

ELF CAPITAL MANAGEMENT, LLC

(ENDOWMENT LIKE FUND MANAGEMENT)

June 6, 2007

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The Power of Rigorous Thinking

“Everything should be made as simple as possible, but not one bit simpler.”

- Albert Einstein, (attributed)

To what degree do we heed the advice of others and who do we find ourselves listening to? How do we go about choosing our investments, the best career move or the right specialist? How do we adapt to and navigate through uncomfortable times or challenges? How do we evaluate new products, processes or strategies? How do we make decisions and how will our decisions affect our careers, our families, and our own lives?

When life is comes at you fast, it is often very tempting to just consider "quick-fix" answers or solutions for challenges at work or at home. The desire to resolve issues rapidly, so you can get on with things, is understandable. But indulging this impulse can often produce a damaging outcome. We may be prompted to act on an issue that we believe we understand, while actually lacking a complete set of facts or operating under some poorly established assumptions. When we over-simplify a complex problem, this often leads to simple "solutions" that can make matters worse. "Quick-fixes" lack rigor.

On the other hand, rigorous thinking doesn't mean we have to be all-knowing before we make a decision – paralysis from analysis does not provide optimal outcomes either.

To think rigorously means making your best effort to ensure that solutions are developed through an adequate combination of reason, logic and available information. The power of rigorous thinking can be found in the quality of the results from our decisions made and our actions taken. With rigorous thinking we can expect that our conclusions will be accurate given the purpose of the exercise, the resources we have available and the effectiveness of our efforts. A rigorously made decision, more often than not, ensures our abilities in achieving the results we desire with a minimum of unanticipated consequences.

At ELF Capital Management, LLC, we are committed to providing our investors and readers with every advantage when trying to preserve and grow their human, intellectual and financial wealth. We seek to empower you with the results of careful, deliberate and rigorous thinking.

In this newsletter we will provide you some insight as to what it means to think rigorously and how doing so may improve the desired outcomes of your decisions made. If you are looking for information and ideas to help you achieve greater success in your endeavors, we think you'll get a great deal from this newsletter. Then, be sure to look over our market comment and performance data at the end.

What is Rigorous Thinking?

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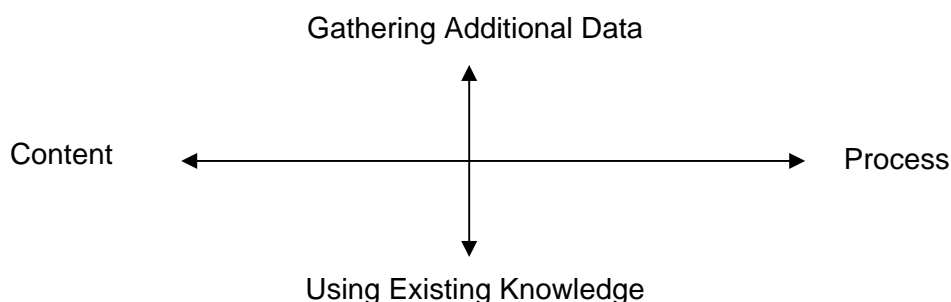
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Can you tell, by looking, when someone is thinking? Because thinking is an inferred process, I'd say, probably not. Cartoonists will often draw gears meshing and turning about a character's head to illustrate this. Or they may draw an image of smoke coming out of someone's ears as to depict them as thinking hard about something. In real life, however, we can only infer that it has occurred when we see the answers or actions that people arrive at as a result of their thinking. If we simply take it on face value that the thinking was rigorously done we can often be misled.

So far, it may sound like "rigorous thinking" is one of those nebulous terms like "love" or "wisdom". When asked, many people have found these words very hard to define. Rather than push to be exhaustive, we'll offer up a working description that should help you begin to understand "rigorous thinking" in the same way that we do and practice in our offices.

Let's begin by asserting that "rigorous thinking" is a disciplined, considered **approach and process** to thinking that involves questioning one's own assumptions in the pursuit of intellectually honest answers and solutions. Wasn't that a mouthful?

This approach and process requires us to contemplate problem solving, whether individually or in a group, on two dimensions. The first dimension involves considering: (a) what we think about (the content of our thoughts); and (b) how we think (the thinking and collaboration skills that we apply in tackling the query). And, the second dimension involves: (a) critically evaluating and assessing the applicability of our existing knowledge of the subject; with (b) the potential need of gathering and introducing additional information into the mix.



One of the better guides for helping to assess the degree of rigor to be employed in a problem solving session, or in setting higher achievement goals for a group, is a tool developed by staff of the International Center for Leadership in Education. Expressed on two continuums, the Rigor / Relevance Framework (see diagram below) is guide for employing a strategy of meeting learning needs and desired achievement goals.

