



# K E R N S

## CAPITAL MANAGEMENT, INC.

**Kerns Capital Management  
Market Report**

**September 1, 2009**

Clients and Friends,

The U.S. financial markets appear to be healing and that is good news. Investor psychology has not yet fully healed, and that too is good news for investors, as I'll explain below. While the popular press may not yet agree, the recovery appears well underway.

Please read on ...



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## Consumer Confidence On The Mend

Since mid-March of this year, the U.S. stock market has been on an historic run. As has happened in the past, the stock market began to rebound when all of the news was the bleakest.

The late Sir John Templeton stated that "bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria." The table below shows why a nervous consumer has historically been good news for stock market investors.

The University of Michigan conducts a survey of U.S. consumers as to their attitude towards the economy and their ability to maintain their standard of living. When consumers feel good about the prospects for the economy and their own standard of living, the reading is near or above 100. Conversely, when consumers feel things are going poorly, the reading can dip into the 60s.

Today the UM Consumer Sentiment reading is at 65.7. Examining the table below shows that when consumers feel prospects are poor, the stock market, on average, has historically produced the best returns over the next 12 months. When consumers are overly optimistic about the prospects for the economy, the stock market, on average, has produced its lowest returns.

Consumer Sentiment	S&P 500 % Price Change next 12 months.
Less than 60 ( <i>consumers fret about economy</i> )	+23.1%
Less than 70	+18.5%
Less than 80	+13.1%
87 (Historical Average)	+10.8%
Greater than 90	+10.8%
Greater than 100 ( <i>consumers feel positive</i> )	+8.1%
Greater than 110	-1.2%

*Source: University of Michigan, LPL Financial and Bloomberg.*

That said, the American consumer accounts for 70% of the US Gross Domestic Product (the value of all goods and services produced within our borders). Consequently, for the stock market to continue its rally, the consumer must open its wallet.

Fortunately, it appears that consumers are beginning to see a light at the end of the tunnel as today's UM Sentiment number, after several months of steady decline, was hardly changed from July's reading of 66. Similarly, The Conference Board's Consumer Confident Index (another similar study) rebounded from a dismal 47.4 in July to 54.1 in August.

With increasing confidence comes increased spending ... earnings ... profits ... and stock prices. I realize things are not this simple, but one thing is certain, the consumer must participate if our economy and the stock market are to recover and prosper.

## Danger Ahead?

There are too many good pieces of economic news surfacing to think that the market will not be higher between now and the end of the year. More recently these signs include:

- **New Home Sales Way Up, Inventory Shrinking.** New home sales increased 9.6% for July, the fourth straight monthly gain, while home inventories declined to lows not seen since March 1993, according to the Commerce Department. As this recession emerged, many economists felt that it would only fade away when the sector where it all began healed itself. It was in late 2006 when the U.S. real estate bubble began to pop, setting off a chain reaction of shocks that hurt homeowners, lenders, and the entire U.S. economy. Three years later, we have new hope in the real estate sector - and the numbers to support it.
- **More Demand for Durable/Hard Goods.** Durables (products that do not have to be

purchased frequently, e.g., appliances, home and office furnishings, lawn and garden equipment, consumer electronics, toy makers, small tool manufacturers, sporting goods, photographic equipment, and jewelry) rose by 4.9%, a third straight monthly gain.

However, as stated in our last newsletter, we continue to believe that there are a number of reasons to use caution for the next few weeks.

- A summer pullback usually follows a summer rally.
- September is historically the weakest month of the year.
- Most of the few really bad things that have happened in the market have happened in October.
- After a run like we have had, the market is no longer grossly under-priced like it was earlier this year. It may need time to digest its gains.
- China, which has provided much of the recent global demand, has indicated that it will curb liberal domestic lending practices, which could in-turn impede its demand for foreign goods. The Chinese stock market fell 6.7% just yesterday on the news.

We are not predicting that bad things will happen, but would not be surprised to see a modest 5-10% pullback prior to a strong rally into the end of the year. If we do not handle your investments, I would suggest setting stop-losses so that a big drop in the market does not surprise you.

## How Are We Doing?

The stock market began its dramatic phase of its fall in August of last year, one from which it has yet to recover. As the chart below demonstrates, **our clients have made money over the last year.** On a \$1 Million portfolio, these returns equate to a gain of \$64,100 for our Aggressive model and \$49,900 for Conservative, as opposed to a loss of \$182,700 for the S&P 500.

Year-to-date, KCM Aggressive is up 15.61%, Moderate 11.74% and Conservative 10.14%.



