Ken Stern & Associates
A Registered Investment Advisor

ALPHASYSTEM

# ALPHA ADVISOR

The Alpha Advisor is designed as a guide to creating Alpha Wealth, Alpha Protection and Alpha Legacy

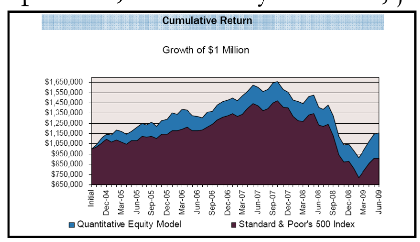
2009: Second Quarter

## KS&A vs. The S&P 500 - And the Winner is . . .

By Eric G. Hoffman, CPA

*"Thank You Sir, May I Have Another?"* Sound familiar? It is one of the most famous lines from the 1978 comedy classic, *Animal House*. To set up the opposition between the two rival frat houses, one of the early scenes shows a pledge being paddled by a cloaked active member. After each smack of the paddle, the pledge states, *"Thank you, Sir. May I have another?"* Presumably, the eventual reward of brothership will at some point outweigh his short-term discomfort.

I began with this quote for two reasons: First, I can only hope that KS&A's second half of 2009 is as good as the first half. During a time when most people are displeased, at best, with the results of their investments, Ken Stern & Associates is finding many opportunities.



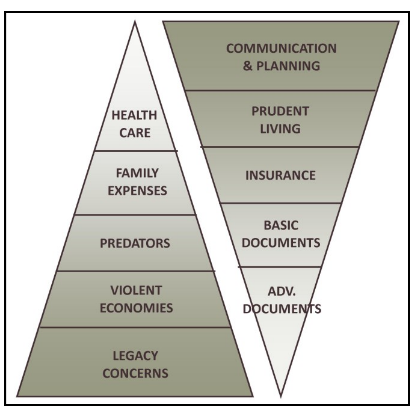

KS&A's QEM Performance

Second, this story is actually a good analogy for the equity markets in the first half of 2009. From lows on the Standard & Poor's 500 Index (S&P 500) below 670 in early March, June saw highs nearing 950, more than 40% off of the lows. As I write this, in late June, the S&P 500 is nearly flat on the year. Yes, just like the poor pledge, investors suffered some this year. But just as the pledge eventually recovered, so has the market - rewarding those with the faith and perseverance to recognize that both manias and panics eventually moderate.

## Inside This Report:



## How Vulnerable Are Your Assets?




Five Levels of Asset Vulnerabilities and Asset Protection

To our credibility, the first half of the year has been positive for KS&A's Quantitative Equity Model (QEM). Our QEM is a hypothetical equity model upon which we base allocations for a number of client accounts. Details of the holdings of this model, as well as sales from the model within the past year and applicable disclosures are attached to the end of this report {1}. As of the close of trading on June 30th, the QEM has returned a higher percentage as

{1} The performance of an unmanaged index is indicative of the performance of any particular investment. Individuals cannot invest directly in an index. The Standard & Poor's 500 is not a guarantee of future results. Index is a widely-recognized, unmanaged index containing a representative sample of 500 large-cap stocks in various industries that is believed to be an accurate gauge of this segment of the US equity markets. The index returns indicated are "Total Returns" with dividends re-invested, which means that the return reflects not only the change in price for the securities in the index, but any income generated by those securities. No adjustment has been made for account fees, sales charges or income taxes; the return indicated would be lower if they were included. Past performance Actual results will vary.

compared to the S& P 500 benchmark. See enclosed performance report and disclosures.

Based on the way we manage this model, we typically expect a slight under-performance in a strong bull-market; a slight out-performance in a strong bear market; and believe that "flat" markets will be some of the most attractive for our value-oriented "stock picking" style. This has certainly proven to be the case this year. In fact, since the inception of the model in October 2004, the QEM Hypothetical Model has returned a double-digit positive return as compared to a loss of the S& P 500 Index. See enclosed performance report and disclosures. When we originally created the QEM back in 2004, we set the goal of out-performing the S&P 500 over time, while maintaining similar risk. Almost five years later, we appear to have been successful in achieving this goal.

