



# Dunn Warren Investment Advisors

## The Portfolio Reporter

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### Lessons Learned from 2008

**Administrative Note: It is tax season again and that means it is time to prepare. Those of you who have a non-qualified account through FolioFn (meaning it is *not* an IRA, ROTH or SEP), will need a 1099, Schedule D, and K-1 to complete your taxes. Please see the enclosed instructions on how to obtain these three forms.**

The Government mandates that 1099s be delivered by January 31st, however financial institutions have until February 20th to make revisions. In the last several years, revisions have become the norm, so whether you have accounts at Foliofn or Schwab, Vanguard, Fidelity, etc, I recommend waiting at least until February 20th to get your 1099 to give time for the revisions to be distributed. The Schedule D is the IRS form you include with your taxes specifying gains or losses from the purchase and sale of investments. Lastly, for Foliofn account holders, you will need a K-1 for two investments we bought and sold in 2008. The investments, Gold Exchange Traded fund (IAU) and Commodities Exchange Traded fund (GSG), are considered a partnership because of their structure, and therefore produce a form called a K-1

Everyone knows 2008 was a terrible year for the markets. The Dow Jones Industrial Average (DJIA) finished down about 35% for the year while the broader S&P 500 and technology-heavy NASDAQ Composite Index were down nearly 40%. From an individual stock perspective, of the 30 blue chip stocks in the Dow Jones, only Wal-Mart (+13%) and McDonald's (+0.5%) showed gains for the year.

There was nowhere to hide from the carnage that devastated the financial markets. Global markets, as measured by the MSCI-EAFE Index, declined by 42%. This index measures the returns from 21 developed economies. Stock markets in emerging economies fared worse, falling by nearly 50%.

Commodities fell by more than 20% on the year after posting gains of 30% through July. As every consumer knows, oil led the way higher and lower. The price of a barrel of crude oil rose by 50% and then declined by about 75% with incredible speed.

Broad measures of the corporate bond market also posted declines. Investors fearing the worst in these markets sought safe investments, driving the US dollar higher by about 6% and US Treasury bonds (Government bonds) posted gains of about 20%.

At Dunn Warren, we watched these events unfold and reacted to the market action rather than trying to guess what would happen next. We didn't try to pick tops and bottoms. We stuck with the disciplined investment approach that has worked well in the past, and we were able to preserve more capital than a buy-and-hold investor would have. In a down market, that is the best we can hope for.

Those who participated in our monthly conference call in January 2008 heard that the US economy was in a recession. Almost a year later, the National Bureau of Economic Research confirmed our analysis and formally announced that the recession began in December 2007. Our economic model allowed us to reduce the risk of our portfolios, which resulted in preserving capital.

In hindsight, we should have hedged our portfolios earlier and more aggressively. We were almost fully hedged for the November crash that occurred in stocks and suffered less than the market averages. Adopting this position earlier in the year would have allowed us to benefit from the decline.

Our relative strength approach to investing did allow us to achieve gains from the commodity bubble. Our risk management tools allowed us to get out of those markets before the crash occurred. Likewise, many of our portfolios were able to take advantage of the run-up in Treasury markets, an area we are now exiting because rates, especially on the short end, just can't go any lower.

For 2009, we see potential rewards and possible risks. The economy will eventually recover, although we don't know when. One thing we do know is that historically the stock market is a leading indicator of economic activity. On average, it has bottomed about halfway through the recession. We expect our methodology to identify that and catch the new leaders as they emerge.

The bond market also offers opportunities. While Treasuries are near bubble-like extremes, corporate bonds, especially high yield bonds, offer potential rewards. While the number of defaults among corporate bonds will certainly increase, diversified holdings through mutual funds and ETFs can still show gains.

Finally, the great economist Milton Friedman said that "inflation is always and everywhere a monetary phenomenon." The Federal government has been throwing money at the economy at unprecedented rates. For now, banks are hanging on to all that cash, but eventually it will flow somewhere and inflation is sure to follow. When it does, our models should identify it and move us into sectors which will benefit from rising prices, preserving your buying power.

*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, February 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".**