



ELLUMINATION

October 15, 2007

A REFLECTIVE DAY AT K&A

It is 10:20 a.m. on Monday morning and our trading day is about finished, even though the markets will be open for another few hours. One of the reasons for that is that I put in a huge amount of work over the weekend and therefore knew exactly what I wanted to do early today. We have simply been staging some trades through the morning to make some adjustments to our models.

Since the trading is done I am sitting here reflecting on lots of things; and wanted to share some thoughts with our readers.

The research that was done over the weekend was just "icing on the cake" for the exhaustive research process that is employed now at K&A. Those of you who are clients know that our research and results have been good for years. But you may also have noticed that our investment results clearly ticked up a notch starting in 2005. It is not that our results were bad before 2005. They were very good. But there is a clear line in the sand at the beginning of 2005, at which time we moved way ahead of market performance, compared to our benchmarks, and have never lost that lead. Here is a complete table of our investment performance.

Model	Annualized Return	Time Weighted Return	2002	2003	2004	2005	2006	2007 thru Sept. 30
Hatteras	6.83%	46.25%	-10.46%	12.72%	8.67%	3.05%	15.84%	11.70%
Mendocino	6.75%	45.55%	-10.02%	11.69%	7.04%	4.25%	15.74%	12.14%
Bonavista	5.95%	39.42%	-13.84%	14.53%	7.00%	4.76%	12.70%	11.84%
Halifax	7.90%	54.81%	-12.28%	17.21%	6.49%	4.45%	16.19%	16.51%
SPX (S&P 500)	5.08%	32.97%	-23.37%	26.38%	8.99%	3.00%	13.62%	7.65%
LEH (Lehman Aggregate Bond)	5.07%	32.90%	10.25%	4.10%	4.34%	2.43%	4.33%	3.85%
Fresnel	24.25%	46.22%					24.74%	17.22%
Fresnel NET (1)	19.36%	36.29%					19.79%	13.78%
SPX	12.20%	22.31%					13.62%	7.65%
LEH	4.69%	8.35%					4.33%	3.85%
The New World (2)		15.82%						15.82%
SPX		7.65%						7.65%
LEH		3.85%						3.85%

(1) Fresnel model has been in existence since January 1, 2006. It is shown "gross" and "net" because this model features a performance fee for K&A.

(2) The New World has been in existence since January 1, 2007.

We have clearly been beating the published benchmarks since 2005. Now, for the qualifier. No one beats the markets forever. That is a well known fact. But the longer we do it, the more

confident I have become in our research and trading techniques; to the point that I am now very confident that we can keep up superior performance for the very long haul.

So what changed in 2005? First, I took over as the sole manager of all client monies invested through K&A and set about to make some changes in the way we did things. First I brought back an old friend and ally from my days at Edward Jones and Angeles Corporation. That was Bank Credit Analyst (BCA). BCA was my macroeconomic guiding light in the 80's and 90's and we got away from them in the new decade of the 2000's. Big mistake; since corrected.

Second, I introduced "quantitative research and modeling" to our research regimen. Simply stated we now use mathematical models to determine the probable results of many of our investment decisions. We now subscribe to two of the best quantitative modeling services available in the United States.

Third, I strengthened my already solid technical analysis skills and overlay good technical analysis on all our work.

Fourth, I consolidated most of the accounts we manage into four very distinct model groups that became Hatteras, Mendocino, Halifax and Bonavista. Since then I have added two more models to our work. They are called Fresnel and The New World. Prior to 2005 most of the accounts we managed were loosely configured into the four basic groups anyway. But we really formalized the distinctions, and really tightened up the trading process to make all accounts within a model group look as much alike as possible. Why? It makes for much more efficient and consistent trading within a model group and that has enhanced performance. The proof is in the improved results for all our clients in the model groups.

Finally, we have always had sound fundamental research capability.

In the end I have designed research, modeling and trading processes that really work well and that are all now highly institutionalized here at K&A. All you have to do is look at our investment results, compared to our stated goals and compared to our published benchmarks, to confirm for yourself that the process is working.



This year we took another big step forward that we hoped would improve investment performance even more. We hired Lee O'Dwyer as a portfolio manager at K&A. Lee now works hand in hand with me on a daily basis to continue and hopefully improve the performance of our models.

Lee is one smart guy, who I have known for over four years, and I am delighted he has joined K&A.

If you want to read his biography you can go to http://www.kaassets.com/co_team.cfm

Lee and I have been talking about the markets together for over 4 years, while he was a partner at another firm. Now we have been working together daily, for approximately 4

months, and we are simply doing great.

In fact it seems appropriate to share with you, our clients and friends, an email that I sent to Lee at the end of his first 90 days at K&A:

Lee,

I did not want the end of your first quarter with K&A to pass without taking the opportunity to congratulate you on your success and clear contributions to K&A during the quarter. Frankly, it has been very rare in my experience, dating back to 1981, to see someone come into a company and integrate themselves so well and so quickly. I can honestly say that of the 200 or so people who have worked for me during all those years you had the most successful start of anyone.