## Performance Attribution

So, how did we accomplish this? As we've discussed in the past, the QEM is a very process-driven model. In our in-depth monthly review we follow the same system and perform the same analysis in the same order every time.

We start with a review of economic and market factors to determine our overall outlook. From there, we review our weightings within each sector and decide upon the changes that we'd like to make – whether we'd optimally like to increase, decrease or leave constant the weighting for that particular sector. We next review our current holdings in each sector to determine if there are any definitive sells that we'd like to make, whether due to reaching our price targets or failing to meet our expectations. We also look for potential sells if we find any "pigs in the trough" – i.e., stronger stocks that would merit pushing out a weaker stock. Finally, we review potential buys.

Using our proprietary screens, we put together a list of approximately 25 stocks per sector that we find most attractive. Depending upon our sector views, we pare this list of 250 down to approximately a dozen potential buys that we'd like to examine in greater detail. Upon the completion of this analysis, we are ready to put together our trades for the month. By following this methodology, we believe that we are potentially able to capitalize from both our differential from S&P 500 sector weightings and by selecting what we believe to be "best in class" positions for each sector.

For the first half of 2009, I believe that our performance was influenced by several factors, most notably - cash. Currently, our model weighting for cash is approximately 10%, but it has been as high as almost 14% at various points during the year. Our benchmark S&P 500 Index does not hold cash, so I believe that our "allocation" to this helped to mitigate the volatility of the market in the first quarter. One of the first pearls of wisdom imparted upon me as a floor trader was that "sometimes the best trade is not to trade." I believe that this has proven to be particularly true so far in 2009.

I also believe that overweighting and underweighting the various sectors, relative to the S&P 500, has made a difference for us. Although the index as a whole is up so far in 2009, the performance of the various sectors has been quite diverse. Of the 10 sectors, only three are positive for the year: Technology, Materials and Consumer Discretionary. All seven of the other sectors have racked up moderate losses thus far, the worst being Industrials , with a year-to-date decline of 7.68%.

Due to our significant cash weighting, we have been underweight in many of the S&P 500 sectors, which helped to minimize the impact of the declining sectors. Of the three sectors that are up so far in 2009, we have typically been slightly overweight in Consumer Discretionary and strongly overweight in Materials, although we have been underweight in Technology. Of the declining sectors, we have been generally underweight. We were, however, strongly overweight in Health Care, which is only very slightly down for the year, and moderately underweight in Telecom. Declining sectors where we were strongly underweight include Financials and Industrials.

## Market Outlook – Or Not…

When someone asks what I do for a living, I'm inevitably asked for my market prognosis; my answer is often surprising. I typically couldn't care less about what happened in the market today and I certainly have no idea what's going to happen next week.

It's no secret that I believe many investors focus FAR too much energy worrying about what's happening today or tomorrow, when they'd be better off thinking further out and considering time horizons appropriate to the various asset classes within their portfolios. Daily market movement is, in my opinion, far too emotion-driven , such as short-term focus is a good way to drive yourself crazy. Knowing that most investors won't heed my warning, we actually use the short-term mindlessness of "the herd" to our advantage as it creates opportunities both in over-sold pessimistic situations, and over-heated, overly-optimistic scenarios.

Regardless of the market direction, one of the keys to investment success is to have a plan and to stick with it. For example, our KS&A Alpha System creates models designed to allocate assets to four different categories: Core Fixed Income, Core Equity, Tactical and Uncorrelated. The mix of these categories will change according to an individual investor's preferences and risk tolerances, but we believe that each investor should be exposed to most categories. The two Core categories remain relatively static, i.e. longer holding periods for positions within core. However, when we are concerned about the market, you will see fewer investments and higher cash balances – as was reflected this year. The Uncorrelated category is intended to help minimize portfolio fluctuations through finding investments that are designed to perform regardless of the direction of the market. Finally, the Tactical portion allows for more opportunistic intermediate-term ideas – which often result from the short-term knee-jerk reactions of the herd.

