



Market Report

May 1, 2008

Dear Friends & Clients,

We're evolving!

Many of you that have known us for years know that we started out almost 5 decades ago as primarily a retirement plan consulting and servicing company. In the 80s, with the introduction of 401(k), we started an investment business to provide a full range of advisory services to our retirement plan clients.

In the 90s, we added private money management with the formation of MLK Capital Management, Inc. And this summer we'll be starting a mutual fund, the KCM Macro Trends Fund, a proprietary fund that will initially be available to only our clients on Schwab's mutual fund platform. We'll also be unveiling a new website with account management capabilities dedicated to Kerns Capital Management in the near future.

New Brand

As part of our growth we recently hired a consultant to help us create some new branding pieces, including the new logo you see above, new brochure, and website (mentioned above), to help grow our business and make it even easier to do business with us.

Our Name Has Changed

Why the name change? As you may recall, my son Marty Kerns joined the firm as a partner last year after practicing law for the better part of 15 years. Marty also has a finance degree which gives him a strong background in all aspects of our business. With his addition, and as part of our branding efforts and business continuity plan, we think the use of our common last name makes good sense.

We're Going Green

Our semi-monthly newsletter distribution list has grown into the thousands. In the past we have sent the newsletter electronically and by hard copy, with many receiving it by both means. In an effort to do our part to protect the environment, we are going to discontinue the mailing of hard copy letters except to those readers who notify us that they do not have email access or that they prefer hard copy. If you'd like to continue receiving hard copy, please let us know by giving us a call or sending an email to KCM@KernsCapital.com with your preference.

As always, this letter will be published periodically with our views on the market, investing and things that seem important to us at the time. Remember, all of this is filtered through over 40 years of experience including a fair amount of both "Good Judgment" and "Bad Judgement". To quote William Hazlitt - "Prosperity is a great teacher; adversity a greater."

Please feel free to share this with anyone you think might be interested.

Lane Kerns
President & Chief Investment Officer

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I don't think most people realize what we have been through over the last few months. We experienced the near failure of the US and world banking systems! We dodged a bullet thanks to the actions of Central Banks worldwide. Our conservative stance would have protected us from major losses had that happened.

Lawrence Meyer, former member of the Federal Reserve Board described it on CNBC last week as "The Most Dramatic Financial Shock of the Post War Period." He was talking about WWII.

In our last letter, I talked about the high level of fear in the financial markets and how that was slowing bank lending worldwide. We talked about the fact that the rate at which banks are willing to lend to each other is an important measure of that fear.

I said "If banks are financially sound, LIBOR is very low and close to the rate of interest paid on US government Treasury funds. The difference between this rate and LIBOR in normal times will be 12 to 25 bases points or .12% to .25%."

Last week I included a chart indicating the the measure of that fear or the "TED Spread" was 164 points and had been as high as 221 basis points. As of today that rate has fallen to 139 points. While still above normal, this is a very good trend and indicates the fear level in the credit markets is subsiding.

This when combined with another trend that has started over the last couple of weeks is extremely important to the health of the stock markets! The other trend is the rise in yields on Treasury Bonds.

Treasury bond yields have been extremely low. Some would say abnormally low since yields usually rise when inflation creeps into the economy. How can yields be low when inflation is rising? The answer is that when there is so much fear in the financial markets that money flows out of stocks in search of safety, it flows into Treasury securities.

The fact that it is now flowing out of Treasury securities is very positive for the stock market!

\$3.5 Trillion Dollars Waiting To Be Invested

That's a lot of zeros. There is currently \$35 Trillion dollars in Money Market funds, Treasury bills and cash setting on the sidelines waiting to be invested! Much of this money has flowed out of the stock market over the last few months as market risk and volatility grew.

Since the stock markets are like everything else economic, they are governed by supply and demand. When fear of market losses rose over the last year, money flowed out of the stock market. When the of money flowed out, the market, over the last year, fell!

Now the "Fear Level" is starting to fall, money is starting to flow back into stocks and the market has risen over the last month! As a matter of fact, April was its best month in years.

How Can the Market Rise With The Economy so Bad?

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This is a question that has puzzled us. With Housing prices falling an average of 12.7% over the last year, gasoline prices and food prices climbing to all-time highs, what can be good about that?

The answer became more clear this week when the GDP report came out. It showed that in spite of falling housing and rising prices, the economy (while slowing) still does not qualify as being in a recession. GDP in the first quarter of this year rose .6%, the same as last quarter!

The technical definition of a recession is two consecutive quarters of negative Gross Domestic Product(GDP). GDP is the total of all goods and services produced in the country.

When we dug deeper into the .6% rise, what we found was part of the answer to why the market is starting to rise. When broken down into its parts, the .6% consists of everything consumed domestically as well as everything produced in the US and exported out of the US.

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The fact is that while most things that are consumed domestically declined (not a good thing) exports (because of the declining dollar) rose more than enough to offset the domestic decline!

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The important thing about that fact is the explanation as to why our unemployment rate has not climbed more than it has. (A very good thing.) It also goes a long way toward explaining why the stock market has not declined as much as expected. If American businesses are producing goods and services - whether they are consumed inside or outside the US - they are making profits.

