

October 24, 2008 **“A Thousand Popping Hedge Funds”**

Well a thousand may be a bit much, but I believe a lot of the noise (crashing) you are hearing on Wall Street now is the sound of the inevitable eventual destruction (and in some cases demise) of hedge funds. Hedge funds may be imploding as their high fees, and flawed mathematical assumptions, multiplied by stratospheric leverage gives those who speculated in hedge funds a dizzying dose of reality. But if we act appropriately then the hedge funds "pop" could be the fizz in our champagne glasses down the road. Due to hedge fund leverage and panicked investors redeeming their shares those funds are now forced to sell investments they otherwise would be buying at these prices.

The illusionary “magic” of hedge funds:

Those sophisticated and mysterious hedge funds are finding out the simple laws of nature and economics *do* apply to them: *they are not magic*. One simply cannot mathematically get greater than market returns and substantially decrease market risk, especially while paying the fund managers 40% of all profits! Hedge funds often operate on similar mathematical assumptions that were used to justify subprime market lending and securitization. I have said time and again: *if anyone finds a pattern in the stock market the simple discovery and exploitation of that pattern will cause that pattern to be useless and obsolete*. It is like entering a time machine and changing history when you act on the patterns you saw in the past.

For example, the subprime crisis started because of the observation that both the number of people who fail to pay their mortgages and the amount home prices decline has historically never gone above a certain number. But just “knowing” that and acting on that assumption made real estate investments and subprime mortgages appear fool-proof, when in fact they were fool-hardy. Had we gone back in time 20 years and employed the same formula then the bubble simply would have occurred 20 years earlier. The fact that we believed the numbers enabled more money to be lent to home buyers which drove prices to astronomical highs - and that made the original observation invalid (because homes and payments surpassed the ability of borrowers to pay). We want so badly to believe in magical formulas, but they do not exist!

We are all lemmings!

On the flip side we get scared when we see those very formulas break down and cause market chaos (even though we really knew those formulas to be ludicrous in the first place). During those times it looks like the market moves make no sense (because they don't) and we often succumb to panic and throw away assets for much less than we paid for them (the “lemming” effect). It is at times like these that the real *fundamental* bargains are out there - and I am seeing bargains like I have never seen before. Try hard to contain your fear when you see the stock market go down even further and realize that just means we can buy an asset cheaper than we could before. We are investing in *companies* for the long-term, not speculating in stock ticker symbols for the short-term. The market *only* wins if we panic into it - and *we win* only if we take advantage of the panic! We must buy when we are most scared and sell when we are most confident!

The time is here to start investing aggressively...

Almost a month ago I implored my speculative investors to start opening their wallets to systemically invest in the markets; now I believe the time has come for almost everyone to start systemically investing. The market may go down further (perhaps much more) but no one knows for sure. Right

now there are fundamental conditions that historically have been excellent investment opportunities. Time generally rewards those with prudence and patience in times like these.

Remember moments in the past when you were scared or euphoric – and learn from them!

Consider the level of fear you *didn't* have last October when stocks were twice as expensive as they are today. Recall when your broker in 1999 called you with the latest hot tech stock or your real estate agent suggested you buy a second home in 2005. I may be wrong this time, and it is certainly possible stocks will be much cheaper next month (I hope so). However the advice I am giving to you now has historically better stood the test of time than the "gurus du jour" that most people listen to. We must "be greedy when others are scared and scared when others are greedy" (Warren Buffet).

And currently we don't *have* to take extra risk for excellent potential returns!

Right now there are *fantastic* opportunities in municipal bonds (though not as good as last week when I sent out the plea "Invest in Municipal Bonds NOW"). I have locked in some of my clients accounts into long-term high-quality municipal bonds yielding the taxable equivalent of 11% to over 12%! I have never seen an opportunity like this before and I don't expect to ever again.

And consider if you are paralyzed by fear that holding cash may not be as safe as people think. In the event the worst-case scenario happens (complete financial market paralysis and no liquidity) then could start "dropping dollars from helicopters" (he has been referred to as "Helicopter Ben" Bernanke, Chairman of the Federal Reserve, for once stating dropping money from helicopters could be a solution to such a crisis). And that (or something with similar effect but with less drama, like printing extra money to pay off our foreign debts) could make the cash you thought was "safe" worthless. It would be better to own a part of a company (stocks) with hard assets and earnings that will likely inflate along with the devaluation of the currency.

I am going to be uncharacteristically aggressive!

I have never been aggressive with asking clients to invest more or to invest in certain things – until recently. This is likely an opportunity of a lifetime for some investments. Furthermore there is no safe place to hide! Therefore get what cash (you can afford to risk) out from under your mattresses and out of your bank accounts and get it invested! You may even consider investing some of your "reserve" money in high quality municipal bonds. If you haven't done so already set up a systemic investment plan. If you need help with setting one up call me, go in to your local Scottrade branch office, or call them at 1-800-619-SAVE (7283).. Meanwhile expect me to become more uncharacteristically aggressive if investment prices become even more attractive.

Warm Regards,

--

Mark Daniel Elliott, President
Elliott Asset Management
Registered Investment Advisor
760-845-7854, Direct
206-222-2772, Fax

DISCLAIMERS

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS. THE INVESTMENTS DISCUSSED HEREIN MAY LOSE SOME OR ALL OF THEIR VALUE.

This document is intended for purposes of discussion only. None of our publications (including this one) is meant as investment, legal, tax, or any other advice of any manner. Consult with your Investment Advisor, Attorney, Accountant, or other appropriate professional before acting on anything contained in this document.

Mark Daniel Elliott is a Registered Investment Advisor under the jurisdiction of the California Department of Corporations and the NASD (CRD#139796). We can legally accept clients from anywhere in the USA. Registering with the California Department of Corporations or the NASD is not and should not be interpreted or construed as endorsement of our company or service.

Disclaimer of Warranty and Limitation of Liability: The information in this document is provided "AS IS". Elliott Asset Management and/or Mark Daniel Elliott (herein referred to as ADVISOR) does not warrant the accuracy of the materials provided herein, either expressly or impliedly, for any particular purpose and expressly disclaims any warranties of merchantability or fitness for a particular purpose. Although the information provided to you on this document is obtained or compiled from sources we believe to be reliable, ADVISOR cannot and does not guarantee the accuracy, validity, timeliness or completeness of any information or data made available to you for any particular purpose. Neither ADVISOR, nor any of its affiliates, directors, officers or employees, nor any third party vendor will be liable or have any responsibility of any kind for any loss or damage that you incur in the event of any failure or interruption of this document, or resulting from the act or omission of any other party involved in making this document or the data contained therein available to you, or from any other cause relating to your use of the document or these materials, whether or not the circumstances giving rise to such cause may have been within the control of ADVISOR or any related party. In no event will ADVISOR, its affiliates or any such parties be liable to you for any direct, special, indirect, consequential, incidental damages or any other damages of any kind even if ADVISOR or any other party have been advised of the possibility thereof. Numbers and calculations in this document have many assumptions and are for illustrative purposes only. Efforts have been made to minimize errors but this publication is not guaranteed to be free of errors. No investment or other decisions should be made solely on the basis of this publication.

This message is intended for the use of the person or entity to which it is addressed and may contain information that is privileged and confidential, the disclosure of which is governed by applicable law. If the reader of this message is not the intended recipient you are hereby notified that any dissemination, distribution or copying of this information is prohibited. If you have received this message by error, please notify us immediately and destroy the related message. Past performance is not indicative of future returns and investments can lose some or all of their value. No information in this communication should be understood as legal, tax, or financial advice unless it is explicitly stated as such.