



ELLUMINATION

JANUARY 21-22, 2008

HOW DOES IT FEEL TO BE WITHOUT A HOME?

Well we are finally finding out just how bad the subprime crisis really is, and it is BAD. Things are not pretty.

We will be revisiting the title of this newsletter, which is from a famous Bob Dylan song a little later. In the meantime, when I wrote our 2008 annual forecast I promised you that I would follow up with detailed reports on the various asset classes we discussed in that report. Frankly the markets have been so volatile in the first 20 days of January that I haven't had time to complete those reports. So I am offering you an alternative. I am using Martin Luther King day to bring you up to date on all the markets, fast and furious as they may be, so that you can tell what we are doing and thinking-right now.

STOCK MARKET UPDATE

The stock market has taken center stage by plunging 10% to 12% in the U.S., depending on what index you are using in the first 3 weeks of the New Year. Many averages in the U.S. and Europe are now down over 20% from their tops and the plunge continues as I am writing this. The U.S. stock market is closed, but markets in Europe and Asia plunged even lower last night and today. Their tumble has accelerated and it now looks like our markets will take a pounding when they open tomorrow. Our futures market is currently signaling that we will open down approximately 5% from where we closed on Friday and extend the losses for the year. If that happens, it will be consistent with what went on in Asia and Europe while we have been taking the day off from trading.

It is now 6:45 a.m. on Tuesday morning and the FED has intervened with an emergency 75 basis point Fed Funds rate cut. The markets are down substantially but not nearly as bad as it would have been otherwise.

Here are the headlines from Bloomberg yesterday, while our market was closed:

"Stocks from Germany, Hong Kong and India to Brazil tumbled, and U.S. futures posted their steepest drop since 2001 on mounting speculation the world economy is slowing and company defaults will rise.

The MSCI World Index slumped the most since 2002, while Europe's Dow Jones Stoxx 600 Index sank into a bear market as Allianz SE and BNP Paribas SA slid. Hong Kong's Hang Seng Index had its biggest drop in six years after BNP Paribas said Bank of China Ltd. may write down overseas securities by \$4.8 billion because of losses from U.S. subprime mortgages. Citigroup Inc. retreated in Frankfurt.

The MSCI World slipped 3 percent to 1,394.23 at 4:47 p.m. in London, extending its decline from an Oct. 31 record to 17 percent. India's Sensitive Index lost the most since 2004, while Germany's DAX had its biggest loss since 2001. Futures on the Standard & Poor's 500 Index sank 4.5 percent. Trading in the U.S. is closed today for Martin Luther King Day.

“It's the worst I've ever seen,” said Johan Stein, who helps manage the equivalent of about \$14 billion at Nordea Asset Management in Stockholm. “The financial system is in terrible shape, and no one knows where this will end.”

Today's declines follow the worst week for U.S. stocks in five years after President George W. Bush's \$150 billion plan to revive the economy and expectations of interest-rate cuts failed to allay recession concerns.

The risk of European companies defaulting soared to a record today on speculation credit-rating cuts at bond insurers including Ambac Financial Group Inc. may trigger forced asset sales. European Central Bank council member Nout Wellink said economic growth in the region may slow more than policy makers had expected.

“This is a stock-market crisis,” said Alberto Roldan, head of research at Inversegueros SVB in Madrid. “Investors believe that neither a government package nor a huge rate cut is going to help evade a recession in the U.S.”

The Stoxx 600 slid 5.7 percent, extending its drop from a 6 1/2-year high on June 1 to 23 percent. (This was its biggest one day drop since 9-11-2001). A decline of more than 20 percent is the common definition of a bear market. France's CAC 40 lost 6.8 percent. The U.K.'s FTSE 100 sank 5.5 percent, and Germany's DAX slid 7.2 percent.

So one theory that we can clearly forget is that the U.S. might slip into recession, but the rest of the world might avoid it this time. That is clearly not the message that the stock markets are sending.

