



# Dunn Warren Investment Advisors, LLC

## *The Portfolio Reporter*

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## Addicted

When you can't do without or you go through withdrawals from not having something, you are addicted. This is the description of the U.S. stock market on easy monetary policies. Specifically, I am speaking of quantitative easing. This is the mechanism by which the U.S. Government has enabled easy money to proliferate through the financial system.

Quantitative easing is the process of buying bonds to keep interest rates low. This means that more money is put into circulation. However, it was a long road for the government to come to this policy. After multiple attempts, first by the Treasury Department and then the Federal Reserve, quantitative easing was implemented in February 2009. This allowed the Federal Reserve to purchase \$300 billion in long-term U.S. Government Bonds. This was later expanded to include the purchase of up to \$1.25 trillion in mortgage-backed securities and \$200 billion in agency loans (loans for Fannie Mae and Freddie Mac.) After over a year of multiple attempts, the Treasury Department and the Federal Reserve finally settled on intervention that stabilized the economy.

All of this action expanded the balance sheet of the Federal Reserve. But where did this money come from? The Treasury Department printed this money and lent it to the Federal Reserve.

From the bottom of the stock market in March 2009 to the end of quantitative easing in March 2010, the S&P 500 (An index of 500 companies commonly used to track the movements of the stock market) increased 80% (drshort.com.) At the first sign that quantitative easing would come to an end in the spring of 2010, the stock market, as measured by the S&P 500, declined over 15%. The second round of easing is scheduled to come to an end June 30, 2011. Therefore, this past week, Federal Reserve President Ben Bernanke suggested that, while the government would not expand the size of the purchase arrangement, the Federal Reserve would use the interest payments that are received to repurchase more securities, consequently, expanding the money supply even more. Since the second round of quantitative easing was announced in August 2010, the S&P 500 has increased 34%. Additionally, since the second round of quantitative easing was implemented in November 2010, money supply, as measured by MZM (Money in bank accounts and money market funds as well as in circulation) increased over 4%.

By increasing the amount of money in circulation without increasing the resources that money represents, you are merely increasing the amount of money it takes to purchase a resource. Think of it in this way. Pull out an 8.5 by 11 inch piece of paper. Think of this piece of paper as representing all the oil in the world. Now I would like for you to cut that piece of paper into 4 equal pieces. Where we previously could represent all the oil with one piece of paper, we now need four pieces of paper. Now let's take each of those pieces of paper and cut them in half. We now have eight pieces of paper. Therefore, we have the same amount of oil (that one 8.5x11 inch piece of paper) but we need eight pieces of paper to represent it. Similarly, as we print more money as a result of quantitative easing, we now have more money to spend, for the same amount of oil. By printing all this money, we have seen the value of the dollar decline tremendously because each dollar represents a smaller amount of the same resources. This is why the price of commodities such as corn, coffee, and gold has increased, as well as oil. (Commodities are bulk goods such as grains, foods, metals, oil and gas).

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If we look at the last quarter, January 1, 2011 to March 31, 2011, the S&P 500 increased 5.42%. However, if we break down the index by sectors, we see that energy led the charge. For example, consumer discretionary increased 4.7%, technology 3.8%, industrials 8.5%, materials 4.5%, healthcare 5.6%, utilities 2.7%, financials 3.0%, and staples 2.6%, while energy increased a whopping 17.2%. I think the strength of oil stocks increasing by this magnitude is a strong indication that the decline in the price of the dollar resulting from quantitative easing is fueling higher asset prices.

Investments that Dunn Warren has in commodities have increased. Market Vectors Agribusiness (MOO) increased 4.7% in the first quarter, SPDR Metals and Mining (XME) increased 8.1%, SPDR Oil and Gas Services (XME) increased 19.6%, Market Vectors Coal (KOL) increased 7.4%. But the portfolio does not consist only of commodities. It consists of industrial, retail, and technology as well. Nor should a portfolio contain investments only from one industry or sector. Specifically, if the dollar were to increase in value, these commodities could potentially lose a significant amount in value. We have to balance the portfolio with more than just commodities, because at some time in the future the decline of the dollar will come to an end and commodities will no longer be the leader.

While the high created in the market is appealing, caution is warranted because expectations for ever higher appreciation are not attainable. Unfortunately, it is becoming evident that investors are craving too much of quantitative easing.

*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, May 19th 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".**