



K E R N S

CAPITAL MANAGEMENT, INC.

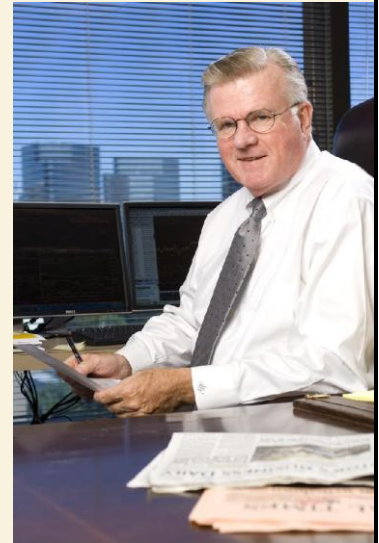
Kerns Capital Market Report

September 15, 2008

Let me start by saying I hope all of our friends in South Texas are safe and with their families following Hurricane Ike.

There are two messages I want to communicate that I feel are of utmost importance:

1. In order to avoid sounding too melodramatic I am just going to quote Alan Greenspan on CNBC last night. "We are in the middle of a once in 100 years event."
2. Our models are positioned to protect your portfolios!



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["Worldwide Meltdown of the Financial System Avoided" \(again\)](#)

I remember the "good ole days" when we could leave the office on a Friday night and not have to worry about the stock market until Monday morning. Now, with markets that trade around the world twenty-four hours each day, it is possible for really big things to happen over the weekend.

Most of the really big disasters this year have happened over a weekend and this one was the biggest of the decade - or as Alan Greenspan said last night this is a "once in a 100 years event".

In case you missed it last night (Sunday), the futures market indicated that the market would open this morning down 300 points. It did not disappoint.

Today's 504.48, or 4.42 percent, drop was the worst point drop for the Dow since it lost 684.81 on Sept. 17, 2001, the first day of trading after the terror attacks. In percentage terms, the drop was the steepest since July 19, 2002. It was also the sixth-largest point drop in the Dow, just behind the 508.00 it suffered in the October 1987 crash. The Dow is now down about 23 percent from its record high of 14,198.09 last October. Broader stock indicators also fell. The Standard & Poor's 500 index declined 59.00, or 4.71 percent, to 1,192.70 -- also its biggest drop since 9/11 and the first time it closed below 1,200 in three years.

What happened? Three major crises came to a head at once:

1. Lehman Brothers, one of the five US investment banks, filed for bankruptcy and will go out of business. Its stock fell 77% last week.
2. Merrill Lynch, another of the five, will cease to exist as a company and will be taken over by Bank of America to save it. Its stock fell 36% last week.
3. AIG, the world's largest insurance company, is on the verge of failing. Its stock has fallen 93% since June.

I do not want people to be frightened by what I have just written and am about to write because, if we handle your portfolio, you are positioned for safety.

On the other hand, if you are a Buy-and-Hold investor, you are in danger of damaging your quality of life in retirement.

The following are Quotes from commentators and people interviewed on CNBC last night and today.

"A moment of fundamental change in American Finance."

"A day of history. We have gone from five major investment banks in America at the beginning of the year to only two greatly weakened ones this morning."

The year started with:

1. Goldman Sachs
2. Morgan Stanley
3. Bear Stearns
4. Lehman Brothers
5. Merrill Lynch

Only Goldman and Morgan Stanley remain ... and no one is sure how healthy they are. These investment banks are important to the health of the economy because these are the companies that provide financing for new businesses and the major corporations in America.

"This will require a complete rethinking of how the American financial system functions... of how capital is provided to business."

Robert Altman, former Deputy Treasury Secretary said, "This moment is historic, tragic, and very disturbing."

"This is a rare and dangerous financial environment."

David Kotoc of Cumberland Advisors said, this is forcing a "Structural change ... the American Fed's capability is being put into question,"

"Credit will be tighter because there is less money in the system. Credit must be priced higher, credit spreads will be higher, Price/Earnings ratios of stocks must fall and the market will be punished starting today. Books will be written and we are living through it."

Enough said. I think you get the point. So where does this leave you?

Are You Happy with Your Performance?

Occasionally we lose a client but it doesn't happen very often. We still have 3 of our first 4 clients from 1994 when we started. In the last couple of months, we have had over 10 times more new money come to us to manage than we have lost so I think most of our clients understand and like our approach. However, once in a while, we get a client that does not have a realistic expectation for any money manager.

Many times, people pick our most Aggressive model and then expect it never to go down, even in a terrible market. That is not realistic. History has proven that in order to reap the rewards of the stock market you must expose yourself to some risk. That means occasionally your account won't go up and will even decline in value. The key is to manage the risk, and we think we've done a pretty good job.

For the one year period ending today, our Aggressive and Conservative models are down 9.72% and 5.34%, respectively. Our 401(k) models are down much less. To put this in prospective, let me point out a few facts.

1. The SP-500 is down 20.20% for the same period; 18.50% if you include dividends.
2. According to Morningstar, our Aggressive model has outperformed 77.44% of the aggressive funds (by prospectus objective) they follow over the last 12 months.
3. When we compare our Aggressive model to those aggressive funds with the same or less volatility (based on 3 yr. Standard Deviation), we have outperformed 93% of them over the last 12 months.
4. When we compare our Aggressive model to those aggressive funds with the same or less volatility more volatility (based on 5 yr. Standard Deviation), we have outperformed 93% of them over the last 5 years.
5. Our Aggressive model (now our mutual fund KCMTX) is down less than half the market, and conservative is down less than 30%, for the last 12 months. Today, when the S&P was down 4.71%, our mutual fund was only down .42%, Conservative even less, and 401(k) models were not down at all!

I think it is clear that we've done a pretty good job of managing risk and in both the short and long-term.

Current Investments and Outlook

Our investment discipline has progressively taken us out of the market. The fund is currently 88% in cash. Although it is our objective to be fully invested in equities, we wrote the fund prospectus with the ability to be up to 100% in cash to avoid losses.

Outlook

There will probably be some Fed action to shore up the markets - perhaps as soon as tomorrow. Today the market was down over 500 points and it was one of the worst days for stocks this decade. Fortunately we were well positioned to avoid significant damage.

Sincerely,

Lane Kerns

All information, data, and contents are obtained from sources believed to be correct, but reliability cannot be guaranteed. Performance information is historical in nature and is not a guarantee of future performance. Actual performance will be different and may be less. Losses could occur. Time periods may reflect a trend in rising or falling stock prices which may not be sustained in the future. 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®. See separate ADV Brochure for more detail.