



K E R N S

CAPITAL MANAGEMENT, INC.

Kerns Capital Management Market Report

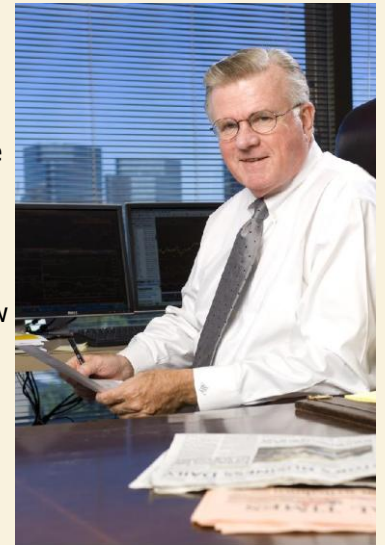
July 15, 2009

Dear Clients and Friends,

July started with seven trading days of sharp decline - a continuation of the decline that began mid June. That sharp decline was followed by a sharp three days of gains as earnings for the second quarter began to be reported.

Are we in a down-trend or an up-trend? We will discuss this question below as well as how we are invested.

Our KCM models continue to lead the major US indexes for the year.



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Which Way Is The Wind Blowing?

As I mentioned in the opening, July has seen a sharp decline followed by a sharp uptrend. Additionally, the nice uptrend that lasted from March 9th through June 11th turned into a sideways market and then a downtrend.

The chart below shows what we are dealing with. I will comment on the chart and then what we think is happening.



Between (1) and (2) we enjoyed a 43.41% rally in the S&P 500. I drew two upward sloping red lines to indicate the channel which bounded that rally. At the red arrow, the market hit resistance and tried for two days to break above it before failing and falling down into a trading range. It took another two weeks to finally break up through that resistance line. Instead of marching higher it moved up only slightly and topped at (2). From there it entered a downtrend.

There are two points to this exercise.

- From the point of the red arrow to the first week in June, it was very difficult to determine which way the market was going to go. It was basically moving sideways in a trading range.

One piece of useless information that we know for sure is that markets always break out of trading ranges either to the upside or to the downside. This one broke to the downside. These trading-range markets are the most difficult to maneuver. If we make a strong bet one way or the other we will either be 100% right or 100% wrong. These are the times we attempt to remove the risk from our portfolios by hedging until a clear direction emerges.

- As the downtrend between (2) and (3) began to reveal itself, we increased our hedge. The last three days have been strong up days and while we had gains, our hedge dampened those gains. But are we in an uptrend?

Do three up days make an uptrend? I will leave that question unanswered until the next section but point out that today's strong surge at (4) on the chart was a result of short-covering. Many people who had hedged their risks to protect them from losses began removing their hedges by covering their short-sales.

Many traders hedge by selling stocks short - borrowing stocks rather than buying them and selling them in hopes that the stocks can be purchased back later at a lower price - thereby making a profit if they go down. This can be very profitable in a declining market and is one way of hedging. (We do not currently use this method.)

The reason I bring up short selling is to point out what happens if the market does not go down. The problem is that if the market goes up, these short-sellers must buy stocks at higher prices as the market is rising in order to return the stocks they borrowed. This is called short covering.

If the market is rallying as it did Monday and Tuesday, the pain of being short is too much for many traders and as they start buying stocks to cover their shorts, they add to the buying pressure and help force the market higher. That is what I think happened today - a short covering rally.

It will be a few more days before we know whether a continuation of the March uptrend will occur or whether the last three days are just a blip based on positive news releases.

Economic and Market Outlook

We all know that the economy has not yet healed. By the time it does, the markets will be much, much higher. The question is, is the economy out of surgery and in the recovery room? For that answer, we need to look at a few economic releases and quarterly company earnings reports.

Here are a few items that indicate signs that the patient is recovering and may soon be removed from life support:

1. The Economic Cycle Research Institute's leading U.S. index rose 1.1% in the week ending July 3. The ECRI has been the most accurate in picking recession starts and finishes. The ECRI Managing Director is quoted as saying "the end of the recession is at hand".
2. There are signs that the German economy is bottoming out according to their Finance minister. The recession may have ended in Q2 with a spike in factory output and new orders.
3. Inflation is still tame (more later) which allows the Fed to keep interest rates low and pour additional stimulus into the US economy.
4. The US trade gap with other nations fell to the lowest level since November 1999. A lower trade gap means lower borrowing by the US to pay its bills which in turn leads to a healthier dollar. The stronger the dollar, the more you can buy with one.
5. Exports rose 1.6% last month. More exports, more US jobs.
6. China's economic growth is exceeding everyone's expectations. They are now the third largest buyer of US exports. A stronger China has mixed implications for the world, but a positive one is a bigger market for US goods.
7. Barclays Capital's global confidence indicator rose further in June, reaching its highest level since October 2008. "If this persists, it suggests that the recovery in world activity could be stronger than our forecast" according to their chief economist.
8. Although only a few companies have reported earnings, 13 of the 16 that had reported as of the 15th surprised to the upside. I think everyone knows earnings will generally be down from a year ago, but they are not down as much as expected. These positive surprises are giving the boost to the market which is catching those who have shorted it by surprise. (See the chart below from Bloomberg.)

Season	Current	07/08/09	-	10/06/09	Periodicity	Quarter	
EPS	Net Income	Sales	Source	Equity Index	Name	SPX	
GICS							
Sector	Reported/Total	Growth	Pos Grw	Neg Grw	Surprise	Pos Surp	Neg Surp
1) All Securities	16 / 498	-11.86%	4	12	20.10%	13	3
2) > Energy	0 / 40		0	0		0	0
3) > Materials	1 / 27	N.M.	0	1	31.22%	1	0
4) > Industrials	3 / 58	-25.42%	0	3	10.15%	2	1
5) > Consumer Discretionary	3 / 80	-15.81%	2	1	14.59%	3	0
6) > Consumer Staples	1 / 41	-3.47%	0	1	6.56%	1	0
7) > Health Care	2 / 53	-1.76%	1	1	2.21%	2	0
8) > Financials	3 / 80	25.98%	1	2	30.87%	2	1
9) > Information Technology	3 / 75	-42.51%	0	3	113.31%	2	1
10) > Telecommunication Services	0 / 9		0	0		0	0
11) > Utilities	0 / 35		0	0		0	0

We all know that obstacles remain to a quick return to sustainable growth in the US economy. But,

we are not investing in the economy - we are investing in the markets. Warren Buffett's approach to investing has been to buy when things look worst, get the best prices and ride the recovery up.

If investors wait until the economy is fully recovered to invest, they will be purchasing closer to the high of the market than the low. The best profits are made from the start of a recovery not from the end of one.

How Are We Doing?

Below is a chart showing our Aggressive and Conservative Models compared to the Dow Jones Industrial Index (including dividends) and the S&P 500 (including dividends) year-to-date. We are outperforming both.



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

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.

We have added a new chart of interest to our website - [Contrarian Value Strategies](#). It shows the historical performance of buying stocks with low price to earnings ratios over other types of stocks. This is the approach we are currently following in KCMTX. It is very enlightening and I encourage you to take a couple of minutes to study it!

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, visit www.KernsCapital.com

In Closing

Summers are typically a dead time in the market. This one may be the same. However, I have a very strong sense that either the bull market that started in March will resume or we will have a new bull market by the fall.

It is possible that due to the positive signs mentioned above, a resumption of the March bull may have started three days ago. We will know soon.

Enjoy your summer.

Lane Kerns

Website

Now you can visit 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.