KAM COMMENTS

KRUSE ASSET MANAGEMENT, LLC

MARK-TO-MARKET (MADE SIMPLE)

Let's say you own a chain of lemonade stands – 100 stands in all. Each of these stands costs you $100 to build and they generate $10 profit per stand per year. The bank loaned you the $10,000 to build the stands because they believe due to Global Warming, the lemonade business will be a good one. The bank valued the stands at 15 times their annual profit (so each stand would be worth 15 x $10 or $150) and with that profit, you could easily pay the bank back over time. So now you have $15,000 worth of stands, a $10,000 loan ($5,000 positive net worth) and you're out there selling lemonade and paying your bills since you're making $1,000/year.

The next year the bank asked you to see what those stands were worth by trying to sell one of them. You found out that a guy named Fred was willing to pay $200 for each stand so the bank declares that you now have $20,000 worth of stands and so you doubled your net worth even though nothing changed…not even your profits. Of course the bank lent you more money to build another 100 stands…

The following year the weather turned colder and people didn't want to buy as much lemonade, so your profits dropped to $9 per stand per year – plenty of money to make payments on the bank's loan – but you still had to ask Fred what he would pay for your stands. Unfortunately, Fred got sick due to the weather and didn't want to own a lemonade stand anymore. You begged Fred to make an offer, and he said he would only buy a stand for $100/each. Now your 200 stands are worth $20,000, and you have $20,000 in loans with the bank, which means your net worth is wiped out even though your profit declined by only 10%.

The bank requires a cushion between their loan and the value of your stands, so they make you sell some of those stand to Fred, but after the first 50 stands at $100 each, Fred doesn't want any more and, in fact, he will only pay $50/stand from this point on. So after selling $5,000 worth of stands and paying down the loan to $15,000, you now have 150 stands valued at only $50 each ($7,500) even though each stand is still making $9 profit per year ($1,350/year total).

Only now you have to borrow money from your Uncle just to stay in business long enough to sell these stands at $50 each — reducing your ability to make money with each sale — and now your Uncle wants to get involved with your business decisions….what a nightmare!

Perhaps everybody would be better off if the bank didn't require you to ask Fred how much he thinks the stands are worth and let you value them based on the money they are brining in.

{Historical Note: this accounting rule was initially instituted in 1929, repealed around 1939 and reinstituted in 2007 and recently repealed — these dates seem like a fantastical coincidence.}

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Food for thought:

* Recessions used to happen every 3-4 years, with unemployment rising to 8-9% on average.
* In the past 60, there have been 19 times that unemployment has risen 0.5% or more, and the worst 12-month return after that spike was 17.6%.

KRUSE ASSET MANAGEMENT, LLC

Note the New Address:
216 S Jefferson St., Suite 302
Chicago, IL 60661

Phone: 312-775-6000
Fax: 312-264-4557
Stuart@KruseAssetManagement.com
www.KruseAssetManagement.com

Principles that Outperform!

"If you're going to panic, panic constructively."
— Unknown

TECHNICAL TALK

When the markets trade on "techincals," what does that mean exactly? Well, "exactly" is not part of technical trading since this is often much more of an art than a science. Put simply, technicals are nothing more than trying to predict a stock's price movement based on the patterns formed by the chart of the stock's price over time.

Some examples of technical evaluations are looking at support and resistance levels. Often times a stock will appear to hit a level and reverse directions over and over again. If a stock seems to be bumping up against a ceiling, that would be a resistance level; alternatively, bouncing off a floor (like below) would be a support. Breaking through either of those artificial lines would signal a continued move in that direction (either up or down, respectively).

Some say that trading on technicals is like trying to read stock-market tea-leaves, but if a significant number of people are reading a chart the same way and believe the markets will go down, they sell, thus driving the price of the stock down and fulfilling the prediction.

Generally, over long periods of time the markets trade on fundamentals, or the underlying economic characteristics; but short-term they often trade on technicals. Therefore making long-term decisions based on technicals is often not advisable, but completely ignoring technicals can also hurt you since much of the market makes short-term trading decisions based on them.

NEW ADDITIONS

Please welcome Kurt Winiecki to Kruse Asset Management. Kurt joins KAM from Merrill Lynch and wishes to leverage his legal background to help his clients via estate planning strategies, which are often over-looked by financial advisors who can be focused on the investment selection only.

In a world where "financial advisors" are often not much more than sales people for the firm where they are collecting a pay check, Kurt shares the philosophy of KAM to always put the needs of his clients first and we welcome him to our family.

Kurt can be reached at Kurt@KruseAssetManagement.com or (312) 798-6729.