

EQUITY BUBBLE DYNAMICS



Chlebina Capital Management, LLC

By: Larry Chlebina

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INTRODUCTION

- Equity Bubbles can be one of the most destructive forces in the stock market and general economy. Their collapse results in incredible amounts of lost wealth and economic distortions. They can also be generational opportunities, particularly in the aftermath of their demise. This presentation delves further into the various aspects of what we call “EQUITY BUBBLE DYNAMICS”.

WHAT IS IT?

- **Equity Bubble Dynamics**= The understanding of industry boom and bust cycles in order to formulate how and when to invest.
 - 1999/2000 Technology Bubble (As represented in this presentation by the NASDAQ Composite)
 - 2007/2008 Commodities Bubble (As represented in this presentation by West Texas Intermediate, WTI, Oil Futures)

SO HOW CAN YOU BENEFIT?

- Understand the characteristics of past bubbles
 - Business Patterns
 - Stock Correlations
 - Impacts on other industries
- Research industries that could assume new leadership positions
- Position in the new leadership industries when the bubble reaches the appropriate phases

The background of the slide features a close-up photograph of several iridescent bubbles floating on a body of water. The bubbles are translucent and show a spectrum of colors including pinks, purples, blues, and greens, characteristic of thin-film interference. The water surface is visible at the bottom, and the sky is a pale blue with some light clouds at the top.

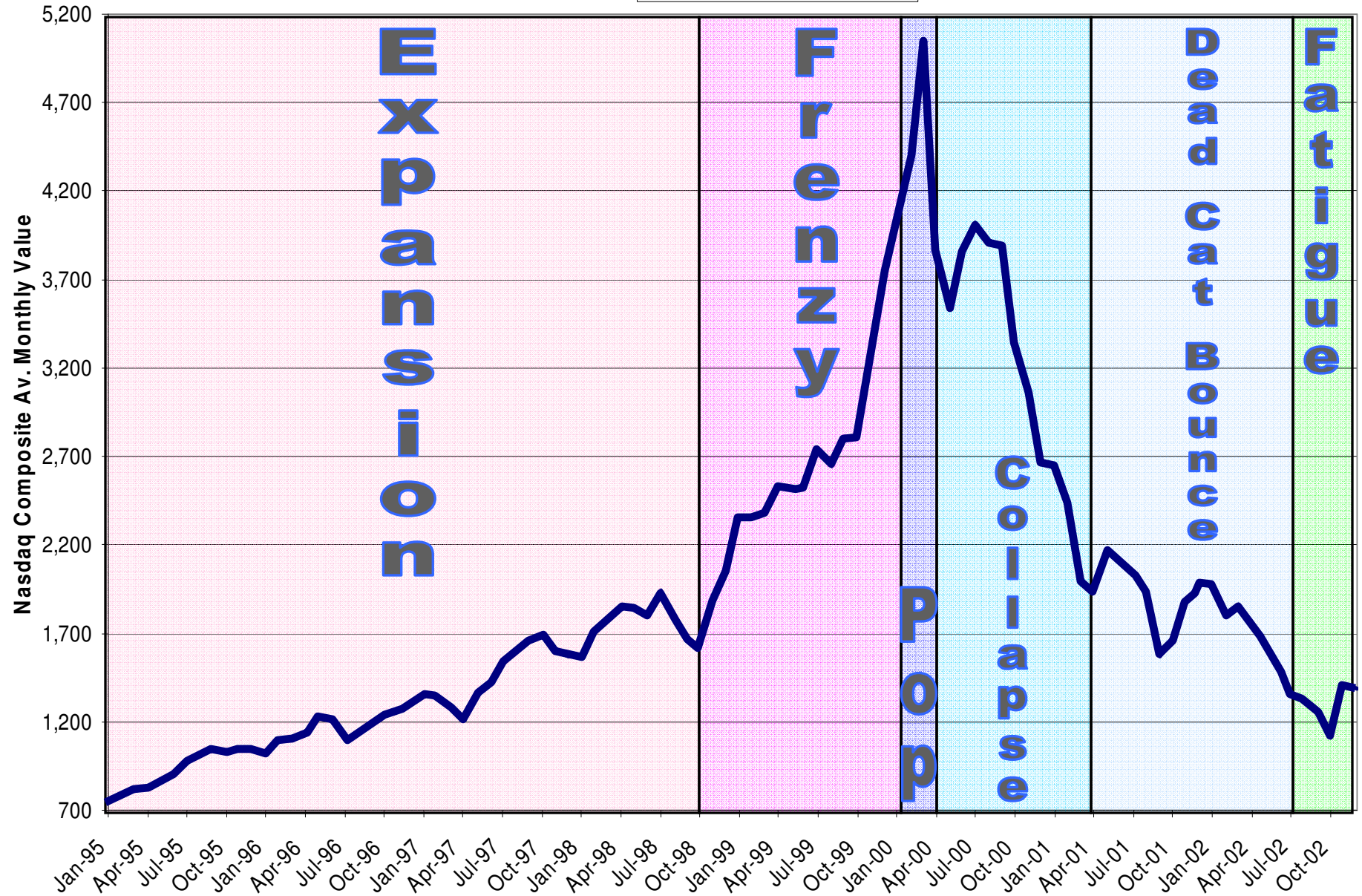
**What can be learned
from past bubbles?**

