

Dear Friends and Clients,

It has been said that "the market does what it needs to do to prove the largest number of people wrong".

In our December 1st letter, we described conditions that looked like the perfect setup for a rally into year end. Instead, the market took a small dip lower. All because of Europe.

Financial markets have turned into a two horse race - the United States and everybody else. The U.S. is steadily improving and the rest of the world is slowing. How do we invest in that environment?

Every investor should have a big picture idea of what is moving the markets. Below, we will attempt to condense the major themes of the day to something short and understandable.



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[It's Still All About Europe!](#)

This morning on CNBC, Art Cashin, who is head of floor trading for UBS Financial Services at the New York Stock Exchange, described Europe as a city with no fire department. Yet, they are spending a lot of time rewriting their fire code.

His point was that unlike the United States, which does have a fire department in the form of combined efforts from our Fed and Treasury Department, Europe has no ability to take concerted joint action to solve their financial problems because they are 26 separate nations.

A picture is emerging from the fog. The U.S. went through its financial crises in 2008 and dealt with it. While the recovery process is still under way, the U.S. is growing and has emerged from recession. Unemployment is improving as demonstrated by this morning's much improved jobless claims report. Manufacturing is improving in the U.S., as demonstrated by this morning's Empire

Manufacturing Index, which came in roughly three times better than expected.

Contrast the U.S. picture with the rest of the world - which is slowing - and it tells us that, for now, the safest place to invest is probably right here at home. Yesterday, one of our clients of over 15 years who is head of European manufacturing operations for a major US manufacturing company stopped by our office to visit while he was back in the U.S. I asked him how he would describe the business climate in Europe at this time. His answer was "A Mess".

Normally, good U.S. economic news like we have had over the last few weeks would be met with a stronger stock market. However, with Europe looming overhead, there seems to be economic fatigue. I could quote a boat load of reasons why we should be having a rally but they all seem to be temporarily overshadowed by news from Europe.

While We Are Waiting

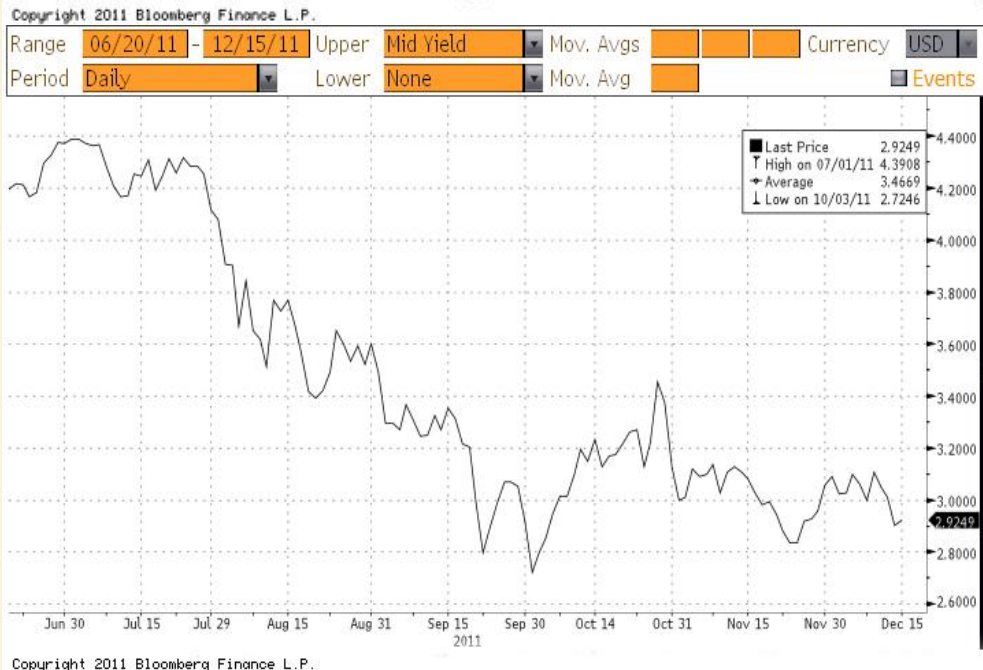
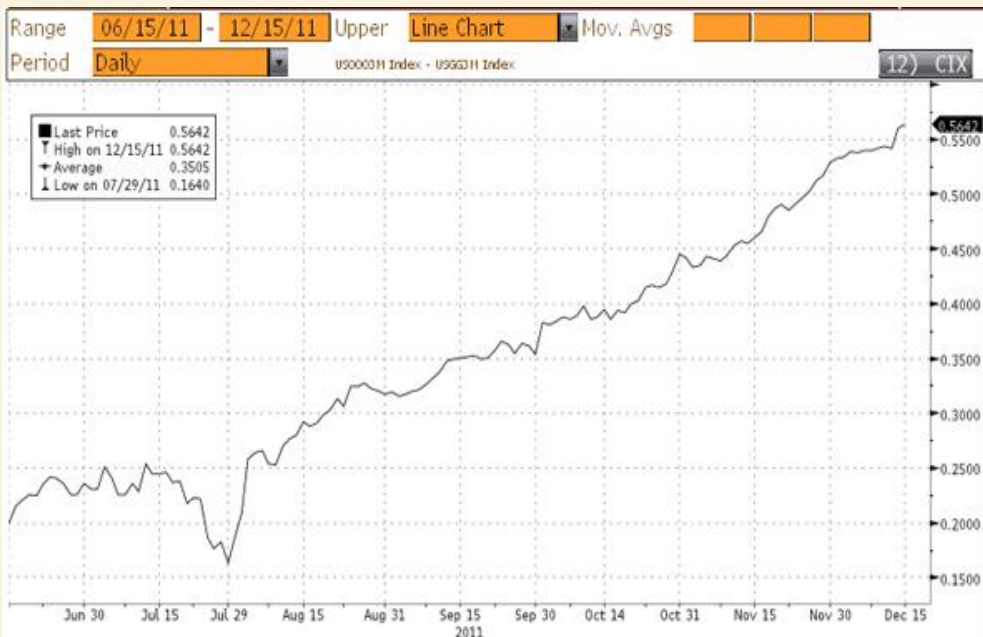
While we are waiting for the next up-leg in the market, let's review why the U.S. is relatively so much better than other markets.

