



# DAVID R. KERN

**ASSET MANAGEMENT**  
*Dynamic Asset Allocation Strategies*

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## 4<sup>th</sup> Mid-Quarter 2008 Newsletter

The bad news keeps rolling out of Washington, and the news media thrives on presenting every aspect of the sweeping changes in our economy and financial lives. There is nothing unusual about a declining stock market over the years, but at this writing in mid November 2008, the broad stock market indexes measured by the S&P 500(i) has declined 49% from its peak in October 2007, and the NASDAQ(ii) has now lost about 52% in this bear market. This makes the current bear market more severe than the other 16 bear markets from top to bottom since 1932. Most of the International markets have also followed our market down and in some cases even surpassed our decline.

Stocks are not the only asset class to decline in this unwinding of excessive leverage and debt held by investors and institutions. With the exception of short-term government bonds, almost every asset class has seen a decline, including real estate, commodities, municipal bonds, gold, and high grade corporate bonds. Concern for safety of bank deposits and other interest bearing accounts has the federal government guaranteeing just about everything that needs to be guaranteed in this shaky economic environment.

The realization that we are in a recession, and the extreme pessimism among investors and citizens around the world have the stock, bond, real estate, and commodities markets extremely over-sold based on long term trends and sentiment indicators. With this bear market already equaling the declines of the most severe bear markets of the last 75 years, we have to look ahead for the light at the end of the tunnel.

There have to be some smart investors out there who can set aside their emotions and anticipate large shifts in the markets and the economy. While many mutual fund managers are outstanding at picking individual securities, and anticipating down turns, their primary focus is picking the securities, not timing the market.

The Investor's Business Daily newspaper tracks 24 mutual fund managers who have outstanding long-term track records and publish an IBD Mutual Fund Index showing each fund's performance year-to-date. The average of these outstanding managers is down 46.4% since January 1, 2008, based on the November 19, 2008 publication.

The November 17<sup>th</sup> issue of Barron's ran an article on a portfolio manager for the Oppenheimer Quest Opportunity Value fund. Barron's tries to find managers that are doing well in the current climate and interview them to find out what they are thinking. They lauded the manager for being down only 23.5% this year through November 12, 2008 and put his fund in the top 8% of the moderate allocation category.

Warren Buffett, sometimes called the "Oracle of Omaha", has made a name for himself as manager of Berkshire Hathaway, which owns a number of name brand companies nationwide. Warren had liquidated his holdings in the market early in 1969, and avoided the market for the next several years. Then five years later in 1974 after the severe 1973-1974 bear market, in a famous interview in Forbes Magazine, he said, "This is the time to start investing again." And he did. Using Berkshire Hathaway, which he took control of and was running while on hiatus from the stock market, as the holding company for his new investment venture, and the rest is history. Warren Buffett is once again saying it's time to buy, and so far he has been a little early, but apparently he thinks a 50% bear market is sufficient to factor in the possibility of a recession as severe as that of 1973-1974. Conditions were very different then, as inflation was out of control and interest rates had risen dramatically in order to combat the inflation problem.

Another smart money manager with a good track record is Jeremy Grantham, founder of Grantham, Mayo, Van Otterman & Co., which manages 140 billion for its wealthy clients.

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***David R. Kern, Financial Advisor***

He has turned bullish again and is beginning to buy into the market. His observations about these large changes in the investment environment include the need to ignore the media, and the crowd sentiment at market turning points. He had been more bearish than most over the last couple of years and now seeing opportunities for the next bull market.

Another successful money manager is Louis Navellier, who says in his MarketMail Special Alert, "It's also important to reiterate that the selling storm has everything to do with deleveraging and almost nothing to do with fundamentals. Stocks are very, very cheap as a result. When deleveraging ceases, the rebound could be enormous and lightning fast. Long-term investors should be adding to their positions at these levels. We suggest you discuss appropriate amounts with your advisors."

Our programs, which through the first six months of the year did much better than the broad markets, have run into difficulty with the extreme volatility in the September-October time frame. We moved most of the management positions in our dynamic programs to the money market fund to wait out the bulk of the storm. The money market funds provide an interest rate return, but no market volatility as the managers seek to maintain a \$1.00 asset value at all times. Most money market funds invest in short-term government bills and notes, and offer a safe haven while we wait for the market to turn.

There are two general categories of investors, those in the accumulation phase saving for long term goals like retirement, and those in the distribution phase who have pretty much completed their earning years and need to preserve and grow capital to generate income. For those in the accumulation phase, contributing to retirement accounts like 401(k) plans and IRAs, these market cycles offer opportunities for the periodic investments to buy in at different prices. The concept that allows savers to continue to invest in a declining market is that they are buying assets for cheaper prices, and a well diversified portfolio will eventually recover with an average cost reduced by these market declines. Periodic investors in 401(k) plans and other retirement accounts should be encouraged to continue their program, but monitor their diversification toward a certain risk objective.

Those in retirement who are concerned about preserving principal are a primary concern with our actively managed strategies. Most of our programs have declined less than any of these indexes or mutual fund mentioned above.

While our timing is never perfect, it has conserved principal in excess of any buy & hold strategy touted by the mutual funds and financial industry as the best way to invest. My experience is that a buy & hold strategy can wreck a retirement portfolio and this is why I actively manage programs to avoid these severe market declines.

InvestTech Research, a publication edited by James B. Stack, says in his November 14, 2008 newsletter that, "Wall Street firms and money managers have long touted that "buy-and-hold" is the only strategy for long-term investors. So our "non-traditional" view that risk management is more important has seldom been popular among the pundits on Wall Street. One reason is because Wall Street has a vested interest in keeping you fully invested 100% of the time." He goes on to say, "Our conservative view dates back to the days of Nobel prize winner prize-winning economist Paul Samuelson in the 1960s. He postulated a simple thesis that the longer one invests, the greater the risk-due to the chance that you will encounter that once-in-a-multi-generation event that no one expects. Today we are seeing that type of event!"

There is, however, a good reason to stay with an existing buy & hold strategy at this point in the cycle. It's simply because the average investor makes decisions based on the emotions generated by the crisis and the media and usually exits the market after the crisis has reduced their holdings, or enters the market long after the recovery has taken effect. This is why there are no simple answers to investing.

With interest rates at a historic low point, and fixed income options offering very little inflation protection, an actively managed approach seems the best of the alternatives.

Please feel free to give us a call if you have questions about your account(s) or if you would like further discussion regarding the current economic investment environment.

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i Standard & Poor 500 Corporate Index is a benchmark for large capitalization stocks that are a part of the 500 largest companies combined in a capital weighted Index. This means that the larger companies have a greater effect on the Index than smaller companies.

ii The NASDAQ Composite Index is composed of approximately 3,500 stocks listed in the National Association of Security Dealers automatic quote system. Like the S & P 500, the NASDAQ Index is capital weighted.