PHASES

- Bubbles tend to display phases that are similar in characteristics but may differ in duration and magnitude.
 - **Expansion**= Equities display a steady somewhat sustainable increase
 - **Frenzy**= Equities experience a sharp unsustainable spike
 - **Pop**= Equities peak and the bubble bursts
 - **Collapse**= Equities go through a period of sharp decline
 - **Dead Cat Bounce**= Short-term cycles occur in the price of equities
 - **Fatigue**= The bubble comes to an end

Nasdaq

— Nasdaq Composite Value

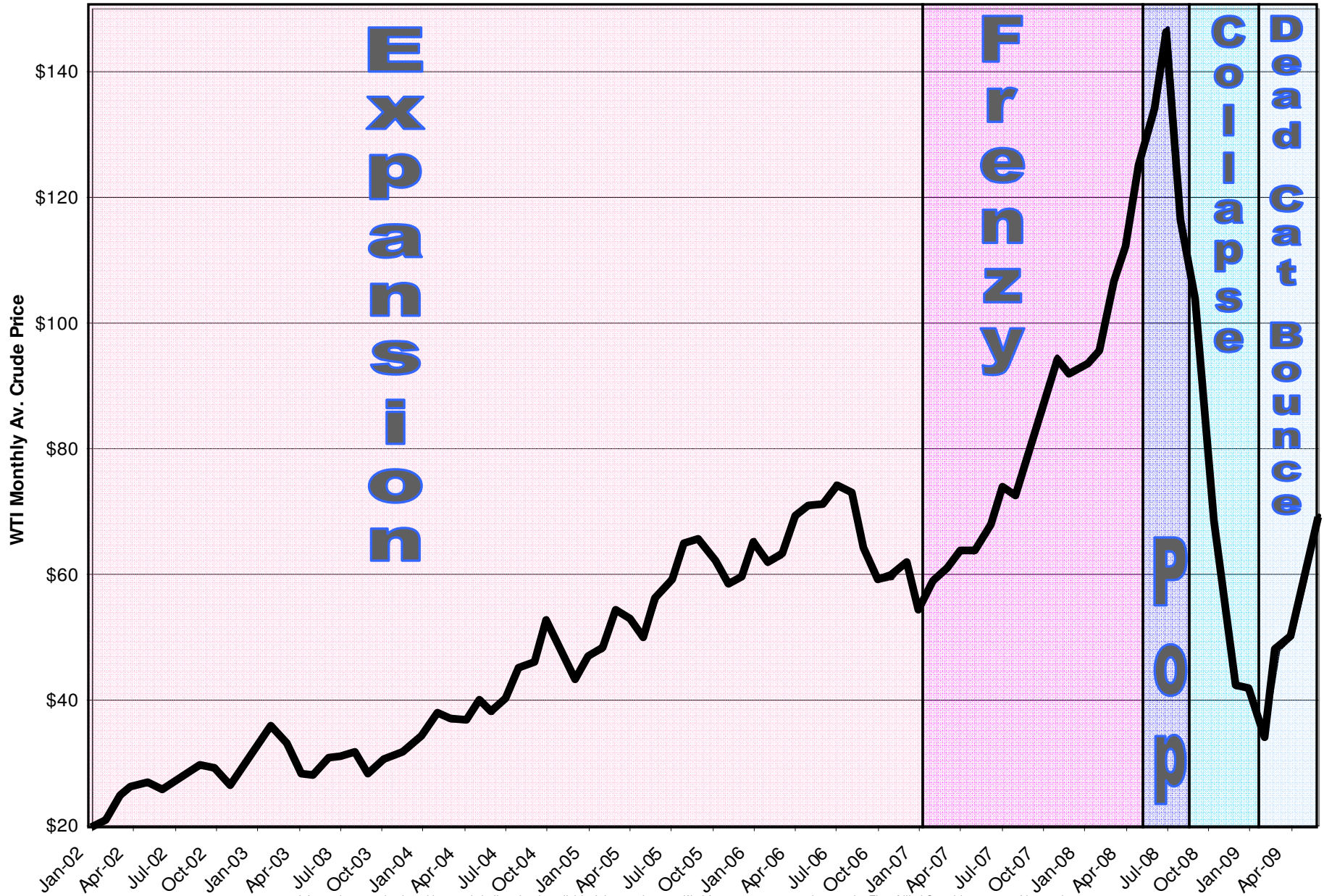


Information contained on this page is believed to be reliable. It has not been verified for accuracy or completeness by First Allied Securities, or any of its employees.

