



K&A Asset Management, LLC

Daily Illumination Newsletter

Why the Friday Rally? Is the market poised for more upside? We think so and we are feeling a little more bullish.

(This newsletter was drafted on Saturday, the 6th of December and is being released on Monday the 8th of December).

Did Friday's rally surprise you? After, all the day started with the worst announcement related to jobs in years. The 500,000-plus job loss was the highest since 602,000 were lost in December 1974. But what you may not know is that it was in September and October of 1974 that the U.S. stock market put in a bottom. It is often when things are looking SO BLEAK YOU CAN'T STAND IT that markets do bottom, even if temporarily. Here is a chart of that market bottom in 1974.

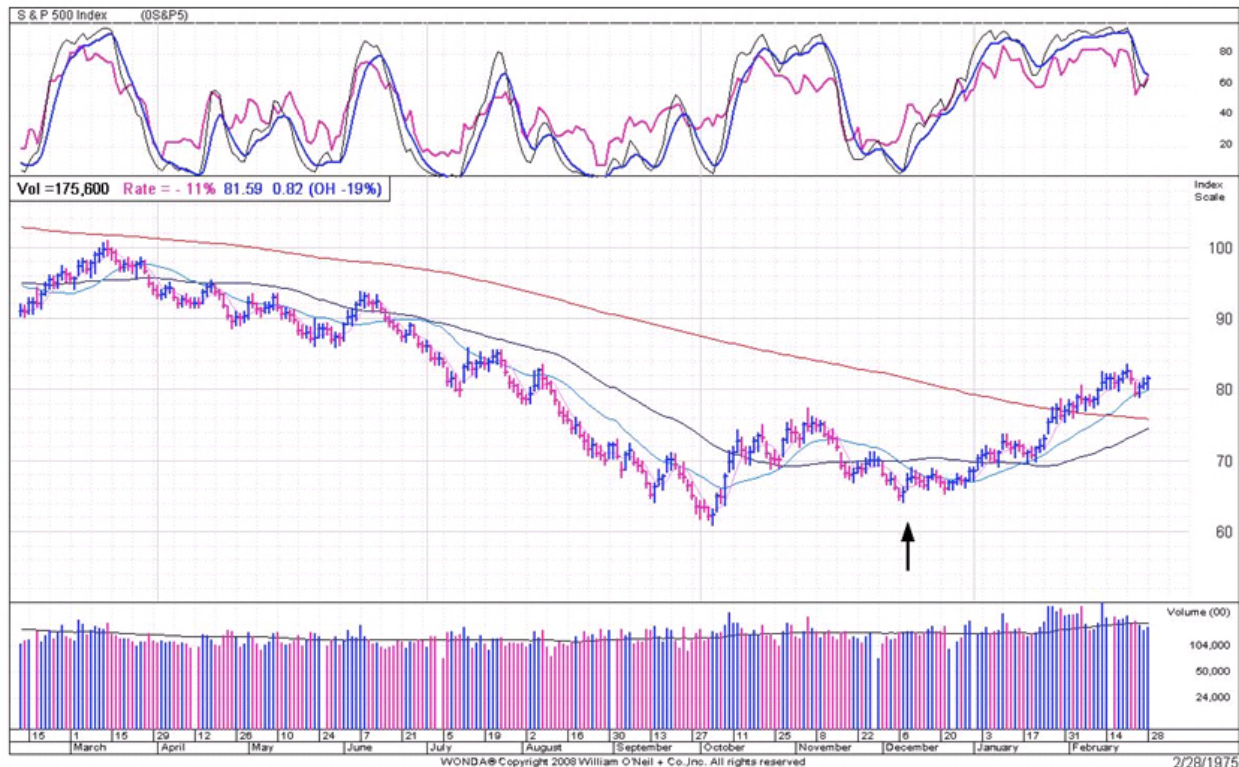


Chart from *The Edge*, RealMoney.com

We have been making the case, off and on, that both U.S. and global stock markets have already discounted a lot of bad news. We have also said that seasonality is now favoring the market. We still think both are true. By making such a statement we are not "calling the bottom". It is quite reasonable to assume that all major stock averages will test their recent lows again before this bear market is over. It is also quite possible that the next test of those lows will fail and that we will go lower. But we think that is a possibility for later in Q1 or Q2 of 2009 if it is to happen at all. For what little remains of 2008 we are very convinced that the lows are in for this year.

It would not surprise us a bit to see the market pull back a little during Monday or Tuesday. In fact it could take a break for more than a few days based on December "seasonality" and while the auto company bailout is still uncertain. More importantly we are waiting for further clarity on the Fed's new mortgage programs. The Fed understands that all the programs it has put in place so far do little for the "average American household" (call it the AAH) . If this crisis is going to end it will do so because the AAH's of the world feel confident enough in their jobs and in their homes that they start participating in the economy at full strength again.

We believe that over the next couple of weeks we are going to be seeing the Fed step up their activity aimed at supporting the AAH's. We also believe the markets will react positively to the Fed's actions. After a pause that refreshes (if there is a pause), and while we wait out the auto company bailout and new Fed action aimed at lowering the cost of mortgages we think the odds favor a run up to about 965- 1000 on the S&P 500 and about 9650-10000 on the DJIA. That is another 15-17% up from Friday's closing prices.



Table from SentimenTrader.com

The table above shows that over the past 30 years, there have been three distinct phases during December - positive during the first week, negative during the next couple, then a bigger positive spurt at the end.

