

ELF CAPITAL MANAGEMENT, LLC
(ENDOWMENT LIKE FUND MANAGEMENT)

August 15, 2006

This is the ELF Capital Management, LLC Market Letter for the month of August 2006. If you do not wish to be included in our circulation, please reply indicating your desire to be removed and we will be happy to oblige. Alternatively, any of your friends or colleagues may receive this on a regular basis by entering their email address on our list-server via this [link](#). Feel free to forward this to any of your friends! Thanks for your interest and we hope you enjoy the letter.

How Fear Impacts Your Wealth

Why does the average investor buy high and sell low (the exact opposite of what they should be doing)? What makes them invest when the market has already experienced a significant run up? And, what makes these same people sell after a significant market correction has already occurred? Conversely, why do others feel compelled to stay with a poor investment rather than change course? It isn't so that they deliberately choose to lose money. Rather we might explain it as "herd mentality," absence of enough information, or a lack of comprehension. The real answer lies deeper than that. It lies in our emotions and their power to overwhelm our reason while driving us to poor decisions.

Fear and greed are two emotions strongly coloring the decisions of many investors. Whether an event produces fear is highly dependent upon our individual circumstances. Changes in the Consumer Price Index (CPI) and news of a rising inflation rate can cause fear in those living on fixed incomes. Corrections in the markets can cause fear as we watch others sell and see the value in our portfolios diminish. When fear becomes the dominant force driving our decisions we tend to make bad ones. We sell when we shouldn't. We sit on the sidelines too long. We act too quickly after considering too little information.

Where are you vulnerable? How much money have you lost as a result of fear based decisions? I know one gentleman who is sticking with a failing strategy because to change course would mean that he would "realize" his losses over the past year and a half. Instead, he's staying put and waiting for those losses to be recouped before he changes strategies. In this way, he believes, that he really won't have lost that money. He's afraid to face reality. How does fear affect you? Most people don't really think about it, as if by not noticing it really isn't a factor in their thinking. Many people don't like to think of themselves as being driven by their fears. Do you?

On the other hand, if we are aware of our fears and their affect upon us we can deal with them. We can stop reacting reflexively and regain control.

As readers of our newsletter well know, wealth management is the ultimate goal of all that we do at ELF Capital Management. Yes, we promote our services; yet, you will find that we always seek to present thought provoking topics that are relevant to our wide audience.

In this newsletter we will take a quick look at the nature of fear and then consider some common examples of situations that will allow us to identify the steps for dealing with any of our fears. As you might guess, this article is the astute work of our Dr. Dan Elash and we think you'll find his view quite helpful. Once you've read his enlightening piece, please be sure to spend some time looking over our market comment and performance for the month past. It will be well worth the investment.

ELF CAPITAL MANAGEMENT, LLC
(ENDOWMENT LIKE FUND MANAGEMENT)

August 15, 2006

How Does Fear Work?

Webster's New World Dictionary defines fear as "a feeling of anxiety or agitation caused by the presence or nearness of danger, evil, pain, etc." This nearness can be in terms of physical distance or the psychologically proximate presence of threat. While any number of dangers or threats may be real, they are perceived through our own perspectives and then magnified or diminished by our assessment of how well our resources can protect us.

Fear is the mind's reaction to a perceived danger or threat of harm. There are two elements required for us to experience fear. First, we anticipate the possibility of consequences that we don't want to face. Second, we believe that the situation we face has the ability to overwhelm our abilities to defend against them. When we face challenges we feel we can handle we are not afraid. We even seek out opportunities to be scared when we believe, deep down, that there is no real imminent threat. Amusement park rides, scary movies, and page-turner books are examples. On the other hand, when we can't imagine how to cope with perceived threats we can become, defensive, avoidant, or even frozen into immobility. The difference all lies in our realistic assessment of our capabilities to cope with the danger or threat.

Fear as a Wise Advisor

The secret to beating a threat lies in our willingness to face it, survive it, and come out the other side stronger than before. This willingness requires a plan. The plan can entail gaining new skills, competencies, and/or resources. This may involve learning new things, getting additional help, or adding protections against the things we fear. The plan might also involve a strategy that restores our confidence in our capacity to handle the potential threat with our current resources, by acting differently in the face of the threatening situation. Fear is the body's self-protective signal that we need to act. It fosters growth, change and adaptability. Fear is your friend if you use it as a wise advisor. It is harmful when it causes us to panic, to act irrationally, or to become frozen in despair. Therefore fear provides us with a choice. When we have a choice, we have options. Options lead to solutions. We can always control what we choose to do about what we feel.

