



Successful Test?

You gotta love a plan that comes together at least for a day. But what about day two? The close today was very disappointing. The best case scenario would have been to see the markets close up today to show some follow through to yesterday's key reversal day. At worst case we would have liked to see the S&P 500 hold above 875 and the DJIA hold above 8500. Neither happened. Small cap stocks got hammered today as the Russell 2000 was down over 7%. The Dow Jones Transportation Index was down over 5%. The iShares Dow Jones US Real Estate (IYR) was down over 9% on the day.

All in all it was not a day that inspired confidence about the chances for a continuing rally.

Here is a chart that shows you the three 10% UP days that we have had in the past two months. They happened on October 13, October 28 and yesterday. The rally on October 13 immediately failed the next day and rolled over to new lows. The rally on October 28 was followed by a down day. Then the market trended upward for four days before rolling over.

By the time we got to yesterday the setup was for the second major test of the October 12 intraday low. Yesterday gave us a successful test. But today the markets rolled over harder and closed much lower than they did DAY 2 following each of the two previous 10% UP days. You can't put lipstick on this pig. It was an ugly day.



We did some buying and some selling today. Let me give you a summary.

We bought one corporate bond position for Hatteras and Pt. Reyes. It has only six months to maturity with a yield to maturity of 5.45%. We are going to continue to look for short term opportunities to move "cash" from money market accounts to short term bonds like this one. We have no illusions that we will be loading up on equities any time soon, so we want to try to gain some yield for all the models, while maintaining flexibility. 90 day to 180 day investments make sense to us for some of the money that would otherwise be sitting in "cash".

We bought a second corporate bond that will go into Mendocino and Pt. Reyes that has a yield to maturity of 6.57% until October 2012.

We sold out of one tech related equity position in Fresnel that was a company that paid no dividend and reallocated the funds in equal portions to two other equity positions already held in Fresnel that are great companies and that pay out dividend yields in excess of 4%. YIELD is king.

We bought small allocations of WalMart for Hatteras and Halifax. WalMart (WMT) continues to outperform ALL other retailers and is the only stock in the DJIA **that is UP for the year**. We added 3M (MMM) to Fresnel and Mendocino. Despite this terrible market MMM just got a "buy" signal from our proprietary technical charting system.

We were stopped out of NOKIA (NOK) in Halifax model.

As the rally today started to fail we made the decision to fully hedge the Fresnel model. As of the close tonight it is net short the market. It holds about 20% long positions and 22% short positions. The 8 long positions are all individual stocks. The average dividend yield on them, equally weighted in the portfolio, is 5%. The short position is an inverse equity ETF.

There are two important things to know about what we just did in Fresnel. If the rally we have been expecting does materialize next week it is not likely that Fresnel will benefit much. The only way it would is if we have been smart enough to pick stocks that go up more than than the market does. That could happen as we have always believed our stock picks to tend to outperform the market. On the other hand if the market drops precipitously on Monday Fresnel should not go down in value. The large short position should act as a full brake on the model.

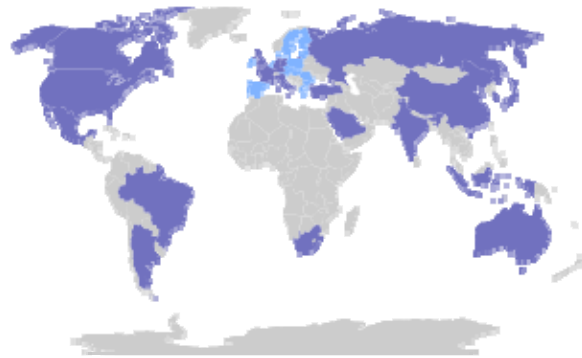
Why did we hedge Fresnel this way? The overwhelming majority of our clients that own accounts in the Hatteras model also own an account in the Fresnel model. We wanted to reduce their overall exposure to equities and the simplest way to do it was by hedging Fresnel. If the rally does materialize at least Hatteras will participate.

On the other hand, if Monday and Tuesday turn out to be weak days for the market our thesis regarding a rally becomes more suspect.

That is why we are keeping equity exposure limited at this time.

We hope you have a great weekend. We are certain that next week will be as interesting as the one just completed. That is the new reality.

The G20 summit is this weekend. Here is picture of the globe. The members of the G20 are in the dark blue. The light blue countries in Europe are represented through the European Union. It is going to be interesting to see if the West, represented by the U.S. and Europe, go hat in hand to the developing countries, looking to them to help bail us out of this mess.



All the best, PK

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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-Ellumination 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