



## Trying to be rational in an irrational market

The stock market just gained back almost everything it lost yesterday on the announcement of Timothy Geithner as Obama's new Treasury Secretary. As we entered the fateful last hour of trading the market looked like it was about to melt down again. It was clearly sinking when this announcement turned things around. It rallied hard into the close.

Is this just another head fake for the market or is this a real turn around? That is the \$64 trillion dollar question. Two days ago we told you that the market had clearly broken down and is headed lower, and nothing happened today to change my mind about that. Ultimately I think this market makes it to at least 7000 on the DJIA and 5900 is not out of the question.

But we have also been telling you that the markets want to rally; seasonality is on our side, etc., etc. Let's step back and take a hard look at where we are at.

**“Depending what index you look at, this market is down as much as the 1929 crash at its lows. Think about that for a second. The 1929 crash has always been the anomaly in the data set, the disaster that could never happen in our lifetime ... and here we are, living through it. The market rallied 50% off of the lows in 1929 before going on to a 90% overall decline for the equity markets, which ended in 1932. If we assume we are in a 1929 scenario and use this as a template, the market is currently oversold by those standards.”**

*From Realmoney.com*

Two days ago we told you that 785 on the S&P 500 and 7450 on the DJIA represented levels that were equal to the magnitude of the 1929 crash, and yesterday we got there. We are down approximately 50% from the top, so it should not surprise anyone if we do rally hard, for a while, from here.

Some of our readers may not understand the next paragraph, but we site it as another example of how far down these markets have come.

**“Yesterday the spread between the S&P 500 and the 200-day moving average reached 40%. The spread on the equal-weighted S&P 500 index reached 44%. Numbers like this were only seen in the 1930s; the max reading was 49% in 1931. A 49% spread would put the S&P 500 at 625, by our calculations.”**

*From Realmoney.com*

The point is that we have experienced A LOT of downside in the shortest timeframe in HISTORY. The markets have clearly reached extremes never seen before, when considering the magnitude of the drop and the compressed time frame in which it has happened.

So what could be the catalyst for a sustainable rally? After all, UNTIL THE MOMENT before the announcement of a new Treasury Secretary we were headed further into the abyss.

We believe that President-elect Obama has to announce his entire financial team and his recovery plan. We recognize that there is only one President at a time, and the one we have is clearly not getting it done. Frankly, we don't know if Obama can either, but we know that the markets and the public are willing to give him the benefit of the doubt if he demonstrates initiative, leadership, creativity and clarity.

So President-elect Obama, lay out your plan. It could be good for a sustainable multi-week rally.

We found it very interesting that the market rallied so hard on a Friday afternoon. NO ONE has wanted to own stocks going into the weekend. So this rally is intriguing in that regard. It is clear that lots of people were ready to own stocks this coming Monday morning. They surely took them home tonight!

On the other side of the ledger Citigroup (C) languished all day and finished down 19.96% on the day, despite the huge rally. Rumors abound that C might be carved up as early as this weekend. Goldman Sachs and JP Morgan are both rumored to be possible players in C's future. We shall see.

**Obama could take this market up on Monday and C could take it down. That is the struggle we continue to deal with. If C were to fail, after TARP, that could be a disaster for the markets.**

Here is a chart of the DJIA (\$INDU) that shows the recent breakdown of the DJIA. The chart is by John Murphy at Stockcharts.com. John's interpretation of the breakdown of the past couple of days is pretty simple. On the 19<sup>th</sup> he wrote, **"The Dow declined three of the last four days and closed below 8000 today. With today's decline, broken triangle support becomes resistance around 8500. This triangle breakout remains in play as long as the Dow is below 8500. For downside projections, the height of the triangle is subtracted from the triangle break. With the triangle over 1500 points high, this projects a move to at least 7000.**



We think that over the longer term this market is almost surely going lower. 7000 is a reasonable target for the DJIA. So is 6000. But just as the markets didn't go straight down in 1929, they aren't likely to this time either.

Be ready for more downside, but don't be surprised by an Obama relief rally.

Today the Mendocino model was flat; Halifax was up; Fresnel was up very nicely, including a trade that won't post until tonight; Hatteras was down 0.58%; Pt. Reyes was down 0.1%; ETF was down 0.1%. The New

World popped over 4% today on a trade that won't post until tonight.

Yesterday we told you that we were going to hedge Pt. Reyes. We didn't. Instead we sold all the preferred stocks in it that have been dragging it down. As of tonight it is invested in bonds and cash only. It is an income oriented model after all. So we substantially lowered the volatility without lowering the income.

All the best. Have a great weekend.

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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 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

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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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