



Dunn Warren Investment Advisors, LLC

The Portfolio Reporter

Mike Carr, CMT
James Cornehlisen, CFA
6143 S. Willow Dr. Ste.102
Greenwood Village, CO 80111
Phone: 800-793-4866
www.dunnwarren.com

January 2011

New Year; New Forecasts

It's an annual ritual. As the new year dawns, investment professionals are expected to know where the stock market will be twelve months later. Much time goes into this exercise, in some cases. Others seem to be making outrageous claims, just hoping they'll be right so they can become the pundit of the year.

A year ago, analysts were uniformly bullish. This is not surprising given that 2009 had ended up being a relatively good year, after a horrible start. In part, many analysts interpolate the recent past to create a forecast. Interpolation means they look at the recent past and expect that will continue to some degree in the future. This is, in many ways, a reasonable approach. Trends continue until they reverse, and that is certainly true in investing.

Stock prices reflect the growth in earnings of the underlying companies. Earnings reflect the fundamentals of the economy. Changes in economic conditions tend to be slow, and that allows forecasters to have some faith in techniques which merely extend the past into the future. Unfortunately, the future is rarely exactly like the past. The recent recession and recovery resulted in rapid changes in economic data, in many cases it was the largest year-over-year changes seen in the data.

For 2010, twelve major Wall Street firms provided forecasts of stock market gains to Barron's, a popular financial weekly publication. Most, actually seven of them, called for gains of greater than 10% in the S&P 500. At the end of the year, their bullishness was proven to be correct as the index gained nearly 15% on a total return basis, which includes returns from dividends.

After seeing double digit gains in the past two years, analysts seem less certain about 2011. Many are still bullish – nine of ten expect gains in the year ahead according to Barron's. Five expect another year of double digit gains.

Combined operating earnings for companies in the S&P 500 hover near \$95 per share. A 10% gain in stocks over the year would leave the index at a price-to-earnings ratio under 15, reasonably valued by historical standards. Based on this, the forecasted gains for 2011 certainly appear to be reasonable.

We always regard these forecasts with a degree of skepticism. No one knows what the future holds and when the future is different than the past, the change can be dramatic. The terrible losses of 2008 are a distant memory to many investors, but at the end of 2007, Barron's found 15 major Wall Street firms were bullish, and none expected a decline in the year that would prove to be one of the worst in history.

This year was a relatively good one for the forecasters in the stock market, but none of those cited in Barron's at the end of last year got the interest rate forecast correct. Most expected rates on the 10-year Treasury note to exceed 4.0% by now, and rates reached that level for less than a week in early April. We ended the year with that key interest rate near 3.3%, about half a percent lower than where it began the year.

In 2011, we will manage investments without the use of forecasted price targets. You probably won't see Dunn Warren's portfolio managers featured in Barron's or appearing on CNBC because we don't have a precise year ahead forecast. We believe that focusing on diagnosing the current state of the economy and the market is the best way to achieve long-term investment success. We will continue to devote our efforts to pro-

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pecting wealth in the year ahead, rather than making headlines.

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, January 20th, 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".