A second general principal for defeating fears rests in our mindsets. When some people face a threat they spend their mental energy focusing on the fear. They imagine the worst case scenario and replay those images over and over again in their minds. In a very real sense, they put their mental energy into rehearsing failure. They anticipate it, fill their minds with it, and become overwhelmed by it. This is what leads to poor decisions and ultimately failure. Winners, on the other hand, focus on what to do in order to resolve the fear. They create a plan. They envision themselves being successful, and they refuse to dwell on the things that are beyond their control. In essence, they mentally rehearse success until they are ready to take action to resolve the situation that frightened them.

Where you put your mind and the choices you entertain and then execute will create a winning attitude that builds you up rather than destroying you from within.

There are two scenarios that I want to consider as working examples for how you can beat fear. People with significant wealth often battle one or more of these fears. The steps to

ELF CAPITAL MANAGEMENT, LLC
(ENDOWMENT LIKE FUND MANAGEMENT)

August 15, 2006

defeat these fears work against any fear, and so the lessons learned here can help you to become not only a happier person, but a more successful investor and a wiser steward of your personal wealth.

The Fear That People Want Me Only For My Money

The situation: Many wealthy people live very lonely existences because they are consumed by the fear that others only relate to them because they want something. What is so insidious about this thought is the reality that everyone relates to everyone because they want something. That something can be companionship, friendship, wisdom, affection, sex, opportunity, validation and on and on, but it is always something and often more than one thing. This isn't bad. It is simply human nature. You want many of those same things from the people with whom you associate as well. Successful, fulfilling relationships are always an exchange of value. The best friendships are often based on one person needing what another can more easily give and vice versa.

If, however, you define yourself by your money, it can be very difficult to believe that others can define you as anything else. When you feed this fear everyone can become suspect. We tend to see what we are looking for if we look long and hard enough, because we can always ascribe motives to people whether they are accurate or not. You begin to create a reality by what you expect. Your fears become self-fulfilling prophecies. You think, "That boy only wants my daughter so that he can get to my money." You think as if your daughter could have no other attractive traits. Or you decide, "He's only acting like my friend so that he can leech off of me." Thinking like that often leads you to treat people badly so that the only ones who come around are those who are willing to suck up to you for what they can get. Viola, your fears are proven! You become resigned to even greater loneliness or you give in and buy your friends.

An effective response: There are choices. In your choices lies your freedom. First, where do you put your mind? Instead of filling it with fear, take a realistically skeptical stance. (The key word here is realistically.) Give people some benefit of the doubt. Do they offer you something that you want or need? What assumptions and presumptions do they make? What do they offer? What do they do when you say, "no?" Don't prejudge but let relationships unfold. Remember, whether you are poor or rich, all relationships are about trading what I have to share for what you have to share. Make sure that you are offering something other than your wealth to the people in your life. Relationships are built over time. Gain confidence in your own likeability. Share the interests and hobbies that intrigue you with like-minded others. See yourself as more than your money. Don't offer money or things only to become cynical when others accept. These choices are yours. Don't abandon them.

Your protection always lies in your ability to stand up for yourself, to say "no" when you are asked for something you don't want to give. True friendships survive occasional "nos." Give the people who intrigue you the opportunity to earn your trust and see what they do. We need friends and companionship. People are social creatures. Just like in strategic arms limitation negotiations, the solution lies in the adage, "trust but verify."

In addition to learning to say "no," develop safeguards. Contractual agreements, trusts, wills and other instruments can be drawn up to protect you from momentary lapses in vigilance or judgment. Get advice and create a plan that adds to your overall protection against that

ELF CAPITAL MANAGEMENT, LLC
(ENDOWMENT LIKE FUND MANAGEMENT)

August 15, 2006

which you fear. Evolve your plan as the conditions of your life and your circumstances change. Make a plan. Work the plan. Let go of the fear.

