



K E R N S

CAPITAL MANAGEMENT, INC.

Kerns Capital Management Market Report

November 4, 2009

Clients and Friends,

Marty and I spent the last two days at an investment manager's meeting in Chicago. All yesterday morning was spent at the CBOE (Chicago Board Options Exchange). It was a productive meeting giving us insights into current market developments and trading advancements.

While it is easy to manage money long-distance, it is not so easy to write the newsletter when all of the research materials are in Houston. I apologize for the delay. I think it is only the second time we have not made our deadlines in all the years we have been writing the letter.

The S&P 500 and the Dow Jones Industrial Average saw an eighth month of consecutive gains during October but last week brought the pullback we have been predicting. In this letter, I will spend a little print on how we decide to ride down a decline or take defensive action.



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A Modest Pullback or a Market Top?

October ended with a market pullback. It needed to stop and give those people who were queasy from the more than 50% advance since March a chance to take profits. A number of smaller pullbacks in a bull market are good and make a large pullback less likely.

Since the March bottom, none of the pullbacks prior to this one have exceeded 4% and the market always stayed above its uptrend line. Until an uptrend is broken, it is usually not productive to hedge or trade actively. Just find the strongest companies and stay with them.

The market did close below the uptrend line on October 28th and we put on an aggressive hedge that day - for one day. It rapidly bounced back above the trend for a day in a much stronger

manner than we expected and we removed our protective hedge that day. The next day (the 30th) was then down strongly and it would have been nice to have retained our hedge.

In the investment business, that is called a whipsaw and goes a long way toward creating humility in investment managers. I am happy to report that the first three days of November are up and our Aggressive Model is up roughly double what the market is up. For the first few days in November, we are fortunate not to be hedged because we are going up - but the market is still below its uptrend line.

It is possible that this is a market top. However, the way the pattern is developing, it will take about 10 days for a clearer to unfold. It is our feeling that the market will rally a few percent from here and then possibly trend down. If the pattern we see unfolding develops, we will make a little money before going to a more defensive position around the middle of the month.

We could be wrong and the uptrend could regain steam and continue upward. If that happens, we are well positioned to benefit from it. Either way, we should finish the year with nice gains and we anticipate we will continue to lead the market. For the record, we still expect the market to move higher between now and the end of the year regardless of any additional correction.

Why October's Correction?

There are many different kinds of investment managers. Size of assets managed does not necessarily guarantee investment performance. There are basically four different approaches to managing money:

- Bottom up Fundamental Stock Pickers - These managers dig into the minutia of a company's financial statements and look at little else other than whether a company's future (predicted) earnings justify a higher or lower price. These guys generally ignore the bigger picture of what is happening in the world. They generally focus on one specific segment of the market - such as large company growth stocks or small company value stocks. They may be the best in their class but when their segment (often called style box) is out of favor, they get beaten by the stronger style boxes.
- Top Down Managers - These managers generally look at what is happening in the US or global economy and make decisions on the bigger picture. They tend to disregard the strength or weakness of individual companies and just make bets on market direction.
- Technical Traders - These managers don't care about the stock fundamentals or the big picture. They look only at the price action of the market or individual stocks. Some people call this an art, others call it a science. A great deal has been written and technical trading software is everywhere.
- Quantitative Managers - These managers take a purely mathematical approach to managing money. Everything is based upon statistics and probabilities. They tend to totally ignore the other three approaches.

Which of these management types have the proper approach to money management? In our opinion, all are correct at different times and all have failed miserably at times throughout market history.

How can you use just one approach and ignore the others? Our belief (and our approach) is that a good money management firm must master a blend of all of these approaches and apply each - or all - when they are the most effective.

During the rally since the March bottom, certain types of money managers have used one or more of the above methodologies which told them that the rally could not be happening. As the rally

progressed, they got left behind.

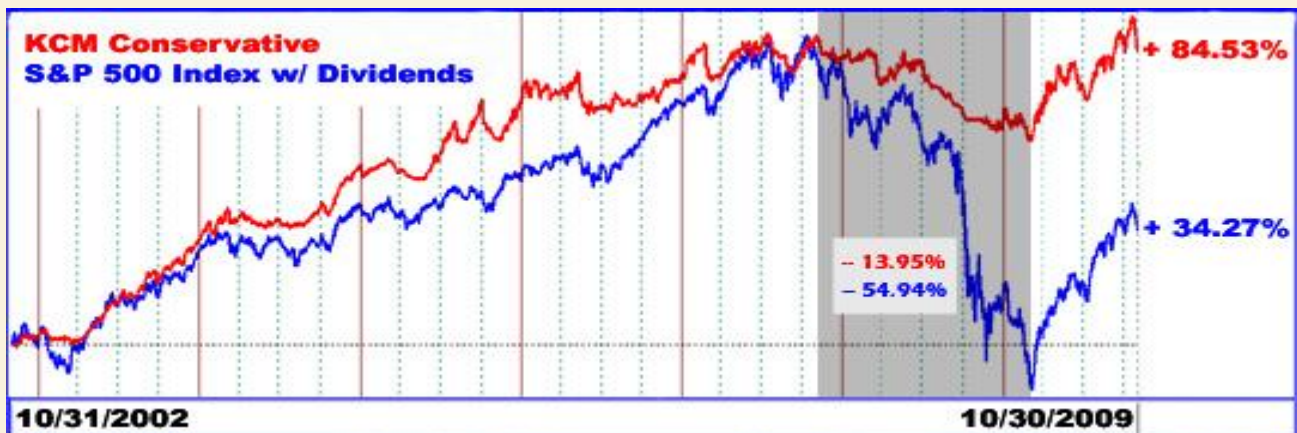
To quote the Financial Times, "Many fund managers who had bought into equities during the stellar rally since March - against their better instincts - had been itching to find an excuse to take profits [sell]. A few weaker data points in the US, the first stirrings of central bank tightening and the end of the third quarter earnings season were enough to give them that [reason]."

When the rally resumes, they will come flooding back into the market.

How Are We Doing?

Whenever we have any kind of a pullback, I think it is important to look at the big picture and compare your long-term financial goals with our long-term financial results. The following chart covers the last seven years which include the bull market of 2003 and the bear market since October 2007 through March 2009.

SEVEN YEARS - Ending October 30, 2009



Our Conservative model has risen almost three times as much as the S&P 500 (including dividends). Even more important is the decline during the shaded period (10/8/07 through 3/9/09) during which **Conservative's decline of 13.95% was less than a third of the 54.95% loss of the S&P 500.**

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

For more information about our mutual fund KCM Macro Trends Fund (KCMTX), including its objectives, strategies and performance, please visit our website at 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 (non-401k) is invested 100% in KCMTX.

In Closing

Hopefully everyone survived Halloween with fond memories and can now get on with Thanksgiving and Christmas shopping.

We still think the market will be higher by the end of the year and that will be our Christmas present.

Lane 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. **The Dow Jones Industrial Average** is a price-weighted average of 30 of the largest and most widely held stocks traded on the New York Stock Exchange and the Nasdaq.



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