

**ELF CAPITAL MANAGEMENT, LLC**  
*(ENDOWMENT LIKE FUND MANAGEMENT)*

September 9, 2009

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## **Reflections on Summer: Indulgence, iPhones and Income Taxes**

In the US, Labor Day traditionally marks the end of the summer season and in most locales our children are back to school by now. While older students are certainly talking about it, the first writing assignment for many elementary school students will likely be to reflect on what they did over the summer.

How was your summer? What did you do with it? Did you learn anything new? Was it fraught with challenges or blessed with successes?

For many working adults, summer is a time when we seek an opportunity to take a much-needed break from work to improve our mental health. While there are many more benefits garnered from taking a summer vacation, after watching the economy take a nose-dive, I'd bet that taking time from our worries was the number one reason this year.

The year started with markets continuing a dramatic fall to levels not seen in more than ten years before finding its bottom in early March. Many who were considering early retirement watched their 401k retirement plans accounts become halved and contended with having to reconsider a change in plans. By spring, the markets had rebounded sharply and continued higher over the summer. There are some who missed the rally. For those who didn't miss it, it is wonderful when one can find solace in a sea of worry. Not that I believe all investors have a lot to worry about these days; I don't. However, we've just come through the worst economic climate in over seven decades and many have endured immense stress in the process. Did you take a vacation this summer?

For my household, going away on a vacation was an iffy proposition this year. Not only did I see my retirement plan account greatly diminished, my business endured swiftly falling revenues as well. It was frightening to say the least. Then in March, when the market began its rally, we experienced a significant influx of new business that has already brought us above prior years' to better than average earnings. Nevertheless, the experience left me very unsettled about whether I should be cautious or optimistic going forward. But, vacation we did and found ourselves savoring the experience more than ever before.

### **Setting the Stage**

Our family tends to vacation around the same time each year – mid July. This seems to work out best when managing around the schedules of school aged children and the cyclicity of my business. And, for as long as I can remember, we journey off to the beach for fun, sun and relaxation with several good books.

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When we went away last summer (in July 2008), the stock market was down more than 20% from the October 2007 highs; oil prices had surged past \$140 per barrel pushing gas prices above \$4 per gallon; the US Dollar was dropping against most major currencies and threatened potential runaway inflation; and the housing and financial crisis were gaining momentum. With all that was happening, it was impossible to leave work behind. I took along my computer with dual monitors and arranged having internet service so that I could manage any needed changes to my client's accounts. CNBC was the only show playing on our television set and I barely ventured far from this "make-shift" office I set up at the beach. So glued to following financial news events each day, my family brought me my meals and informed me about happenings at the beach. While we had arranged a two-week rental, we wound up leaving a few days early.

**Fast Forward to This Year's Experience**

Having been fortunate enough to get clients reinvested into the markets by mid-March, there was far less tension heading off to the beach this year. Yet, there remained enough uncertainty in my mind about the economy that I was not going without bringing along my computer workstation set-up. Clearly, this time – the circumstances were different. Two weeks before we left, my cellular phone contract came up for renewal and I retired my BlackBerry and opted for an iPhone.

If getting my clients monies invested back into the markets in March was the smartest business decision I made this year, getting an iPhone will have been a close second. This device not only allowed me to enjoy my vacation, it has become a valuable business tool to have at my disposal.

When they say "they have an app [short for application] for everything", believe it! Not only did I find "apps" to get the Wall Street Journal, New York Times and Bloomberg news services, I found apps to keep me "plugged" into global stock and bond market activity. They even have an "app" that provides economic statistics from the Federal Reserve Bank's database. On top of that, it is also GPS enabled and helped me track weather, find restaurants and even look up and purchase movie tickets. With this new tool, I had instant access to the news and markets wherever I was – at the beach, at a restaurant, where ever I went.

As a result, I determined very quickly that I didn't need to set-up my computer workstation – which drew hearty applause from my family! They were obviously worried about the prospect that we might repeat the unpleasant vacation experience from the prior year.

In addition to the ability to procure my favorite music on this device, I was also able to obtain audio-books or e-books with great ease. I'm hooked... It didn't take me long to determine that Apple has a real winner with this product. Not only do they have an excellent smart-phone device, they also have significant potential for follow on purchases with their iTunes and App store.

In the spirit of proper disclosure, I do not own Apple stock personally or in any of my client accounts. But, I certainly will be following this company going forward.

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With far less stress driving this year's vacation agenda, I had the opportunity to let my mind relax and allow my thoughts to wander. Shouldn't this be among the more important things to do when on a vacation? I began to ponder the concept of how the economic downturn might impact the average person's income taxes for the 2009 tax year.

**When the Mind is Able to Wander**

While it is widely expected that we will see income tax rates raised to pay for most of the economic stimulus spending directed by Washington, we've been told that those increases won't come until 2010 or 2011. And then, there is also the possibility that tax rates will be further increased to pay for those controversial "cap and trade" and health-care initiatives that the Obama Administration is trying to push through Congress. Those increases, while less certain, probably won't impact us until 2010 or later as well. But what about our income tax bills at the end of this year?

Following the worst economic environment in more than seven decades, it might seem intuitive to think that the average person will pay less in income taxes. However, I believe that the average person might actually wind up paying more in income taxes this year.

How did I come to conceive this idea? The answer lies in the belief that consumers have been frightened into spending less and saving more. And, the impact of significant increases in our national savings rate will produce greater income tax revenues than expected from lower spending and higher unemployment.

Have you noticed that in the second quarter's earnings reports, many corporations have been able to increase profits in the face of decreased revenues? Unless you are pumping savings into a tax deferred account, like an IRA or 401K, money saved is also money taxed. When a business spends, almost all of those expenditures are tax deductible; and, while individuals are far more limited in what they can deduct against their taxes, I'm only guessing that far less is being spent on tax advantaged expenditures – cash for clunkers and the first-time home-buyers credits being the exception.