Jason Goepfert, of SentimenTrader.com, is quick to remind us, **"As always, these are tendencies only. Even at its best, I consider seasonality to be a tertiary indicator that is either a gentle breeze blowing with us or against us...especially now during these unprecedented times when there are so many larger factors at work."**

We clearly understand that seasonality is a "tertiary indicator", but at year end it is always hard to ignore. Wall Street likes to finish years on an upbeat note. This year, of all years, we suspect that "the Street" will be gunning a rally into the end.

We just finished the first trading week of the month and we all saw how it ended. If this December acts like the "average" December of the past we have already entered into the weakest part of the month. Monday will be the equivalent of day 6 on this table. It is an interesting coincidence to us that we are now in that period at the same time we are waiting out Congress and the Fed to make their next moves. The only reason that the markets may not pull back immediately is that more Fed intervention is already highly anticipated. That may push the markets higher before they pull back.

Below is a picture of the S&P 500 at the close Friday. You can clearly see the descending channel that the market has been in since its decline accelerated in September. By closing at 876 on Friday the S&P 500 made it first feeble attempt to break back above the upper limit of the channel. If you look closely you can just barely see the last bar on the chart poking ever so slightly above the descending line that marks

the upper limit of the channel. It is not much to get excited about - truly. In fact no major U.S. average moved above the top of their descending channels last week. They are ALL bumping right up against the upper edge of the channel.



If the channel remains intact, then the next move for the market is back down. Possibilities for the market in the near term include the following:

- The market starts back down as if to move to the bottom of the channel and does so. If that happens we are making new lows and that is a VERY BEARISH INDICATOR
- The market starts back down and "holds support" at the old low near the lower blue horizontal line and that is a NEUTRAL INDICATOR.
- The market starts back down but holds above 800 on the S&P 500 and 8000 on the DJIA then reverses and moves back and that is a SLIGHTLY BULLISH INDICATOR
- The market starts back down and holds above 850 on the S&P 500 then moves back UP to break out of the current channel on the UPSIDE and that is a VERY BULLISH INDICATOR

- The market doesn't retreat at all, and instead breaks out to the upside immediately (Monday) and that is an EXTREMELY BULLISH INDICATOR

We don't know which of these scenarios will actually play out but we put the odds of new lows in 2008 as close to zero as is statistically probable without being certain. We believe the odds are overwhelming that the S&P 500 and other major averages are setting up to break out of their channels to the upside. We will be paying very close attention to the levels at which the markets find support over the next 8 to 10 days. We will be looking for whether or not they can confirm a breakout and move up.

If the S&P 500 does break above its current channel it is likely that all other averages will be doing the same thing. Our response will be to sell all off the S&P 500 index short that is in the models, at a loss, and let the long stock positions rise in value in an attempt to take advantage of the year-end rally. We are also likely to add to the long positions. **The gains on the longs will far offset the loss on the shorts in this scenario. This is the set up we have been anticipating going into year end.**

If the market retreats back to the horizontal support line on the chart we estimate that the models will lose 1 to 1.75% of their current value - assuming that we keep the current short position constant on the way down, and do not reduce the long positions. That would be happening while the market is retreating approximately 16%.

We would likely add to the long positions if we saw the old lows holding.

THIS DOES NOT APPLY TO PT. REYES AS WE WILL BE KEEPING IT ENTIRELY IN BONDS FOR THE REMAINDER OF 2008 AND INTO THE FIRST QUARTER OF 2009.

SO IF YOU ARE CONCERNED AND THEREFORE DO NOT WANT TO BE IN A MODEL THAT HAS ANY EXPOSURE TO THE STOCK MARKET PLEASE LET US KNOW. WE CAN MOVE YOUR ACCOUNT TO PT. REYES.

NOW FOR SOME CLARIFICATION AND AMPLIFICATION ON THINGS WE SAY IN THE NEWSLETTERS.

These newsletters are being written as frequently as they are and in as much detail as they are to keep our clients as informed as we possibly can. We have had overwhelmingly positive feedback on the letters. We know that they are being forwarded to friends, relatives, other money managers and brokers all across the country. And we are glad about that. We are glad that we are providing an honest and constructive alternative to much of the blabber and garbage that is out there.

But we want to offer a caution about the letters to our readers. ALL of the models are quite fluid and we often make changes in them on a daily basis. Therefore what you read today about the construct of a model is likely to be different tomorrow, even if ever so slightly. So you can't take comments about the construct of the models as "gospel". I repeat, tomorrow they may be different.

The best way for you to keep up is to know what model or models you are in and to check your statements, online or in print, to see what you own on any given day - or at the end of a month. If you have questions on the assets in your account(s), or the construct of a model, PLEASE DO NOT HESITATE TO CALL ME (707-603-2672) OR LEE (707-603-2673).

At the present time all the models, except Pt. Reyes, have exposure to equities, even if in very small amounts. That will not change for the remainder of 2008.

We loved Friday's close

We loved Friday's close. The market made an interesting stand at key technical levels. It shook off very bad news and moved up. It has not shown signs of being able to do that in this long decline. Friday may have set us up for a key, even if short term, turning point.

All the best, PK

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Overcoming the Crisis One Day at a Time



Disclosure and Disclaimer - Updated last on August 13, 2007 by Paul Krsek:

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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.

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.