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## Embrace the 5 Levels of Asset Protection

By Ken Stern, CFP

I think of asset protection as I do a gas gauge – I think that it's best to check it often, confirming that the tank is full. Without an asset protection plan, you are left unprotected and your assets are potentially left floating in the wind, at the whim of life. Is this any way to live? Of course not.

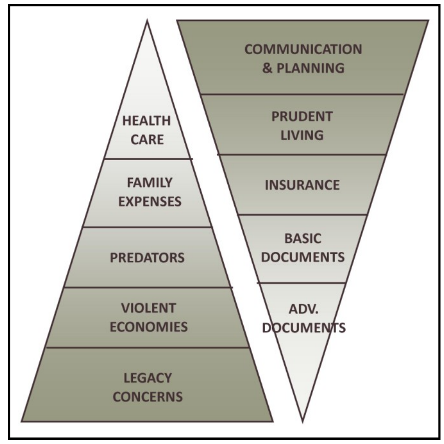
To control this risk, I advise those I work with to develop a strategy that anticipates the threats their assets may face. By preparing for the unexpected, I believe that my clients are more able to take advantage of opportunities that may present themselves. This level of planning is what I call "Alpha," a positive variance from the norm. Ken Stern & Associates philosophy is based around the idea that people can create this type of positive variance in all aspects of their lives – financial or otherwise – and effect changes that improve upon the base that they start from. Protecting assets is obviously an improvement upon potentially putting at risk those assets that we have all worked so hard to accumulate!

Asset protection is centered around planning for the unplanned. How can you plan for an unknown future event that may or may not happen? The key is in understanding that each threat deserves a different plan and understanding it is possible to categorize the main threats into five specific areas. It's not enough to just say, "I have an LLC (or a Trust, etc.), so I'm protected" – there's far more to the story than that. Sadly, these types of statements are common and overly simplify the situation. Often assets are protected from one particular type of threat – perhaps a personal lawsuit – but are left exposed to a multitude of others.

## The Process of Asset Protection Begins with the 5 Levels

Threats to your wealth and standard of living can and will come through many different avenues. Consider organizing your protection into 5 threat levels and 5 levels of protection strategies. I like to say that your goal should be "5 X 5" - identify 5 threats and implement 5 strategies to neutralize them.

Prior to discussing the 5 Levels of Asset Protection, it goes without saying that the major, all-encompassing threat that we all seek to protect ourselves from is jeopardizing our standard of living and / or compromising our financial freedom when we begin to draw down our assets in retirement.




Five Levels of Asset Vulnerabilities and Asset Protection

## The Five Levels of Asset Protection

- Communication and Planning
- Prudent Living / A Lean, Mean Cash Flow Machine
- Insurance
- Basic Documents
- Advanced Documents

The debate about health care is unlikely to ever cease, but health care costs are monumental and are likely to continue to grow. For most of us, it is a certainty that we or someone in our immediate family will experience significant health issues at some point that could potentially eat up our savings. A combined effort will be needed to protect assets from this serious threat. Communication is essential to ensure that family member have the appropriate level of information regarding insurance, basic and advanced documents to protecting our savings.

The expenses of raising and educating our children, as well as caring for elderly parents, are likely to be ever-present. To protect assets from this also requires communication, planning and documentation. Utilizing provisions available within the tax code, along with solid investment strategies and early planning, allows the opportunity to turn these expenses into investments and potentially reduce the hit to our savings.

