CAPITAL MANAGEMENT GROUP, INC.

Alternative Investment Strategies

Halftime

Stock markets reached the midpoint for the year in decidedly better shape than most expected after strong rallies in April and May. We remain in the short-term reversion to the mean recovery bounce camp. While June started strong for the major indices, investors proved to be more cautious in the second half of the month in anticipation of quarterly earnings reports. The DJIA finished the month down 0.41% bringing its YTD to -2.01%, the S&P 500 finished the month +0.20% bring its YTD to +3.16%. Technology continued to outperform with the NASDAQ Composite finishing the month up 3.42%, bringing the YTD to +16.36%. The first half of 2009 was a whirlwind of emotion. The first couple months brought desperation, deleveraging and panic while the last 3 months have breathed a sigh of relief into the markets. We have mentioned in recent correspondence the significant technical levels that have boxed the markets into a trading range over the past month. A choppy range bound market is likely to characterize the next several months as trading volumes will be light during the "summer doldrums".

At the midway point of the year, we would like to take a look at some of the key themes that could determine the market's direction over the next six months. The recent optimism has many economists and market prognosticators predicting the economy will emerge from recession by the end of the year. While plausible, the potential for disappointment is great as there are a number of headwinds that can derail the prospects for growth and sour many investment portfolios. The banking sector has stabilized, but lending capacity has shrunk dramatically from recent years, primarily due to the frozen securitization market. With no secondary market for mortgages and tighter lending standards, the housing market has been unable to rebound with the velocity that is needed. We believe an economic turnaround will be highly correlated to the recovery of the housing market. Yet, with so much excess supply, it will take some time to improve. The commercial real estate market is also mired in the bottoming process as rents have come down, supply is up and few businesses are in a position to make commitments to expand. Lending capacity is further constrained by the need for larger capital cushions for banks. Regulators, rightfully, want banks to have a larger cushion in case of further losses or subsequent crisis, but this must come at the expense of anemic credit expansion. The PPIP (Public Private Investment Program) has yet to take off, as banks prefer to raise capital than sell deeply discounted assets. If participation picks up and bad assets are removed from bank balance sheets, the potential for expansion could increase. Overall, the prospect of several quarters of slow earnings growth is highly probable. The next several weeks of earnings reports will provide a clue as to the health of banks. While markets are predicting a great quarter for Goldman Sachs, disappointing earnings from the other major banks, like JP Morgan, Morgan Stanley and Bank of America, could send equity markets lower. Risk remains high.

Unemployment continues to rise and will likely exceed 10% in the coming months. Consumer confidence may well have rebounded from dismal levels, but Americans are less likely to spend if their employment is not secure. The continued uptrend in the savings rate is a further indication of a shift in consumer sentiment. It may take several quarters of positive economic growth before consumers gain the confidence to spend again. Despite deep discounts from retailers to autos, many consumers have been hesitant to make new purchases, especially with incomes stagnant and likely to go down next year. A recent sign of optimism came from the JP Morgan global purchasing – manufacturing index which showed global manufacturing expanded in June for the first time since May 2008. This is a good sign that inventories have come down, but it is unlikely that any manufacturers return to full capacity before year end. With current capacity utilization around 60%, it is unlikely the manufacturing sector is looking to hire more workers.

The government's roll in the recovery will receive more scrutiny in the coming months. Politically, the Republican Party is looking to get back on its feet and rally behind an issue that can unite the party. There are a couple big issues that could prove a lightning rode for the political right, both of which are tied to Obama's economic policies: healthcare and the budget deficit. The battle over healthcare will leave most Americans dizzy as they try to comprehend whether any proposal will actually help or hurt them. Businesses are likely to balk at any additional healthcare costs or taxes that may be levied against them, especially in the current environment while additional government spending on healthcare will put the Democrats in a defensive position on the growing budget deficit. Despite the growing criticism regarding the ineffectiveness of the first stimulus package, there are talks amongst Democrats about the need for a second stimulus. As the debates get heated, the two issues are joined at the hip and Democrats may need to concede on healthcare to get a second stimulus in place. The debate over a second stimulus will also bring up the topic of state budgets, namely the growing deficit in California. California's current budget gap is $26.3 billion and growing ($25 million per day). Most recently, the state began issuing IOU's (officially called "registered warrants"), but it does not look good for the largest economy in the U.S., and one of the top ten economies in the world (if taken alone). While other states may not have budget problems of the same magnitude, there are many states that are facing equally difficult decisions of whether to raise taxes (political suicide) or cut social spending, thereby further crippling those who may need government help the most. From the federal level, down to municipalities, government spending is running up huge deficits with no clear plan for a balanced budget.

The dramatic market rally since March lows has brought reasons for optimism, but it has also brought back a complacency that is misplaced in the belief that the recession may soon be over. The potential for economic growth by the end of 2009 is very real, but what comes next? A myriad of headwinds could derail the recovery and if the U.S. does not emerge from the recession in early 2010 (when 2009 Q4 GDP will be reported). After a highly anticipated reversion to the mean recovery bounce, we believe we could see a further leg down in the equity markets in 2010. Mixed economic signals have made for an extremely difficult investment environment that will persist. This type of trading environment will persist over the summer and likely through the end of the year. With valuations high and earnings growth anemic, there is an increased likelihood that the bigger picture points to a continuation of the long-term bear market. The worst may be behind us, but there is still a long road ahead.