Currencies	USD Exchg Rate as of 2/29/08	YTD% Change	1-year % Change	5-year % Change
Australian Dollar	1.07	-6.1	-15.7	-34.8
Chinese Renminbi	7.11	-2.6	-8.1	-14.1
Hong Kong Dollar	7.78	-0.3	-0.4	-0.3
Indian Rupee	40.02	1.5	-9.6	-16.0
Indonesian Rupiah	9,104	-3.1	-0.3	2.5
Japanese Yen	103.7	-7.2	-12.5	-12.2
South Korean Won	942.3	0.7	-0.1	-21.1
Malaysian Ringgit	3.20	-3.3	-8.6	-15.8
Philippine Peso	40.45	-1.9	-16.7	-25.8
Taiwan Dollar	30.93	-4.6	-6.2	-11.0
Thai Baht	31.26	4.9	-7.8	-26.9
Singapore Dollar	1.40	-2.8	-8.5	-19.5

Source: Bloomberg

*Negative numbers indicate U.S. dollar decline

Corporate Profits - a Deeper Look - a Bullish Setup!

There are two things that raise the price of stocks and therefore your stock investments:

1. The first is Profits. If the company you are invested in has rising profits, they can pay you a bigger dividend and that makes their stock more valuable, and if their Price to Earnings ratio stays the same, the Price rises.
2. The second is an increase in the Price to Earnings Ratio. Some people call this multiple expansion. When there is a lot of money flowing into the stock market with only a limited number of stocks to invest in, the increasing supply of investment money chasing a limited supply of stocks forces the amount investors have to pay to get a stock (and its earnings) higher.

Let's deal with Profits first. A look at the accompanying chart - *The Good and the Banks*- shows that taken as a whole, S&P 500 earnings have declined 14.1%. This is a great negative headline! However, when we look at the S&P 500, excluding financials, we see that earnings of all companies that have reported have grown an average of 8.6%!

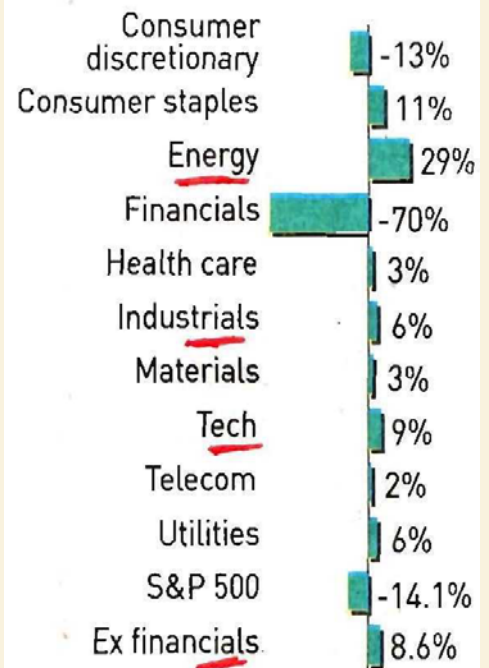
Take banks out of the equation and we have fairly positive growth in profits. One of the two ingredients for stock growth is still intact.

Then add the fact that if only part of the \$3.5 trillion dollars sitting in cash on the sidelines continues to flow back into the market, to expand price multiples, you have a potentially bullish situation!

Additionally, neither of these arguments take into account that the rest of the world's economies including both developed and emerging economies are growing much faster than the United States. They have money to buy our more competitively priced products (due to the fact that the dollar has declined about 40% against an average of world currencies over the last few years).

The Good And The Banks

Q1 earnings, yearly change



Source: Thomson Reuters

Current Investments and Performance

We still feel strongly that the global outlook for commodity demand remains strong and will continue to do so. In today's Investor's Business Daily there was an article entitled "Can Commodity Stock Party Continue?" Some quotes - "...most commodity cycles last about a decade....we're maybe in the middle innings." "Many oil stocks could rise even if crude oil goes down to \$65 per barrel, because that price would still get good multiples." Boone Pickens said last week that he thought current prices of oil company stocks were only pricing in about \$80 per barrel. Oil closed today at \$112.52.

The outlook for the price of other hard commodities (other than food) remains very strong. Again IBD, "Meanwhile, demand for metals in emerging markets is rising faster than ever."

Our portfolios are over-weighted in commodities and we feel that even though they add volatility to the portfolios, the opportunity for long-term growth exceeds the jitters that come with short-term volatility. Remember why you are investing. We need long-term growth with manageable risk. We feel the volatility is manageable and acceptable over the next few months and perhaps 2-3 years.

We also hold High-yield bonds and an S&P 500 Index fund. All our models were up nicely during April.

Closing

We welcome the new clients that have chosen both our companies this year.

Last month I attended the annual meeting of AAPTA (American Association of Professional Technical Analysts). On the whole, very smart people many of whom you see on CNBC and Bloomberg from day to day. I feel privileged to have been accepted as a member based upon the Technical Analysis work we have done.

Next week, Marty and I will attend the NAAIM (National Association of Active Investment Managers) meeting where I will start a three year term as a member of the Board. The nice thing about our Internet age is that we can continue to monitor and manage our investment models from anywhere in the world.

As you have probably gathered from the tone of this letter, we see the possibility of an explosive rally building. It may be starting now or it may come later - but it is coming. When it happens we will participate.

Lane Kerns

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