

ELF CAPITAL MANAGEMENT, LLC
(ENDOWMENT LIKE FUND MANAGEMENT)

October 10, 2009

This is the ELF Capital Management, LLC Market Letter for the month ended September 2009. 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.

Emerging Markets: Rice Paddy to Rice Paddy?

When pondering the possibility of emerging market countries leading us through the next wave of a bull market, two thoughts immediately come to mind: the saying “shirtsleeves to shirtsleeves in three generations” and how the “Made in America” label has changed in the past fifty plus years.

Most serious investors in the US and in Europe have always considered investing in the emerging markets to be very risky. We have been taught to be equally cynical when we hear “this time it’s different”. Is it wise to maintain this level of skepticism? Could it really be different this time?

A good friend of mine once advised me that “What is common knowledge in one industry, can often lead to an amazing break-through or innovation in another industry”.

In the paragraphs that follow, I’ll try to craft an argument why some common knowledge in estate planning and in consumer behavior might just support a belief that emerging markets could lead the next bull market expansion.

Shirtsleeves to Shirtsleeves in Tree Generations

This saying embodies one of the most common challenges encountered in estate planning. For some families, estate planning is not only about minimizing administrative and tax burden in transferring personal assets to chosen beneficiaries; it is about passing along a family’s intellectual and financial wealth for generations to come. The saying appears in every culture – hence, “rice paddy to rice paddy”.

In James Hughes Jr. book, *Family Wealth*, he characterizes the “shirtsleeves to shirtsleeves” phenomenon as follows: The first generation begins the cycle when they start from a position of modest means and create a financial fortune. They usually do this without making significant changes to their values, customs or lifestyle. The second generation elevates their lifestyle by moving into more lavish surroundings, acquiring material possessions, joining country clubs or other “high society” networks. As a result, the family’s fortune begins to plateau. The third generation, with little to no experience of work, consumes (liquidates) the family’s financial fortune. After which, the fourth generation finds themselves back into a position of modest means like their great-grand parents, to begin the cycle anew. This captures the challenge of perpetuating intergenerational wealth on a micro-economic level.

We can also apply this saying on a macro-economic level to emerging markets. Today, we are seeing advancements in global trade that have greatly benefited emerging market

ELF CAPITAL MANAGEMENT, LLC
(ENDOWMENT LIKE FUND MANAGEMENT)

October 10, 2009

countries. As a result, EMC's appear to be experiencing the first and, in some cases, be at the beginning of the second phases of this intergenerational wealth cycle. Whereas, developed countries appear to be further along the cycle by enjoying a relatively higher standard of living – even through this economic downturn. When US nationals are characterized as the world's greatest consumer, this view is hard to dispute.

Made in America

As one who is old enough to say that my childhood spanned the 1960's and '70's, I remember a time when Made in America represented the highest quality of goods available. European goods were similarly thought to be of high quality back then as well. Alternatively, products made in Japan or other Far East nations were considered quite inferior, often “breaking” very soon after bringing them home from the store. Because of this wide variance in durability, US producers evolved towards a strategy of “planned obsolescence”. This was a process whereby manufacturers stimulated demand by encouraging consumers to buy again sooner if they wanted a functioning product. Products were being designed to become obsolete or non-functioning after a certain period of time or a certain amount of use. This was a time when US manufacturers had a more captive US consumer market and global trade was less broadly practiced.

I can still remember when FORD, the US auto brand, was considered an acronym for “Fix Or Repair Daily” or “Found On the Road Dead”. As a result, imported European auto makers began to increase market share in the US – but they were far more expensive.

By the 1980's, the Japanese had earned great respect for the quality and durability of their automobile and electronics products. Not only did their quality begin to exceed that of US and European manufacturers, they were more competitively priced.

Now, in the last decade, emerging market producers have enjoyed the ability to flood world markets with low cost, high quality goods. This has created more of a challenge for developed countries to garner competitive edge in this world of growing global trade.

Don't Count US Markets Out!

