K&A Asset Management, LLC
Daily Ellumination Newsletter

Rally On!

The pieces of the puzzle are being put in place for a serious year-end rally in stocks, corporate bonds and gold. All three rallied hard today and we now expect them to keep rallying right through December 31st and possibly right onto Inauguration Day on January 20, 2009. The last piece is specificity on a plan for the Big 3 auto companies.

Our target for December 31, 2008 is 950-975 on the S&P 500 (SPX). We actually expect that it could rally back to 1000 before December 31st and then back off in the last few days of the month. By January 20, 2009 our targets are 1050-1075. The SPX opened today at 871 and closed at 913, a 5% gain on the day.

Corporate bonds moved up nicely today too. For example we saw gains today that ranged from 1% to over 5% in the value of various corporate bonds in the models.

Gold (GLD) keeps getting stronger and was up 2.24% today.

The Fed surprised the markets today by cutting the Fed Funds target rate by approximately .75% (75 basis points) to the lowest level in history. In fact the Fed actually announced that they have a target range of 0% to .25% for the Fed Funds Rate. They also affirmed that they are ready, willing and able to continue being the “lender of last resort” to support the U.S. banking system and the general economy. The markets loved it and never looked back.

The cynics and skeptics who are reading this are probably shaking their heads and asking how risky assets can be rallying in the face of all the bad news that just keeps slamming us each and every day. We can all argue that question until we are “blue in the face”; but we are not really interested in arguing the question. The charts we use to follow the markets are getting stronger for the first time in a very long time. While the major averages have not yet flashed what we call a “K&A proprietary buy signal”, most of the individual stocks owned in the models have. That means that our stocks are tending to lead the market. There are many stocks that are not owned in the models that are also back on “buy” signals and we suspect that the major averages will get similar “buy” signals within the next few days.

Assuming this happens then it will be the first time since May that many of the U.S. stock averages are on actionable buy signals. It is of equal interest to us that the SH (Short S&P 500 ProShares Fund) got a “SELL” signal today on its daily chart. It has been on a “buy” signal since June 2008. Remember the SH goes UP on days the market goes down. The fact that it converted to a “sell” signal today is significant because it will be going DOWN if the market does keep going up.

Given the "sell" signal and given our positive view of the markets over the next few weeks we sold the remaining SH in all the models today. That means that none of the models are hedged in any way after the close today. We are going to let the long exposure run and try to make some good money from this rally.

Here is the warning. IF WE ARE WRONG ABOUT THE RALLY THE PORTFOLIOS WILL LOSE MONEY. WE REPEAT THAT IF YOU DO NOT WANT TO BE EXPOSED TO EQUITIES THAT WE SHOULD MOVE YOUR ACCOUNT TO THE PT. REYES MODEL.

But before you consider that, consider this excerpt from a report by Tony Crescenzi, contributed to RealMoney.com. Tony Crescenzi is the chief bond market strategist at Miller Tabak + Co., LLC, and advises many of the nation's top institutional investors on issues related to the bond market, the economy and other macro-related issues. At the request of the Federal Reserve, Crescenzi is a regular participant in the board's Livingston Survey of economic forecasters.

"The Federal Reserve took dramatic steps today to combat the financial and economic crisis, meeting hopes on two key fronts and putting an exclamation point on its efforts with two others. The two most important features of the Fed's policy statement consistent with my note from earlier today were:

1. **The Fed reinforced the theme of "low for longer." (low interest rates)**
2. **The Fed indicated it would purchase "large quantities of agency debt and mortgage-backed securities," adding that "it stands ready to expand its purchases."**

The two unexpected features were:

1. **The Fed cut the funds rate more than expected, to a range of 0 to 0.25%.**
2. **The Fed said it is "evaluating the potential benefits of purchasing long-term Treasury securities."**

The impact of the Federal Reserve's actions will likely be as follows:

1. **LIBOR will collapse; three-month LIBOR will likely fall below 1% by early January.**
2. **Through the expectations theory on interest rates, the theme of "low for longer" will push interest rates lower across the yield curve. Remember, long-term rates are in essence a series of bets on where short-term rates will be in the future.**
3. **Mortgage rates will fall much further, with the average 30-year fixed-rate mortgage rate likely to move toward 5.0% or lower from 5.5%, currently.**

4. **Investors will move one layer out the risk spectrum. Investment-grade corporate bonds might begin to see increased demand and this will rally corporate equities.**

If you do not believe in any of the four conclusions I just made, remember that you are fighting the Fed's balance sheet, which is impossible for any investor. The negative implications of the Fed's actions are for another day (or year).”

We are in complete agreement with Crezcenci. Today’s rally across stock and bond markets punctuated his remarks. We expect the rally to continue and we believe we have all the models positioned to benefit.

All the best, PK

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Overcoming the Crisis One Day at a Time

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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 polices 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.