Note: For 401(k) plans without self-directed brokerage accounts, please see your Plan's Investment Performance Summary for actual performance.

## KCM Macro Trends Fund - Happy Birthday

Our **KCM Macro Trends Fund** (KCMTX) is one year old ... and growing!

In hindsight, it would have been difficult to pick a more challenging period in market history to start a new fund. Despite the challenges presented, we believe the Fund is meeting its primary goals: (1) to reduce client losses during declining market periods, thereby seeking to preserve capital for future market advances; and (2) to capture the majority of major market advances. Indeed, the Fund has significantly out-performed the major market indices since inception.

For more information about the Fund, including its objectives, strategies and performance, please visit our website at [www.KernsCapital.com](http://www.KernsCapital.com); or click on the following direct links: [Fund Fact Sheet](#) (FINRA reviewed) or [KCM Macro Trends Fund](#).

The Fund is open exclusively to our Clients and Investment Advisors (for their clients) via Fidelity, Charles Schwab, TD Ameritrade, Pershing, Southwest Securities and Trust Company of America.

The KCM Aggressive Portfolio is invested 100% in KCMTX.

## 401(k) Model Portfolio Performance

The KCM model portfolio performance we report in our newsletters is for Individual Brokerage Accounts, including Personal Choice Retirement Accounts (PCRAs). It differs from the performance of our 401(k) models. The difference is due primarily to 401(k) rules which preclude us from investing 401(k) plans in our mutual fund, the KCM Macro Trends Fund. Our investment philosophy, however, is the same: "**Capital Appreciation Through Capital Preservation**".

So how do you obtain 401(k) Model Performance? We report 401(k) model performance monthly via your Plan's Investment Performance Summary (IPS). The IPS, which is Plan specific due to differing core investment options, is distributed mid-month to the employer after we have collected mutual fund data from Morningstar, Inc., an independent research and reporting service. The employer then posts or distributes the IPS to participants. Check with your employer for this report.

Our 401(k) models are currently invested in varying percentages of a large cap growth fund, small cap growth fund, intermediate bond fund, emerging markets fund and money market. The allocation is dynamic and will change depending on our opportunity and risk assessments.

If our sister company, M.L. Kerns & Associates, administers your company's 401(k) plan, you can view your account, including the model portfolio holdings, by logging into your account via [www.KernsCapital.com](http://www.KernsCapital.com) or [www.MLKerns.com](http://www.MLKerns.com). Please check with your employer if you need help with your login ID or password.

## In Closing

The market is due for a consolidation. That is another way of saying that it needs to either go sideways or pull back slightly to digest the significant gains it has had since March. Positive signs continue to unfold - but the damage to the US and world economies was great and recovery will take time.

This is a time of opportunity to add companies to our portfolios that have pulled back to undervalued prices. We look at modest pullbacks as buying opportunities and bigger pullbacks as hedging opportunities. While we do not like the bigger pullbacks our investment strategy allows us to take defensive action. This gives us the opportunity to avoid big losses.

Enjoy your Labor Day weekend.

Marty Kerns

#### **Important Notice & Disclosures**

**Performance data is historical.** Past performance does not guarantee future results. Current performance may be lower or higher than the performance data quoted.

**Kerns Capital Management, Inc. ("KCM") performance figures** represent a composite of all individual portfolios managed in accordance with the investment category, are after the deduction of KCM's actual management fee, and include reinvestment of dividends and earnings. The composites contain accounts structured with mutual funds that are managed with a view toward capital appreciation. Standard Deviation and Alpha are calculated monthly and then annualized to be consistent with Morningstar®.

**Mutual Fund investing involves risk including possible loss of principal.** Investors should carefully consider the investment objectives, risks, charges and expenses of the **KCM Macro Trends Fund**. The Fund may invest in small, less well-known companies, which may be subject to more erratic market movements than large-cap stocks; foreign securities, which are subject to currency fluctuations and political uncertainty; and derivative securities, which may carry market, credit, and liquidity risks. The Fund may also engage in short selling activities, which are more risky than "long" positions because the potential loss on a short sell is unlimited. These risks may result in greater share price volatility. This and other important information about the Fund is contained in the prospectus, which can be obtained by calling 1-877-275-5599. The [Prospectus](#) should be read carefully before investing. The KCM Macro Trends Fund is distributed by Northern Lights Distributors, LLC member FINRA/SIPC.

**The S&P 500 Index** is an unmanaged composite of 500 common stocks. This index is widely used by professional investors as a performance benchmark. You cannot invest directly in an index.