



E-llumination

Tough Markets, Tough Calls September 11, 2006

I wore a New York Fire Department tee shirt to work today. Meghan bought it for me when she toured Ground Zero and visited a couple of the fire houses when she was in New York shortly after the attack on the World Trade Center. It says,

All Gave Some, Some Gave All September 11, 2001

We all have our own way of dealing with 9/11. One of mine is to turn on the TV with a little trepidation, fearing that Al Qaeda, or someone else, might try it again. We have been blessed in the USA that there has not been another attack; and therefore it is easy for us to forget that over 18,000 people have died from terrorist attacks around the world since 9/11. That figure does not include the deaths from insurgency or civil war in Iraq or Afghanistan.

Needless to say I am sure that we all spent at least a little time reflecting today on the events of five years ago, and what they mean in our lives today.

At K&A one big difference in the way we behaved then versus the way we behave now is that we do understand that another 9/11 type incident could do violence to the financial markets just as it did back then. We also know that there is no way we can totally prepare for such a day, nor can we quantify the odds of such an event happening. We would have believed those odds were 100 percent that an attack of similar magnitude would have happened by now.

Yet nothing has happened in the USA; and we, like everyone else, are thankful. We also remain hopeful that horror will never be revisited. That doesn't take away the fact that financial markets have been difficult to manipulate for the past five years—and for many reasons that are unrelated to terrorism.

That is why the name of this newsletter is [Tough Markets, Tough Calls](#).

Stock	9/9/2001	9/11/2006	Difference	Here is a table that lists the top 5 stocks, by volume, traded on the NASDAQ today; followed by the top 5, by volume, traded on the NYSE. Seven of the 10 stocks are worth less today than they were 5 years ago. One of them, called Freescale Semiconductor, didn't even exist at the time. Two of them are up over five years! But cumulatively these are ten stocks that have gone no
Intel	\$26.07	\$19.40	-\$6.67	
Microsoft	\$28.79	\$25.91	-\$2.88	
Dell	\$22.57	\$21.99	-\$0.58	
JDS Uniphase	\$6.21	\$2.08	-\$4.13	
Oracle	\$11.46	\$16.29	\$4.83	
Nortel	\$5.35	\$2.26	-\$3.09	
Lucent	\$4.83	\$2.29	-\$2.54	
Freescale Semiconductor	NA	\$37.06	NA	
Exxon-Mobil	\$41.24	\$64.94	\$23.70	

where in 5 years. That is what Wall Street spent the most trading effort on today! Talk about an exercise in futility; talk about tough markets.

Our top volume trades were made far away from these ten stocks today. Although I must admit that we are warming up to Oracle. It has a nice rising trend line and has bucked a lot of the “tech” negativity of the past year, let alone five years. Don’t be surprised to see that one in some portfolios.

Today we gave up on gold (GLD) for the second time. As long time readers know, we sold most of the GLD and two gold mining stock mutual funds back in May, just as gold was peaking. Our timing couldn’t have been better.

Gold has been whipsawing participants in the market ever since. Trading gold has become darned near impossible; and one of the main “investment themes” related to rapidly rising global liquidity (money supply) has all but disappeared in the face of central banks around the world tightening the screws on money supply. So has the counter trend against the U.S. dollar as the dollar has held up well despite lots of negative bias towards it. Check out the chart at the left, and below, of the U.S. Dollar Index. Note its collapse, which ended in May—coinciding with the top in gold prices. Notice how an upward counter trend has started since then. Gold has been working its way downward since May.



Today several indicators broke below what we considered critical support levels and we sold the small allocations that remained in some portfolios. We frankly don’t know where gold prices are going from here. But we do know that technical market patterns have turned quite negative for gold and other commodities as well, and that the odds now favor more downside. We are stepping aside from gold and mining stocks, with the exception of one uranium mining company called Cameco, to see how the situation plays out.

Check out the chart below of the CRB Commodities Index. Notice the clear break in the upward trend (the break below the rising blue line). Notice the “double top”

that commodities recently put in before the break down came. That rising blue line now becomes “overhead resistance.” Don’t be surprised to see this average bounce back up to the blue line in the next few days or weeks. If it can’t break back above the line, the commodity bull market is over for now.

Oil prices are moving down quickly as well. What we call the “technical damage” is not so severe yet, as far as we are concerned. But we have been trimming and pruning in the various portfolio models. We have sold out the Select Energy SPDR (XLE) in the Bonavista and Halifax model accounts. We had sold Chesapeake Energy and Nabors Drilling in the Hatteras and Mendocino models some time ago.

More and more market players are starting to make allowances for oil to fall back to \$60 per



barrel. Some are talking about \$50 per barrel. Those things may indeed happen. We have always articulated our bias on price direction by saying something like this, “We now believe that we will see \$60 again before we see \$80.” That would be our bias at the moment. We have to admit that “bias” is related to a shorter term outlook of the markets. Longer term we still believe that the trend in oil prices is upward. See our last newsletter called “**The Road to Kazakhstan**” for some clarity on that issue. Using my favorite “hedging statement” let me say also that we expect to see \$70 again long before we ever see \$40.

We are carefully monitoring the prices of the remaining oil related stocks that are in the Hatteras and Mendocino models and have made no decision yet on whether on not to sell ConocoPhillips (COP), for example, or to buy more on weakness. All that we can tell you is that the stock now trades at a price to earnings ratio (PE) of 5.45 times earnings. It sells for .56 x sales. That is RIDICULOUSLY low and seems to price in the possibility of oil returning to \$30-\$40 per barrel.

