

# The Portfolio Reporter

Newsletter By Dunn Capital Management, LLC

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Though this summer seems especially hot, investors seem to be finding ways to stay cool and invest, because stock prices began climbing at the beginning of May and have made a nice ascent. While we do not see a great appreciation potential in the stock market, as long as investors have a positive outlook and cash continues to flow into the market, stock prices should remain stable or move higher from here. Areas of interest are emerging markets, energy, and utilities. These sectors will all benefit from escalating commodity and oil prices.

Money is not flowing into the stock market as quickly as it might, however, because investors are choosing to invest in real estate. There is a saying on Wall Street that once magazines start publishing cover stories on the stock market, the market will reverse direction. Over the last couple of months several noteworthy magazines have written about the real estate craze. Time Magazine published their story on June 13, 2005, and the Economist published on June 18. Both stories covered profitable home prices as well as a potential "bubble in the market".

Some people fear that the real estate market bubble may pop. However, our fear, and one we believe could impact the stock market more, is the number of people taking interest-only mortgages to purchase their homes. Individuals took advantage of the low interest rates and the enticement of these interest-only loans to lower their monthly payments while moving into larger, more expensive homes. The problem is if interest rates rise (and rise they will, although I can't tell and won't guess when), individuals will find it difficult to pay their monthly bills. At the very least, as their bills rise individuals will have less money to pay for other things such as clothing, vacations, and dining out.

Homeowners usually benefit from the "forced savings plan" of principle payments as well as the appreciation in the value of their homes, both of which increase their equity in their homes. Interest-only mortgages can dramatically lower this increase.

Exchange Traded Fund Market Performance - As of July 29, 2005		
	1 Month % change	12 Month % change
S&P 500	3.7	11.6
S&P 500 Growth	4.3	8.9
S&P 500 Value	3.1	14.3
S&P 400 Mid-Cap Growth	4.9	22.6
S&P 400 Mid-Cap Value	5.6	26.1
S&P 600 Small-Cap Growth	6.1	26.5
S&P 600 Small-Cap Value	5.9	25.1

Federal Reserve Governor Alan Greenspan voiced this problem this way to a sub-committee of the House of Representatives:

"The increase in the prevalence of interest-only loans and the introduction of more exotic forms of adjustable-rate mortgages is a development of particular concern. To be sure, these financing vehicles have their appropriate uses. But some households may be employing these instruments to purchase homes that would otherwise be unaffordable, and consequently their use could be adding to pressures in the housing market."

We are comfortable with the current position of the stock market, despite the concerns about interest-only loans; however, we are mindful of the risk and would position a portfolio to guard against high valuations, interest rates, and oil prices, any of which have the potential to create a dramatic decline in stock prices.

*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.*

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