

The Portfolio Reporter

A Newsletter Provided by Dunn Warren Investment Advisors

January 2008

What a roller coaster! For 2007, the S&P finished up with a gain of 5.5% and the Dow finished with a gain of 8.9%. Getting to this point was a wild ride. The S&P and the Dow declined three times by 6% to 12% in February, August, and November.

The main culprit was the downturn in the housing and mortgage market. The overextended lenders, the rampant investors, and the high valuations created a huge mess that will continue to linger into 2008. The impact on the economy is still in question. I, for one, can't say whether a recession is likely or not. Two factors that can indicate the direction the economy is headed are job growth and the ISM index (Institute of Supply Management).

This brings me to an annual tradition of reviewing how accurate the analysts were in predicting the performance of the S&P 500 for this past year and what their projections are for 2008. Of the 12 analysts polled last year in Barron's, five correctly estimated a 5% to 10% increase. Four expected better returns and three expected lower returns. Therefore, the analysts had 41% accuracy. Not very good. I enjoy this review each year because it demonstrates that estimating where the market is going is an exercise in futility. There are just too many variables to determine where the S&P 500, or any other market index, will be next year. (You can read our historical analysis from past January editions of "The Portfolio Reporter" on our website). *That is why we do not make predictions.* We invest where the best risk/reward trade-off is. This means looking at investments that have a large enough return potential to justify the risk that exists.

For 2008, analysts polled by Barron's forecast increased gains of, on average, 10%. Of the 15 analysts polled, eight anticipate a 5% to 10% increase, two have forecast between 0% and 5%, and five expect greater than a 10% increase in the S&P 500. The historical average is an

increase of about 10% year over year. This is why most of the analysts polled continue to expect a 10% increase. However, it is those years that do not continue the trend that make the exercise of predicting the gains in the market absolutely useless.

So where could the market go from here? Down, flat, or up. I know, "What kind of an answer is that!" Sorry I can't give you a determination. But I can tell you the different factors to look for.

If the market goes down, it is because we are continuing to experience **uncertainty**. Investors feeling uncertain about the growth rate of the economy or who will win the presidential election, will pull the market down. Large institutional investors, like mutual funds and pension plans, will not want to take risks with uncertainty so they will not purchase investments at higher prices. They will wait until prices decline to purchase investments.

A market decline of greater than 10%, however, is usually caused by a decline in corporate earnings or a decline in the economy. If this were to happen, we would see the manufacturing industry decline. The ISM index provides this information. This is my favorite gauge of the manufacturing sector. Any reading below 50 will indicate a decline in manufacturing, and normally a decline in the overall economy. Second, we need to see jobs begin to decline. By this I mean companies slow down advertising to hire employees, employees' salaries decrease, and there is an increase in unemployment claims. Lastly, we would see a decline in imports and exports, signaling that the global economy, which has been so strong these past few years, can no longer prop up the US economy.

If we see a flat market, or more accurately a market in limbo that stays within a 10% range, the driver will surely be uncertainty, (which will continue, at least about housing and

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a presidential election without any clear outlook).

For a market to increase, we will begin to see positive clarity in the housing market and the economy, as well as large investors willing to step up and take risk and buy investments at a higher price.

As we move into 2008 and a market that is in limbo, we look at investments that can benefit from the demand in commodities and a decline in the US dollar and that have good dividends. These investments include large exporting companies with solid dividends, gold and natural resources, oil, utilities, and smaller dividend-paying companies. For those variable annuities that we manage, some changes we are making include disposing of technology and large cap value (the Dow Jones Index) and replacing that with consumer products, like Coke and Proctor and Gamble, and gold or weakening-dollar investments (the investment increases when the dollar declines).

For investors that we are investing directly into individual stocks (outside of variable annuities), in the last year we have purchased BT Group (BT), formerly known as British Telecom. We like this investment because it has a dividend yield of 5.44% and it generates revenues in British Pounds and Euros, which are appreciating against the US dollar. BT and Nucor are examples of stocks we have bought for some investors that may not be appropriate for your own portfolio due to the timing, risk exposure, or your own objectives. Nucor Corporation (NU) is a steel manufacturer that has less international exposure, but with a great management team that looks out for both shareholders and employees and a dividend yield of 5.02%, this makes a good investment in turbulent times.

We cannot predict the market, but we will search out those investments with good rewards relative to the risk they present. The market will certainly be turbulent, but that offers us the opportunity to seek worthwhile investments when other investors are making poor emotional decisions.

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.

MONTHLY CONFERENCE CALL

Our next monthly conference call will occur Thursday, January 17th at 11am Mountain Time (1pm EST).

Phone Number: 866-740-1260 Access Code: 4682824

To access slides on the internet during the call, go to www.readytalk.com and enter 4682824 in "Participant Login"