



## ELLUMINATION

November 16, 2007

### QUICKENING THE PACE TOWARD THE EXIT

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We have taken some rather drastic action during the past week. We have now sold off almost all U.S. stock positions, and many foreign stock positions, in all six models. The selling hit a crescendo today. It is options expiration day and we are taking advantage of the rise in the markets to exit the last U.S. equities except for oil, defense and gold related positions.

Hatteras will end the week with about a 50% allocation to cash, plus another 10% invested in relatively short term municipal bonds.

Mendocino, Halifax and Bonavista are now over 60% cash. Fresnel will end today at more like 80% cash and The New World (TNW) is 97% cash.

All the models, except TNW, still have sizeable allocations to oil and gold related assets; they still hold at least a 5% allocation to China, a couple of percent to Russia, and not much else.

Fresnel and TNW also hold some small option positions that are essentially calls on the NASDAQ 100 and certain technology related stocks. These options are “place holders” in the markets and are small bets that the major U.S. averages might still rise significantly before the end of the year. If they do the options positions will pay off with significantly higher returns to the model accounts than we would achieve from holding the equities. On the other hand, if the markets head south from here, the potential for losses are much lower than if we still owned the actual stocks.

All this selling is really about one thing; we want to preserve the gains that we have in the models. It is just that simple. In our last newsletter we were bragging about the great year we have had, and we were particularly pleased with the month of October. Well, as of two days ago, all the gains from October had evaporated. If you think that is bad, the S&P 500 has given up most of its gains for the year. We are not at all interested in joining the market in that dubious achievement if we can prevent it.

Here is the bottom line—all of our models hold commanding leads over the markets in year-to-date performance. All of our models have absolute returns that would be respectable for an entire year in any market environment. We'd like to preserve that even if the markets go negative for the year. On the other hand, our mathematical projections tell us that the overall market can not “outperform” our models for 2007 under any foreseeable circumstances. So it is simply time to take some chips off the table and walk away a winner.

Let me now tell you that we are neither bullish nor bearish in reference to the U.S. or global stock markets. We really don't know if the markets will finish the year up or down from where they stand today. It should also be noted that is a change in attitude for us. For the past several months I have been finishing most of the newsletters with a remark about the fact that we expect the markets to “finish the year higher than they are today”. We simply don't know if that is true any longer.

We do know that volatility is HUGE these days; BIGGER than BIG. We recently endured a week in which three stocks in our models dropped over 33%. We commonly see daily swings of 7 to 10% in the values of individual stocks. A stock can be down 10% on Monday and back up 10%

on Tuesday, on no news. That kind of volatility is often seen at market tops. It is also seen in markets in which there is extreme uncertainty, and huge leverage.

Whether we are at or near a market top is not certain. But the markets are reflecting the extreme uncertainty and ambiguity of the times.

The markets are also subject to HUGE leverage these days and that leverage is clearly adding to the volatility. Where has the leverage come from? Think hedge funds and Yen carry trade. Almost all hedge funds employ leverage in their investing. That simply means that they use the equity they raise from their partners AND borrowed money to make their investments. Leverage raises the risk.

If you own shares of stock that are paid for with your own hard earned cash and the stock goes down all you can lose is your hard earned cash. If you own stocks paid for with borrowed money, and they go down—guess what? You may lose your money and still owe your lender. That is not a very appealing prospect but it is a very real one. It is also the reason you see so much trading in the markets these days. People operating on borrowed money simply can't afford to lose it, so when things turn down, the borrowers seem to head for the exits all at once.

That is why we are quickening the pace of our exit from the markets. We do NOT want to be caught in a liquidity squeeze if a climatic sell off materializes.

The Yen carry trade? I am not going to spend a lot of time on it. Suffice it to say that no one knows how big it really is but it has added huge leverage and uncertainty to the markets. I have seen estimates that range from \$200 billion to \$2 Trillion. Whatever the real number, it is all money that has been borrowed out of Japan and reinvested around the world. It is all money that must be paid back at some point. We don't want to be in the markets on the day it is all called home!

So we sit here at 12:07 p.m. on Friday, November 16, 2007, all but out of the stock market for the first time in my career. We have never had so much cash in the models during K&A's entire history. We are really down to two basic investments—gold and oil; or things that should trade in tandem with gold and oil.

Is this a permanent retirement from stocks? The answer to that should be obvious. It is a resounding NO. We may actually be trading opportunistically as early as Monday. But between now and the end of 2007 any equity position we buy will be considered a “rental” for the purpose of enhancing the returns of the models; that is, unless we see a major sell off that could put a more solid floor under this market.

We will obviously be keeping you posted.

Have a great weekend.

Paul Krsek  
For K&A Asset Management, LLC

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The investment portfolio models or management services mentioned in ELLUMINATION may or may not be available in some states, and they may not be suitable for all types of investors.

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-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.**

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Sincerely,

Paul Krsek  
Updated: August 13, 2007