First, there is the KNOWLEDGE continuum, which describes the increasingly complex ways in which we think. The low end involves acquiring knowledge and being able to recall or locate that knowledge. The high end labels the more complex ways in which individuals use knowledge, such as taking several pieces of knowledge and combining them in both logical and creative ways.

The second continuum, known as the APPLICATION model, is one of action. Its five levels describe how knowledge is put to use. While the low end is knowledge acquired for its own

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sake, the high end signifies use of that knowledge to solve complex real-world problems and to create unique projects, designs, and other works for use in real-world situations.

KNOWLEDGE	6 Evaluation	Assimilation Extend and refine gained knowledge to be able to routinely analyze challenges and create solutions		Adaptation Achievement of the competence to apply knowledge and skills in complex ways. Confronting unknowns, creating solutions and taking actions that further develop skills and knowledge.		
	5 Synthesis					
	4 Analysis					
	3 Application	Acquisition Obtaining and storing bits of knowledge and information		Application Use acquired knowledge to solve problems and design solutions for both predictable and new situations		
	2 Comprehension					
	1 Awareness					
		1 Knowledge in one discipline	2 Apply knowledge in one discipline	3 Apply knowledge across disciplines	4 Apply knowledge to real-world predictable situations	5 Apply knowledge to real-world unpredictable situations
		APPLICATION				

As reflected above, the Rigor/Relevance Framework has four quadrants and each is labeled with a term that characterizes a person’s learning or performance at that level. In any given situation or challenge, the ability to recognize your strengths and weaknesses on both continuums will help in understanding when and how to quantify the need for greater rigor. And, when working in groups, it is very important to understand and respect the level of contribution each party brings, or doesn’t bring.

The goal of rigorous thinking is to think in a disciplined, considered fashion as opposed to haphazardly. Rather than an approach of “shooting from the hip”, it involves a more deliberate action of working through each step of the problem solving process. The power of rigorous thinking is that you optimize your efforts; significantly build upon your existing knowledge base; and, become able to routinely build upon and leverage your successes.

How Can You Begin to Think Rigorously?

Rigorous thinking doesn’t have to be slow or plodding, but it should be reasonably thorough and complete. Some problems don’t always require us to think rigorously. Your first instinct may be your best. You don’t have to know at what temperature flesh burns before you move your hand off of a hot stove. However, when a complex problem requires rigorous thinking, anything less will not serve you well.

The best way to begin is to make sure you understand the issue or challenge. You need to start off asking the right question(s). Have you ever tried to solve a problem and found out

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later that you started by asking all the wrong questions? Come on now, be honest. Did you also find that asking the wrong or ill-conceived questions frustrated your information source? [I've personally been on both sides of this situation before.] As with any diagnosis, masking the symptom does not cure the underlying disease. How do you work through this?

You can start by gathering your thoughts on the topic and assembling the relevant facts pertaining to the situation. Are you clear about the challenge or issue? Keep an open mind and raise several questions. Explore some of them on your own by playing them out in your mind. Identify the key assumptions that led you to frame those questions the way that you did. Think out loud. Run your ideas past a skeptic if you're not sure. Do you believe you know enough to answer the question? Do you need to acquire more information? Do you need to ask for input? Are you involving the right people to help you?

Once you believe that you have the right question(s), you should seek out two or three possible "right" answer(s). Think out of the box. Challenge all answers to complex questions. Delay judgment until you have collected a reasonable amount of facts. Identify things you might not have considered the first time through. Look for them. Are there potential consequences arising out of the anticipated results from your first solution that are unwanted or troublesome? From your second? From your third? Which can you live with?

Spend some effort analyzing your ideas from various points of view or fields of thinking. Often common knowledge in one field leads to amazing breakthroughs in other fields. This is where diversity in thinking is valuable. You can do this by shifting your own frames of reference, or by involving different types of thinkers in the process. Have the courage to question your own logic. "Nobody is as smart as everybody." – Daniel Elash, (attributed)

Tie your various threads of thinking into the simplest explanation that handles all of the facts (this may be easier said than done). It may seem quicker to discard facts that don't fit, but when this happens you must be sure that the fact is truly irrelevant or recognize that this may indicate a pre-conceived bias that will keep you from the best right answer. Build various good ideas and multiple perspectives into an outstanding answer.

Finally, evaluate your answer from the points of view of other constituencies. Does it solve the core problem or answer the key question? How well did you work the process? Were there flaws in your process? Was your thinking rigorous? Finally, assess the strengths, weaknesses and unexpected implications of your answer. And, remember that creating solutions while working from erroneous assumptions, or thinking from a narrow perspective, and/or indulging personal biases, leads to poor or stagnant results.

