CAPITAL MANAGEMENT GROUP, INC.

Tactical Investment Solutions

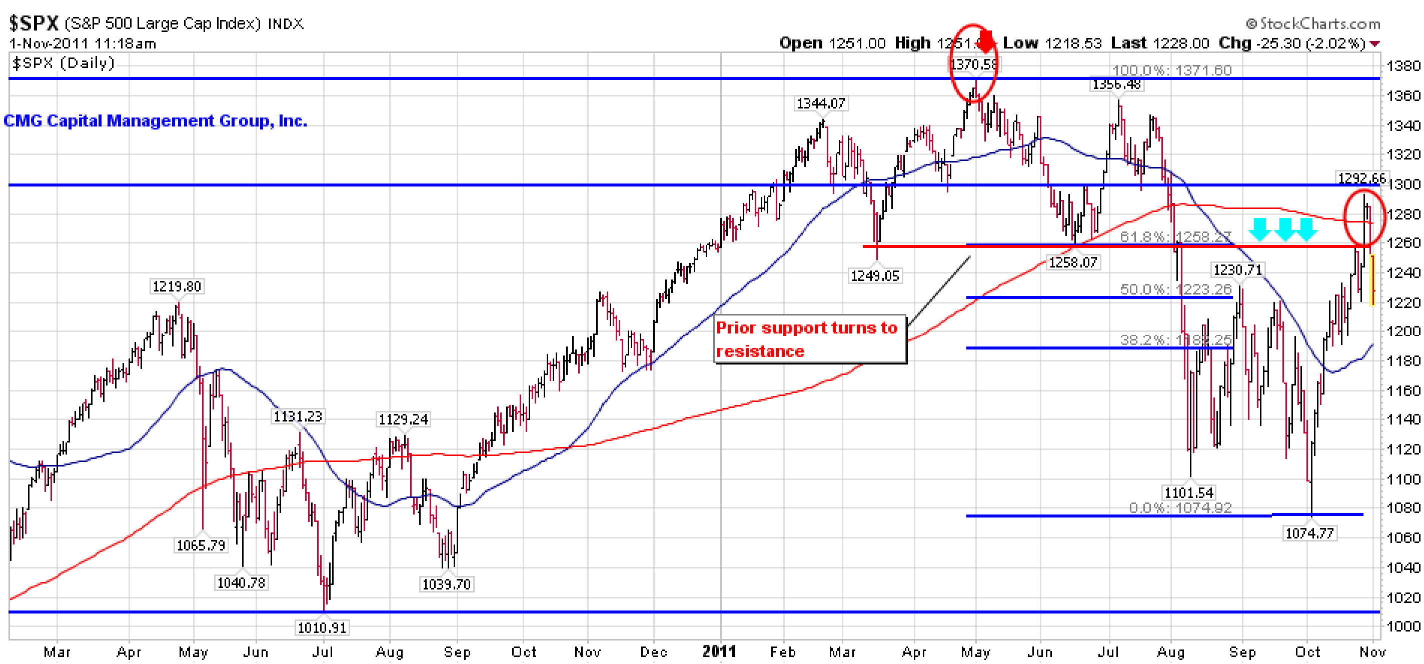
The Blumenthal Viewpoint

November 1, 2011

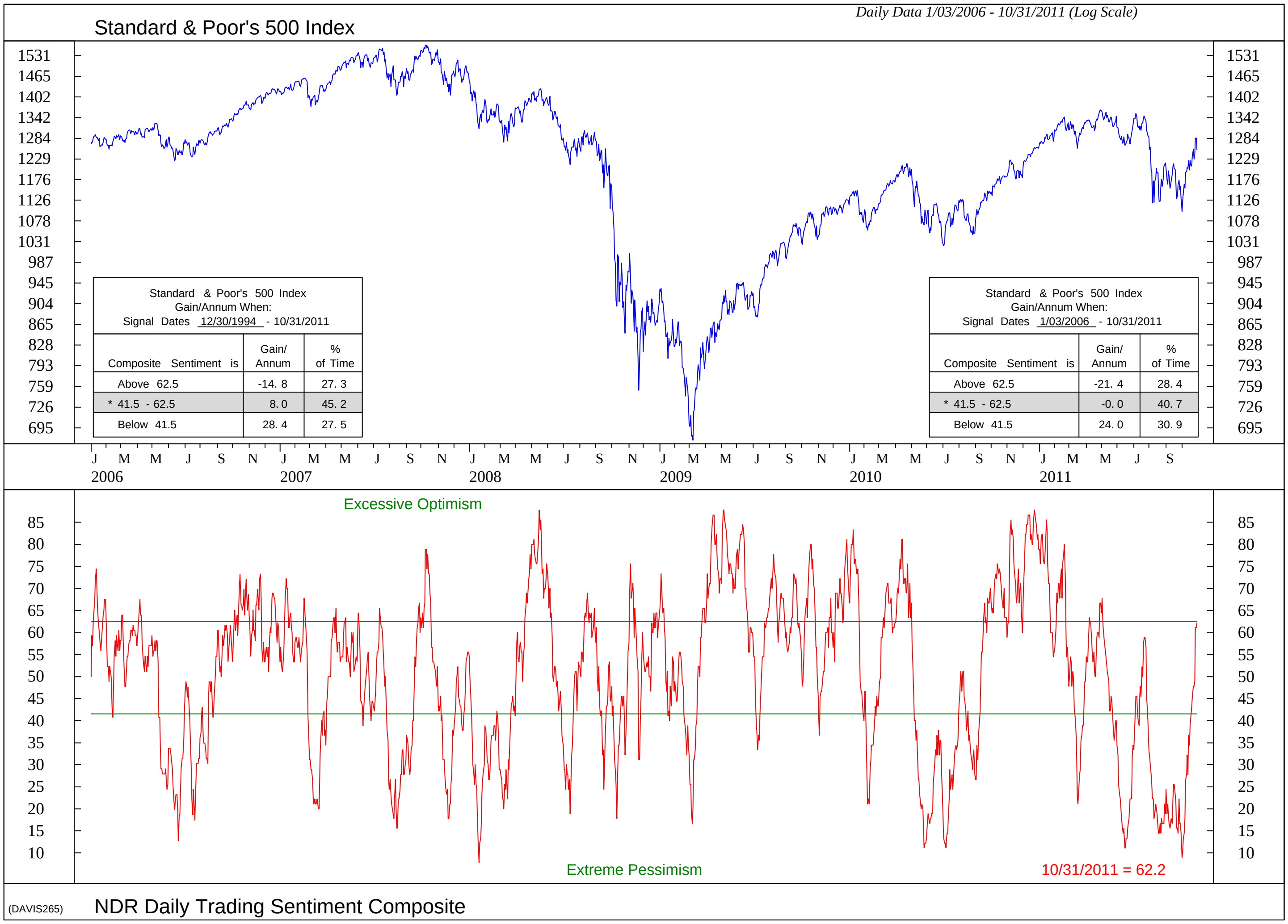
Chart and Sentiment Update

Last's week rally was impressive. Technically, the S&P 500 Index moved above what I felt was significant resistance (S&P 500 Index 1258). I recommended reestablishing hedges on long directional equity portfolio exposure. Investor Sentiment has moved back into the Optimistic Zone (chart below). I continue to believe the key to risk management in the secular bear environment is to add portfolio protection (hedge) at logical points of resistance tied to excessive optimism. Conversely, it is equally important to reduce protection at points of pessimistic extreme.

Following is an updated version of the chart I sent on October 11. I noted the resistance marked by the teal colored arrows and suggested that would be a good level to re-establish hedges. Thursday's EU news created a "melt up" in price and a break above the 1258 resistance line. Of course, the most recent EU news has changed the picture to a negative tone once again. Be prepared to remove the hedges with an Investor Sentiment move back into the Extreme Pessimism zone. Such is the nature of the environment we are experiencing. Key to me is necessary risk management at points of optimistic extreme.



Understanding the EU triggered market "melt up" on Thursday: Novice investors feel that all is ok in the world again. It is not. I believe that the melt up was tied to the covering of short hedges put in place to protect long sovereign debt exposure. Political moves – unintended consequences. Never the less, it never ceases to amaze me how quickly the mood can swing from extreme fear to extreme confidence and back to extreme fear. This is reflected in the next chart.



The Euro mess:
We hold hope that the world's politicians can come up with grand solutions to unmanageable debt problems yet they are amongst the least educated in the workings of the markets. It is like hiring a lawyer to perform open heart surgery and having faith that the end result will be positive. A lot of pain and a period of recovery remain.

Read the following from John Mauldin posted this past Saturday. I think he does a really nice job at putting it all together. It is an important read.

Finally, this is an environment that favors Tactical Investment Strategies and other alternative actively managed strategies. There is no need to hedge these positions as it is extremely difficult to do. Focus on putting on and taking off hedges on your long equity exposure and add Tactical, CTA, and other non-correlating alternative strategies (strategies that can trade the markets either up or down or risk protect by raising cash) to your portfolio. Just how much of an allocation to Tactical depends on your goals, needs, time horizon, risk level, etc. Find an experienced advisor with knowledge in total portfolio construction and risk management.   I believe another 6 to 7 years remain of secular bear market issues. When PE ratio's drop below 10, most investors will forever swear off investing in long-directional stocks and miss the beginning of a new long-term secular bull market (just as they did when I began my career with Merrill Lynch Institutional in 1984). A PE below 10 is a key indicator to me. Until then, I believe it is important to have a balanced plan with a continued focus on risk management at points of optimistic extremes.

Sorry, I wish the news was more favorable for the buy-and-holders. It just isn't that way right now; however, there is such a great opportunity if you position differently. Think Tactical!

Wishing you the very best.

With kindest regards,

Steve

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