



K E R N S

CAPITAL MANAGEMENT, INC.

Kerns Capital Management Market Report

January 2, 2009

Thank God 2008 is over!

The Dow Industrials had their biggest fall in 77 years. Only 1931 was worse. The S&P 500 had its worst fall since 1937. The NASDAQ had its worst year ever! The media jumped on board and almost gleefully reported any "Bad News", which of course made things even worse.

Well, I am sorry to report for those who enjoy being depressed that I see a light at the end of the tunnel and our client's performance last year was substantially better than the stock markets of any of the major economies.

The market's worst quarter of 2008 was the fourth quarter. We missed almost all of the market's downdraft. This letter will talk about what I consider to be investment opportunities and how we plan to take advantage of them while keeping a sharp eye on risk.

One thing is certain, any Buy-and-Hold investor who did not learn their lesson after the 2000-2002 decline should have certainly learned it in the last year - if they have any money left.



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Misery Loves Company or The Rich Get Poorer

I thought that the following excerpt from Investor's Business Daily might shed light on the fact that even the Rich had trouble finding a place to hide last year.

"Consider the declining fortunes of some of these immune-from-disaster elites:

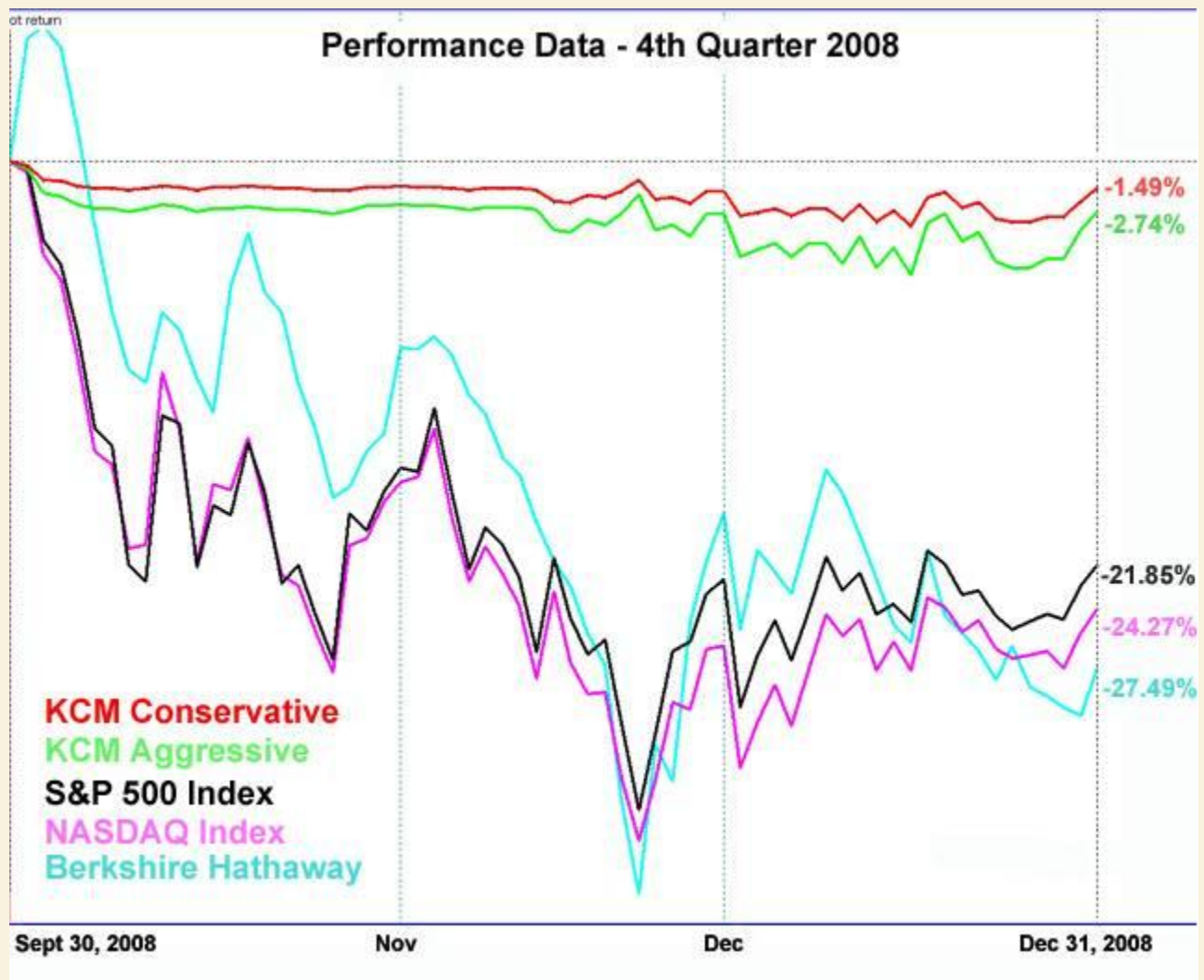
- Anil and Mukesh Ambani of Reliance Capital, Indian brothers, lost a combined \$60.7 billion. Anil dropped \$32.5 billion - perhaps making him, worldwide, the biggest loser in today's downturn.
- Lakshmi Mittal of Mittal Steel - whose \$50 billion net worth last year made him the richest man in India and the fourth richest man in the world - has lost \$30.5 billion, sending his net worth plummeting down to about \$20 billion.
- Sumner Redstone is CEO of National Amusements, one of the largest entertainment

