

February is Mercifully Short

March 2, 2009

Given how the month turned out it is probably good that February had only 28 days. All markets including stocks, bonds, and gold were in retreat toward the end of the month. Now we can reset the clock and see how things go in March.

Here are a few dubious achievements that are of record as of February 28, 2009.

- It was the worst February for the U.S. stock market since 1933.
- The S&P 500 (our benchmark) fell over 10% for the month and is down over 18% in 2009. That is the worst 2 month start for the market EVER.
- Michael Santoli of Barron's reported in his weekly column, "Some very long-term landmarks are in sight. Right below Dow 7000, not 2% down from here, is a point at which half of the entire rise from the 1932 Depression low to the ultimate October 2007 high will have gone away...losing half of 75 years worth of upside in 16 months is quite something."
- The legendary Warren Buffett released Berkshire Hathaway's annual report on February 28th, for the 2008 year. It was the worst year in Berkshire's history.
- Buffett writes in his shareholder letter that: "the economy will be in shambles throughout 2009 -- and, for that matter, probably well beyond -- but that conclusion does not tell us whether the stock market will rise or fall."
- Berkshire Hathaway stock has fallen 46.5% since September 19, 2008. CONSIDER THAT WHEN THINKING ABOUT HOW YOUR PORTFOLIO WITH 5T WEALTH HAS BEEN DOING.
- The U.S. stock market is at 12 year lows and technical indicators point to more downside on the way.
- Gold put in a "double top" at 1003 and has faded since.
- January and February were record months for the issuance of new corporate bonds.
- New supply of Treasury bonds are at or near record pace. Yields are rising and prices dropping.
- The U.S. aggregate bond benchmark that we follow is down 1.23% for the year. Our benchmark international bond index is down 5.16% for the year.
- GDP fell at a 6.2% seasonally adjusted annualized pace in the final three months of 2008, revised from the initial estimate of a 3.8% drop, the Commerce Department reported. It was the worst decline in GDP since a 6.4% decrease in the first quarter of 1982, and the 4th worst quarter since World War II.
- Citigroup now has more ownership by the government (36%) than by common private shareholders (26%), a dubious achievement indeed.
- The number of job hunters receiving continuing unemployment benefits from the states topped 5.1 million, a record. In the same week a year ago, the continuing claims total was 2.8 million.
- The Labor Department also noted that an additional 1.4 million workers were getting federal unemployment benefits under an extended benefits program approved last year as part of an economic stimulus plan. That means about 6.5 million workers were receiving jobless benefits.
- President Obama announced a huge budget, that if passed will feature the BIGGEST SPENDING DEFICIT IN THE HISTORY OF THE UNITED STATES.

OK, that is probably enough for one short month! Let's move on.

Welcome to more NPR listeners

I was interviewed by Madeleine Brand of NPR for the 3rd time on February 27th. We were deluged with phone calls and emails following the interview and we welcome our NPR listeners.

If you haven't heard the interview it is available online at <http://www.npr.org/templates/story/story.php?storyId=101248350>

The first two interviews are there too. It makes for some EXTREMELY interesting listening given all that has happened over the past 16 months.

How was February for 5T clients?

Some models actually ended the month with a little "Ca Ching"; others did not. But before anyone draws a breath because of that statement let me get specific. I am going to provide you brief descriptions of what happened in the models during February. All the performance numbers I am about to quote are simple annual change for the model account for each model group.

