

The Portfolio Reporter

A Newsletter Provided by Dunn Capital Management, LLC

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"As long as my account value increases, I will take all the volatility you give me. But I don't want any volatility if the market goes down."

I should just offer this option on the risk profile and leave it at that, since most would request this option. With the market's recent appreciation and even greater volatility, I thought this would be a good opportunity to discuss volatility and swings in the market. The increase in the market means that there is a greater likelihood that market and account values will reverse their recent trend and go **down**. This is natural and should be expected.

A "normal correction" is one that lasts for a couple of months and has a loss of about 7%, give or take. I calculate that in any given month there is a 95% chance that the market could rise or fall by 7%. Therefore, you should expect a "drawdown". Drawdown is a term money managers use to describe a loss from the most recent peak to the lowest low, before the market continues going higher. In a recent analysis I conducted, I determined that, on average, the difference between the high and the low in any one month (a normal correction) was **6.0%**.

"Then why," you may ask, "am I having you manage my money?" I look for and try to ameliorate the larger correction—the cyclical correction. Cyclical corrections, like the correction we experienced in 2000 to 2002, is a correction that is tied to the **business cycle**. They are longer and larger in magnitude.

Ned Davis Research Group tracked these corrections for the Dow Jones Industrial Average. Since 1900 there have been 33 cyclical bear markets. The mean peak-to-trough drawdown was a **loss of 30.8%** and lasted 406 days. Even the smallest loss of the cyclical bear markets was 13%, which is probably more than you are willing to stomach with me or anyone else managing your portfolio.

Exchange Traded Fund Market Performance - As of Jan. 31, 2006		
	1 Month % change	12 Month % change
S&P 500	2.7	8.4
S&P 500 Growth	2.3	7.5
S&P 500 Value	3.0	9.3
S&P 400 Mid-Cap Growth	5.7	21.9
S&P 400 Mid-Cap Value	6.2	19.7
S&P 600 Small-Cap Growth	7.4	17.6
S&P 600 Small-Cap Value	9.2	18.7

At the peak it is virtually impossible to determine the difference between a normal correction and a cyclical correction. If we were to rebalance your portfolio anytime we thought we were reaching a peak, **we could be wrong**. Then you would be asking me why we are not making you money when the market is still rising.

Remember when we were children? We would ride our skateboards or roller skates while holding onto a rope tied behind a bicycle, and any turn of the bike, left or right, would **whipsaw** us even farther. This is exactly what could happen if we try to **guess** what the market is going to do at the top. That is why we look for confirmation in the market and in the economy with our Risk/Reward Matrix, to see if in fact a cyclical bear market is upon us.

This risk should be our primary focus. We can not guarantee that we will prevent this type of loss or drawdown, but my approach continues to prove its validity. This is the value we hope to bring to you.

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.