1. Unemployment is improving - not getting worse as it is in many other countries.
2. Interest rates are historically low making it easier for financial institutions and businesses to build profits.
3. Inflation is tame.
4. Corporate profits are at historically high levels and while many companies are projecting a "challenging environment", the feeling is that when fourth quarter earnings reporting season starts next month, it will show strong results.
5. For the last four years, the U.S. stock market has outperformed the combined BRIC (Brazil, Russia, India & China) stock markets. On Monday, India actually reported a 5% decline in industrial production. China's market hit a 2 1/2 year low today.
6. Below is a chart showing YTD performance of all developed markets worldwide. As you can see, while the U.S. is down 3.32% for the year, it beats 22 of the other 23 developed markets. The U.S. beats 100% of emerging markets worldwide (not shown).

| Primary Equity Index | | | | Primary Equity Index | | | |
|----------------------|----------|-------|--------|----------------------|----------|-------|--------|
| Country ↓ | Value | Time | %Chg | Country ↓ | Value | Time | %Chg |
| 1) Australia | 4139.80 | 17:59 | -12.76 | 13) Italy | 14627.69 | 11:30 | -27.49 |
| 2) Austria | 1773.55 | 11:35 | -38.94 | 14) Japan | 8377.37 | 12/15 | -18.10 |
| 3) Belgium | 2001.53 | 12:10 | -22.38 | 15) Netherland | 294.62 | 12:10 | -16.91 |
| 4) Canada | 11504.42 | 16:01 | -14.42 | 16) New Zeala | 3263.19 | 12/15 | -1.39 |
| 5) Denmark | 374.08 | 11:00 | -18.25 | 17) Norway | 338.60 | 12:15 | -15.43 |
| 6) Finland | 5112.58 | 11:30 | -33.27 | 18) Portugal | 5342.74 | 12:10 | -29.59 |
| 7) France | 2998.73 | 11:49 | -21.19 | 19) Singapore | 2635.25 | 12/15 | -17.39 |
| 8) Germany | 5730.62 | 12:30 | -17.12 | 20) Spain | 8250.40 | 11:35 | -16.32 |
| 9) Greece | 660.14 | 10:19 | -53.31 | 21) Sweden | 946.68 | 11:30 | -18.08 |
| 10) Hong Kong | 18026.84 | 12/15 | -21.74 | 22) Switzerlan | 5784.14 | 11:31 | -10.13 |
| 11) Ireland | 2708.27 | 15:00 | -6.13 | 23) United Kin | 5400.85 | 12/15 | -8.46 |
| 12) Israel | 1093.37 | 9:25 | -17.57 | 24) United Sta | 1215.85 | 16:01 | -3.32 |

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7. The two 6-month charts below show two additional things. First, costs for European banks to borrow money overnight are rising. This is a sign of stress for them. Second, borrowing costs in the U.S. are falling. This is a sign that investors worldwide like the safety of the United States and want their money here compared to other places in the world. The second chart shows the cost the government is paying to borrow money for 30 years by selling 30-year Treasury Bonds. As you can see, it is getting cheaper to borrow in the United States.



The Point

Don't despair. As the markets settle down (which will probably require some resolution of the European situation) and the U.S. continues its recovery, there will be a point where the people who have stayed out of the markets will not be able to stand the pain of missing out on profits and will come back into the market. We want to be there when this happens.