1. **Pt. Reyes** was up for the month and is up for the year. That should surprise no one. It is all bonds and cash and has felt no impact of the movements of the stock market or gold. The model is currently more than 90% bonds and less than 10% cash. We will be investing more of the cash into bonds during March. We will reduce cash to less than 5%.
2. **The New World** was up for the month and is just below the zero line for the year to date. (down 0.17%) It was up for the year right through February 26th and faded to negative on the 27th. It had three stock holdings and no bond holdings through the month. We sold two of the stocks during February and as of right now it has only one position. That is Smart Balance (SMBL). We very much like SMBL even in this terrible bear market. We also day trade regularly in The New World. Day trades are just that-all positions are closed out each day.
3. **Fresnel** was up for the month and is down 0.84% for the year to date. Fresnel experiences day trading, owns some S&P 500 calls, owns gold, bonds and cash. The day trading and interest from the bonds helped Fresnel achieve a positive return for the month. The S&P 500 calls held it underwater for the year. The calls are a very tiny position that may get sold on any early rally in March. If not they will expire later in the month with almost no more downside from here.
4. **Hatteras** was up to flat for the month of February and is down 1.33% for the year. What does "up to flat mean"? Some accounts in this model group were up on the month. Some were literally flat. Differences seem to be attributable to cash flows. Hatteras owns a small position in Annaly Capital (NLY) which was a positive that turned into a drag on the model during the last several days of the month. Most of the rest of the negative performance can be traced to the few stocks that Hatteras owned as we entered 2008. Those stocks are gone. Other than the small position in NLY (dividend yield of 14.4%), Hatteras currently owns no equities. Hatteras has experienced a few day trades. Hatteras has a large corporate bond position. Older accounts in the model also have a significant muni bond position. It owns gold and cash.
5. **Mendocino** was down 9 basis points for the month (0.09%) and is down 1.23% for the year. Like Hatteras, most of the negative performance can be traced to the few equity positions that were in the model at the beginning of 2009. Mendocino owns no equities at this time. It owns gold, corporate bonds and cash.
6. **Halifax** was down 47 basis points for the month (0.47%) and is down 1.15% for the year. Like Hatteras and Mendocino most of the negative performance can be traced to equity positions that were in the model at the beginning of 2009. Halifax does own Pfizer (PFE) and it has been a drag on the model. Pfizer is scheduled to merge with Wyeth. That is a combination we liked very much when the deal was announced. We still believe it will provide significant strength and upside to PFE, but the stock is getting killed right along with the market. Halifax owns corporate bonds, gold and cash.

We like how we have all these models positioned and are extremely confident about their ability to show positive returns for all of 2009. I will come back and explain that more in a minute.

Key West is struggling a bit. It was down 52 basis points for the month (0.52%) and is down over 2% for the year to date. Its goal is to emulate the performance of Mendocino without using individual equities. The problem is that it has not kept up with Mendocino because it does not have the bond exposure that Mendocino has. Therefore we are in the process of adding individual bonds to this model to give it an "assist" and boost its performance. It is significantly underweight bonds, when compared to the other models. We are working on correcting that. We added some bonds in February and will add more over the next several weeks.

Now back to why we like all the models for 2009, starting with the bond market

We still love the short term corporate bond market for 2009. Longer term readers and clients should understand that Hatteras, Mendocino, Halifax, Fresnel and Pt. Reyes all own five year "ladders" in corporate bonds. The difference, from model to model, is the size of the allocation to the bond market.

We were fortunate to buy most of the bonds well before January 1, 2009. We bought many of them at significant discounts to face value. During January and into the middle of February almost all of the bonds traded up in value. There was a point in mid February when all of the models, except Key West, were up significantly for the month because of the rising bond prices. Halifax, Mendocino and Fresnel were approaching up for the year to date. But bond prices softened into the end of the month and pulled down the values of our models ever so slightly. Why? Huge new supplies of bonds came to market.

February was one of the biggest months in history for issuance of new bonds, both corporate and government. EVERYONE is raising new capital. Interest rates tended to move up and bond prices tended to move down in response to the deluge of supply.

Before anyone starts to worry about the models please understand that our bonds held up extremely well. It is just that the froth that may have built up by mid month came off a bit. By the end of the month we weren't quite feeling the "ca ching" that we were feeling in mid month.

Is the trend down at the end of the month a sign of more downside to come? We don't think so. Keep in mind that we are heavily invested in shorter term bonds. We did that intentionally. They hold their value better when yields are adjusting upward. The shorter the bond the less likely it is to move much in price.

