

The Portfolio Reporter

A Newsletter Provided by Dunn Warren Investment Advisors

May 2008

Is this a “dead cat bounce” or an overbought rally within a downward trend? The economy is in the dregs, and as far as I can see, will continue to decline. However, the stock market is showing some willingness to look past the risk and anticipate a turn. The Nobel Prize-winning economist Paul Samuelson once quipped that “Wall Street indices predicted nine out of the last five recessions!” If this is the case, can it also predict nine out of the last five turnarounds?

There is no sign of the economy improving. We see a decline in manufacturing and services (Institute of Supply Management) and continued declines in the housing market, home starts, mortgage applications, and the Case/Shiller Home Price Index. Employment is on the decline, citing slowing job advertising and unemployment claims. The result of the further weakening of the economy will result in more job layoffs and a domino-effect slowing consumer spending. The government stimulus plan will help alleviate this pressure in May. But the delay in distributing these checks could have alleviated this recession earlier.

The recent upturn in the stock market has been driven by three significant occurrences. First, the Federal Reserve (FED) helped bail out Bear Stearns by expediting its purchase by JP Morgan. (Full disclosure: I was once employed by Bear Stearns.) Second, the FED opened up the discount window to investment banks, thereby allowing them to trade in poor-performing mortgage-backed bonds and exchange them for Government bonds. Last, large investors have stepped in with billions of dollars to invest in other investment banks like Lehman Brothers and UBS. This has taken a great deal of uncertainty out of the stock market.

At our last conference call on April 17th, I introduced the **Turnaround Watch**. This is a focus on the following items to gain an insight into the credibility of a turn in the economy.

Specifically, we are looking for an improvement in consumer sentiment, investor sentiment, the housing market, and corporate earnings. As of the time of this writing, the only positive sign is an improvement in investor sentiment.

As a result, we have made changes to the portfolios. Bonds have quickly eroded any upside due to the delayed, but abrupt, move by the FED to lower interest rates this year. Gold and commodities still have some limited upside, but we are reducing the exposure there. Where possible, depending on availability, we like international investments for the pure fact that international economies continue to grow while the US economy declines. When we can't get the direct international exposure, we have chosen to invest in large US companies with global exposure (such as those companies in the Dow Jones Index) and those large technology companies that can benefit from international exposure (such as those companies in the NASDAQ 100). We are trying to avoid those companies that have high expenses associated with commodities that are seeing a dramatic rise in expenses, a rise exceeding revenue growth.

Consequently, our conclusion remains the same: we have to be adept and nimble. We have to stay focused on the Turnaround Watch and those opportunities where reward offsets the risk.

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, May 15th 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".