



Dunn Warren Investment Advisors, LLC

The Portfolio Reporter

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Elections and Quantitative Easing Shouldn't Drive Investment Decisions

November's first week brings two potentially significant events. Voters speak on the first Tuesday and decide on the makeup of Congress, defining the players on the political stage for the next two years. The next day, the Federal Reserve meets and issues a statement as they do every six weeks. While they are discussing only their actions for the next six weeks, given the amount of time required for their monetary policy actions to have an impact on the economy, their message will also impact the future of the country for the next two years. As investors, we always face the question of what we should do in reaction to these turning points.

In hindsight, we often see that the news made on Election Day rarely has an impact on the stock market. The last weeks of the year tend to be a seasonally strong time for the stock market, with gains seen in most Novembers and Decembers. Standard & Poor's Equity Research shows that November has been an up month 58% of the time since 1929, while December has closed up 73% of the time.

Two years ago, after the 2008 election, we saw significant declines in those two months, but those losses weren't directly attributable to the elections – stocks were already in a strong downtrend and the global economic crisis was pushing financial markets to the brink of disaster. Our Economic Market Indicator had actually begun a steep descent in the spring of 2008, leading us to be defensive within the portfolios. Going into the end of 2010, stocks may move higher or lower, but the election is unlikely to be the driving factor.

Likewise, the actions of the Federal Reserve may not have much of a long-term impact. Traders like to say, 'buy the rumor, sell the news,' and it is widely believed they will act. In an environment such as that, the market prices usually reflect the impact of the Fed action and the actual announcement is often met with a lackluster reaction. In other words, traders are buying in part based upon the rumor of Fed action, and markets are unlikely to have a large move when the news is finally released. Short-term traders can often profit by selling the news, but we will most likely make no changes on the news.

Many analysts believe the Federal Reserve will be enacting a quantitative easing program. Traditionally, the Fed sets the short-term interest rate and uses those tools to fine tune economic growth. As growth slows, the Fed can lower interest rates, hopefully making it less expensive for businesses to borrow money and create jobs. The Fed Funds rate, an interest rate that banks pay to borrow money overnight, has been set at 0.00 to 0.25% since December 2008. Since low rates aren't providing the hoped for economic boost, the Fed is looking at nontraditional tools to stimulate growth.

Quantitative easing involves buying securities like Treasury notes from banks, increasing the amount of cash they have available for loans. The Bank of Japan has used this strategy for most of the past ten years, but many question whether or not it has been successful. GDP growth, a broad measure of economic activity, has averaged 0.21% a year in Japan since the beginning of 1999, according to tradingeconomics.com. As a point of comparison, in the United States, growth averaged 2.12% per year over that same time.

Japan's experience demonstrates that central bank actions may not always lead to rapid and sustained growth. The results of the Fed's actions will be known in the fullness of time, and should not be a significant influence on long-term investment strategies. There is ample time to make buy and sell decisions based upon facts as they unfold, rather than reacting based on the emotions drawn from an analysis seen on CNBC, a cable

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business news channel.

Over the short-term, we have seen that almost anything can happen in the markets. In mid-September, Japan tried to stop the appreciation of the yen against the dollar, which was hurting the profits of local manufacturers. After spending \$23 billion in several hours, they forced the yen down by almost 3.5%. In less than three weeks, the market had returned the yen to its pre-intervention level, and the long-term down trend in the yen compared to the US dollar remains intact.

At Dunn Warren, we will watch the results of the election and the progress of the Fed's quantitative easing with great interest. But we will not alter our investment policies because of these events. Our tried and true approach of following economic indicators, evaluating risk, and capitalizing on relative strength will drive our decisions.

Those principles continue to point us towards overseas investments and sectors which can be thought of as inflation hedges. In some portfolios, we recently added an exchange traded fund (ETF) that invest in small cap stocks in emerging markets, an investment that can profit from global economic growth but that also might do well in a downturn as these countries tend to have lower debt levels and lower wages. These factors may allow them to weather a slowdown because of the low cost structure.

Another recent portfolio addition for some investors is an ETF that holds retailers. This may seem like an area that would be hurt by rising prices. Food retailer Kroger is one of the largest positions in this ETF. A noted analyst, Jack Barbanel at Gruntal & Company, recently noted that "Rising prices in retail food products enables supermarkets to experience higher profit margins, particularly in the early stages of a short spurt of inflation, and the profit spread can be maintained as long as the inflation trends continue." For now, relative strength in the sector supports his opinion, if that changes, we will sell this position, just like we always do as we follow our rules-driven strategy.

Tax Time: While your tax forms won't be due until next spring, now may be a good time to take any actions that might be possible to lower the bill. For the first time in several years, we expect many of our taxable portfolios to have capital gains for 2010. You should be able to log into your account at anytime to see the exact amount of capital gains. The October conference call included specifics on how to do this at Folio and those instructions will be repeated in future calls.

If you have unrealized capital losses in other accounts, it might be beneficial to use them to offset these gains. However, there are many factors that affect that decision. We do not provide accounting or tax advice. Your financial advisor should be able to help you or be in a position to recommend someone appropriate for your circumstances.

Please feel free to pass "The Portfolio Reporter" to interested friends and family members. For more information about your investments, please contact your financial professional.

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MONTHLY CONFERENCE CALL

Our next monthly conference call will occur Thursday, November 18th at 11 a.m. Mountain Time (1 p.m. EST).

Phone Number: 866-740-1260

Access Code: 4682824

To view slides on the internet during the call, go to www.readytalk.com and enter 4682824 under “Join a Meeting”.