# KAM COMMENTS

KRUSE ASSET MANAGEMENT, LLC

## CRASH=OPPORTUNITY?

Warren Buffet believes so… For all intensive purposes, the stock markets have "crashed" recently, which can be defined as a sudden drop in price in a short period of time. While we may like to think the markets are generally efficient and trade on reason, during crashes (and bubbles), the markets often trade away from fundamentals and are ruled by emotions instead.

Crashes are generally fueled by a self-reinforcing cycle of panic selling, which causes more supply of stocks in the market please. Greater supply generally causes declining prices. Declining prices cause more panic and fear of loss, which in turn cause even more selling. Often this cycle has little to do with the long-term value of the underlying securities and much more do to with the emotions *du jour*.

Investments will eventually trade on their value propositions again, which means there is often a disconnect between today's prices and tomorrow's. Taking advantage of the current potential mis-pricing that we should eventually correct is where the Opportunity Exists.

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**Kruse Asset Management is Expanding**

* We have purchased 1,500 square feet of commercial space to accommodate our growth.
* We are in discussions to bring more people into our fold (employees, advisors and partners) to better service you and your accounts.
* Go to www.KruseAssetManagement.com to view the latest news on Kruse.

## FINANCIAL BEHAVIOR BASICS

"Group Think" or Crowd Behavior is the underlying mechanism in the positive feedback loop that contribute to stock market crashes (and bubbles to the up side).

Typically the market is comprised of millions of individuals making relatively independent decisions as to what the perceived value of a security may be at a certain point in time.

Generally, the current price of a security is the equilibrium point of supply and demand. As the security increases in price, there is less demand, which keeps the price from increasing too much. Contrarily, if a security's price declines, more people in the marketplace will have an appetite (more demand) and will keep the price up.

During market crashes, the opposite occurs. Individuals are influenced by the market's actions. Selling causes a decline in prices, which creates fear of losses for individuals and therefore more selling. No longer does the market trade on the value of the security, because the individual investor is no longer making independent assessments of the security's valuation. Instead the individual is acting within a group as a part of a feedback loop that is inherently unstable - causing huge swings in prices (clearly the actual value of the security does not change as dramatically).

The good news is that this is a temporary state of being, and there will be a return to normalcy. However, when the norm returns, it will be too late to take advantage of the disconnect so make your moves now.

Be patient and be disciplined and you will be rewarded.

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*Principles that Outperform!*

"The advantage of emotions is that they lead us astray." — *Oscar Wilde*

## SOUND PORTFOLIO CONSTRUCTION

Yale: a thinking man's case study to Investing

Yale University has a 20 billion dollar endowment fund and one might think that with that kind of money they would take on very little risk.  However, Yale has also achieved an average of over 20% returns for the past 20+ years, so one could then think they take on excessive amounts of risk.

The truth is closer to both and neither.

Did you know that Yale will provide a free education to any student admitted whose parents earn less than $75,000/year?  As such, the portfolio manager at Yale feels it is his responsibility (and way to give back to the world) that the endowment fund earn higher than market average returns as safely as possible so Yale can continue to offer one of the best educations regardless of income levels of those who are admitted.

So how does Yale go about this task? Admittedly, they do have a few advantages over the average investor.  One, they have access to basically any money manger, hedge fund and/or investment vehicle they choose; and two, they consider their investment time line not to be just "long-term," but infinite, so they can outlast any business or economic cycle.

However; there are some lessons that can be taken from Yale.  First, their asset allocation is very different from the average investor (who generally invests in assets that are familiar to them).  The two asset classes that most investors use - domestic equity and bonds - comprise approximately 11 and 4%, respectively, of Yale's allocation…leaving 85% for assets that most investors do not consider.  Yale will invest in international equity and bonds as well as market neutral and absolute return funds and assets which tend to be less correlated with the afore mentioned investments.  Diversification is King.

Second, Yale employs a tremendous amount of back-testing, both in their own analysis and that of the money managers that they use.  Back-testing tend to reveal long-term trends in the markets that are overlooked by most investor who are trying to evaluate the most recent market changes, which are often times just noise.  As such, Yale will not use large asset managers since they tend to have a goal of asset collection which contrary to Yale's goal of outperformance.

## KAM IN THE NEWS!

Due to the recent market turmoil and the collapse of Bear Stearns and Lehman Brothers, two companies where I was once employed, several newspapers have interviewed me for my views, including the Chicago Tribune, New York Post and Pittsburgh Post Gazette. If you have an interest in viewing the articles, please visit the KAM web site.

Additionally, I wrote a piece titled "5 Mistakes an Investor Should Avoid During a Crisis," which was published by several online sources like Yahoo Finance, Market Watch and Forbes.com, which can also be viewed at www.KruseAssetManagement.com.