

# The Portfolio Reporter

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A Newsletter Provided by Dunn Warren Investment Advisors

July, 2006

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*These are the times that try men's souls. The summer soldier and the sunshine patriot will, in this crisis, shrink from the service of their country; but he that stands it now, deserves the love and thanks of man and woman. Thomas Paine "The Crisis"*

The quote is from "1776: America and Britain at War", a book written by David McCullough about the struggles of the revolutionary war in 1776. I thought the message of standing in the face of crisis was fitting, given the stock market's own crisis. You now know that I enjoy reading about early American history and politics. So if you ever think about giving me a gift you know what to get.

Unfortunately, most of you are more likely to give me a pie in the face due to my poor performance the last month. Those of you who started with us in the last couple of months will want to give me a knuckle sandwich due to the decline in account values.

The stock market decline began in earnest on May 12, about the time the Federal Reserve (FED) declared their fight against inflation. Then investor's emotions and fear took over. After further anti-inflation interest-rate boosting declarations by the FED, the market continued its decline. On June 6 FED chairman Ben Bernanke not only commented that the FED would continue to raise interest rates, but indicated that the economy is slowing down. This tough talk was, in **the opinion of this author and portfolio manager**, just that, "tough": calculated to prompt the markets to do the FED's dirty work.

The above review of what happened is an explanation of our positioning of the portfolios, not an effort to find a scapegoat. The fact of the matter is that the FED is "just the messenger". The FED's comments simply expedited the troublesome economic outlook.

In addition to the upward march of interest rates, due to apparently relentlessly-rising inflation, other components of our **RISK/REWARD Matrix** are showing weakness. The yield curve—the comparison of short-term rates (3-month treasury bills) to long-term rates (10-year treasury bills)—is flattening, owing to short-term rates increasing due to inflation and long-term rates declining due to a rise in demand from foreign investors searching for safety.

On the risk side, we see investors seeking safety in stocks that pay high dividends or in those industries that are most likely to survive a recession. Large institutions continue to take cash out of the market, and the ratio of advancing stocks to declining stocks is faltering.

Due to these weaknesses, we continue to position **all** portfolios in a conservative mode and will not make new investments in equities until emotional reactions or economic indicators show improvement.

*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.*