

The Portfolio Reporter

A Newsletter Provided by Dunn Warren Investment Advisors

April, 2006

DON'T LOSE – two words, each four letters long. Pretty easy to synthesize, and yet the words are so difficult to internalize. There are two rules to the words don't lose. One: don't lose too much money in any downturn. Two: don't lose site of your objectives. If you stick with these two rules, you should be just fine. Of course, it takes discipline to stick with your plan even when things look like they are not going your way or to cut your losses before they become unwieldy.

Last month, I discussed drawdowns and indicated how normal drawdowns occur even for the Dow Jones index. The last two months, we experienced a drawdown for our portfolios that began at the beginning of February, seeing a loss of 5-6% from account value highs. Those who invested at or around this time had a scare, because your first few weeks of investing with us just created losses for your portfolio. But here is where discipline is so vital. While you may have just started investing with us and have not experienced our discipline in action, we cannot run and hide at the first signs of cracking. It just means we have to revisit our expectations and our observances. Our way is not always going to work as we would like it to. There will be periods of time where we underperform and are below our expectations, but this is not—I repeat, not—a reason to give up on the rules or discipline. A good plan will not always work, but over time if you stick with it, it should prevail.

I was reminded of this when I read “The Little Book that Beats the Market” by Joel Greenbelt. He told the following story of a portfolio manager for whom I have much respect. The portfolio manager was an ardent follower of the scientific process. He researched and double-checked all that he did and developed a fine formula for picking stocks. The formula worked so well that, in the mid 1990s, he opened a mutual fund based on this successful formula. It

| Exchange Traded Fund Market Performance - As of Mar. 31, 2006 | | |
|--|---------------------|----------------------|
| | 1 Month % change | 12 Month % change |
| S&P 500 | 0.8 | 9.9 |
| S&P 500 Growth | 0.5 | 7.3 |
| S&P 500 Value | 1.2 | 12.6 |
| S&P 400 Mid-Cap Growth | 2.2 | 20.0 |
| S&P 400 Mid-Cap Value | 2.3 | 20.4 |
| S&P 600 Small-Cap Growth | 5.0 | 22.9 |
| S&P 600 Small-Cap Value | 4.4 | 22.8 |

began performing just as planned. The next two years the fund underperformed the S&P 500, an index of the overall market. After two years of poor performance the manager decided to sell the mutual fund company he had developed around his “successful” formula. Unfortunately for him, in the early 2000s his mutual fund was one of the top-performing funds over the next three years and since inception (including those years that started so poorly). Should he have stuck with his original work? You better believe it.

Over the short term—a couple of months, even a year—we will under-perform the market. Losses will occur, but our exhaustive research and analysis dictates that we should not lose site of our plan and that our plan should provide consistent returns over time.

We are seeing a shift in leadership for the market. Oil and energy, which had been strong over the last 12 months, are now giving way to other industries. While it is unknown from where the new leadership will emerge, we remain invested in international markets including Japan and Latin America.

All numerical data has been provided by Barclays Global Investors, unless indicated otherwise.

Please feel free to pass the “Portfolio Reporter” to interested friends and family members.

The opinions expressed here are based on the author's views and should not be construed as financial advice. For more information about your investments, please contact your financial professional.