



# K E R N S

## CAPITAL MANAGEMENT, INC.

### Kerns Capital Management Market Report

June 15, 2009

Dear Clients and Friends,

The market has taken a rest for the last month and is trading sideways. There has been no heavy selling which is a healthy sign.

I have included a summary of where I think we are in the economic recovery and where I think we are going.

Our models are up nicely for the year and Aggressive is slightly more than 11% ahead of the S&P 500 YTD as of last Friday night. Conservative and Moderate are also well ahead of the S&P.



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### Market Resting

In our June 1st letter, I included a chart of the market trending upward in a channel with a total gain since the March bottom of 42%. The market is no longer in that upward trending channel and is now trending sideways. After a 40% plus climb, the market has temporarily run out of buyers. That is very normal market action.

The chart below shows how the market, when viewed from May 10th to June 15th, has drifted sideways with a 0.75% decline. Looking at today (June 15) by itself is a bit of a scare with a decline of 2.38%, but again the market is displaying very normal action. The declines we have had over the last month have been on very light volume.

Light volume indicates that the institutional investors are not trading. The large institutional investors like Mutual Funds, Pension Plans and Hedge Funds are the ones that move the market with

large volume. That has not been happening. They are not selling or the market would be falling in high volume.



Traders say that the market has gotten ahead of itself and needs a rest. That means that the balance between buyers and sellers is equal. The 40% rally was caused by money flowing out of the cash and bond markets and into the stock market. That has occurred for a number of reasons which all indicate the markets are anticipating an economic recovery.

### Why Has Buying Dried Up?

There has been a chain reaction over the last few weeks that makes a lot of economic sense. It goes like this:

1. There has been massive economic stimulation by governments around the world.
2. With the notable exception of Europe which has had virtually no economic stimulation, most economies around the world have shown signs of a bottom in their economic declines.
3. The market always recognizes these leading indications of recovery from recessions and investors start getting back into the market while stocks are available at bargain basement prices. Look what has happened to banking and commodity stocks over the last few months. Many of the stocks we hold in our mutual fund are up over 100%.
4. As the signs of recovery start to appear, the economic sectors that sold off the most and became the biggest bargains are now the most sought after.
5. Commodities always start to rally strongly during early stages of recovery. Look at oil prices over the last few months.
6. As demand picks up and commodity prices rise, fears of inflation start to appear.
7. Fears of inflation by Central banks around the world cause them to slow their economic stimulus efforts in anticipation of needing to slow economic overheating down the road.
8. Interest rates begin to rise. During the early part of the rise, the markets view this as positive because it confirms that economies are recovering and even though they are rising, they seldom equal the rate of inflation during the first part of the recovery. Interest rates below the rate of inflation are "negative real interest rates" and are still stimulative to the economy.
9. As a recovery strengthens, further rising interest rates above the rate of inflation are the Fed's way of throwing out an anchor to slow the growth of the economy thereby slow inflation.

Getting it just right is a dangerous balancing act which governments seldom succeed at. They either raise rates too slowly and inflation takes off (like the 1970's) or they raise them too fast and kill the economic recovery.

10. During the last month, interest rates on government bonds have risen by almost a full percentage point. This has slowed the housing recovery and has given investors a reason to pause.

Everything is happening as it should for a global economic recovery to occur. By this, I do not mean that all our employment, housing and economic problems are solved. What I do mean is that the steps to recovery are occurring as they always do.

There is still much fear in the market place and that is good. Market tops occur when there is no fear and everyone is fully invested. Markets can go no higher when there are no more buyers being left behind and only sellers remain. In the present case there are still many buyers with over \$2 trillion waiting on the sidelines.

We are now in the sweetest part of the economic cycle for equity and commodity investors! We have entered the worst part of the economic cycle for Bond investors. Since the price of bonds moves in the opposite direction as interest rates, bond prices will be falling. The notable exception to this is Junk Bonds which behave much more like equities.