Despite evolution of the behaviors and events discussed above, these factors alone don't necessarily fore-tell the future of the markets. In fact, all that I've hoped to accomplish was to articulate a reasoning why emerging markets appear to have momentum in their favor. On the other hand, the relative newness of emerging market expansions bring with them significant risks. Everything has limits. The notion that emerging markets are immune from the political and financial risks of navigating through their rapid growth challenges is fallible. And most, if not all, of this emerging market expansion has been dependent upon exports to the world's largest consumer, the USA.

From my viewpoint, the US consumer has played a large role in expanding global trade and aiding opportunities for wealth creation in emerging markets and around the world. This transfer of wealth has an inevitable effect of creating greater consumption from that wealth and additional sources of investment as well.

ELF CAPITAL MANAGEMENT, LLC
(ENDOWMENT LIKE FUND MANAGEMENT)

October 10, 2009

With this opportunity, I would not discount the experience and ability of the US, and other developed nations, to find ways to participate and gain share in a global economic expansion. After all, competition is often the spark that pushes experienced players to enhance their skills. Provided, however, that complacency or obstacles don't inhibit our ability to compete. Which leads me back to the concept of political risk...

If China and Russia are among the more prosperous emerging markets as a result of steps that has reduced socialism and increased privatization (capitalism) in their countries, what should that tell you about our own potential for political risks?

Market Update

During September, equity and bond markets continued to move higher as economic indicators reflected that the recovery is grinding forward. The sentiment seemed to be captured best by Barron's, Kopin Tan:

"The stock market certainly is supported by benevolent monetary policy, benign inflation, and both a wall of money and a wall of worry. For all the grousing about the government's money-printing, investors have lapped up government debt, and the 10-year treasury yield is slumping below 3.4%. Trillions parked in both bond and money-market funds can drive stocks higher, if investors get over their well-documented worries about missing revenue growth, future tax hikes, looming rate increases, unemployment, strapped consumers, the threat of deflation -- and the threat of inflation."

This month, we are moving into earnings season where companies will report on their results for the 3rd calendar quarter of the year. Stocks are up nearly 60% since the March lows and expectations are high for continued evidence that the recovery is gathering steam. In recent weeks, analysts have raised their estimates for almost twice as many companies than they've lowered expectations on. Yet, I'm not convinced that the market will reverse its trend if we see earnings expectations unmet. So long as the recovery continues to grind forward, the long term trend looks to support an upward trend rather than portend the potential for a deep retracement to the downside. Yes, we could see a sell off if earnings expectations are not met, however, longer term, we still have positive economic indicators reflecting a recovery in progress.

As for how the recovery is taking shape outside of the USA, last week Australia's central bank increased interest rates by 25 basis points to 3.25%. They cited the economic strength of their Asian trading partners as the reason for this increase in rates. This offers just another reason to believe that emerging markets could lead us through the next wave of a bull market.

Putting to work some of the cash we raised in August seemed to benefit our client portfolios during September. We were able to make some opportunistic purchases, while at the same time, continuing to maintain average cash balances above 20%. As such, I am happy to report that our ETF Strategy performance was UP 6.05% (after management fees) for the month of September. On a year-to-date basis, we continue to look pretty good as well. Here are some comparative numbers for you to review:

ELF CAPITAL MANAGEMENT, LLC
(ENDOWMENT LIKE FUND MANAGEMENT)

October 10, 2009

	Sept 2009	3 Month	Y-T-D	1 Year
ELF's ETF Strategy (net)	6.05%	16.98%	33.40%	8.69%
S&P 500	3.64%	15.06%	17.11%	-9.18%
Russell 2000	5.63%	18.89%	20.99%	-11.08%
MSCI EAFE Index	3.59%	18.80%	25.49%	-0.02%
MSCI All County World	4.41%	17.28%	26.15%	-2.56%

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.

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.

If the information in our articles is helpful for you and you're not a client, please look over our web site www.hwkfs.com to see if we can be of service. Also, please consider booking your business or holiday travel with our online travel agency affiliate www.marketlettertravel.com. They offer the same or better prices as other online travel websites and share with us a portion of their profits. So, your ability to use them is very much appreciated as it helps offset the time and production costs in researching, writing and distributing these letters.