.2%. Consensus +2.6%. Previous: +2.6%.
Wednesday, May 14, 2008	10:00a.m. Mar Pending Home Sales Index: -1.0%. Expected: -2.0%. Previous: -1.9%.
8:30a.m. Apr Consumer Price Index. Consensus: +0.3%. Previous: +0.3%.	3:00p.m. Mar Consumer Credit: +\$15.3B. Consensus +6.0B Previous: +\$5.16B.
8:30a.m. Apr CPI, Ex-Food & Energy. Consensus: +0.2%. Previous: +0.2%.	Thursday, May 8, 2008
Thursday, May 15, 2008	10:00a.m. Mar Wholesale Trade: -0.1%. Expected: +0.6%. Previous: +1.1%.
9:00a.m. Mar Treasury International Capital Flows. Previous: \$60.1B.	Friday, May 9, 2008
9:15a.m. Apr Industrial Production. Consensus: -0.3%. Previous: +0.3%.	8:30a.m. Mar Trade Balance: -\$58.21B. Consensus -\$60.8B. Previous: -\$62.3B.
9:15a.m. Apr Capacity Utilization. Consensus: 80.1%. Previous: 80.5%.	
Friday, May 16, 2008	
8:30a.m. Apr Housing Starts. Previous: -11.9%.	
10:00a.m. Mid-May Reuters/U Mich Sentiment Index. Consensus: 62.5. Previous: 62.6.	

Comment: Given the propensity to borrow against one's home, I wonder where US consumer spending might be headed with home prices headed lower, as the following chart illustrates.

Focus: Consumer Price Index

The last time the yearly CPI reached these levels (fall 2005) the core CPI followed suit approximately one year later (fall 2006). It is likely this time, however, that price pressures in the core rate will occur at an earlier rate as the global growth story is dangerously close to overheating with the spillover effects on the US economy nearly unavoidable.



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Full disclosure: Neither Vincent Catalano nor any member of his family hold positions listed in the Model Growth Portfolio. Accounts managed by Blue Marble Research do hold most of the positions listed in the Model Growth Portfolio.

Some of the sectors and styles mentioned in this report are the recipients of trends and themes that might vary from those noted in this report.

Vincent Catalano certifies that all of the views expressed in this research report accurately reflect his personal views regarding any and all of the subject securities or issuers.

About Sectors and Styles Strategy Report

The Sectors and Styles Strategy Report is a weekly investment strategy perspective produced and published by Blue Marble Research 50 times a year.

The Sectors and Styles Strategy Report is available on an annual subscription basis of \$250 per year. An introductory first year rate of \$150 is available for first time subscribers.

Based on its GEM (government, economy, and the markets) research methodology, the report is a weekly examination of the key macro trends and themes impacting the investment markets. The GEM research methodology provides a comprehensive approach to investment strategy by incorporating the critical variables within each area of analysis.

The purpose of the report is to provide insights to investors and other interest parties. The investment goals of the insights are:

- Earn a positive return
- Minimize risk
- Outperform the market

The Sectors and Styles Strategy Report predominantly employs ETFs (Exchange Traded Funds) in its Model Growth Portfolio, as they provide the sectors and styles exposure needed to build a cost effective diversified portfolio.

Sources used in this report typically include: Wall Street Journal On-line, Barrons.com, Big Charts, Finance.Yahoo.com, FT.com, Standard and Poors, First Call, Merrill Lynch, Morgan Stanley, PIMCO, among others.

Note: The Model Growth Portfolio performance data is reflected on a price change basis only. Dividends and their reinvestment are not factored into the returns. Returns are calculated on weekly chain-linked basis and may differ from the returns calculated using other methods. Transaction expenses and other administrative fees are not included in the return results.