Fear That Money Will Corrupt Your Children

The situation: At HWKFS we occasionally deal with people who want to give away a lifetime's accumulated wealth because they are afraid it will corrupt their children. This is a realistic fear. Money can do that. We all know of cases where it has happened. And, there is nothing wrong with charitable giving. But giving your money away based upon fear is an extreme and possibly unnecessary option.

An effective response: The alternative is for you to use your money to build the capabilities, judgment and wisdom in your children so that they are prepared to handle money responsibly. Start early. Start by not overly indulging your children while you are in control of your money. Don't substitute things and money for your time and attention. Make them earn what they want through their own efforts. Recognize that being overly indulgent is not a loving thing to do.

Let me share a story about a young CEO that I know. He has two boys in high school who wanted to design and sell t-shirts and they wanted dad to give them the money to start their venture. After some coaching, dad decided to act as an angel investor. He had the boys develop a business plan (he helped them but didn't do it for them). They had to research the market and make a case that their business idea was viable. When he was convinced by their seriousness and effort, he lent them some but not all of the money that they needed. They had to earn the rest. Then he sat on the board with them and held them accountable for their decisions (he advised, but did not tell them what to do). He made them repay the investment out of their profits. He ensured that they came away with wisdom and experience worth more than the money they generated. This summer, the older of the two chose to go to business camp on his summer vacation.

This particular dad is working today to fan the flames of passion and ambition by using the wealth that he has to teach valuable life lessons that are now theirs forever. It took his time and effort to create this experience with his sons. He used the same leadership skills that serve him well at work to pass on these lessons. Foremost, in what he did, he started out with the intention to use this opportunity to educate his boys. He put his mind in the right place. He worked a plan. He rehearsed success.

It is never too late to begin to foster competent behavior in your children, but the longer you wait, the more difficult the task becomes. Many parents mistakenly think they can't adequately teach money competencies and so they don't try. Common sense can go a long way in this effort. I'll share a mantra with you that I use in coaching corporate executives around America. "What you tolerate, you validate." Habits are formed early and if you accept dysfunctional behavior in your children you are teaching them that such behaviors will foster long-term success, but they won't. Feeling entitled, being lazy, and expecting that the world will take care of you are dangerous mindsets to inculcate. Don't allow them in your home and you will be preparing your children to make mature, responsible decisions throughout their lives, in financial matters as well as others. Put your mind in the right place. Develop a plan. Work the plan. Exercise good choices.

ELF CAPITAL MANAGEMENT, LLC
(ENDOWMENT LIKE FUND MANAGEMENT)

August 15, 2006

In Conclusion

Fear does not have to be a constant companion. It can be, but it doesn't have to be. Get your mind in the right place. Identify your options. Build your resources. Create a plan. Make good choices. Anticipate and rehearse success. Work the plan. Let your fears trigger your growth into a better person, a better investor, and a better steward of your wealth.

ELF Capital Management Investment Performance Update

Given where most major market indices are right now, it isn't hard to believe that we are in a "side-ways" market right now – with lots of volatility in between. Yet, it is precisely the increased volatility that can obscure your view. It also doesn't help that the more visible market professionals – those that we regularly see on TV and in the news – don't seem to agree, with any consistency, on the direction of the US economy and how that may impact other economies around the world. So, why the confusion? I think that changing monetary policy is the key, yet there are other issues contributing to the increased levels of uncertainty rotating through the markets – in the form of volatility. The biggest questions are: Is the US economy past its peak and rapidly approaching the next recession? Or, will the US economy continue its expansion at a modestly slower pace? Where in the cycle are we?

Here's my tally: The housing market is slowing, the impacts of higher short-term interest rates have yet to be felt by the consumer, high oil prices remain a continuing drain, the yield curve is inverted, failed trade talks are fanning protectionism, and inflation remains a threat. On the other hand, second quarter corporate earnings came in strongly positive, corporations are flush with cash and the latest retail sales report suggests that the consumer is not slowing. We think the markets are vulnerable until there is less confusion.

Our taxable accounts are positioned with a short bias at present and our plan accounts are approximately 20% to 25% long our best equity ideas with the balance in cash and high yielding floating rate notes.

For the month ended July 31, 2006, our one-month performance is down 2.08%, our three-month return is down 6.29% and our one-year return is up 5.63%.

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.