



K E R N S

CAPITAL MANAGEMENT, INC.

Kerns Capital Management Market Report

March 2, 2009

Is the Glass half full or half empty?

The Dow finished February with a 12 percent decline, down more than 50% since October of 2007. According to the Wall Street Journal, it was the worst first two months of any year in its 119 year history. Not much fun for the Buy-and-Hold investor.

We did much better! (See Chart Below)

Many investors and 401(k) participants (not our clients) look at their accounts and see them as half empty. We, however, see things differently.

Our stated goals are to miss three-fourths of the major declines and catch three-fourths of the major advances. We have accomplished that for a number of years now. If you do the mathematics on that type of performance, it produces remarkable results.

So why do we see the glass as half full? I will talk about that below and part of my commentary will discuss some of Warren Buffett's annual report to Berkshire Hathaway shareholders. Very interesting and entertaining reading.



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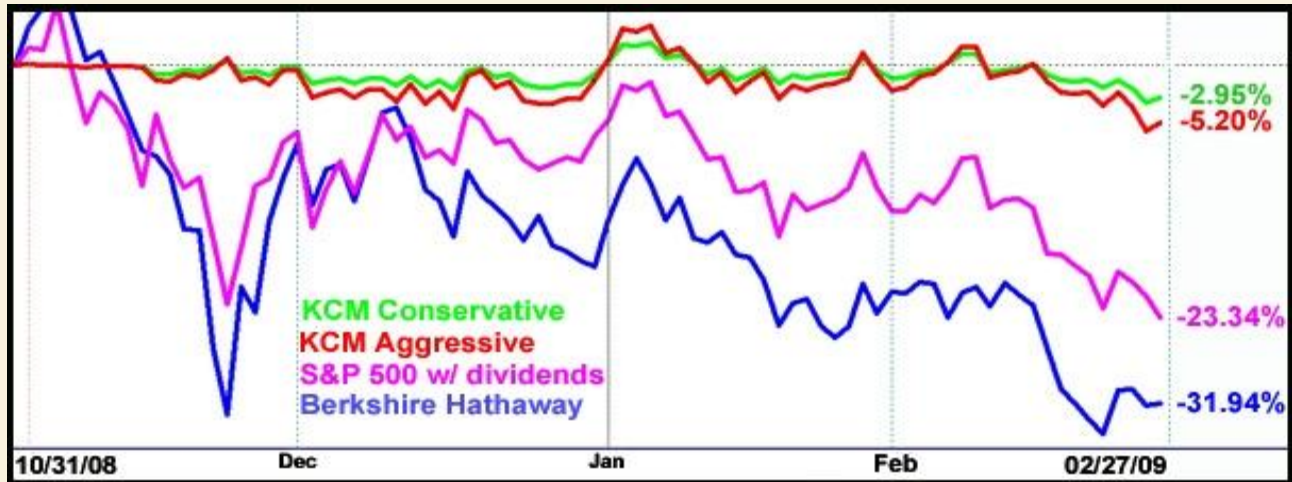
KCM Performance Versus the Market

We have been very fortunate in that we seldom lose a client. Three of our first four clients are still with us. They have stayed with us through good times and not so good times in the market. The market is currently in one of those not so good times, but that will change - and we intend to go into the next bull market with most of our capital intact.

Unfortunately, many investors will miss the opportunities that develop because they become discouraged and just tune out. Let's compare how our models have done over the last four months to the general stock market. Avoiding big losses during Bear markets is key to long term gains.

I have also added Berkshire Hathaway to the chart because I want to discuss some things from Warren's annual letter that I think have great validity.

Kerns Capital Management Vs. The S&P 500 (with dividends reinvested) and Berkshire Hathaway



The green and red bars represent the performance of our Conservative and Aggressive models over the four months ending last Friday night. During that period we were down only 2.95% for Conservative and 5.20% for Aggressive. The S&P 500 and Berkshire Hathaway were down 23.34% and 31.94% respectively.