When they mature they will return to "par value" and we will be cashing them in to participate in the bond market that is at hand at the time. If interest rates are higher when our first bonds start to mature (a few months from now) we will be able to reinvest that money in the newer higher yielding bonds. However, we are not expecting interest rates to rise significantly in the next few months. In fact, if the Fed intervenes aggressively and steps up its buying of longer term Treasury bonds you could see rates drop again in the short term.

Using shorter term corporate bonds as the "backbone" of the models is a theme that is VERY INTACT. It gives us a significant yield premium over Treasuries and the safety of being a creditor with a ladder of maturity dates to rely on. We like it!

Will gold continue to glitter?

Gold reached for its old high above \$1000 during February and immediately backed off as you can see. Gold bears are interpreting this "double top" negatively. They are expecting gold to retreat from here. Gold bulls see this as just the first assault on old resistance that will surely be surmounted. 5T is neither bullish nor bearish regarding gold. We have it in the models that are eligible to own it for one reason. It is the only asset that we know of that is on a 5T proprietary buy signal on daily, weekly and monthly charts.

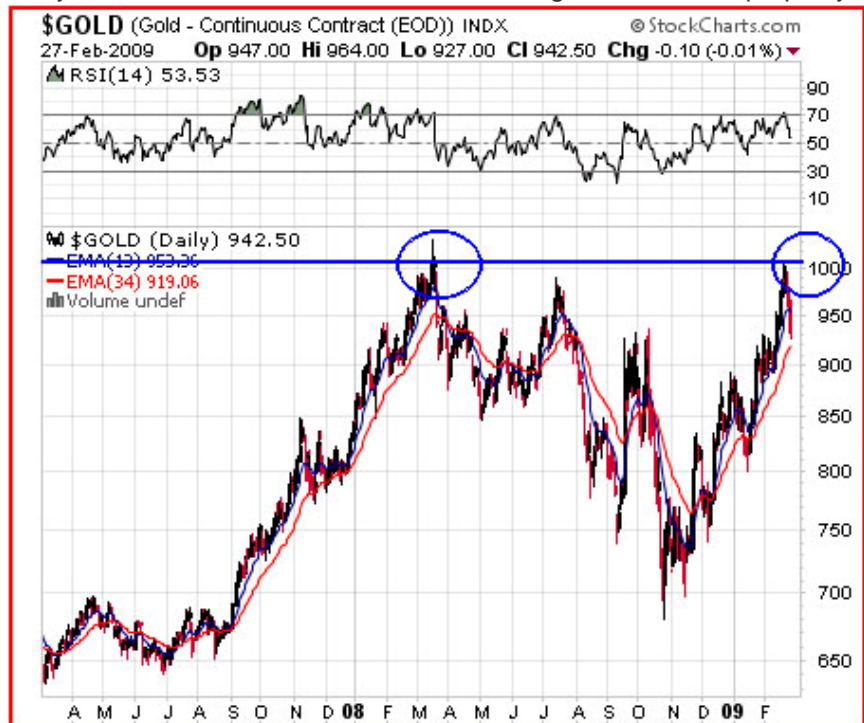
It is however on a sell signal on its daily MACD. We will continue to hold it as long as it holds our proprietary buy signal.

We frankly admit to a tactical error in February. We added to gold, using the GLD. When it did not stay above \$1000 it would have been a good idea to sell the additional allocation. We hesitated. After GLD got a short term MACD sell signal we did reduce the allocation back to 5% in all the models eligible to hold it. That is where it remains today. We will not add to GLD again until it breaks through the old highs. If it can make a sustained break through our targets of \$1200 to \$1400 come into play.

The energy patch

We have told you several times that we continue to monitor prices of oil and natural gas. They are both clearly nearer their lows and they are near their highs, but the bottom could easily be 10 to 15 percent lower than today's prices.

Even as prices of these commodities drift toward what we expect to be the low end of their ranges we are not likely to buy the stocks of oil and gas producers. We will be more inclined to enter the market by buying either the U.S. Oil Fund (USO) and/or the U.S. Natural Gas Fund (UNG).



Here is a 20 year chart of the USO. Who could have imagined this collapse a year ago? We will be looking for some signs of stability before jumping in.

