



Stocked Up on Crazy

Here is a great comment from Rev Shark, a trader, who posts regularly on RealMoney.com

“When I contemplate the intraday market action, it makes me think of Jack Nicholson’s line from As Good as It Gets: “Sell crazy someplace else, we’re all stocked up here.”

These markets are as crazy as I have ever seen and I don’t expect that to change anytime soon. The rally today was supposedly driven by a rebalancing of the S&P 500. ANHEUSER BUSCH (BUD) went out of the S&P 500 today because it is being taken over by InBev NV. So managers of funds pegged to the S&P 500 had to be buying today to rebalance their funds to the BUDLESS S&P—or so the wisdom goes.

We used the rally today to add to our short position in the S&P 500, for Hatteras, Mendocino, Halifax and ETF.

We told you a few days ago that the Fresnel model was fully hedged. We now have approximately 20% of the Fresnel accounts money invested in individual stocks, with an average dividend yield in excess of 5%. We have offset that exposure to the market by shorting the S&P 500 to the tune of a 22% weighting. In the days that Fresnel has been fully hedged the S&P 500 has moved up and down more than 4% each day and after all that movement is down. The Fresnel accounts have experienced almost no volatility. Frankly we like it.

So we used this opportunity to add significantly to the hedging program for the other models as well.

At this point we can’t honestly tell you whether the stock market is going to rally in the short term or not. Today it seemed to put in another successful test of recent lows. But did it? The Russell 2000 made a new closing low today. Many U.S. stock indexes are trending ever so slightly lower, even though the most often cited indexes like the S&P 500 and the DJIA have held their ground:

Indexes that have closed lower in November than they did in October include:

- Nasdaq 100
- Nasdaq Composite
- NYSE Composite
- S&P Mid Cap 400
- S&P 100
- Nasdaq Computer Index
- AMEX Major Market Index

So rather than assuming we have had a “successful test” of the October lows, what is really happening is that the markets are leaking around the edges. We have made the case in many of the recent newsletters that we are expecting a year end rally and we are certainly not alone in that expectation. But there is nothing so far in the behavior of the market that would confirm that expectation.

In fact as the markets have been leaking around the edges, so are the models. We continue to see them drift down ever so slightly and ever so slowly. But even at a pace of “slightly and slowly” it adds up day after day. We don’t want that and neither do you.

Therefore until we see some real sustained movement in the markets we are going to keep the models hedged.

Why not just go back to cash? Why hedge? Frankly at these levels we want to buy some stocks. Some companies seem to us as if they are actually priced to go out of business and they aren't going to be doing that. So on days when the market goes down now we want to be adding to positions that we hope we can hang onto. But we can't leave that long exposure to the market unhedged. Every time we try, the accounts get burned.

So the plan is simple. Buy the big dips, and then add to the hedges in equal amounts. We have literally been adding lots to stock positions that represent a half-percent at a time. We are not buying anything in size, but by the time this market does find a bottom we want to own some of the great companies of the world, at fire sale prices.

Why don't we wait for the bottom to do this? Many think we are already there. We are not so sure of that, but if you can tell me where the bottom is—with certainty—I will be glad to wait. In the meantime, buying small lots of high quality assets, paying outsized dividends, while hedged seems like a reasonable course of action to us.

We bought no bonds today.

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
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