It was less than eight weeks ago, on December 4, 2007 when I wrote: “It has finally dawned on me that I am struggling because I am writing during a time when conditions are probably more uncertain than at any time I can remember in my investment management career.... The question on my mind now, getting back to what is making this newsletter so tough, is that I am starting to wonder if we are now seeing the last gasps of this super cycle bull market. The honest answer is that I really don't know. If we are not seeing the end of the super cycle, we certainly might be seeing the last convulsive phase of the 3rd leg of this 25 year bull market, which kicked off in 2003....”

“It all really comes down to one simple equation. If this credit and housing crunch gets as big as I now think it might the conditions will be in place to tip the economy into a serious recession and tip the markets into bear market territory. If the credit and housing crunch is well contained, and almost over (as a minority now claim) then other global economic conditions should still be sufficient to lead the markets out of this mess and the bull market should remain intact.”

“Now let me ask you a question. Do you know whether this housing and credit crunch is going to keep getting bigger, more far reaching and more economically destructive, or is it well contained? With that question on the table, which is unanswered in my mind; please read on?”

Seven-plus weeks later we have a lot more answers regarding that question, and all of them indicate that the real problem is HUGE, and the markets are reacting to that condition. If anyone, including us, had any previous doubt about whether or not we are in a stock bear market, all doubt has now been removed.

The good news for K&A clients in our modeled accounts is that the name of that newsletter on December 4, 2007 was “Leaving the Building”. It was the third in a series of newsletters in which I explained why we were essentially vacating the stock market and raising huge amounts of cash in our model portfolios. Thank goodness we did!

If you want to see our entire forecast on stocks for the year all you have to do is go to our website at http://www.kaassets.com/media_ellumination.cfm. You can get the whole thing there. Here is one comment we made about stocks in that forecast issue: “It wouldn’t surprise us to see “rolling capitulation” in various sectors of the market during different parts of 2008. By that we mean that various sectors of the market will put in bottoms as the year progresses. As that happens we plan to be ready at the time to capitalize on the situation.”

Well, at this point it looks like you can forget the “rolling” part, except to say that the global stock market is rolling over in one fell swoop.



The question now becomes, “how far will the stock market fall”? Unfortunately there is no pat answer to that question. There is no reliable study that can tell us how far down the bear market will take us or how long its duration will be. I could quote you all kinds of meaningless numbers, but you can take my word for the fact that there is simply no way we can tell. PLEASE NOTE: ANY TALKING HEAD ON BLOOMBERG, CNBC, OR MAGAZINE, OR NEWSLETTER, THAT THINKS HE OR SHE CAN ACCURATELY FORECAST THESE THINGS IS FULL OF CRAP. RUN AWAY FROM INVESTING WITH ANYONE WHO PRETENDS THEY CAN.

EVERY bear market, and EVERY recession (if we are in one) has been different. For the record K&A does not doubt that we are now in a stock bear market.

Only statistical data, using 20/20 hindsight will tell us if we are in a recession or not. We can use charts to give us some clues about what might happen to the markets however. This one portrays the S&P 500’s cyclical bull market move upward starting in 2003. It has been overlaid with blue lines that show the Fibonacci Retracement lines. They are the lines that give us targets as to how much the market might fall now that we are clearly in a “bear market”.

Here is a short definition of “Fibonacci Retracement, which is a very popular tool among technical traders and is based on the key [numbers](#) identified by mathematician Leonardo Fibonacci in the thirteenth century. However, Fibonacci’s sequence of numbers is not as important as the mathematical relationships, expressed as ratios, between the numbers in the series. In technical analysis, Fibonacci retracement is created by taking two extreme points (usually a major [peak](#) and [trough](#)) on a stock chart and dividing the vertical distance by the key Fibonacci ratios of 23.6%, 38.2%, 50%, 61.8% and 100%. Once these levels are identified, horizontal lines are drawn and used to identify possible [support](#) and [resistance](#) levels. Before we can understand why these ratios were chosen, we need to have a better understanding of the Fibonacci number series. (For a more in-depth discussion of this subject, see [Fibonacci and the Golden Ratio.](#))”

Charting is never 100 percent accurate or reliable as a forecasting tool. Charting can only serve as a guide. These "Fibonacci Retracement" levels are only as reliable as my steady hand in picking the top and bottoms, and drawing the graph.