* NASDAQ data was compiled from the Yahoo website.

OIL

— WTI Crude Av. Monthly Price



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Average Monthly WTI Crude Price data represented in this graph was compiled from the EIA website.

BUBBLE BUSINESS CYCLE

- The industries involved in bubbles typically demonstrate similar trends.
 - Demand Builds
 - Demand Explodes
 - Overbuying and Inventory Building Occur
 - Supply & Demand Tilts
 - Demand Falls Off
 - Companies Burn Off Inventory
 - Inventory Gets Oversold and Bottoms
 - Inventory Builds Back to Meet End Demand

STOCK CORRELATION

- So how does the stock market correlate to the business cycle?
 - Stocks tend to lead the business trends. For example, stocks will peak months prior to the peak in demand.
 - There are some wildcards
 - Analysts= They tend to put buy ratings on stock long into the upturn, and sell ratings after the stocks have already dropped precipitously.
 - Dead Cat Bounce= Once stocks have fallen sharply from the peak they tend to display short term increases
 - Perhaps due to an uncertainty in the Supply/Demand equation
 - Or, to a belief that the stocks have been oversold

NON-BUBBLE INDUSTRIES

- What happens during a bubble to the industries not included in the bubble?
 - Initially the bubble lifts the whole market
 - Once the bubble starts to Frenzy it pulls the capital from the other industries
 - When the bubble pops it collapses the whole market
 - At this point the market is a little turbulent as it searches for new leadership
 - New leadership forms and pulls in capital that chased the bubble industry



INDIVIDUAL BUBBLES

TECH BUBBLE

- The Tech Bubble was a typical bubble in the respect that it was formed by the business trends described earlier.
- In the late 90's new technologies such as the internet and cell phones increased in popularity accompanied by a build-out of the telecommunications infrastructure.
- This drove the sale of electronics components such as semiconductors and introduced a new crowd of internet startups such as Yahoo and Ebay

TECH BUBBLE CONT.

- In early 2000 the Tech Bubble popped followed by a steep decline in the stock prices.
- Many of the internet startups failed, the telecom industry overbuilt, and electronics manufacturers burnt down inventory.
- After a couple Dead Cat Bounces the Tech Bubble reached its Fatigue phase in late 2002.

COMMODITIES BUBBLE

- During the Commodities Bubble, we believe speculation was more pronounced than in previous bubbles, which led to a disconnect between the price of the underlying commodity and supply/demand fundamentals.
 - “There is no question that speculators and unregulated energy traders have pushed prices far beyond the supply-demand fundamentals and into an era of a speculative bubble in oil markets.”¹
- Regulations that are supposed to guard against excessive speculation have been weakened by loopholes that have enabled speculators to trade without enforceable limits.
 - Under testimony, Congressman Bart Stupak stated that speculators in the oil futures market represented 71% of the market in April of 2008, a significant increase from the year 2000 when speculators represented only 37% of the market.
 - “Price bubbles have become possible in the commodities derivatives markets because of the proliferation of loopholes and the general dismantling of speculative position limits.”²
- Regardless of how this phenomenon was formed, the bubble occurred and eventually peaked-out on July 11, 2008 at a record high price of \$147.27/barrel.

¹ Slocum, Tyson, “Testimony of Tyson Slocum”, U.S. House Committee on Agriculture, Director, Public Citizen’s Energy Program, July 11, 2008

² Masters, Michael, “Testimony of Michael W. Masters”, Senate Committee on Agriculture, Nutrition and Forestry, Managing Member/Portfolio Manager, Masters Capital Management, LLC, June 4, 2009

COMM. BUBBLE CONT.

