

The Portfolio Reporter

A Newsletter Provided by Dunn Capital Management, LLC

July, 2005

The stock market faces a difficult environment. Valuations are high at 20 times peak earnings, economic growth is slowing, and oil prices at or near \$60 a barrel are weighing on investors' outlook. This has us monitoring cash inflows to the stock market with great interest, because this will be the deciding factor in determining our portfolio composition. Specifically, valuations and the economy already would lead us to a more conservative stance on our market exposure. There is no reason to take added risk to get market returns when the reward potential is not that great. However, cash inflows continue to be strong, indicating good demand for investing in the stock market.

FINANCIAL OPPORTUNITY: Illusion to reality

For an information junky, the stock market is like having a golden wrapper to enter Willy Wonka's chocolate factory in Roald Dahl's children's fantasy. The stock market offers continuous information, but watch out for what you wish for, or else curiosity will get the best of you. You can drown in all the information you review if you are not disciplined and focused on the information you choose to consume. Each hour of the day an "analyst" comes on television to describe what caused the market to make one move or the other. This is why I take to heart in reading a line from *Money Ball*, by Michael Lewis. "There was, for starters, the tendency of everyone who actually played the game to generalize wildly from his own experience. People always thought their own experience was typical when it wasn't. There was also a tendency to be overly influenced by a guy's most recent performance: what he did last was not necessarily what he would do next. Thirdly- but not lastly- there was the bias toward what people saw with their own eyes, or thought they had seen. The human mind plays tricks on itself when it relies exclusively on what it saw, and every trick played was a financial opportunity for someone who saw through the illusion to reality."

Money Ball is about proving that traditional yardsticks of success in baseball players and teams

Exchange Traded Fund Market Performance - As of May 31, 2005		
	1 Month % change	12 Month % change
S&P 500	3.2	5.9
S&P 500 Growth	3.2	2.4
S&P 500 Value	3.2	9.4
S&P 400 Mid-Cap Growth	6.1	10.8
S&P 400 Mid-Cap Value	5.9	14.3
S&P 600 Small-Cap Growth	7.2	15.1
S&P 600 Small-Cap Value	6.0	14.0

are fatally flawed. Although not your typical source of stock market theories, *Money Ball's* story could prove more valuable for the stock market analyst. What this passage and most of the book is expressing is that human beings are not always rationale in their thought process. Human beings take steps to simplify their lives, however in doing so they create foibles in rationale thought.

What happens all too often is the investors and analysts fall into a false sense of security. They believe what they hear on television without understanding or analyzing the numbers that are creating the real market environment. These illusions are costly to investors if they forgo the opportunity derived from reality.

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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