Predators come in many shapes and sizes. They could be extra or unnecessary fees for simple transactions such as a mortgage refinancing, asset management or long-term care insurance. They could be something more sinister and costly, such as scam artists or identity theft. A few simple rules may allow you to again reduce your exposure to these threats. You, personally, are your own first line of defense – never feel forced into making a decision, particularly on someone else's timetable. Creating a trusted "board" of advisers to consult with on these matters helps in making informed decisions and in reducing the possibility of falling prey to the unscrupulous.

Your legacy is your mark on the world. This could be in the form of a monetary inheritance, tangible gifts or intangible gifts such as your moral code and life lessons. Most us wish to leave a combination of all of the above. For example, I wish to leave my daughters an inheritance, but don't want the funds to be needlessly taxed or spent irresponsibly. Furthermore, if either of them were to be divorced at some point or experience credit problems, I would like to ensure that my legacy for them won't be compromised. In addition to just the money, I also want to leave them with memories – what their great-grandparents were like, how I met their mother, that kind of thing. To accomplish this, I have compiled some basics forms and letters that I complete monthly, some advanced documentation for the tax and inheritance side and hold regular family and family board meetings to make sure that we are all on the same page.

Violent economies should be considered the norm and to be expected. The fast movement of information almost forces investors to make quick decisions based on the latest information available, verified or not, rather than waiting to make more strategically sound decisions based on "good" information. I feel that there is the opportunity for savvy investors to benefit from this by stepping back from the "mindless herd."

Whether we are discussing major shifts in the economic or market cycles or just a mania or panic in a particular position, your trusted board should look to create strategies to harness these shifts rather than fear them. You may have heard the Ken Stern & Associates campaign "Got Alpha?" If not, and if you have not considered such a strategy – take heed!

## Summary

I have heard it said that *Dreams are Simply Dreams*, but that *Goals are Dreams with Plans*. Don't dream of a prosperous, asset-protected life – plan for it!

Treat your family's finances like you would a business - with goals, budgets, rewards and consequences. During your monthly family meeting (even if you are the only family member attending!), track your progress towards the annual plan for your various asset protection and wealth management needs. Consider the fact that many successful people hire a family wealth manager like Ken Stern & Associates.

KS&A is a solutions-based, performance-focused company. We strive to add Alpha to your life. We expect to be held to a higher standard and, if we don't meet those standards, we expect to be fired. We are accountable to you.

Join our Money Revolution . . .
Get **ALPHA***TIZED*!

Contact Ken Stern & Associates to obtain your complimentary **ALPHA** ANALYSIS today!

WEALTH PROTECTION LEGACY | **ALPHA**SYSTEM

Ken Stern & Associates
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# KS&A QEM PERFORMANCE

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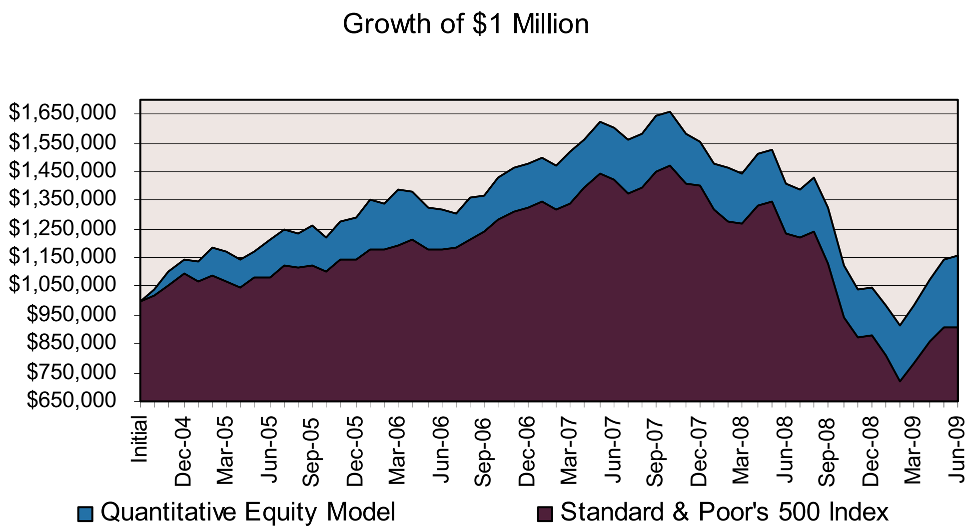
Results are for the period from October 2004 through June 2009

See the final page of this document for important disclosures.