Please note that on the last day of the chart, both our models were up and the S&P 500 was down significantly - 2.36% to be exact. This happened as a result of our strategy of picking stocks with much better earnings potential than the stock market as a whole and hedging out market risk in major down periods.

We were down a bit for the week primarily because we were blindsided by our new President's aggressive attack on some sectors of the stock market we hold.

Some of the best performing sectors of the market this year have been healthcare, pharmaceutical and biotech. They are generally considered to be very defensive and good to hold in bear markets - at least until the government takes a "shock and awe" (to coin a military phrase) approach to attacking them. Last week healthcare was attacked, today it was the coal industry. Fortunately, we only hold one coal producer in our portfolios.

I would like to point out that the above numbers only apply to non-401(k) and Personal Choice Retirement accounts. Most of our 401(k) models were primarily in cash for this period, with only a few days exposure to the market. The 401(k) models do not always track non-401(k) models due to trading rules unique to 401(k) plans.

The Glass is Half Full!

In Warren Buffett's annual letter to shareholders, he says, and I paraphrase "... I feel like a mosquito in a nudist camp. Juicy targets are everywhere." He was of course referring to the great bargain prices at which companies can be purchased. America is on sale!

Another quote, "When investing, pessimism is your friend and euphoria is the enemy." When everyone is running from the market - it becomes a buyer's market. His annual letter to shareholders reported performance in a manner different from what we would normally expect. Instead of reporting decline in stock price which was a decline of 32%, he reported book value which only declined 9.6%. This is important.

What these two different approaches are demonstrating is what I have been talking about in our investment process. Let me explain. If the true value of the company only went down by 9.6% but it is selling at a discount of 32%, isn't it a better buy than it was a year ago?

We are finding this true across almost all industry groups. We want to own these bargains before they start their next bull market run, not buy them after they have had their initial gain - which is always a more rapid advance in the early stages of a new Bull market than it is later in the Bull market.

As always, the problem is the bloody decline that precedes the start of a new Bull. That we are dealing with through our risk management process. To use last Friday as an example, our stocks did decline, but they declined about one percent less than the market. In addition, our stock position was almost fully hedged and our hedge made a profit that exceeded the decline of the sticks. Today, our gain on the hedge in our mutual fund exceeded \$1.1 million dollars - for the day!

When will the decline in the market stop? I do not know. The market is already down 50% which exceeds the decline of the average Bear market. Most Bear markets are turning into Bull markets at this point so we could be near a bottom.

What I do know is that our hedging is working and we intend to go into the next Bull market with most of our capital intact.

So why is the glass half full? Because, the purchase price of good companies has declined by much more than their value and we are avoiding large losses in our portfolios. When the market does bottom and start a protracted rally, as it eventually will, we do not want to start from the bottom of a deep hole.

One last quote but this time from the man who taught Warren Buffett. This comes from Benjamin Graham. "The habit of relating what is paid to what is offered is an invaluable trait in investing."

Other Thoughts

Last week Marty and I spent two days at a meeting of investment advisors whom I admire and respect. I felt honored that they ask me to make a presentation. As always though, much more is learned by listening than by talking.

I did hear a rumor that due to tough economic times and the new administration's new budget which will call for some cost cutting - "The light at the end of the tunnel will be turned off." Just joking! This country has endured much harder times than we are experiencing now and has pulled through stronger than ever. We will do it this time also.

Lane Kerns

Website

We take pride in providing a high level of personal service. We continually work to earn your trust by investing in tools and resources that strengthen our relationship with you. I'm pleased to announce our latest service - our firm's new Web site. We hope you like it. Please give us your feedback.

Now you can visit www.KernsCapital.com to view your Schwab Account, as well as your 401(k) Account if our sister company M.L. Kerns & Associates administers your company's 401(k) plan.

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