To cut to the chase the key levels of "support" for the S&P 500 now lay somewhere near the 1267, 1172 and 1077 points shown on this graph. "Support" means the points at which the market ought to find the opportunity to bottom. If nothing else, these support levels should be the areas at which the Bulls and Bears battle out the direction of the market for the short term. The only trouble with "support" is that in bear markets support often fails. So as each level fails, the next one down becomes key new "support". For the S&P 500 we will be closely watching the ranges of 1267-1276, 1177-1184 and 1080-1091 as "support" areas.

Every other stock market average in the world has similar "support" areas that can be identified using "Fibonacci Retracement". We monitor about 100 of them.

In our 2008 Forecast we did say that: **"Forecasting a trend in the U.S stock market for 2008 is probably a fool's errand. The market has weakening technical characteristics as we close 2007, even through the last trading day of the year."**

Weak you say! How about a 10-15 percent global stock market retrenchment in the first 21 days of a new year? That has NEVER happened before. Not even in 1929. It does not bode well for the near term.

The good news is that our model portfolios are down only 1.5 to 2.5 percent in 2008, compared to 12-15 percent for the broad global stock market (through this morning). The bond index that we most often quote in comparison to our models is up 1.68 percent year to date (as of yesterday). That is the Lehman Brothers Aggregate Bond Index.

Our models remain mostly in cash, with the exception of very small equity positions (mostly energy related) and positions in Gold (GLD). They are all EXTREMELY WELL POSITIONED to buy stocks at rock bottom prices sometime in the future.

No one rings a bell at the tops of markets, and no one rings a bell at the bottom. You only know you have been to the top after it happens. You only know you have seen the bottom when you are looking back at it from above. We didn't call the top exactly, but our actions clearly got our models out of any real danger in fine fashion.

At this point we are not anxious to buy stocks. Patience may be the best "watchword" we can use right now. But we are almost giddy about the fact that our models are sitting on so much cash. There are going to be opportunities ahead to buy stocks at prices we probably could not have imagined just a few short months or weeks ago.

GOLD MARKET UPDATE

In the 2008 forecast we said: **Gold will rise in price in 2008, continuing the multi-year trend that will ultimately culminate in gold prices rising to levels that we can't yet imagine. If you are a new reader of our newsletters don't jump to the conclusion we are "gold bugs". We aren't. We have simply been right about this trend for four years. We expect to be right again in 2008.**

We are as confident as ever about this call. Gold took the opposite direction of stocks in the first couple weeks of trading in 2008. It popped over \$900, and actually satisfied our short term target for it.

It has since pulled back and over the next few weeks the GLD (Street tracks Gold Trust) should actually pull back in price to the \$81.50-\$85.00 range. This is roughly equivalent to \$815 to \$850 per ounce of gold.



If it does we will be adding more shares to all the models that currently own GLD. We will also be adding it to some accounts we manage that are not modeled accounts. **When 2008 is done we expect gold to be one of the best performing assets of the year.**

You don't have to be a technician to interpret this chart. The current path of gold prices is up and that trend has not been interrupted by all the current turmoil in global stock markets or real estate markets. We will remain bullish on gold until we do see and interruption in the trend.

That is the end of our comments on gold, and that figures. When things are going up the comments always seem to be short and sweet. It is only when they are going down that a lengthy explanation seems to be needed.

CURRENCY MARKET UPDATE

K&A has never really participated fully in the currency markets. For a few years we farmed out the management of currencies through a hedge fund manager that I was a founder of and partner in. It was called Predictive Financial Technologies (PFT). We hired an outside manager to run the fund on a day to day basis. It was actually quite successful for the investors but one of the partners got too greedy and another got too eccentric (for my taste) and we dissolved the fund and the management company. Since then we have only dabbled in currencies, other than gold.

