KAYINVESTMENTS
SEC REGISTERED INVESTMENT ADVISOR

February 11, 2013

*You can always amend a big plan, but you can never expand a little one. I don't believe in little plans. I believe in plans big enough to meet a situation which we can't possibly foresee now.*

*~ Harry S. Truman*

We have survived and overcome the debt ceiling crisis (2011 version), the European debt crisis, the U.S. debt downgrade and the fiscal cliff crisis. In fact, the markets seem poised to rise from here. All through these events people have asked and continue to ask me whether the markets are going to tank.

Will the Markets Tank?

Of course they will. They always do – every 5 or so years on average. No one has been able to eliminate recessions and bear markets in all of American economic history. All that differs is the timing and the depth. The better question is when will it happen (so I can protect my money) and when will it end (so I can resume making money). This is a very different question. I've found predicting the major ups and downs of the markets to be very, very difficult. That is my perspective. I've heard compelling arguments predicting a recession (and the demise of the market) since June of 2011. I've heard equally compelling arguments for the bull market.

Although it may sound trite, I've come to realize that we need to invest as if we don't know what's around the corner. It's almost human nature to feel the urge to jump during these "crises", yet jumping out and in just doesn't seem to pay.

So What's Around the Corner?

OK. Everyone keeps insisting. There are lots of signs indicating that 2013 could be a good year for the markets. In the short term, a correction of at least 5% might be healthy and I believe is more likely than not.

What Are We Doing?

The better question is how are we investing? Without the luxury of knowing when the snow will hit, we can't simply rely on switching over to snow tires in December. So we need the best "all seasons" strategy possible – hopefully, as Harry Truman said, big enough to meet situations we can't foresee now.

My strategy has multiple parts:

1. Emphasize 5 star funds and 5 star fund managers. The 5 star designation refers to the well known (in our field) comprehensive rating system developed by Morningstar. 5 star funds generally make more and lose less. They fit into the top quintile of funds with a track record of sustaining that outperformance. Examples in our portfolios

include the Walthausen fund, the Fidelity Focused, the Putnam Spectrum, the Nicholas, the Lazard International and the T Rowe price funds.

2. Find and utilize funds capable of making money when the markets are down. These are diversifiers and it is VERY difficult to find good ones. The 361 managed futures fund uses a strategy with a track record of making money in down markets, even 2008. They built a tested strategy into a mutual fund in 2011 and it made 11+% in 2012, just as expected/hoped. If this were only guaranteed, it would be the only fund we would need to use. The ATAC inflation rotation fund should achieve similar results as the 361 fund while using entirely different methods. The strategy, which I've investigated extensively, was incorporated into a fund in 2012.

3. Use good bond funds to further diversify and reduce risk. These are in the moderate and conservative models. I like the RiverNorth funds. RiverNorth is a smaller manager with a 5 star track record. Their Strategic Income fund is closed to new money because of its excellent track record but grandfathered to many advisors including KII. Last year the bond funds were actually very competitive with stocks but this year our RiverNorth fund is only up 1+%. January was a month where you might feel annoyed because your bond fund is only up 1% for the month.

4. Use low volatility funds. Right now the one such fund we are using is SPLV, the S&P 500 low volatility fund. S&P has published surprising research showing that a fund of the lowest volatility stocks in the S&P 500 will actually outperform the major averages over entire cycles, meaning ups and downs combined. For patient investors, this actually means lower risk and eventually higher return. Morningstar's research shows that it captured 93% of the gains and 73% of the losses during recent up and down periods compared to their large company stock index.

If you would like to discuss your risk/reward orientation or any changes that may be appropriate, please contact me at the below.

Regards,

Darrell J. Kay
Kay Investments Inc.
5000 Seneca Point Road
Canandaigua NY 14424
www.kayinvestments.com
darrell@kayinvestments.com
(585) 396-1312 phone
(585) 486-1312 fax

This newsletter contains general information that is not suitable for everyone. The information contained herein should not be construed as personalized investment advice. Past performance is no guarantee of future results. There is no guarantee that the views and opinions expressed in this newsletter will come to pass. Investing in the stock market involves gains and losses and may not be suitable for all investors. Information presented herein is subject to change without notice and should not be considered as a solicitation to buy or sell any security.

Use of the S&P 500 (and other Indexes) is for comparative purposes only. The volatility of the Kay Investments Inc. portfolios may be materially different from the volatility of the S&P 500 (or other) Index due to varying degrees of diversification and/or other factors.

Kay Investments Inc. is an SEC registered investment adviser with its principal place of business in the State of New York. Kay Investments Inc. and its representatives are in compliance with the current registration and notice filing requirements imposed upon registered investment advisers by those states in which it maintains clients. Kay Investments Inc. may only transact business in those states in which it is notice filed, or qualifies for an exemption or exclusion from notice filing requirements. This newsletter is limited to the dissemination of general information pertaining to its investment advisory services. Any subsequent, direct communication by Kay Investments Inc. with a prospective client shall be conducted by a representative who is either registered or qualifies for an exemption or exclusion from registration in the state where the prospective client resides.

For information pertaining to the registration status of Kay Investments Inc, please contact us or refer to the Investment Adviser Public Disclosure web site www.adviserinfo.sec.gov. For additional information about Kay Investments Inc, including fees and services, please contact us for a copy of our disclosure statement as set forth on Form ADV. This is also available on the home page of the Kay Investments Inc. website, www.kayinvestments.com. Please read the disclosure statement carefully before you invest or send money.