conglomerates, which owns Viacom, CBS and all their subsidiaries, among others. His net worth, so far, has declined by more than 80%. Three months ago, Forbes placed his net worth at more than \$5 billion. Facing a margin call (lenders wanting their money back) Redstone unloaded, fire-sale-like, hundreds of millions to pay it off.

- Sergey Brin and Larry Page, the Google guys are down \$12.1 billion this year - nearly half of their net worth.
- Sheldon Adelson, a Las Vegas casino and real estate mogul, was called the third richest man in the country by Forbes magazine in 2006. He has lost \$30 billion, perhaps the largest loss on paper in the history of the United States - and this includes John D. Rockefeller's adjusted-for-inflation Great Depression losses.
- Even Warren Buffett is down \$13.6 billion on paper, and thus forced to scrape by with only \$48 billion.

No one is passing the hat for any of these people. They're still rich. But this shows that even smart guy's money can go south - Antarctica-like south."

Most of the damage occurred in the latter part of the year. For comparison, I have included a chart of our Conservative and Aggressive models compared to Warren Buffett's Berkshire Hathaway, the S&P 500, and the NASDAQ for the fourth quarter of 2008.



If you know people who did not fare as well as this, please tell them about us and us about them. All of the above returns were after all management fees and any expenses.

While I feel badly that we were not up for the year, I feel good that our style of Active Risk-Management protected clients from the majority of the market's damage.

I need to point out that our models in 401(k) plans that were not in "Self-Directed Brokerage Accounts" actually did even better; they were in Money Market for the entire quarter and actually made a little money. In the following section I will discuss the great opportunities that have been created by the decline the market has experienced.

Bad News Brings Opportunity

Because there has been so much bad news, the entire market became very oversold. As I have said many times, when the market goes down, three out of four stocks go down. Even the good ones. We have been able to pick up some very under-priced companies at bargain basement prices.

Remember what makes a market bottom. There is nothing but bad news with people finally capitulating or throwing in the towel. "Just give me what I've got left and I don't care how much I've lost." Of course it doesn't sound like a good time to buy because you don't know if the market is going to go down more.

The market stops falling when good companies with growing earnings are priced so low that knowledgeable investors who see the values that are being created start to accumulate them. We have actually purchased some stocks whose prices are only four times the earnings of the companies. That means that they have earnings equal to 25% of their price - a 25% return - and the earnings are projected to grow. With this type of stocks, even if the earnings fell by 50%, we would still have a better investment than a money market fund yielding 3%.

Early in December, a rally started. You can see it on the chart in the prior section. It was very volatile and at the time was hard to invest into. Now that it is behind us, it is obvious. The last three days including today (January 2nd) have been strong up days. Today the major indexes were all up around 3% for the day.

This month-old rally is probably just a Bear market rally. We may yet see a new low as the year progresses. On the other hand, the low may be behind us and 2009 could turn out to give us a market surprise to the upside. I do not know which this is, but we are taking advantage of it to grow our client's portfolios as long as it lasts. The good thing about our active style is that while we try to hold our stocks for the long-term, we can actively trade our hedge to manage risk.

There have been a number of technical indicators appear over the last few weeks that pointed to a higher stock market - which - combined with the bargain basement prices of some very good stocks, compelled us to increase our market exposure.

We wish all of you a Happy and Profitable New Year.

Lane Kerns