Yes gold is a currency and over the next several years it will continue to prove itself to be the currency of choice.

We said the following things regarding currencies in our 2008 Forecast:

"The U.S. dollar will spend much of the year in a trading range. Much fuss will be made about the potential for a dollar rally. Don't be fooled by minor moves up in the dollar should they occur. The long term trend of the dollar is DOWN."

"The Chinese Yuan will appreciate significantly vs. the U.S. dollar in 2008."

"The currency surprise of the year may be that at least 5 or 6 Muslim nations will confirm their intent to join together in the use of a common currency. They will announce that they hope to do so by 2010, but we predict that it will take them to 2012 to really make it happen."

It will be generically called the “dinar” and it may be backed by gold; or tied to a basket of currencies and commodities that includes gold. This new currency will contribute to the long term demise of the dollar’s value against a growing field of competitors including the Yuan, Euro, Yen and Dinar.”

At this point we could add that the Yen has been the strongest paper currency of the past few months. We think it will maintain its strength against the dollar. **We may add the Yen to our model portfolios at any time.**

We do not have a strong opinion one way or the other about the short term direction of the Euro vs. the U.S. dollar. If Europe starts to weaken quicker than we thought and the European Central Bank (ECB) starts to lower interest rates, there could be a race to the bottom of the pile between the Euro and the Dollar.

Own GOLD!

Oil and GAS MARKET UPDATE

Our forecast for 2008 was that “Oil prices will be equal to or higher at the end of 2008 than they are now. They are quite likely to pull back significantly in the first half of 2008 due to short term conditions that may be impacting the market at that time. It would not surprise us to see \$80-\$85 pricing. Don’t be fooled by any pull back in oil prices that may happen in 2008. Any pull back will be quite temporary and relatively short lived. Over the next several years the price of oil is heading UPWARD, and like gold it will get to levels that are currently unimaginable....

“Natural gas prices have been volatile within a trading range throughout 2007. 2008 should be no different. Natural gas prices won’t start to rise significantly until the world finally understands we are running out of oil.”

Oil prices are pulling back, just as we expected. So far natural gas prices are still locked in a trading range. We also expected that. But oil prices are pulling back faster than we expected. That is correlated to the collapse in the stock markets. “Market mavens” are already forecasting lower demand for oil during 2008 tied to “recessionary demand models”.

Let’s cut right to the chase on this one. Demand may indeed erode and that could bring prices down to our \$80-\$85 downside target. But erosion of demand, or even the thought that demand might erode, will keep OPEC on the sidelines, and there will be no talk of increased production. Increased production was being counted on by some to bring prices down.

We are on record many times that we don’t actually think that OPEC has significant spare production. Others disagree with us. But we recently found out that the chief executive officer of Total (TOT) is evidently at least thinking along at similar lines. Total is the most valuable publicly traded company in the Euro zone, and one of the largest of the Western oil companies.

According to “**The Economist**” their CEO, Christophe De Margerie went on record late last year by saying that *“the world would never be able to increase its output of oil from the current level of 85 million barrels per day to 100 million barrels per day, let alone the 120 million that energy analysts predict will be needed by 2030.”*

Mr. De Margerie is careful to point out that he is “not referring to peak oil (a phrase we have often used) in a geological sense. His definition of peak oil is “when supply cannot meet demand”. “**The Economist**” goes on to report that, *“He believes that the fuel that the world needs to keep its cars*

and factories running may well be out there, somewhere. It is just getting harder and harder to extract, for technical as well as political reasons.”



On January 31, 2008 K&A will be participating in a webcast sponsored by the Oil and Gas Journal. This webcast is based on the Annual Forecast & Review Special Report appearing this year in the January 21st issue of Oil & Gas Journal. The Forecast & Review projects oil and gas demand worldwide and in the US for the New Year. The US forecast analyzes demand by petroleum product (such as gasoline, diesel, jet fuel, and so forth). The Forecast & Review includes forecasts for US and Canadian drilling activity. In addition to the 2008 forecast, the webcast will include past predictions compared with actual performance and industry trends for the previous four years.