## Cumulative Return




## Trailing Period Returns

| | QEM | S&P |
|---|---|---|
| Previous Month (June) | 0.89% | 0.20% |
| Trailing 3 Months | 17.87% | 15.93% |
| Trailing 6 Months | 10.29% | 3.16% |
| Trailing 12 Months | -17.95% | -26.21% |
| Since Inception | 15.61% | -9.02% |

## Description of the Fund

Quantitative Equity Model ("QEM")

The stocks that make it into our hypothetical model are selected using a number of screening criteria and a proprietary ranking system, which takes into account a spectrum of ratios and parameters. These factors, coupled with a defined trading discipline, were developed with the single goal of outperforming our benchmark, the Standard & Poor's 500 Index.

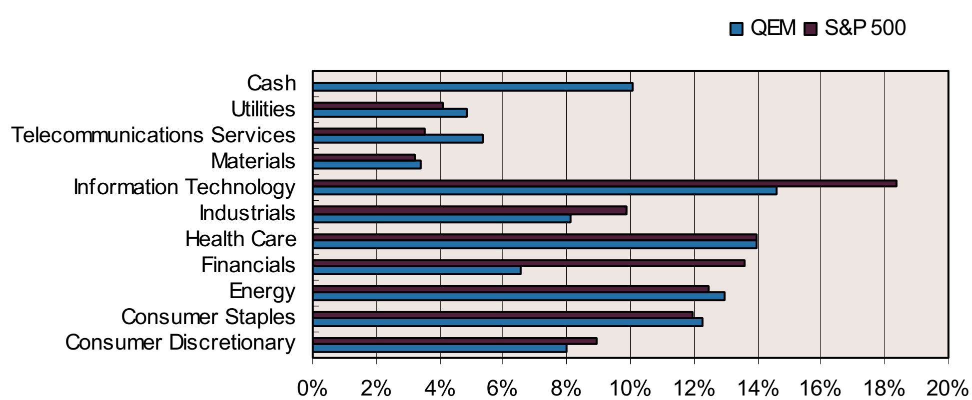
## Monthly Performance

| Year | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | QEM | S&P 500 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2004 | | | | | | | | | | 3.74% | 5.92% | 4.21% | 14.51% | 9.23% |
| 2005 | -0.65% | 416% | -1.23% | -2.40% | 2.65% | 3.52% | 2.90% | -0.93% | 2.04% | -3.35% | 4.67% | 1.14% | 12.83% | 4.89% |
| 2006 | 4.68% | -0.87% | 7.62% | -0.08% | -4.71% | 0.06% | 0.73% | 4.54% | 0.36% | 4.41% | 2.51% | 0.98% | 14.22% | 15.80% |
| 2007 | 1.64% | -2.11 | 3.24% | 3.01% | 3.86% | -0.96% | -2.88% | 1.32% | 4.07% | 0.64% | -4.47% | -1.65% | 5.36% | 5.50% |
| 2008 | -5.17% | -0.97% | -1.35% | 4.80% | 1.06% | -7.64% | -1.63% | 2.88% | -7.30% | -15.03% | -7.29% | 0.67% | -32.58% | -37.00% |
| 2009 | -5.94% | -7.15% | 7.14% | 9.44% | 6.75% | 0.89% | | | | | | | 10.29% | 3.16% |