Maybe I should conduct all interviews for 4 years prior to hiring—kidding of course. It is clear that we took a long time to get to know each other well before making the decision to have you join K&A, and it is gratifying to know that the decision has worked out so well for everyone.

It is good to know that you are as happy about being with K&A as we are about having you as a member of the team. I actually choose the words "member of the team" specifically to describe part of the reason for your success. You have come in and willingly embraced the rest of us and I have enjoyed watching you work closely with Sharon and Meghan, supporting their efforts, and therefore supporting K&A. I know that each of them is as happy as I am that you are part of the team.

It was clear to me that you brought with you a rare combination of skills in that you have the market knowledge, technical market expertise, fundamental research skills, mathematical proficiency and administrative skills all wrapped into one package. You are genuinely curious about everything, delightfully in love with the markets and have a tremendous work ethic. Your math skills and logical bent have made you an instant asset to Meghan. Your administrative, trading, and back office knowledge have made you an instant support system for Sharon, and Anthony—not to mention our clients.

We have not really gotten you engaged in sales or marketing, and that has been by design so far, but it is clear you have much to offer in those arenas as well; and Rob will benefit from your assistance and input.

*Finally, anyone who can come in and survive the baptism of fire that you did, relative to "**Mr. Toad's Wild Ride**" in the markets this quarter is to be congratulated. Particularly when the boss walks out the door for a 2.5 week vacation just as the collapse happens and you are confronted with a portfolio of stocks which you know nothing about.*

(See http://www.kaassets.com/media_ellumination.cfm for our newsletter called Mr. Toad's Wild Ride dated August 14, 2007)

As I have expressed to you several times; the last 90 days have been delightful for me. I finally have much of the support that I have been seeking for a long time.

I am particularly pleased that our management styles have blended so well. It is very clear that I had our portfolios on the right track when you arrived, and now I am extremely confident that we can continue to build on all the ground work that has been laid in and that we should be able to grow assets under management for years to come, from the great investment results we are likely to produce for our clients. I am also confident that K&A's story has gotten much stronger and that gives us marketing fire power as well.

Have a great weekend. I hope you enjoyed your cigar. Q2 starts on Monday.

All the best, PK

So there you have it. There is another first class money manager at K&A and he is successfully on the job.

Lee and I spent a lot of time last week and over the weekend reflecting on the markets. We came to work today confident that the U.S. stock market would be pulling back from its recent highs. We were also just as confident that the U.S. dollar would be declining; gold would be rising and oil would pop up to near \$85 today. Ya think?! That is exactly what is happening, and our trades this morning were designed to take advantage of those trends, each of which we think has more room to run.

As long as I am sharing emails with you today, here is one that I wrote to Lee and Rob back on September 30, 2007:

OK. Sit back, close your eyes, breathe, relax, and think about what are the surest bets in the markets for the next week, month, 3 mths.

Here is my take:

- 1) Gold hits \$800 by year end. Approximately a 9.5% rise.*
- 2) The Fed funds rate gets cut to 4%*
- 3) The U.S. dollar index is lower, but I don't know by how much.*
- 4) Goldman Sachs is at \$225, \$235—how about \$245.*
- 5) Oil is at \$85.*
- 6) Wait, wait, I am losing my vision. Nothing else is clear.*

Buy Gold!

Sure looks right today.

All the best,

PK
For K&A Asset Management, LLC

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

Krsek makes frequent reference to the model portfolios called Hatteras, Mendocino, Halifax, Bonavista, Fresnel and The New World. 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>.

Not all accounts managed by K&A are "modeled" accounts. We strongly urge our clients to understand which model, if any, are being used to manage their accounts.

As of July 3, 2007 Lee O'Dwyer joined K&A as a portfolio manager. Paul Krsek and Lee O'Dwyer frequently discuss investment ideas, model portfolio strategies and the 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 generally makes all final investment and trading decisions relative to those accounts that are considered to be "modeled." However, in Krsek's absence O'Dwyer does have the authority to trade all client accounts. He has been actively trading accounts in the various models since joining K&A.

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 has encouraged clients to hold such securities in a separate account for the client. Because K&A is a "fee only" registered investment advisor" it charges its normal management fee for monitoring such securities in the separate accounts in which they are held.

K&A makes every effort to exclude securities that are 'requested by the client' from the 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 ELLUMINATION 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 or exchange traded funds (ETF's), 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.

From time to time Krsek lists the simple annual returns of the six model accounts in this newsletter. These accounts are "models" and do not represent the actual results accruing to individual accounts. Simple annual return does not represent "time weighted return" as reported individually to clients in their quarterly reports prepared using Centerpiece.

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Sincerely,

Paul Krsek
Updated: August 13, 2007