

# KAM COMMENTS

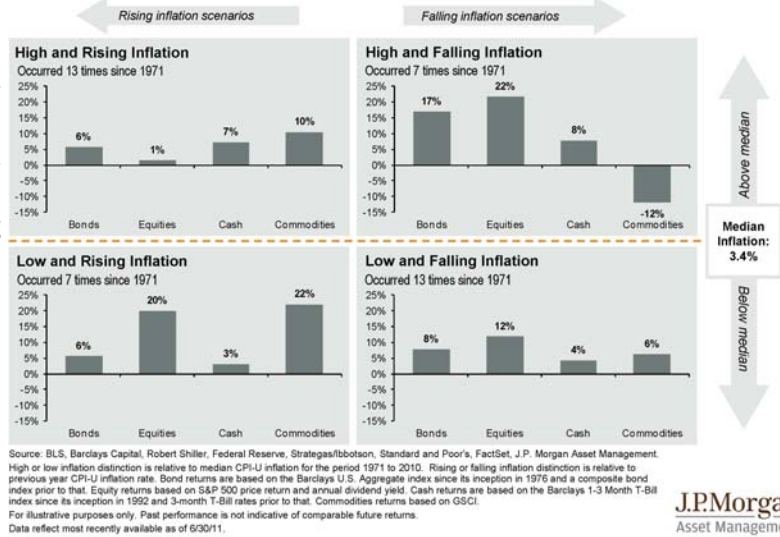
KRUSE ASSET MANAGEMENT, LLC

## INFLATION OUTLOOK

Monetary policy of the Fed has been extremely loose for quite some time. The big fear is that excessive liquidity will create looming inflation.

While Bernanke still maintains there is no inflation in our economic system, how should we position our portfolios if he's wrong (or late to take corrective action)?

Our friends at JP Morgan did a study on a various asset returns in different inflationary scenarios. Currently, we are in a low inflation environment (see the two bottom graphs in above chart). If we argue that inflation is rising (bottom-left), then the best places for you investment dollar are likely to be in equities and commodities. If we believe inflation is actually falling (bottom-right), then equities and commodities still have an edge. Either way, it seems that KAM's decision to overweight equities and commodities is the most prudent play of the day — JSK.



### Volume 4, Issue 2

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#### Did you know?

- \* The U.S. has a record high 727mm barrels of oil in its Strategic Petroleum Reserve (SPR) — the most it has ever had!
- \* Corporate Cash as a % of Current Assets is at a near-term high of over 26% (it was 15% in 2002).
- \* The average length of post-recession expansion is 44 months; we're at 25 months and counting...
- \* Housing makes up 2.2% of our GDP.

## THE PAYOFF

Kruse Asset Management spends an usual amount of time for a Registered Investment Advisor analyzing statistics. We check the "stats" on your accounts, on stocks in which we invest, on the economy and economic indicators. KAM makes VAR ("value-at-risk") calculations, estimates and updates correlations of asset classes, calculates your portfolio's standard deviations of returns and a variety of other unusual analytics — all in an efforts to

slant the odds in our clients' favor.

We are pleased to report that our efforts have been rewarded: on average, our clients see almost twice as much up-side market participation as they see on the down.

**The Bottom Line: KAM's clients have consistently seen more returns with less risk. This means your portfolio is working harder and smarter for you!**

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### *Principles that Outperform!*

J. Stuart Kruse, CFA  
Matt Kraus  
Amir Rafizadeh



**"Money Never Sleeps."**

## FIXED INCOME OUTLOOK

Weren't rates meant to rise as the Federal Reserve finished up with "QE2"? It looks like the credit markets didn't listen to the pundits calling for a backup in U.S. Treasury rates, but rather to the investors who still clamored for safety amongst the global uncertainty. The 2<sup>nd</sup> Quarter began with Japan worries and Mideast upheavals and ended with Greece and United States debt problems on the front pages. It's funny how fickle some investors can be; with inflation fears creeping into the market place the 1<sup>st</sup> quarter and then suddenly disappearing towards the end of the 2<sup>nd</sup> quarter with safety concerns now front and center.

The best performance in the 2<sup>nd</sup> quarter was turned in by the Municipal sector: up 3.9% for the quarter (+4.4% YTD), and the worst was the High Yield sector, +1.1% for Q2 (+5.0% YTD). All in all it was a steady return for all groups. Where does this lead us to in the 3<sup>rd</sup> Quarter and beyond? Firstly, don't become too complacent with inflation. Having some inflation protection within your fixed income portfolio is a must, using TIP's and/or bank loan ETF's will accomplish this. Secondly, the high yield sector should outperform most other sectors as the economy strengthens and investors eventually look for more yield and coupon protection. Lastly, a small portion of

U.S. Treasuries will help give your portfolio quality protection but not coupon protection, so keep your allocation small. Combining these three ideas with a sound ladder strategy will help your portfolio continue to grow in the near and distant future.

With interest rates and coupons historically low across most sectors and capital appreciation having run its course in the near-term, it will be important to remain flexible and short in duration. One thing is for certain there still remains an insatiable appetite for dollar denominated fixed income products – be it from foreign governments, pension funds, insurance companies or flight to quality investors. With this in mind, there is still plenty of room in the market place for quality paper to be issued. Remember the old adage "don't fight the Fed"? Well, the Fed's QE2 is now officially finished; however, that doesn't mean they're still not in the ease mode. Keep an eye on the yield curve (2/10 year spread) for any indications of the economy drifting back into a stalemate condition. The Fed wants a steep yield curve to help foster growth in the economy. Be careful and listen to the Federal Reserve for clues on when they will begin to try to normalize rate levels. Until then, look for small backups in rates to be met with buying interest.

— Matt Kraus

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Before making any investment decisions, consult with an investment professional about your particular situation.

Past performance is no guarantee of future results.