Ned Davis Research published their 2012 Outlook today. Their feeling is that the possibility for a strong resumption in the bull market is more probable than not. "With inflation pressures contained, long-term and short-term interest rates close to zero, credit conditions favorable, the U.S. banking system healthier, profit margins rising, the U.S. economy still expanding, and the recession threat off the table, **conditions are right for the market to respond to the bullish seasonal influences through the end of 2011 and into 2012.**"

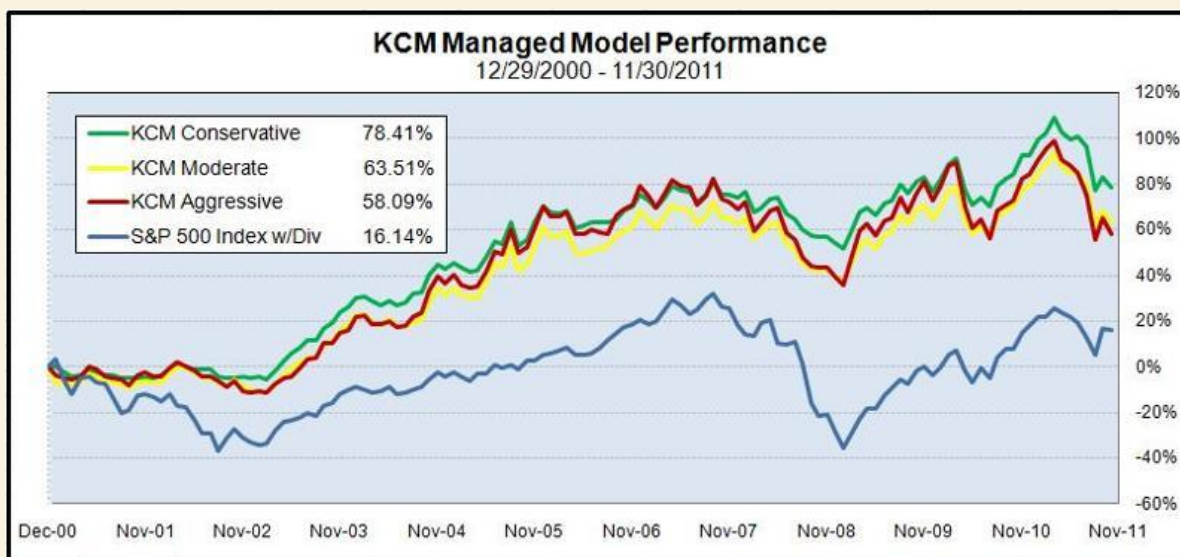
I think it is safe to say that volatility will remain with us. However, the VIX has been falling. The VIX is considered a gauge of market fear - a falling VIX equals falling fear.

One of the things we must do as investors is go with the highest probability choice. No one expects this to be right all the time as we have seen thus far in 2011. However, to go with the highest probabilities will pay off over time. We certainly don't want to play the lowest probabilities.

How Are We Doing?

We are beating the S&P 500 with all our models in December so far. While this has certainly not been a good year for us and our clients, we continue to have faith in our process for the long run.

The following chart carried over from our last letter, shows performance of our three equity models (after fees) since 12/31/2000. All of our models have substantially outperformed the S&P 500 (including dividends).



In Closing

When we write the next letter, it will be 2012. Another year will have passed and another Christmas will have been enjoyed. We feel blessed that we were born in the United States. As Warren Buffet says, "an accident of birth". Why were we blessed by being Americans at this time in history rather than a country or place with less opportunity and values?

As we plan for the new year which will have the turbulence of a U.S. election, remember that the biggest challenge to our way of life is not caring enough to stand up for what is right for the country.

Our feeling is that the biggest gift we can give our children and our grandchildren is the opportunity to build a successful life for themselves. This means being rewarded for effort, intellect and the willingness to work harder than others may care to. To take away that opportunity is to change America to something other than what made it great.

Have a wonderful Christmas and New Year.

Our best to all of you,

Lane and Marty Kerns

[KCM Macro Trends Fund](#)

The [KCM Macro Trends Fund](#) is an out-growth of the model portfolios we have been managing for our clients for more than 16 years. The Fund is open only to our clients and Investment Advisors (for their clients). Shares are available through most custodians including Charles Schwab, Fidelity TD Ameritrade, LPL Financial, Pershing, Southwest Securities and Trust Company of America.

Mutual Fund investing involves risk including the possible loss of principal. For more information about the Fund, including its objectives, risks, strategies and expenses, please see the Prospectus which should be read carefully before investing.

Important Notice & Disclosures

Performance data reported above 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, unless otherwise described, 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 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.