

ELF CAPITAL MANAGEMENT, LLC
(ENDOWMENT LIKE FUND MANAGEMENT)

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Surviving This Economy by Assuming Less

Are you looking for ways to improve or preserve the quality of life for your family and self? Are you anxious about the state of the economy?

The current downturn in the economy is changing the way we do things. Many people are dramatically altering their spending habits and relationships are being tested. I'm seeing people scrimp and save in ways that don't always seem to be the best course of action. And, these decisions may even wind up hindering their lifestyle over the long-run. So how can we make better decisions in these challenging times? Assume less.

How do you make decisions? Do you rely mostly on assumptions? Do you do your homework beforehand? Or, are you influenced by a little of both? How do you determine what to buy and who to buy it from? How is that working for you?

Everybody relies, to some degree, on their own assumptions. If we didn't, we'd be forever researching the what, what, when, where, why, who and how of every thing we did. We look for the simple way out. For transient or trivial decisions, our use of assumptions might guide us well; but for more important ones, relying on assumptions can do more harm than good. Let me explain...

My good friend Dan Elash always taught me that the success of any relationship rests on a "three-legged stool". Dan is a management consultant with a Psychology PhD. and his three-legged stool is a metaphor for why relationships begin and what makes them flourish. The three legs of the stool are: shared purpose, mutual impact and familiarity.

While it is somewhat easy for individuals to come together over a shared purpose, it is harder to determine whether the relationship will deliver an adequate level of mutual impact. Unless you gain enough familiarity to fully understand the value of what you will give and receive, how can you know whether you're making the right decision? In this instance, gaining familiarity is important to understand the value of the relationship for you and the other person. But the need for familiarity doesn't stop there. Even after the relationship is established, maintaining familiarity keeps the relationship healthy. Because, when we let our familiarity dwindle, we begin to operate with less information and begin to rely more on our assumptions.

The thing about assumptions is that they are often inaccurate. And, more often than not, our assumptions are more negative than the truth. Think about it. How many times have you wrongly assumed the worst about someone or something? I'm sure that's where the saying came about: "When you ASSUME, you make a MULE out of U and ME".

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But how can you be expected to remain familiar with each of the relationships that impact your life? It's hard, yet you can give priority to your more important relationships and make an effort to reach out as best you can. In my own life, I try to maintain familiarity through writing and distributing an article to my clients and friends each month. At the same time, I work at being able to respond to my client emails or calls within one business day. Sometimes I get back to them within minutes.

While gaining familiarity takes time, there are other things you can do to improve your decision-making skills. Here's some short cuts that might work well for you.

Last summer, I read an interesting book called Influence written by Robert Cialdini. The book discussed many of the emotional triggers that guide our assumptions and our decisions made as a result. While the book uncovered seven emotional triggers, I came away believing that only three of them were more reliable than the rest. These were "social proof", "authority" and "liking".

Social proof involves looking to see what other people are doing to help us through a decision. When people are uncertain, they look to the actions of others. Isn't it a lot easier to follow someone else's decision instead of doing our own homework? And, in some cases, it can save us from making a terrible mistake. Observing a long line at a new restaurant could lead you to a very pleasurable experience; whereas, waiting on a long line to use a public restroom could very well lead you to an unpleasant one. You just have to know how and when you might seek to use social proof to your advantage and when not to.

One way to increase the potential benefits of "social proof" is to ask a friend for advice. In fact, some of my best clients have come to me after being referred by another happy client. Yet, this time tested concept can sometimes backfire on you. If you've heard about Bernard Madoff's Ponzi scheme, you know that "social proof" alone can lead to a tragic outcome. If something seems too good to be true, it probably is.

When I'm looking to buy goods or services that I don't understand very well, I rely on social proof. If I'm buying a product, I'll search the internet for customer reviews and then shop for a reasonable price; otherwise, I'll ask a friend. My doctor, my dentist and even my lawyer were all introduced through my family or a friend. Yet, when knowledgeable about what I'm looking for, I'll often look off the beaten path. Sometimes you can find a better product or more personal service from businesses that few people know about. If you know what you're looking for, you could very well uncover a "diamond in the rough" by exploring a little and asking some questions. It always pays to be as friendly as possible when going this route. And, I always "spread the word" when I find a gem!

Here's a little gem for those of you who shop online. At ELF, we often buy office supplies online to save time and effort. We came across a shopping club web site called Aisle19. The site alerts you to available sales, discount coupons and cash back offers from a large number of well known online stores. You can join for free and we posted a link for it on our home page at www.hwkfs.com. Do yourself a favor and skip watching the steaming video presentation as you get more intelligent information from the FAQ page once you've joined. It costs nothing to join. We saved a larger than usual 30% on our first office supply order. Have a look.

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Now back to decision-making shortcuts.

The next emotional trigger is “authority”. Authority has to do with how we react to symbols. Examples of symbols we use in formulating our authority assumptions include job titles, clothes, cars, homes, offices, etc. And, they tend to fall into one category or another; they either have to do with ornamental trappings or achieved stature. While some should carry more weight than others, we don’t always focus on what might be more important when our assumptions get the best of us. More often than not, we tend to be swayed more by surroundings than stature.

I’ve used the word “trappings” instead of finely styled and expensive surroundings, because these types of symbols can cloud one’s judgment and serve as value traps. “Things are not always what they seem to be” and “You can’t always judge a book by its cover” are two sayings the come to mind. Through very little effort and some quick observations, it is all too easy to formulate assumptions based upon trappings. And for impulsive decision-makers, the shinier a “rock” looks, the more it is desired. If you’re buying granite counter tops, shiny rocks are a good thing; if not, all that glitters is not always gold.