The UNG is an exchange traded fund that tracks the price of natural gas. It has been in existence for only a little over 2 years, but its recent collapse is just as steep as the USO's collapse. Winter is almost over and we are expecting natural gas prices to break below \$4 by spring. We will be closely monitoring price movements with an eye toward adding both the USO and the UNG to

certain models in March or April. We will keep you posted.

We are not necessarily trying to catch a bottom here. We would actually like to see some signs of price stability for both oil and gas before adding either of them. Based on all our research we believe the collapse in price for both of these commodities is nearing an end.

The stock market

What the heck can I say? As I am writing this the DJIA has broken below 7000. The S&P 500 is poised to break below 700. It has been an unbelievable collapse that we have chronicled for you all the way down. We have gratefully avoided most of the damage.

We have seen the talking heads on CNBC and Bloomberg "calling the bottom" all the way down. They have ALL been wrong and they have cost people billions by holding out false hope, based on nothing really. Interestingly in the past couple of sessions the "bottom callers" have disappeared-as they should.

Long time readers of Ellumination know that I often get off on a rant or two. Today's rant is against the "bottom callers". I watched these same knuckleheads on the same networks during the "dot.com" bust. They cost people billions back then, and they have done it again. When is the public finally going to learn that the likes of Art Hogan, Michael Farr, Ned Reilly and Vince Farrell, to name a few, KNOW NOTHING?! How do these guys hang onto their jobs? It just amazes me. Hogan has got to be the dumbest of the bunch. I can't ever remember seeing this man be right on a major market call. Hey, it is just a personal opinion and I can't be sued for my opinions.

Doug Kass, on the other hand, is one of the smartest guys I know. He has made a huge reputation as a short seller and runs several hedge funds that profit from the market going down. He recently announced that he has started a "long only" fund to own stocks.

He is quoted in the latest issue of Business Week: **"I think we're at the beginning of the end of the bear market," he says. "The path still looks icy, but I can see in the not-too-far distance the bartender standing in sunshine and mixing piña coladas."**

Doug has clearly been early on this call and the best we can tell he is underwater on his initial long positions. But I am deeply sympathetic with his point of view and his reasons for doing this. There is NO DOUBT that many individual stocks have gotten DIRT, DIRT, CHEAP. Some look so low it would be hard to imagine that a snake could slither under them. The only problem is that they just keep going lower.

We will need to see prices stabilize before we can reenter the market in any significant way. So far we are not seeing too many signs of stability. Large cap tech may be the only exception. With the markets making new lows stocks like Amazon (AMZN), EMC, Apple (AAPL), IBM, and Google (GOOG) to name a few, are holding well above their lows.

If large cap tech can maintain some stability this may be the first area of the market that you see us reenter in size.

I am writing this while looking out the window of our condo and watching the snow fall in the Lake Tahoe area. The path is still icy. Later this spring my wife and I will be going back to Fiji, one of our favorite places on the planet. I would not have thought that by spring we might be able to see Doug Kass' bartender standing in the sunshine and mixing pina coladas. But now that this market collapse has

accelerated once again, that may be possible. Maybe that drink might have a steely "tech" taste.

We shall see.

All the best, PK



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5T WEALTH MANAGEMENT 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 5T WEALTH MANAGEMENT, 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 5T WEALTH MANAGEMENT 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 5T WEALTH MANAGEMENT as a portfolio manager. Paul Krsek and Lee O'Dwyer frequently discuss investment ideas, model portfolio strategies and the investment policies of 5T WEALTH MANAGEMENT. 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 5T WEALTH MANAGEMENT.

From time to time 5T WEALTH MANAGEMENT receives requests from clients to purchase securities that are not included in the model portfolio to which they are assigned. Effective May 24, 2006, 5T WEALTH MANAGEMENT has encouraged clients to hold such securities in a separate account for the client. Because 5T WEALTH MANAGEMENT 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.

5T WEALTH MANAGEMENT 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 5T WEALTH MANAGEMENT.

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.

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The portfolio managers at 5T WEALTH MANAGEMENT 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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