KAM COMMENTS

KRUSE ASSET MANAGEMENT, LLC

2ND HALF

"Sell in May and Go Away" is a Wall Street axiom because most of the markets' returns have traditionally occurred from the beginning of the 4th to the end of the 1st quarter, while the 2nd and 3rd quarters have averaged flat returns.

Of course, this is not always the case, as is demonstrated by the two quarters following the recent bottom installed in March, '09, which was up 13.9% and 11.5% in the 2nd and 3rd quarters.

However, this pattern does hold for the two most recent years following that deviation. In the 4th quarter of 2009 and 1st quarter of 2010, the returns were 10.0% and 3.9%, respectively, while the 2nd and 3rd quarters saw combined returns of –2.7%. Q4, 2010 and Q1, 2011 totaled for 16.2% while Q2 and Q3, 2011 lost 17.4%!

So far, the 4th quarter is up double digits, thus following the trend that the 4th and 1st quarters tend to be the most productive.

As can be seen by the chart, we have been range-bound for a few months waiting to break-out one way or another. If the trend continues, that break-out could be to the up-side for several months to come. Don't be afraid of pull-backs — they are commonplace and occur every year.

- JSK

Volume 4, Issue 3

October 15th, 2011

In this issue:

Did you know?

- Taxes collected by the U.S. Government (% of personal income) are the lowest since the 1950s.
- S&P 500 forward P/E ratio is at a 20-year low: 10.6x.
- Congressional Approval Rating is at a 35 year low of 13%.
- Company earnings and corporate profits are higher today than at the peak of 2007.

TACTICAL SHIFT

Kruse Asset Management has added a new arrow to our quiver in our never-ending goal of finding ways to protect your portfolio: the "Tactical Shift" model.

We find that most of our clients' risk profile is asymmetric — more specifically, large market down-turns are generally more painful than commiserate up-turns are beneficial to them. As such, for some of our clients we need to protect from downside losses more than going after huge gains.

Our answer: the "Tactical shift" model.

Part of your portfolio can be tagged to move "in" or "out" of the market according to long-term forward indicators with the goal of protecting you from significant draw-downs while still allowing for participation in "good" markets.

KRUSE ASSET MANAGEMENT, LLC

216 S Jefferson St., Suite 302
Chicago, IL 60661

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

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Principles that Outperform!

J. Stuart Kruse, CFA
Matt Kraus

Happy Halloween!

OPERATION TWIST

We have all heard by now that the Federal Reserve is going to employ "Operation Twist" — something that was done in the 60s during the Kennedy Administration. But what exactly is "Operation Twist"?

Previously, with QEI & QEII they set out to buy a set amount of securities to help keep rates down. With "Twist," the Federal Reserve will be looking to extend out the duration of their portfolio, hoping to drive down interest rates that are out longer on the curve by buying longer term debt while selling their shorter term debt.

The question arises then; how far out on the curve do they go? Will the Fed concentrate around the 10yr sector or move all the way out to the 30yr sector? As we have already seen, there has been a sizable drop in yields out on the long end of the curve, as the market anticipated the Fed's actions.

As an investor, what should I be aware of? First and foremost, don't fight the Fed. If the Fed wants to buy long dated paper, play along. However, keep in mind that the market has priced in a good deal of the move already, as evident in the collapse of the yield curve spreads (July 1st, 2/10 year spread was 271 bps, but on Sep. 2nd, the spread was only 179 bps). The spread between corporate bonds vs. treasuries and High yield bonds vs. treasuries, as a result, has widened. Investors might want to use these two sectors to add duration. While not overweighting treasuries, still owning them will continue to give you peace of mind as the global debt crisis's continues to unfold and the Fed continues to bid on them.

One obvious note to remember: if the Federal Reserve is finally able to stimulate the economy and create self sustaining growth, there isn't any place for interest rates to go but up. With this in mind, be aware of your duration and be nimble. Look for sectors that will outperform treasuries when, and if, a back up of rates does occur. Depending on how far out the Fed goes, will also determine how difficult of a time they will have when they unwind these trades. The 30yr sector could cause headaches due to the higher duration of the securities.

Will "Operation Twist" work better then QEI or QEII — or at all? Only time will tell.

— Matt Kraus