



K E R N S

CAPITAL MANAGEMENT, INC.

**Kerns Capital Management
Market Report**

September 15, 2009

Clients and Friends,

This letter will be a shorter mid-month version. I have a few observations about economic and market actions that I think will affect the market's performance in the near term.

I will also comment on a number of positive influences that should give the market a tailwind between now and the end of the year.

Our client portfolios are doing well this month with Aggressive and Moderate well ahead of the S&P 500.



IN THIS ISSUE

[Reasonable Expectations](#)

[Some Positive Signs?](#)

[How Are We Doing?](#)

[KCM Macro Trends Fund](#)

[In Closing](#)

Reasonable Expectations

The S&P 500 topped and began a bear market decline on 10/09/07. It lost 56.8% before bottoming 17 months later on 3/09/09. By the end of August, it had regained 50.9% from that bear market low, but would still have to gain another 40% to get back to its 2007 high.

While I feel strongly that this rally has further to run, it is unlikely that the prior high will be reached before the next bear market begins. That does not mean that we can't make money. Consider the following examples of how good investment selection has yielded wonderful gains during a flat market period.

The Bespoke Investment Group has just posted the following remarkable statistics. On 9/11/01

(Destruction of the World Trade Center) the Dow was at 9605 and on 9/11/09 it also closed at 9605.

Although the Dow overall showed no movement in the eight years since that terrible event, the individual components showed some remarkable variation. Hewlett-Packard was up 157%, followed by Caterpillar up 100% and MacDonald's up 88%. At the other end of the scale General Motors was down 98.5%, Citigroup 88% and Eastman Kodak 86%. The article may be accessed at <http://bespokeinvest.typepad.com>. Investment selection was everything.

Some Positive Signs?

The recession we have been experiencing is the worst since the great depression, but there are positive signs that make our group feel the recovery may be stronger than many are expecting.

In the last 50 years there have been nine recessions. During this period, the U.S. economy has averaged a GDP annual growth rate of 3.1%. During recessions, GDP growth has been much less. By definition, a recession is two or more quarters of negative GDP.

Since GDP during recessions is negative, it stands to reason that recoveries from recessions have to be above the long-term average of 3.1%. Last week, we attended the J.P. Morgan Fifth Annual Investment Forum. Their Chief Market Strategist is predicting the recovery will average 5-7% growth. This is much higher than the consensus and would cause the market to absolutely explode to the upside.

I do not know if we are going to have 5-7% GDP growth, but I do know that we are in the recovery phase of the economic cycle and interest rates will remain low because it is the government's intention to keep them low. Low interest rates are always good for the market. Look at the 50% climb from the bottom that has occurred since March.

How Are We Doing?

Many of our clients pay close attention to CNBC and the financial papers. Exactly one year ago, one of the major financial events in history occurred: the failure of Lehman Brothers investment bank. Lehman was a major wall street firm with financial contracts and connections around the world. The U.S. Treasury and the Federal Reserve had no available tools to save them and their bankruptcy accelerated a market decline that began months earlier.

Many thought Lehman's failure was the start of the second great depression. It truly could have done just that. Had the government and congress not taken drastic actions to save our banking system, we could have led the world into depression.

In the chart below we show the performance of the S&P 500 (including dividends) compared to our Aggressive and Conservative models. Notice that even though the S&P is still **down** 13.88% over the last year, we are **up** 13.77% and 10.15% respectively in our Aggressive and Conservative models. A difference of over 27% in the case of Aggressive.

When you look at the sharp S&P 500 decline that occurred at the beginning of the chart when Lehman failed, one wonders what would have happened to the S&P 500 if the Fed and Treasury had not been able to stop the failure of the banking system.

ONE YEAR



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 **KCM Macro Trends Fund** (KCMTX) is one year old ... and growing!

For more information about the Fund, 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 is invested 100% in KCMTX.

In Closing

One month ago we said, "The market is due for a consolidation. That is another way of saying that it needs to either go sideways or pull back slightly to digest the significant gains it has had since March." We did get a consolidation but it was less than 5%. We expected 5-10% which would have set things up for a strong rally into the end of the year and early next year.

We may still get that 5-10% correction but it is looking less likely in the near term. At the March low, there was \$4 trillion dollars setting out of the market on the sidelines. Since then only 1/2 trillion has come into the market and look at the rally we have had!

Many investment managers who have remained under-invested are feeling that they must become fully invested or their year will be a bust. Imagine what could happen to the upside pressure on the markets if the other \$3.5 trillion is put back to work!

If I sound optimistic, I am. It will not be a straight march upward but we feel strongly the market

will be higher at the end of the year. If it is not, we will use the same defensive measures to protect capital that have served us well over the last ten years.

For those of us in Houston, we are now beginning to see the cool weather season approaching. For those of you in the North, start thinking about coming South for the next few months. If you can't come, send your money - we will take good care of it for you.

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.