If we learn any new information that may alter our view of the oil and gas industry, or pricing structures, we will pass it on to you.



Our current view is that the rapid drop in oil prices toward the \$80-\$85 range will be a false signal to the market regarding the long term trend of oil prices, but it has already started to drag oil company stock prices down. Check out the chart of the Amex Oil Index (top chart) which is a price-weighted index designed to measure the performance of the oil industry through changes in the prices of a cross section of widely-held corporations involved in the exploration, production, and development of petroleum. Look closely at the blue arrow and you can see that the long term upward trend in oil stocks was violated on Friday, January 18th.

On the other hand, the long term upward trend in oil prices has not yet been violated. In fact it is not even close to being threatened. But there is enough uncertainty in the market place right now that it is understandable that the oil stocks are breaking down, well in advance of the

commodity itself. Below is a chart of the price of oil. It would be easy to reach the conclusion from looking at the chart that oil prices are ready for a breather. The 50-day moving average is now down around \$75.90.

That is approximately \$4.00 below our 2008 Forecast minimum price target. If the global slowdown that is clearly emerging accelerates it would certainly be reasonable to assume that oil prices might slip to at least that level.

If that happens and prices hold there, that would be an incredibly bullish indicator for the upward long term trend in prices. If prices hold above the \$80-\$85 level that would be an even more bullish indicator and solid verification of our long term thesis relative to "peak oil".



If prices spike above the upper blue line defining the current price channel, watch out and get ready to bar the door. There is no telling how high prices are going then.

The natural gas price picture is entirely different. (chart at left) Natural gas, which is plentiful (for now) has traded in a price range for years, with the exception of a big spike down and a big spike up. Here is what that looks like on a chart for this decade.

We think this battle of bulls and bears will be resolved once and for all to the upside once the world figures out that there is no more cheap oil.

Unlike the oil stocks, natural gas stocks have not yet broken their upward trend that has been in place since 2003. That could change any day, given the current condition of global stock

markets. But so far the trend is still intact. The XNG (AMEX Natural Gas Index) is comprised of a basket of natural gas company stocks, just as the XO1 (AMEX Oil Index) is comprised of a basket of oil company stocks. For now they hold their upward trend.

INTEREST RATE UPDATE

OK. Global stock markets are collapsing. The subprime problem is clearly bigger than anyone knew. You tell me which way interest rates are going. **Answer:** U.S. rates are going down. Europe's rates may go down.

We repeat that the U.S. Federal Reserve Bank cut rates today!

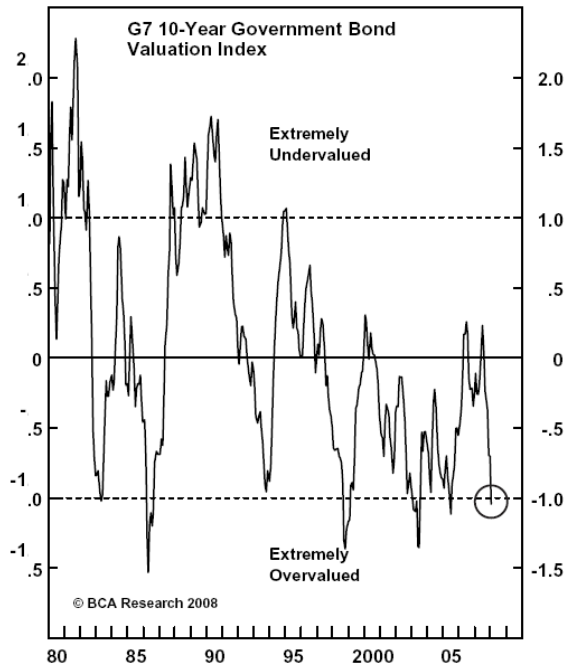
Here is our 2008 Forecast regarding interest rates:

“Short term U.S. interest rates will continue to decline. The Fed Funds rate may get as low as 3%. It will surely drop below 4%. Long term U.S. rates will remain contained and not rise significantly. But the “yield curve” will steepen thanks to significantly lower short term rates. Inflation, if measured the same way as prior to 1997, would be running at 7 to 9 percent per annum, despite the housing price collapse. But the annual rate of inflation will not get worse in 2008. Higher real inflation than we are experiencing now is not realistic in 2008. The Fed can relax. As our friends at BCA say, “There is no value in any of the G-7 bond markets” and we have a tough time imagining that we will be buying bonds any time soon (except to keep the Hatteras model in balance).”



One short month later we would not make many revisions in that forecast. For the past month bonds, as measured by the Lehman Aggregate Bond Index, have outperformed our models. We do not expect that relationship to last. Bond valuations are at multi decade extremes and they are very overvalued (chart courtesy of Bank Credit Analyst)

Bond Valuations Stretched



While extremes in valuation can persist for sometime, they only have so far to stretch. We do not see good value in bonds and will not be aggressively pursuing bond positions for the models.

REAL ESTATE UPDATE

Here is the forecast we delivered in the 2008 report:

“Residential real estate prices will be lower across the U.S. at the end of 2008 than they are now. Few markets, if any will be immune. Pity the poor fool that thinks this crisis will be over by summer of 2008. Unfortunately, I have met a few. Commercial real estate prices will soften across much of the country in 2008, but the magnitude of the decline will not be as

much as in residential real estate prices. The real estate downturn is very real and will last for several years. The U.S. housing stock is overbuilt and supply simply exceeds demand. It will take several years to be sold off. The truth is we have seen this before. Real estate developers just can't help themselves.”

The ink wasn't dry on the paper and the report had been in email ether for no more than a day when I heard back from a slug of Realtors that I was too pessimistic about real estate. Sorry I wasn't. We have been very patient and very plodding in coming to a conclusion about the depth and breadth of this crisis. We have not wanted to get ahead of it, forecast it, or make more of it that it really turns out to be. Frankly we manage money for a lot of people that have huge vested interests in the real estate markets, as owners, brokers, developers and the like. God bless us for going to cash in their financial assets, because they have not been able to do that with their real property.

This crisis is HUGE and will take YEARS to work off. Period, end of story. It is clearly a crisis that is going global. Don't even think about sending me an email in rebuttal. It will be put in spam. Instead, do a reality check on yourself if you still think this is a minor problem. If you are a professional in the real estate business and are still in denial you are not doing yourself or your partners or clients any favors. That is my sermon for the day. Do with it what you like.

OTHER THOUGHTS

When I first started drafting this letter it had a very different beginning, which is now inserted here. Markets are turning down around the world really quickly. This is an amazing market to be a participant in. Speaking as a student of the markets, I can tell you that we are breaking new ground. That is always exciting, especially when you know that in the end you are on the right side of the trade.

Problems are bigger than most people projected (including us) and markets are unraveling faster than many are prepared for. People are hurting. I can't tell you how glad I am that they are not our clientele. We are ready for this bear market. Our nearly all cash position can be perfected in a day. We can short. We can stay in cash. We can buy stocks when they have absolutely CAVED IN!

It is fun to be in this position as the new bear market unfolds.

One of the things I said in the 2008 forecast was: "2008 will be another year in which the gap between the life styles of the "haves" and "have nots" continues to get wider. If you are in the "investor class" and can afford to own stocks and liquid tradable investments then 2008 is likely to be a good year for you. If you are a "borrower" making less than \$100K per year, and who managed to "trick up" your credit score during the past few years to buy two to five houses that are now in foreclosure, you are in the deep doo. Your plans for prosperity are over.

I have every intention of being more prosperous when this crisis is over than I was when it began, and the only way I can do that is through the investment of my own money, and that of our clients. I know that my colleagues at K&A feel the same way. So Lee and I have every intention to work our tails off for K&A clients to experience the same potential for continued prosperity.