- **We believe this bubble popped in July 2008 due to the possible crack down on commodities market speculation by a new incoming administration and a fall off in oil demand.**
 - In 2008 presidential hopeful John McCain stated that he would quit buying oil from the Strategic Petroleum Reserve, presidential hopeful Barack Obama went a step further and said that he would sell oil out of the SPR.
 - Both presidential hopefuls pledged to close loopholes such as the “Enron Loophole” that enabled excessive speculation.
 - Total Crude Oil & Petroleum Product consumption decreased 5.84% in 2008 according to Energy Information Administration (EIA) data.
 - According to the Department of Transportation, miles driven in the U.S. decreased by 3.6% in 2008, which marks the first annual decrease since 1980.

COMM. BUBBLE CONT.

- The Commodities Bubble has displayed a unique set of drivers, as all bubbles do, but has still demonstrated the same set of phases that are present in most bubbles
 - Expansion, Frenzy, Pop, Collapse, Dead Cat Bounce & Fatigue
- We believe we are currently in the Dead Cat Bounce phase of the bubble, which means that we may experience short-term bounces in the price of commodities until we finally reach the Fatigue phase.



**SO HOW CAN YOU
POTENTIALLY BENEFIT?**

TECH BUBBLE

- During the Tech Bubble Peak, Chlebina Capital avoided Tech Stocks because we felt the bubble would pop and anyone invested in that area would incur losses.
- Chlebina Capital focused on determining who would be part of the New Leadership group
- In 2000 we began positioning in Commodities and Healthcare Stocks, which we subsequently exited.

COMMODITIES BUBBLE

- We believe we are currently in the Dead Cat Bounce phase of the bubble, which is typically when New Leadership groups emerge
- The combination of the popping bubble and severe recession, in our opinion, sets the stage for a recovery in New Leadership groups.
- Chlebina Capital has identified industries we believe will be in the New Leadership group and are positioning accordingly.

OTHER MARKET DRIVERS

- Money on the sidelines
- General Economic Recovery
- Drivers specific to what we believe will be the New Leadership Group.

MONEY ON THE SIDELINES

- During the market decline investors took money out of stocks and placed those funds into safehavens.
 - Joseph-Anthony Sawe, a UBS strategist, “noted that in 2008, investors withdrew money from equity mutual funds at a record pace, seeking safety in safer near-cash assets.”³
 - “Money sitting in savings deposits, money market mutual funds and small certificates of deposit (those under \$100,000 each) now totals \$9.5 trillion. That’s more than twice the assets of stock mutual funds.”⁴
The data comes from MoneyNet.Inc and the U.S. Federal Reserve.
- When the fear subsides and confidence returns, those funds will return to the market in an effort to achieve higher returns than can be found in safehavens.
 - The CIO at Harris Private Bank, Jack Ablin, notes in a research report released on June 8, 2009 “whenever money market assets have exceeded 25% of the capitalization of the Standard & Poor’s 500 index, stocks have rallied over the following two years. That number currently is 43% after having peaked at 58% in mid-December.”⁴

³ Pett, David, “Cash in hand and ready to invest”, FP Trading Desk, June 22, 2009

⁴ Hamilton, Walter, “Sideline cash is huge, but is it antsy to go somewhere?”, Los Angeles Times, June 10, 2009

GENERAL ECONOMIC RECOVERY

- \$787 Billion Stimulus Package
 - The Stimulus Package was established to create or save jobs and encourage economic growth. According to Recovery.org, as of June 19, 2009 only \$52.9 billion has been spent, and we are already seeing signs of an economic recovery starting in the second half of this year.
- Stabilization of the Financial Industry, Auto Industry & Housing Market
 - Aggressive action in the form of spending, lending, interest rate reductions, and reform should stabilize these areas by the end of 2009.
 -
- GDP Growth
 - “the NABE panel expects economic growth to turn positive in the second half of this year, with the pace of job losses narrowing sharply over the remainder of this year and employment turning up in early 2010”⁵

⁵ Varvares, Chris, “NABE Outlook: Recession End in Sight, but Subpar Recovery to Follow”, National Association for Business Economics, June 2009

NEW LEADERSHIP GROUP

- We have identified industries that we believe will be in the New Leadership Group based on:
 - Industry data and our own proprietary models, which indicate possible record growth rates
 - Comments and increased guidance by companies in this space
 - Historic industry cycles and dynamics

SUMMARY

- Chlebina Capital
 - Recognizes the impact of **Equity Bubble Dynamics** on industries
 - Avoided the bust of the Tech Bubble by investing in non-tech industries
 - Has identified what we believe will be the New Leadership groups
 - Is currently positioning in these groups



To Get an Independent Perspective for Your Investments

Please Contact:
Larry Chlebina
President, Chlebina Capital Management, LLC
Ph: (330) 668-9200
Toll Free: (800) 848-9201
www.chlebinacapital.com