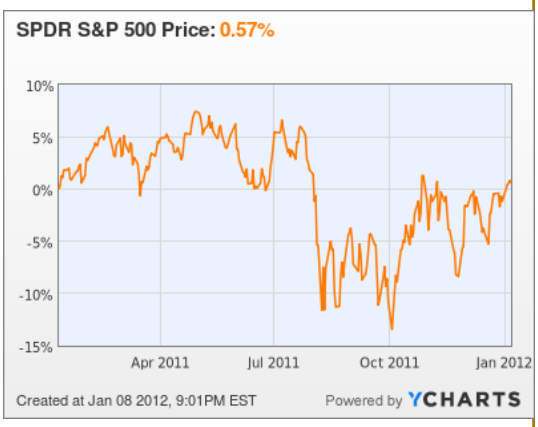
KAM COMMENTS

KRUSE ASSET MANAGEMENT, LLC

MUCH ADO ABOUT NOTHING



The S&P 500 had a bumpy ride in 2011. The fist half started off in a solid territory (see chart to the right), jumping off to a nice gain. However, the S&P traded in a range and bounced off the starting point twice before dropping below it in the second half of the year.

Again, the market traded in a range on the down side with a ceiling roughly around the beginning point.

The scary part was the transition from floor to ceiling, which did so in a short period and accounted for almost a 20% decline top to bottom.

At the end of the day, with all the problems in the U.S. and Europe and all the talk about the sky falling, we are back to where we started. If the market thought there really was going to be a debt contagion, this chart would look a lot different — there would be a 40% drop from the start like in 2008, not a round trip back to flat. Additionally, the bond market would be showing wider spreads, but instead both markets are saying that things look decent out there.

What does this means? Well, nobody can ever say for sure, but we feel that with the pent up demand, low relative multiples and massive cash on the sidelines, things are looking better all the time.

- JSK, CFA

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In this issue:

Did you know?

* Our political representatives are more polarized now than they've been since the early 1900's.
* Rental vs. Mortgage payments have diverged in recent years (rents are high vs. mortgage), but there is always a regression back to the mean.
* 1-year annualize returns are highly correlated with P/E Ratios — given our current P/E ratios, models would project an average annual 10-year return of around 16-17%!

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Please check out our new site at www.kruseassetmanagement.com. We have updated it to reflect our evolving business practices like:

- **True Diversification** — KAM may use over 20 different asset classes to reduce your risk and improve your returns
- **Independence** — Our only loyalty is with our clients, so we do not use one product (like mutual funds) or one firm as a solution for everybody.
- **Outperformance** — KAM's quantitative strategies have consistently outperformed their respective benchmarks.

We are always looking out for better way to improve your portfolio's efficiency so you can rest more easily knowing your money is working as hard and as smart as possible.

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Principles that Outperform!

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Make it a Great Year!

2011 FIXED INCOME RECAP

2011 began with high hopes for the economy and potential Fed tightening to follow in 2012. This initial belief, however, was never fulfilled. After the credit market backed up slightly in the 1st and 2nd quarters of the year, markets began to realize we weren't out of the woods and the treasury markets began to see strong buying. The world markets were hit with many jolts throughout the year (Japan's Tsunami, U.S. debt downgrade and Europe's debt overload) all of which continued to scare investors into the safety of the U.S. Treasury market. Add The Fed's "Operation Twist" to the scenario in the 3rd quarter and U.S. Treasuries once again were the envy of all.

Where will this led us to in 2012? First Europe has to find a solution. With the threat of a Euro-zone breakup hanging over the markets, U.S. treasuries will continue to find buyers. Also, The Fed's operation twist will be still in action for the first part of the year; remember don't fight the Fed. Lastly, we can't forget about Washington and their inaction on "must" things. All three items should continue to leave the investor reacting like a "deer in headlights," scared to do anything but hold U.S. bonds.

However, the more sophisticated and rational investor will begin to realize that there is no valve left in U.S. treasuries except for safety and begin to look elsewhere. The fixed income market sees valve through spread relationships and now is the time to look at the how spreads have moved out to 2007/8 levels again in some asset classes. You can pick up yield and not sacrifice too much credit risk. Also with interest rates at historic lows, duration risk will be a big concern once the markets begin to regress to the mean.

Be careful — bonds have risk too. Do your homework and when in doubt contact your bond professional.

— Matt Kraus