



It is looking more like Option #1

The U.S. stock markets are set to open this morning at “limit down”. That means that the futures have sold off to their limit and can’t go lower until the market actually opens at 6:30 a.m. (Pacific Time). Japan is down more 10% over night. That is a reasonable indication of what could happen here today.

On October 16th we sent you our newsletter called “**How will we get back into the market?**” In that letter I outlined three optional scenarios for getting back into the market. We described our **Option #1** as **(most probable and least problematic and least risky)**.

Option #1 was really a pretty simple concept. It was based on the assumption that the markets had not yet reached the bottom and that we would see cascade selling similar to what took place in 1929, within a very short period of time. That time is

here.

As of this morning our models have limited exposure to equities. Here is a table that shows you the exposure for each model.

Model	Equity Exposure	Likely Loss	
Hatteras	6.9%	0.69%	If the market drops 10% today and our stocks drop in line then our models will probably experience the “likely loss” indicated here. You all know those numbers can’t be exact. They are estimates to illustrate that relative to what is about to happen we are in a pretty comfortable position.
Mendocino	6.7%	0.67%	
Fresnel	6.8%	0.68%	
Halifax	6.9%	0.69%	
The New World	2.5%	0.25%	
ETF	0.0%	0%	The next question is “How low will these markets go?” Over the past several newsletters we have tried to give you some
Pt. Reyes	0.0%	0%	
Mutual Fund Accounts	0.0%	0%	

targets, based on comparisons to 1929 and 1972-74. They are the only other times in history that we have to compare with.

If all this were to play out like 1972-74 the targets are 8000 on the DJIA and 850 on the S&P 500 (SPX). I get the distinct impression that the 1972-74 targets will be broken today.

If all this were to play out similarly to 1929 the downside target estimates were 7450 on the DJIA and 784 on the SPX.

On October 22nd we sent you the newsletter called “**NOW THAT WAS UGLY**” We offered two potential targets on the SPX if cascade selling started. Those targets were based on “Fibonacci retracement” patterns of the entire bull market of 1982-2007. The first target was 830 on the SPX. If that didn’t hold then 657 becomes possible.

It is now quite clear that we are in a massively destructive sell off that is happening at a pace that is unprecedented in history. This sell off has been quicker than the pace in 1929 and also quicker than the 1972-74 debacle. There has clearly never been anything like it in terms of sheer speed.

There has probably never been anything like it in terms of sheer terror too. Think of it this way. I can ski down 2000 feet on a BLUE run at Heavenly or Northstar and never feel a moment of fear. I can do the same thing on a BLACK DOUBLE DIAMOND and scare myself half to death several times on the way

down. Same 2000 feet, just two different ways of getting there. A day like today is going to surface lots of terror, anxiety, and sheer disgust.

The very good news is that we are in an excellent position to ride this out.

Do I wish we had a chance to get short again before this morning? You bet. I would love to be making money today. But the speed of all of this simply did not allow that.

Until this morning our other optional scenarios were just as much in play as #1. Those scenarios assumed the prospective year end rally would start from the lows of October 10. Option #2 actually assumes that the intraday lows of October 10th HOLD. Those number are 7773 on the DJIA and 839 on the SPX. It is still possible that turns out to be the case. We might test those limits successfully today.

In any event I wanted to get this report to you before the open.

Art Cashin, my favorite floor trader (for UBS) just made his morning appearance on CNBC and gave the gladiator salute (in Latin). In English it is, "THOSE OF US WHO ARE ABOUT TO DIE SALUTE YOU".

K&A clients and models will not die today. This is a small speed bump for us on the journey to the greatest buying opportunity of the century.

I'll be back to you tonight.

Take care, PK

Paul Krsek
MANAGING MEMBER & CHIEF INVESTMENT OFFICER
K&A Asset Management, LLC
702 Trancas Street, Suite 200
Napa, California 94558

(707) 603-2672 Office

(707) 486-7333 Cell

(707) 224-2521 Fax

paul@kaassets.com

www.kaassets.com

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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.

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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

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