And, what if the average taxpayer does wind up paying more in taxes this year? Not to worry, the current majority of our elected officials in Washington are looking to expand their business efforts too.

In a well articulated Barron's article this past month, University of Kansas Professor Anderson Chandler argues how "politicians rail against what they describe as the misplaced interest of investment bankers, CEOs and other corporate executives" while diverting the same type of scrutiny from themselves. The following passage from his article "The Capital of Self-Interest" alerts us how, in his words, politicians can be considered greedy too:

*"For example, legislators routinely increase the tax on cigarettes to reduce smoking, but argue that increasing minimum wages will not decrease employment among low-wage workers. They ignore how increasing the minimum wage makes it more difficult for employers to justify the training costs necessary to make teenagers into useful workers.*

*Eliminating low-wage job opportunities prevents lots of kids from gaining valuable job skills. Lawmakers do not reduce poverty by getting teenagers and other part-time workers fired or never*

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*hired in the first place. Kids need better basic education and training, but they also need low-wage job opportunities for the experience that will allow them to earn higher wages. Enlightened economic policy would focus on ways to help workers earn maximum wages, not minimum wages.*

*Why is unenlightened minimum-wage policy popular and invariably supported in Congress and state legislatures and municipal councils? It isn't credible to argue that presumably well-intentioned politicians are simply ill-informed and naive about the link between rising minimum wages and higher teenage unemployment. They don't need to read government-provided unemployment statistics to see the problem. Many are old enough to remember low-wage assistance from carry-out kids at the grocery store, gas-pump jockeys, and waiters and waitresses in popularly priced restaurants. So many of those jobs are gone; do they ever wonder why?*

*The legislative jihad against minimum wage jobs continues because it is in the self interest of politicians to kill such jobs. That's how you increase the need for public assistance and government-sponsored training programs for jobs that don't exist. Politicians prefer handouts to wages because recipients of handouts are beholden to political providers. Public dependency grows when the market system is forced to shrink."*

I don't know about you, but I don't agree with Washington's push to increase the size of government or for having us move several steps further into becoming a socialist society – I am somewhat Libertarian in my philosophy. I do believe that it is every American's duty to pay their fair share of taxes; and, I also believe that socialism is un-American. But, enough about politics – I was just beginning to feel good about remembering my summer vacation and don't want to spoil that thought...

## **Market Update**

The second leg of the market rally that began lifting stocks significantly higher in July, continued its upward climb in August – albeit, at a more modest pace. Now, it would seem that the stock market is getting way ahead of itself in terms of pricing in a recovery. Market pundits seem to be gathering momentum around the thought that the market is over-due for a healthy correction. Yet the market hasn't yet accommodated this thought.

In August we continued to see improvement in many economic indicators, but we also continued to see companies shed workers from their payrolls at a concerning rate. As well, the latest consumer confidence numbers lacked any meaningful improvement – in fact, they receded a little. On the plus side, the latest purchasing manager's survey for both the manufacturing and service sectors came out much better than expected. Yet, it continues to be somewhat of a challenge to measure the pace of the recovery.

While, normally, one can gauge the pace of an economic expansion through stock prices, stocks have too much going for them to help us measure. There remains considerable cash on the sidelines receiving little interest in return, much of which represents investors who have missed the rally from March's lows. On the other hand, there is also the possibility that we could have an initially explosive recovery that would make current stock prices look cheap. While for fundamental reasons, the market currently looks oversold; behavioral reasons seem to be keeping more buyers than sellers in the market place.

We continue to think that the market has gotten ahead of itself and have reacted by taking some profits and increasing our average cash position to between 35% to 40%. To me, it

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seems more prudent to do so. No, I haven't turned bearish on the prospects for an economic recovery; I just think that stocks have come too far too fast and opted towards playing it safe. At the same time, I am moving towards a repositioning strategy that includes some international equities back into the mix.

Despite migrating more heavily into cash during the month, our portfolios lifted higher at a more modest pace relative to the broad indices reflected below. As such, I am happy to report that our ETF Strategy performance was UP 2.20% (after management fees) for the month of August. On a year-to-date basis, we continue to look pretty good as well. Here are some comparative numbers for you to review:

	<b>Aug 2009</b>	<b>3 Month</b>	<b>Y-T-D</b>	<b>1 Year</b>
<b>ELF's ETF Strategy (net)</b>	2.20%	12.46%	25.78%	-10.12%
<b>S&amp;P 500</b>	3.36%	11.04%	12.99%	-20.44%
<b>Russell 2000</b>	2.76%	14.05%	14.54%	-22.67%
<b>MSCI EAFE Index</b>	5.16%	13.79%	21.14%	-17.69%
<b>MSCI All County World</b>	3.36%	11.51%	20.82%	-18.52%

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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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.

ELF's 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.

Broad market index information provided is solely for the purpose of comparison. This index data was obtained from third party sources believed reliable; however, ELF does not guaranty its accuracy. An investment account managed by ELF should not be construed as an investment in an index or in a program that seeks to replicate any index. In most cases, investors choose a market "index" having comparable characteristics to their portfolio as a benchmark. An ETF is a security that tracks an index benchmark or components thereof. As ELF actively manages a strategic allocation of primarily ETFs, selecting a comparable benchmark poses significant challenges. Over time, the broad market indices provided above may exhibit more, similar or less variability of returns and risk than ELF's strategic allocation. As well, the broad market index information provided above reflects gross returns and have not been reduced by any estimated fees or expenses that a person might incur in trying to replicate an index.

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