



## ELLUMINATION

OCTOBER 26, 2007

### GOING BACK TO PLAYING OFFENSE

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My little experiment in using a new format in presenting the last newsletter was a bomb. It looked good online, but couldn't be printed well, so we are back to using simple letter format. That's quite OK.

The real message I want to convey to you today is that we are going back to "playing offense" in the model portfolios. In our last newsletter called "**A Brief Update**" I told you that "*We have gotten a little more defensive in the model portfolios during the past 10 days, but we expect this storm to pass just as the storms in February and July/August passed.*"

Well, we think the recent market storm is passing. We are also aware that the next two weeks are usually a pretty good time for the U.S. stock market. In fact from 2000-2006 the market moved higher from October 25-November 7 each and every year. Check out the table below. Focus on the "**Focus Here**" column. It shows you the percentage gains in the market during each of the October 25 to November 7 periods.

#### SPX Trading History 10/25 - 1/07

	SPX Open	<b>Focus Here</b>	SPX Close		SPX Close		SPX Close
	25-Oct	Percentage change	7-Nov	Percentage change	31-Dec	Percentage change	7-Jan
2006	1377	<b>0.36%</b>	1382	2.60%	1418	-0.63%	1409
2005	1200	<b>1.67%</b>	1220	2.79%	1254	2.47%	1285
2004	1095	<b>6.48%</b>	1166	3.95%	1212	-2.15%	1186
2003	1029	<b>2.24%</b>	1052	5.61%	1111	1.26%	1125
2002	897	<b>0.56%</b>	902	-2.55%	879	5.12%	924
2001	1085	<b>2.76%</b>	1115	2.87%	1147	1.48%	1164
2000	1396	<b>2.51%</b>	1431	-7.76%	1320	-1.67%	1298

We think that it would be a mistake to ignore this trend for several reasons; so we aren't ignoring it.

We closed out all short positions in all models yesterday, on the 25th. Short positions are bets that either a specific security or a portion of the market will go down. The odds are that history is likely to repeat itself and the next two weeks should be a good period for the market—so why would we want to be holding bets that the market will go down? One of our considerations in making this trade is that the period from 2000-2006 includes a huge bear market during 2000-2002 and a very big bull market from 2003, right through today.

If stocks could advance during this two week period back in 2000-2002 we know of no reason why it can't happen this year too. Particularly since the Federal Reserve Open Market Committee (FOMC) is meeting October 30-31, 2007. The futures market is now pricing in a 100 percent probability of another Fed Funds rate cut. We fully expect the Plunge Protection Team (the Fed and the Treasury Department) to do their parts, and the Fed should cut another 25 basis points

on October 31. The anticipated rate cut should help support equity markets, and may provide fuel for another move upward.

Another consideration is that we remain bullish on the markets for the remainder of the year. We must admit that our enthusiasm for U.S. stocks has cooled a bit in the past week. But we still think the odds favor U.S. stock markets finishing higher on December 31 than they were on October 25.

Finally, October 31<sup>st</sup> is the date a lot of U.S. mutual funds close out their fiscal year. All those managers want to end their year on an up tick and therefore we expect them to be doing everything they can to finish their fiscal year's on a high note.

Therefore, given all these factors, it didn't make sense to us to leave our short positions on through the end of the month. Here are the percentage gains in our six model accounts from January 1, 2007 through tonight, compared to the S&P 500. Remember, these are the returns for the six actual client accounts that I use as our trading models. If your account is in one of the model groups its return for the year should approximate the numbers presented here, through the close tonight.

<b>Model Account</b>	<b>Gain</b>	Needless to say, it has been a good year for the models so far, and we are doing everything we can to keep it that way.
Hatteras	17.17%	
Mendocino	17.98%	All the best,
Halifax	19.03%	
Bonavista	15.01%	
Fresnel	26.17%	
The New World	24.96%	Paul Krsek
<b>S&amp;P 500</b>	<b>6.77%</b>	For K&A Asset Management, LLC

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The investment portfolio models or management services mentioned in ELLUMINATION 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.

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 Andrae 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.**

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

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