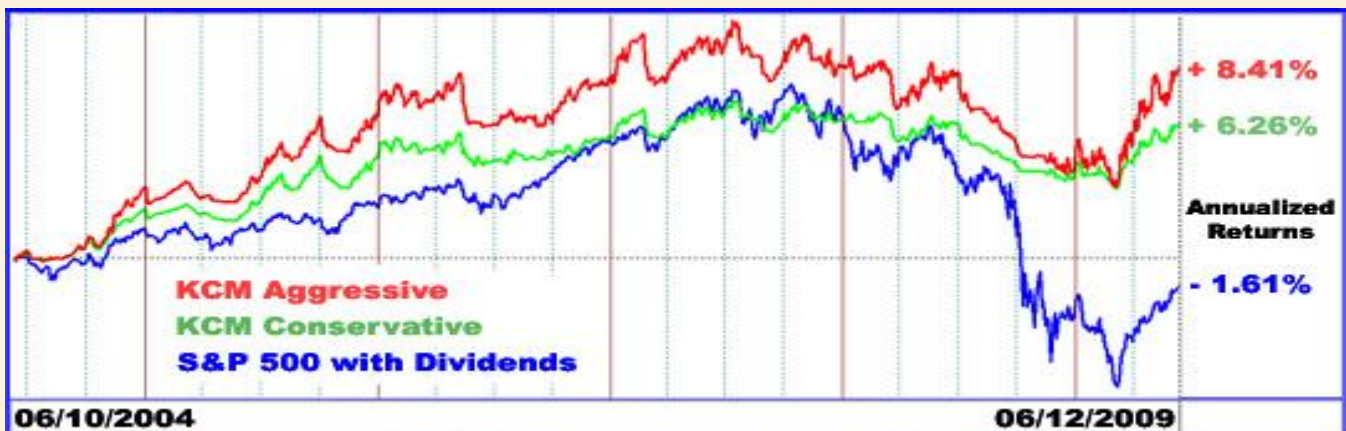
It will not be a straight line, but I feel strongly that the market will end the year higher and equity investors will be rewarded. If you have a risk management plan, you should not be afraid to commit capital.

## How Are We Doing?

When I tell people that we have outperformed the market by roughly 10% per year on average, some act surprised. Especially many larger investment advisors.

Below is a chart of our Conservative and Aggressive model performance compared to the S&P 500 (with dividends) over the last FIVE YEARS. Notice the rates of return. These are **compound annual rates of return - not the total return for the five years**. If you add the 8.41% annual return for our aggressive model to the negative 1.61% annual return for the S&P 500 (including dividends) there is a 10.02% annual difference! Conservative has not done badly either with less volatility.

**KCM VS. THE MARKET (FIVE YEARS)**



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

Treasury Bonds, which were so hot during the last quarter of 2008, are down 15.69% year to date according to the Shearson Treasury Bond Index.

## KCM Macro Trends Fund

Our mutual fund - KCM Macro Trends Fund (KCMTX) - continues to grow both from investment gains and deposits from clients and new investors. The fund's assets have grown more than \$20 million since the first of the year.

The fund is open exclusively to our Clients, Advisors and Institutional Investors. It is now available through Fidelity as well as Charles Schwab, TD Ameritrade, Pershing, Southwest Securities. Our Aggressive Model is invested 100% in KCMTX.

For more information go to [www.KernsCapital.com](http://www.KernsCapital.com)

## In Closing

The year is going well. Our family is doing well and the grandchildren are growing. I am blessed with good associates and family in the business. We seem to attract wonderful clients. We still have three of our first four clients.

My only regret is that I am not writing this letter from Colorado. Instead we are enjoying another Houston summer.

I am looking forward to an even better finish to the year. (Perhaps we will find a way to visit the mountains before fall).

Lane Kerns

## Website

Now you can visit [www.KernsCapital.com](http://www.KernsCapital.com) to view your Schwab Account, as well as your 401(k) Account if our sister company M.L. Kerns & Associates administers your company's 401(k) plan.

## 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. 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.