

# *The Portfolio Reporter – A Supplemental Issue*

A Newsletter Provided by Dunn Warren Investment Advisors

November 22, 2008

I think the market could fall another 20-30%. So I have started to buy stocks now. Yes, that's right, I think the S&P 500 can fall from 780 to 600 and I am going to buy. My greatest fear is not a fall in the market, but missing out on future returns in the next 5-10 years.

First, I think the S&P 500 can fall 20-30% because stock valuations, the multiple investors are willing to pay for a dollar of earnings, will be 7 times earnings after the fall. If I assume peak earnings are \$84 a share and the lowest valuations have been 7 times peak earnings, this brings us to 588 for the S&P 500. (The multiple has only gone below 7 times earnings in 1918, 1921, 1932 and 1949). Could it go lower? Of course. This is because investors are not basing sell decisions on company fundamentals. Stock prices are being driven by fear, uncertainty, and forced sales.

1. Fear - The economy, unemployment and sales are all at poor levels and there is no sign of improvement.

2. Uncertainty - What will the Obama administration orchestrate for the economy? Will the U.S. automobile industry collapse? What will Hank Paulson (treasury secretary) and Ben Bernanke (Federal Reserve Chairman) decide the seventh proposal of the bailout plan will do?

3. Forced to Sell - States, companies, endowments and individuals are forced to sell good investments to pay off debt for factories, mortgages and credit cards.

In the summer the market was trying to go higher but there were issues that investors weren't acknowledging. Now the issues have been realized and going forward these issues have mostly been accounted for in stock prices, which are low right now.

1. Earnings growth of 6%, dividends of 3% and an improvement in valuations of 1-5% annually, nets 10-14% annualized returns in the next 5-10 years.

2. Dividend yield of the S&P 500 of 3.8% is greater than a 10 year government bond and a lot (but not all) of the CDs you can get.

3. After economic downturns in 2001 and 1974, the stock market returned 47% from October 2002 to February 2004 and 53% from October 1974 to July 1975.

My fear is that if investors are in cash, money market or bonds and don't have a plan for selling these and buying equities/stocks they will miss out on these future returns. (You don't have to invest all at once, you can invest over time. And if you have been invested, stay invested). This is why I have started to buy now.

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