I can put those ratios to you another way. If you are a business owner, ask yourself if you would sell your business for 5.45 times annual earnings; or if you would sell for .56 times your annual sales (revenue). I’ll bet the answer is that you wouldn’t even consider values twice that high, under any circumstances. If you feel that way, you know why I think COP is so cheap—and being undervalued by the marketplace. You also have a better feel for why this newsletter is called [Tough Markets. Tough Calls.](#)

On the other hand I am starting to allow myself to feel a little bullish about the possibility of a decent rally in the broad U.S. stock markets during the last 60-90 days of this calendar year. Rob and I have been discussing the possibility that 2006 may turn out to be a year in which we made all the money in gold, commodity related stocks, and oil during the first half of the year—only to see those rallies fade and be replaced by rallies in “common stocks” during the last quarter. We shall see.



Oh yea, the Matthews China Fund has yet to disappoint either! Check out this chart from October 2004 to present.

We’re glad that September 11, 2006 was uneventful and a beautiful day in California.

We are grateful to our clients for being with us. We wish you and your family and friend’s peace, pursuit of happiness and prosperity.

All the best,

Paul Krsek
For K&A Asset Management, LLC
September 11, 2006

**Disclosure and Disclaimer
(updated 05/24/2006):**

E-Illumination is the proprietary newsletter written for clients, friends, and affiliates of K&A Asset Management, LLC (K&A). Until January 6, 2006 K&A published a second

newsletter called Illumination. That format has been discontinued. Henceforth K&A will publish all newsletters under the name E-Illumination.

Paul Krsek is the sole author of E-Illumination. While the views and representations found in the newsletter generally reflect the attitudes and opinions of the K&A Asset Management, LLC members and staff, Krsek writes without editing and therefore is solely responsible for the content and opinions contained in E-Illumination.

E-Illumination does not represent the opinions of Fidelity, Fidelity Institutional Brokerage Group, NFS or anyone employed by Fidelity in any capacity. Neither Fidelity, Fidelity Institutional Brokerage Group, nor NFS, nor anyone employed by Fidelity in any capacity has participated in the creation of E-Illumination and they are not responsible for the contents or distribution of E-Illumination.

E-Illumination is written to provide general information to clients, friends, and affiliates. The contents of E-Illumination are not to be taken as individual investment advice. No investment decisions should be made based on the opinions or information offered in E-Illumination.

K&A does not represent that the information in E-Illumination is accurate or complete and it should not be relied upon as such. Opinions expressed herein are subject to change or modification without notice.

The investment portfolio models or management services mentioned in E-Illumination may or may not be available in some states, and they may not be suitable for all types of investors.

K&A manages accounts with various histories and investment objectives. Various accounts may be managed differently from time to time.

During 2005 Paul Krsek was appointed Chief Investment Officer of K&A, and as such is responsible to make all trading and management decisions for all client accounts which are being managed according to a specific portfolio model. A description of each of our models can be found on our website at <http://www.kaassets.com/choices.htm>.

Some accounts managed by K&A are managed individually and not subject to the discipline of a particular model portfolio. Individual advisor representatives, including Krsek or Andreae, may be assigned to an account and have the authority to make decisions related to accounts that are not subject to a model's discipline. K&A Asset Management, LLC, as an entity, does not manage investment accounts.

Paul Krsek, Rob Andreae and Nancy Widener currently act as the investment policy committee for K&A, and as such do review general and specific investment policies of K&A. But when it comes to the implementation of those policies Krsek is primarily responsible to manage the accounts that fit into each model portfolio description. He makes all final investment and trading decisions relative to those accounts that are "modeled."

From time to time K&A receives requests from clients to purchase securities that are not included in the model portfolio to which they are assigned. Effective May 24, 2006 K&A will accommodate such requests by opening a separate account for the client in which to hold such securities. Because

K&A is a "fee only" registered investment advisor" it will charge its normal management fee for monitoring such securities in the separate accounts in which they are held.

No securities that are 'requested by the client' will be held in modeled portfolio accounts.

The investment objectives of various accounts and models may be substantially different from one another. Therefore topics or investments mentioned in E-Illumination may or may not apply to specific managed accounts and/or models.

Trades or adjustments to accounts mentioned in E-Illumination may or may not happen in every account managed by portfolio managers at K&A.

If you are not satisfied with the investment results in your account it is your responsibility to inform Krsek or Andreae and to discuss possible changes that can be made to the account to accommodate and satisfy your needs.

The assets held in managed accounts at K&A Asset Management, LLC may include stocks, bonds, cash, commodities, foreign exchange or mutual funds, money market accounts or limited partnerships that represent the same. They are subject to market fluctuation and the potential for losses. The assets are not insured. The value and income produced by these investment products may fluctuate, so that an investor may get back less than they initially invested.

The portfolio managers at K&A Asset Management, LLC do not guarantee results.

Past performance should not be considered an indicator of potential future performance. If you do not consider yourself suitable, either emotionally or financially, to experience volatility and/or losses in financial markets, you should not invest.

This document is for information purposes only and it should not be regarded as an offer to sell or as a solicitation of an offer to buy any securities or other instruments mentioned in it.

Sincerely,

Paul Krsek
Updated: May 24, 2006