

ELF CAPITAL MANAGEMENT, LLC
(ENDOWMENT LIKE FUND MANAGEMENT)

May 5, 2008

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Humpty Dumpty Market: He Didn't Fall; He Jumped.

As this famous nursery rhyme goes:

Humpty Dumpty sat on a wall.

Humpty Dumpty had a great fall.

All the king's horses and all the king's men

Couldn't put Humpty Dumpty together again.

Used as a colloquial term in 15th century England, Humpty Dumpty came to metaphorical life when devised in a poem during the English Civil War (1642 - 1649) to depict the toppling of a large fortress cannon; and, was later thrust into infamy when characterized as an egg, in Lewis Carroll's "Alice, Through the Looking Glass".

In this letter, Humpty Dumpty will serve as a metaphor for equity investor portfolios. And, "all the king's horses and all the king's men" will refer to US monetary and fiscal policy makers. In this story, we will see Humpty Dumpty back on the wall and there is a very good chance that he will look healthier and more handsome than before.

The evidence shows that Humpty, being light as a feather as he was, began his fall from the wall on October 9, 2007. He first touched down on January 22nd, bounced, and came to rest on March 10th. After stumbling around a little bit, he picked himself up, dusted himself off and surveyed the damage from the fall. Yet none of the evidence shows that Humpty lost his balance and fell off the wall. And any damage sustained was more an effect of the fall than a cause. In fact, I believe he was encouraged to jump off the wall and did so because he was scared. Also I believe that wall was of modest height before he jumped and that he will actually suffer less long-term damage than most people think. If you've read my last several letters since the beginning of this year, I've argued that this correction was more fear induced rather than fundamentally driven.

By all accounts, it seemed that several motivated "town-folk" had threatened him and were yelling "jump Humpty, jump", even some of his so-called friends. While this was going on, "all the king's horses and all the king's men" were trying to talk Humpty out of leaping off the wall. After seeing him jump, they tried throwing him several ropes to anchor to and pull himself back up, but he wouldn't reach for any of them. Ultimately, they put a safety net under him to cushion his landing (via forcing a resolution to the "run on the bank" at Bear Stearns). Now that he's down, they are continuing to say and do things (through tax rebates, interest rate cuts and term lending facilities) in an effort to get Humpty back on the wall and to keep him from trying to cause further harm to he and those around him.

Are you starting to get the picture? While Humpty has some scrapes and bruises, he needs more help coping with fear and his reaction to it than needing to see a medical doctor. And, it looks like the patient is already making efforts to climb back atop the wall.

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What can we look forward to and how can we gauge the pace of this market recovery?

The strongest catalyst for pushing stock prices higher may very well come in the form of confidence returning to the mortgage-backed security (MBS) and asset-backed security (ABS) markets – inclusive of those now infamous CDO's (collateralized debt obligations). If you remember, CDO's were the initial focal point that sparked the credit crisis which, in turn, precipitated the fall in global equity markets. Once confidence returns to these securities, their trading spreads will tighten, write downs on the books of companies in the financial sector will become write-ups and financial stocks will recover with exuberant strength. This will add significant fuel to earnings of technology stocks, which - by the way - are doing just fine right now – as financial companies have been the biggest tech customers in recent past. This would, in turn, boost consumer confidence too. (As a matter of disclosure, we are long financials and technology in our client portfolios.)

As well, a return of confidence to credit markets can also be expected to put a halt to falling housing prices and lend much needed stability to that market. Yet, expect lenders to be far more conservative going forward and, as a result, making fast money in real estate, over the next several years, will be the exception rather than the rule.

At the same time, confidence in the MBS and ABS markets will do wonders in supporting our currency – the US Dollar. The faltering US Dollar exchange rate has played a large role in pushing up oil and other commodity prices beyond normal levels. And, in turn, has been the main culprit behind the above average inflation we are experiencing right now.

Yes, while the boom in oil and commodity prices can be attributed to expanding emerging market country economies, it is also believed that commodity prices are trading at large premiums due to investors fleeing from the US Dollar – the world's largest reserve currency. Yet, this current currency dilemma is a double edged sword – both a curse and a blessing so to speak. It is also proving out that our weak US Dollar has significantly benefited US exports, which is helping our economy through this credit crisis.

While it is challenging for the average investor to monitor price levels of MBS and ABS markets, you can look for other signals. There are two ETF's (exchange traded index funds) you can watch: XLF, the ETF for the S&P500 financial stocks; and, GLD, the ETF for gold. The signal for Humpty climbing back up the wall will be rising XLF prices and or declining GLD prices. We think he's already climbing back up the wall. This is definitely not a "sell in May and go away" market!

Lastly, in case you didn't notice, our firm name has changed to ELF Capital Management, LLC. This was accomplished to help our audience have a clearer picture of what we do as many found our old name – Hoffman, White & Kaelber Financial Services – quite confusing. Not only is it more clear that we manage money, our new name facilitates an understanding of the Endowment Like Fund (ELF) strategy we employ.

We are also happy to report that our performance for April 2008 reflects that we also began climbing Humpty's wall – our returns were up 6.19% for the month.

For disclosure purposes, past performance is not necessarily indicative of future results and ELF Capital Management LLC (ELF), formerly Hoffman White & Kaelber Financial Services LLC, cannot guarantee the success of its services. There is a chance that investments managed by ELF may lose a substantial amount of their initial value.

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