Think of the ancient sailors who never left the sight of shore for fear that if they sailed too far they would fall off the edge of a world they thought to be flat. Ancient maps that noted, "beyond this point there be dragons and demons," limited the choices of all but the most intrepid explorers. Thinking evolves by adding new data points and forming insights built on accurate extrapolations arising from that additional knowledge. Just coming up with an answer is not proof of rigorous thinking.

What are the Benefits of Thinking Rigorously?

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Decisions, decisions, decisions... Whether for business or personal pursuits, our lives unfold through the decisions we make. Good decisions bring smiles, confidence and benefits or profits; and bad decisions bring frowns, insecurity and costs or losses.

Rigorous thinking helps minimize the "Accuracy Gap" and can dramatically increase the quality and effectiveness of our decisions. An "Accuracy Gap" exists when we allow erroneous assumptions, miscalculations or conclusions to lead us into costly decisions. In business, this "Accuracy Gap" often introduces unacceptable risk and unnecessary costs into critical management decisions. And, it is the reason that certain projects or under-takings do not deliver the predicted value sought.

As a result of working a considered, disciplined thinking process a number of consequences can emerge. You develop a deeper understanding of the problem that was vexing you or limiting your success. Think about it. If you know how to solve a problem it isn't a problem. The vexing, or recurring, problems are the ones that lie beyond your usual approaches. New understandings, new perspectives, and new information are usually required. In the famous quote from Einstein, "Insanity is doing the same thing over and over while expecting different results."

A second by-product is that you have exercised your thinking muscles, stretched your frame of reference, and developed more confidence in your ability to tackle tough problems, think innovatively and make better decisions. We strongly believe that if your thinking isn't driven by the emotions of fear or greed, if your perspective is less narrow, and if you are not bounded by erroneous assumptions you'll become a savvier, more successful investor no matter how good you are at the moment.

By thinking rigorously, you will ultimately increase your intellectual capital; capital that you can spend to build both your wealth and the quality of your social life. You will strengthen your sense of competence as well as your overall effectiveness, and the additional skills are yours forever.

ELF Capital Management Investment Performance Update

Global Insight reports: "The world economy is expected to grow 3.5% in 2007 and 2008, a pace that is near its expected potential. Despite the pronounced slowdown in the U.S. economy, the world's real GDP growth is projected to slow by just half a percentage point this year. After a period of robust growth in 2004-06, global output is nearing its potential and resource utilization is tight. Rapid liquidity growth worldwide suggests central governments may feel the need for further interest rate increases to contain inflationary pressures. With the exceptions of the Middle East and Africa, every major region of the world is expected to experience some diminution in growth this year. Global trade imbalances are beginning to narrow in response to exchange rate adjustments and shifting growth patterns.

After a first-quarter lull, the U.S. economy is beginning to accelerate, led by exports and business investment. As 2007 began, growth was held back by a plummeting residential construction, a downward adjustment in inventory investment, and a surprise drop in exports. With the inventory correction progressing, exports rebounding, and capital spending strengthening, real GDP growth is expected to pick up from a 1.3% annual rate in the first

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quarter to 2.2% in the spring quarter and hit its 2.6% potential rate by year's end. This improvement comes despite an expected moderation in consumer spending and further declines in residential construction.”

Bottom line: The world economy seems to have strong momentum, and the risks look to be shifting to the upside. Rapid liquidity growth, rising asset prices, and inflationary pressures could lead us into a boom-bust cycle. And, stronger global growth and inflation could prompt more aggressive tightening of monetary policies, which would probably set the stage for weaker performance beyond 2007.

For the month ended May 31, 2007, our one-month performance is up 5.48% and our three-month return is up 10.93%.

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.

ELF is an independent discretionary investment management firm established in February 2003. ELF manages a strategic allocation of primarily exchange-traded index funds (ETFs), and may invest in other carefully selected securities. ELF may also employ hedging techniques, through the use of short positions and options. ELF manages individual portfolio accounts for both individual and business clients.

The ELF ETF Strategy returns presented herein represents a composite of actual results from all client portfolios managed by ELF. Currently, it is the only composite presented by ELF and separate client account portfolio positions are substantially similar, except as may be modified for retirement plan accounts and accounts with net equity of \$60,000 or less. There is no minimum account size for inclusion into ELF's ETF Strategy composite and accounts with net equity of \$60,000 or less have a tendency to downwardly skew the combined results.

The performance data presented herein includes the reinvestment of dividends and capital gains; as well, ELF's ETF Strategy composite returns are presented after deducting actual management fees, transaction costs or other expenses, if any. ELF charges an annual investment management fee as follows: 1.25% on the first \$250,000; 1.00% on the next \$750,000; 0.95% on the next \$4,000,000; and, 0.75% thereafter.