But not everyone will be so fortunate.

It is getting really ugly out there, really fast. Let me give you a very personal example. In April of 2006, Meghan and I closed on the sale of the house we then lived in here in Napa. The couple that bought the house from us immediately put it on the market for 33% more than they paid us. It was their intent to "flip it". FYI, they paid us approximately 47% more than we had paid for it in 2003. Just to make the story more interesting, we later found out that they had purchased another house at the same time in Sonoma County and were trying to "flip" that one too. I can cut to the chase in this story very quickly. We have recently been informed that they vacated our former house on Christmas day in 2007. They literally sneaked out and gave the keys back to one of the banks that financed them (we are told they had three mortgages on the house). The house is now in foreclosure and evidently on the market for 15% less than they paid us. **Badda-Boom.**

We just got back from a week in the Lake Tahoe area where we were staying in our condo and skiing at Heavenly. The slopes at Heavenly were filled with members of the "Florida Ski Council". Yes, that is for real, and 600 of them traveled from all over Florida to spend a week skiing at various ski areas around Lake Tahoe. I tell you about this by way of introducing the idea that we spoke to a couple dozen of them during the week, and it was always about two topics. Number 1 was their love for skiing and all the travel they did related to skiing. Number 2 was about the real estate debacle that is going on in Florida. It didn't matter where they were from in Florida—prices have collapsed and none of them expected them to come back any time soon. **Badda-Bing.**

Yesterday I got a call from a dear friend of mine. His 27 year old daughter is going through a divorce. She owns a home in a state that is not California. She and her soon to be ex-husband bought the home a few years back for \$100,000. It "appreciated" in value and last year they refinanced it and "pulled out" \$80,000. Their mortgage is now \$180,000. In the past few months, since their divorce proceeding got underway, the house price collapsed. It is now on the market for \$165,000 (\$15,000 less than they owe). They have had no offers and her EX wants to quit-claim the house to her and stick her with the debt! (Now there is an honorable man for you.)

The bottom line is that the proverbial "shit has hit the fan". If anyone has had any doubt, and we at K&A certainly did, we are now in a bear market in real estate, and a bear market in stocks, and very probably a recession.

POSTSCRIPT

Once upon a time you dressed so fine
You threw the bums a dime in your prime, didn't you?

People'd call, say, "Beware doll, you're bound to fall"
You thought they were all kiddin' you
You used to laugh about
Everybody that was hangin' out
Now you don't talk so loud
Now you don't seem so proud
About having to be scrounging for your next meal.

How does it feel
How does it feel
To be without a home
Like a complete unknown
Like a rolling stone?

Lyrics from “Like a Rolling Stone”, Bob Dylan, 1965

I was 17 years old and working part time while attending high school when I first heard “Like a Rolling Stone”. I was in a stock room of a discount department store, where I worked, when I heard this song on the radio for the very first time. Bob Dylan had already been around for some time and I knew of him, but I was very young at the time and it was these lyrics that struck me and made me a fan for life.

The lyrics go on and in total they are a simple story about not getting too uppity or haughty when you are riding high, because the next stop on the ladder of life may be much lower and humbling. Coming from very humble origins I never forgot these lyrics, or this life lesson. Even as I have grown older and more and more successful I have always been loathe to spend even a minute being content with my successes, and I sure as heck never gloat about them. I think more about making sure the success never goes away. Now that I am responsible for so much of other people's money I think constantly about that for them (you) too. It is truly a vigil.

It is now 43 years since I first hear Bob Dylan sing this song. He and I are both a lot older. But it is also a year in which it is now extremely clear that a lot more people than I ever expected are going to get a chance to answer the question, “How does it feel to be without a home?”

I have a feeling that a lot more of our fellow Americans are going to get an answer that question. We have to find ways to do more than just make money from their misfortune.

Respectfully and Reflectively,

Paul Krsek
For K&A Asset Management, LLC

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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-llumination 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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