## Statistical Summary

| | |
|---|---|
| QEM Mean Return | 0.35% |
| QEM Standard Deviation | 4.38% |
| S&P 500 Mean Return | -0.06% |
| S&P 500 Standard Deviation | 4.23% |
| # Months QEM Return > S&P 500 | 31 |
| # Months S&P 500 Return > QEM | 26 |
| Sharpe Ratio QEM | 0.26 |
| Sharpe Ratio S&P 500 | -0.07 |
| BETA QEM (as of 7/1/09) | 0.94 |

## Sector Weightings as of July 1, 2009




Ken Stern & Associates

# IMPORTANT DISCLOSURES

*The model shown on these pages was traded in an actual account from the date of May 2, 2005 to the present. For the period October 1, 2004 to May 2, 2005, the model was "mock" traded and the returns shown are entirely hypothetical and for illustrative purposes only. Ken Stern & Associates believes that the returns illustrated are substantially similar to those an actual client would have received had they invested in the model at its inception, held it throughout the entire period and been charged fees at the same rate that the model assumes. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities on this list. For a listing of all stocks included in the model since its inception, please contact Ken Stern & Associates at 1-800-529-2884.*

*The results shown here reflect the inclusion of a Management Fee of 1% annually, which is shown as monthly fees of .0833% of the Beginning of Month Portfolio Value. The fees that an investor would pay for these or similar services may vary. The model results illustrated assume that Ticket Charges for trades made in the account have been waived. Ticket Charges for actual client accounts are negotiable and may be waived at the discretion of the Portfolio Manager. The additional expense of any Ticket Charges would negatively affect the returns that an actual client would receive.*

*The results shown here reflect the inclusion of any dividends that would have hypothetically been received had the issue listed actually been owned during the period in question.*

*Investment accounts substantially similar to the model illustrated here were first offered to clients of Ken Stern & Associates beginning in May of 2005. No actual accounts were allocated to this model from the model's inception in October 2004 to May 2005.*

*Trades made for the account (both buys and sells) are assumed to have been made at the Opening Price on the first trading day of each month. The prices that an actual client would receive for similar trades could potentially differ from the prices illustrated. This deviation could negatively impact the return to the client.*

*For the period from inception of the model to February 2007, performance was reported from the opening price on the first day of trading each month to the opening price on the first day of trading the next month. Beginning in March 2007, KS&A began reporting their performance numbers from the closing price on the last day of trading each month to the closing price on the last day of trading the next month. This change was made in order to more closely compare to the way that Standard & Poor's reports the performance of their S&P 500 Index. Due to this change, performance for the month of March 2007 is reported from the opening price on the first day of trading to the closing price on the last day of trading.*

*Ken Stern and Eric Hoffman are registered representatives of and offer securities through First Allied Securities, Inc., Member FINRA/SIPC. Ken Stern & Associates is a Registered Investment Advisor.*

*The performance of the portfolios illustrated is benchmarked to the Standard & Poor's 500 Index, an index that contains a representative sample of 500 large-cap stocks involved in leading industries of the U.S. economy. An index is a portfolio of specific securities, the performance of which is often used as a benchmark in judging the relative performance of certain asset classes. Indexes are unmanaged portfolios and investors cannot invest directly in an index. The index returns are "Total Returns" with dividends re-invested, which means the return is not only the change in price for the securities in the index, but any income generated by those securities. The performance of an unmanaged index is not indicative of the performance of any particular investment.*

*As of the publication date of this model, individuals involved in the research of this model, employees of Ken Stern & Associates and its' affiliates and / or members of their households held positions in every single common stock included in the model.*

*Securities included in models shown here are selected based upon a variety of fundamental and technical factors. This process may include both objective and subjective criteria. Events affecting the world economy and / or the securities markets, both domestic and international, are likely to have significantly negative impact of the securities included herein. Funds allocated to international investments could be subject to risks associated with changes in currency values, economic, political and social conditions, the regulatory environment of countries in which the funds are invested, as well as the difficulties of receiving current and accurate information.*

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