By the way, if you are in the market to upgrade your home with polished stone counter tops, a fireplace or a shower stall, then Cogswell Stone – in Palmyra, Virginia – has some of the most interesting shiny rocks I’ve ever seen. In fact, their warehouse is like an art museum. You can find out more about them on their website: www.cogswellstone.com.

When relying on “authority”, it often takes much more effort to understand the stature of a product or service to be purchased. Determining stature may involve reading a product specification sheet and service record or reviewing someone’s background for relevance and fit. In the latter case, looking over the person’s resume of accomplishments is a good place to start. And, in order to make a good decision, you have to know what you’re looking for and be able to understand the product specifications or person’s background. How many times have you purchased something that looked great but really didn’t meet your needs? Again, exerting a little more effort to gain familiarity can lead to better decisions. And, if you don’t quite understand the symbols of stature that you’re looking over, you can always ask a friend to look it over for some social proof.

The last emotional trigger I’ll cover is “liking”. Liking has to do with our pleasurable appreciation for something we see or hear. In most decision-making situations, it has a lot to do with the social skills exhibited by the person we’re buying from. A long-time friend of mine who has spent a career in sales had always told me: “If people like you, they will find a way to purchase from you; and if they don’t, it won’t matter how good your product or service is, they will seek to do business with someone else”.

We like people or things for various reasons. We like what appeals to our eyes; we like what appears similar to our own thinking; we like compliments and cooperation. We respond well to people who listen to us. These are all good things. However, when we overindulge our sense for liking, it can undermine our decisions. When we shun people who challenge our thinking, we stifle any opportunity to learn about how we can do something better or find a better deal. Yet, it takes diplomacy and good social skills to

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challenge someone and to be comfortable being challenged. This takes patience, an open mind and much effort. Yet, the benefits are many when done well.

Good decisions come from discussions where both people listen patiently. How can someone help you if they don't listen to understand your needs? How can you help yourself if you don't listen to what the other person has to say? When our thinking is challenged, we have the opportunity to rethink what we are doing and can either confirm our commitment or chose another direction. No one is as smart as every one and we can always learn from another's point of view. Being heard and being a patient listener can save us from our mistakes. If we let it happen.

When the world comes at you fast, it is easy to rely on shortcuts and fill in the blanks with assumptions. The less familiar we are with a person or topic, the more likely our assumptions will cause more harm than good. And, hastily made decisions rarely save time or money as a result. Yet, we can assume less by simply gaining a little more familiarity and thinking about which emotional triggers are guiding us.

Market Update

In my last monthly update, I mentioned that I am looking for large US stock market recovery by mid year, but that we had to make it through the middle of February first. Wow! Was that an understatement! Most major indices were down more than 10% for the month of February. While the media did not report about it, I believed that hedge fund redemptions had much to do with the selling. Now, as we are approaching mid-March, I think we have a good chance to see the markets react a little better. At least until mid-May, if we are going to see the lows tested again. However, the next quarter could be much different and the economy might actually have a chance to start turning around.

Some events and data that came out last week began to show some positive signs and I don't regard them as false signals. The latest University of Michigan consumer sentiment numbers have reflected modest improvement and it looks like consumers have begun to pay down debt in record numbers. And while unemployment seems to be accelerating, we're hearing less about further layoffs and some firms have actually begun to announce that they will begin hiring. The most important developments have to do with the banking sector. The CEO's of Citicorp, Bank of America and JPMorgan Chase all came out last week to announce that they were profitable for the first two months of the year; President Obama has softened his attacks of Wall Street; and most importantly, U.S. lawmakers told FASB Chairman on Thursday to deliver new guidance on mark-to-market accounting within three weeks, or face legislation changing the rule that has forced banks to write down billions of dollars in assets.

This last item is very important and could play a big role in turning around the economy. If this gets done before the end of this month, you will see banks posting some very big gains for the first quarter as they begin to reverse many of the asset write-downs that has roiled the banking sector and stifled lending.

With respect to our client portfolios, in mid-February we sold off most of our equity holdings and brought our exposure down to 2%. On average, we brought cash levels to approximately 48% and invested the remaining amount into diversified bond funds earning an average yield above 15%. The bond funds are actively managed closed end funds by

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some of the US's pre-eminent bond management firms. The names we went with include PIMCO, Blackrock, Putnam and Western Asset Management.

After bringing our bond fund allocation up to 50% and holding 48% in cash, 30% of the cash will be used to rotate in and out of equities. And, given the recent developments in the banking sector, we may begin to accumulate a small position in the financial sector. Yet, we continue to favor the bond markets at the present and may increase our allocation to that sector.

At the point when the economy begins to show signs of improvement, speculators will have already taken the stock markets much higher. This is a move that we will not want to miss and I remain focused on the data to calculate our collective risks. At the very least, our bond fund positions will participate in that upward move while offering us a high rate of interest income over the interim. Yet, know that the bond funds will also fluctuate in price. However, bonds are senior in the priority of payments over stockholder positions and offer a greater degree of protection in addition to the interest income.

In a normal market, bonds generally offer far less attractive opportunity for growth than stocks. But we are not in a normal market right now and bonds are more attractive now relative to the risk taken.

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