

ELF CAPITAL MANAGEMENT, LLC
(ENDOWMENT LIKE FUND MANAGEMENT)

February 11, 2008

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Shopping Advice: You Should Be Buying Stocks Right Now!

Timing a market bottom or market top is a futile exercise. It is a proven fact and anyone who has been able to do so has beaten the odds with a certain amount of luck on their side. However, what one can do with a greater degree of certainty is be able to recognize when market panics create bargain opportunities.

From its peak on October 9, 2007, before hitting its low on January 22nd, the current market correction will go down in the record books as one of the most significant market drops since the peak to trough corrections from August 25, 1987 through December 3, 1987; and from March 25, 2000 through October 9, 2002. So, how do we assess the differences and gain from what history tells us? Take a look at this chart below:

Then and Now	August-87	March-00	October-07
S&P 500 Index	336.77	1527.46	1565.15
12 Month Change	35.9%	18.4%	15.9%
S&P 500 P/E	22.7	29.4	18.0
10 Yr US Treasury Yield	10.20%	6.20%	4.67%
US Inflation Rate	4.3%	3.4%	3.5%
Fed Funds Rate	7.25%	6.00%	4.75%
Fed Policy Direction	Tightening	Tightening	Easing
Fed Chairman	Greenspan	Greenspan	Bernanke
Correction Decline	-33.5%	-49.1%	-18.9%

Let's also consider what was going on when the markets peaked in 1987 and 2000. In August of 1987, stock and real estate markets were bid up to almost bubble like levels; corporate balance sheets and real estate investors were highly leveraged; 10 year US Treasury securities were trading at attractive yields; the Fed was in tightening mode; and the country was at the beginning of the Savings and Loan crisis created by loose lending standards. Whereas in March of 2000, the stock market was trading at "irrationally exuberant" levels with the "Tech Bubble" leading the way; corporate balance sheets were highly leveraged once again; the Fed was in tightening mode; and, the bursting of the "Tech Bubble" was exacerbated by the events of September 11, 2001.

OK, now let's have a little fun with simple math and extrapolate a potential relationship between the S&P 500 P/E (price to earnings) multiples during these two previous corrections. The difference between the 2000 and 1987 peak to trough correction declines is -15.6% (-49.1% less -33.5%); and, the difference between the overly inflated, pre-correction peak P/E multiples is 6.7 (29.4 less 22.7). Let's assume, for the sake of argument, that each overly inflated 1.0X P/E multiple accounts for 2.33% (15.6% divided by 6.7) of decline and that each correction period's respective multiples would have bottomed at 8.3X peak level earnings. It's plausible. Now, if we use simple math to extrapolate the assumption forward, one might expect the current correction to form a bottom after declining a total of 22.6%.

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With this potential relationship as an indicator, we may only have to retest recent lows by 3.7% more before we begin to stage a recovery. Also, let's not overlook some key factors this time around: First, stocks began this correction at fair to modestly over valued levels by historical standards. Next, corporate balance sheets are now only showing moderate leverage, on average, and, in fact, many are actually cash rich. Also, 10 year US Treasury yields are not nearly as attractive as they were in 1987 or 2000; and, right now, the Fed is now more focused on growth rather than on merely easing. Factoring this in, we may have already reached a bottom. This is one set of reasoning why we believe that it is now time to buy this market.

Another interesting tidbit to consider is that 12 months after the 1987 and 2000 corrections bottomed, the S&P 500 Index gained 20.7% and 33.7% respectively.

As reflected below, January delivered us our largest monthly loss to date of -12.24%. At the finish of 2007, we handily out-performing most broad US equity indices and performed in-line with the MSCI All Country World Index. Yet, in January, we under-performed all of these averages. Much of this under-performance was due to our conscious decision to rotate into and over-weight the over-sold sectors of financials and tech and bought in before the market continued to punish them further. We wrongly assumed that these sectors were buffered from further downside volatility. As foreign markets dropped in reaction to our own and the benefits of diversification, for the moment broke down, our BRIC related and Pacific Rim investments contributed largely to this month's poor performance as well. We believe that, given the weak dollar and significant monetary and fiscal stimulus coming into play, our over-weighting of financials and tech will lead the market recovery strongly by benefiting from exports and business investment picking up bargains and front-running consumer demand. We also believe that the BRIC related and Pacific Rim economies will continue their rapid growth. As such, we are optimistic about being well positioned for a strong recovery in our performance this year.

On a more positive note, we have initiated coverage into special situation, single company stock opportunities. We believe that such coverage adds to our potential for achieving greater returns as well as providing greater diversification from market corrections. In data mining through ETF sectors, we had begun to notice opportunities where a single issuer looked extremely attractive and the opportunity presented would otherwise be greatly diluted by owning the entire ETF basket. At present, we have only identified two such "special situation" stocks that meet our criteria of being either a distressed company in the midst of a turn around or a company on the verge of exploiting a promising new technology. The two special situation opportunities on our "buy" list were up 41.3% and 19.8% respectively during the month of January. Unfortunately, many of our clients could not participate in these opportunities without having executed amendments to their existing investment management agreements. Amendments were sent out by electronic and regular mail. Those that had returned them were able to participate and see results. As we are quite optimistic with how this effort will improve our risk – reward potential, all of our new and amended agreements will allow us to invest up to 15% of their separate account portfolio into special situation single company stocks.

Lastly, we want to thank our clients for the many positive sentiments and faith given during this challenging market correction.

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