



# Dunn Warren Investment Advisors, LLC

## *The Portfolio Reporter*

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## Room for Optimism

Over the past month, we made a significant change in many of our portfolios and eliminated positions in leveraged inverse exchange traded funds (ETFs). These funds are designed to go up in (down) value on days when the stock market index they track declines (increases). In that way, they can be thought of as serving almost like an insurance policy against extended downtrends in portfolios. We believe they offer a hedge against downside risks at some times.

While the market may decline from current levels, the downside risks now seem to be less than the upside potential. This is not an opinion that we developed by reading economic news or by listening to some of the countless commentators presented in the financial media every day. It is a conclusion driven by the indicators we follow closely to diagnose the state of the market.

In particular, many of the economic indicators we track improved dramatically over the past few weeks. Our composite index appears to have formed a bottom and history has shown that's a good time to own stocks. Additionally, the rate of change of this indicator (a measure of its relative strength) is also in positive territory. We should note that although unemployment and housing dominate the headlines, there are many other facets to the economy and our Economic Market Indicator is designed to be a broader measure of economic strength and weakness. It is possible that unemployment can remain uncomfortably high for some time and home prices may stagnate or even decline further while the overall economy shows growth. Hiring should follow growth, and that should be bullish for stocks.

As the summer ended, stocks did seem to take a bullish turn. Major stock markets indexes closed above key moving averages on a weekly basis, which usually indicates that the price uptrend is likely to continue on an intermediate term basis. The moving averages in several of these indexes also recently completed a crossover pattern which tends to be supportive of future price gains.

In the stock market, prices change over time and analysts often look at the average of several recent prices to help them assess the direction of the trend. This calculation is called a moving average, where the values used in the average move forward in time while the number of values used in the calculation remain fixed.

The moving average is designed to smooth the short-term trends within the price data and help the analyst spot the longer-term trend. By looking at an average of the recent price action, the volatility of the moving average should be less than the volatility seen in the price action. In this way, the moving average acts as a filter and helps isolate the longer term trend in prices.

In recent weeks, we have seen prices generally closing above their moving average. This is usually considered to be bullish, meaning analysts expect to see further price gains after this happens. Moving averages do not work all the time and losses can occur after these signals are given. We never rely on any single indicator, and look at a variety of tools to make investment decisions.

Weekly relative strength measures on some of the major stock market indexes that we track also closed above their moving average, which is generally believed to be associated with buy signals. At the same time, some of the inverse ETFs gave relative strength sell signals as the relative strength line closed below its mov-

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ing average. This does not always happen on a coincident basis because they are relative strength based signals rather than traditional price based indicators. Their recent behavior seems to be offering confirmation of higher stock prices ahead.

Stock market breadth has turned positive in the past few weeks across all of the time frames that we monitor, and across all major averages. Breadth is an indicator that looks at the number of stocks participating in the general market trend. In bull markets, most stocks move higher along with the stock market averages. Bear markets are characterized by lower prices in the averages and most stocks will also decline. We track the number of individual stocks rising and falling on a weekly basis and use it combined with the price trend as a valuable tool in assessing the expected near term direction of prices. Breadth and price trends often confirm each other and both indicators will usually move in the same direction in bull and bear markets.

From a preponderance of the evidence approach, considering economic data, relative strength, and breadth indicators, our models indicate that stocks seem to offer more potential reward than they did several months ago. Of course the markets are dynamic and of late, the economy has been more volatile than it was in years past. By the time you read this, we may have already seen the evidence change, although our long-term approach to the markets makes that unlikely.

For now, the economy and the stock market give us reason for optimism.

*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, October 21st 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](http://www.readytalk.com) and enter 4682824 under "Join a Meeting".**