



# Dunn Warren Investment Advisors

## The Portfolio Reporter

### **New Year Brings Economic Optimism; Stock Market Volatility**

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Gross domestic product, the broadest measure of economic growth, showed that the recession is over. For all of 2009, according to the U.S. Department of Commerce, the economy shrank by 2.4%, the worst single-year performance since 1946. But that decline occurred in the first half of the year and GDP grew in each of the last two quarters of the year. The 5.7% increase in GDP during the fourth quarter of 2009 beat the estimates of analysts and was the fastest pace of economic growth since the third quarter of 2003. The growth was largely driven by businesses rebuilding depleted inventories. This activity contributed 3.4% to GDP, the most in two decades.

Manufacturers, including high tech giants like Intel which also reported a strong fourth quarter, might continue to lead the recovery as increasing sales prompt companies to restock. However, there is still a lot of unused capacity in the economy with the Department of Labor reporting 9.7% unemployment and the Federal Reserve finding that factories are producing at only 72% of their potential. This should allow the Fed to maintain its easy money policy. In fact, the Fed released a statement after its January meeting saying that the recovery is gaining strength and business investment "appears to be picking up." They also repeated their plan to keep interest rates low for an "extended period." The central bankers held the overnight lending rate between banks in the range near zero, where it has been for more than a year.

Other economic reports released in January added to our belief that the recession has ended. Consumer confidence improved in January for a second straight month. New orders at factories also increased, and inflation remained subdued. Consumer spending, which makes up about 70% of the economy and is tracked by the Bureau of Economic Analysis, rose at a 2% pace, more than anticipated and enough to keep the recovery intact.

Perhaps most importantly, inflation remained below the Fed's long-term forecast. The central bank's preferred price gauge, which is tied to consumer spending and ignores volatile food and energy costs, rose at a 1.4% annual pace in the fourth quarter, following a 1.2% increase in the prior quarter.

As we look back over January, it seems to us that stock market investors generally ignored the good news as markets started the year with a volatile, and down, month. The S&P 500, an unmanaged list of common stocks frequently cited as a measure of stock market performance, fell by more than 4% in January. Of course the market may be warning that an economic slowdown is possible in the second half of 2010. If this is the case, then large investors may very well share the fears of government regulators.

In the most recent report to Congress, the Office of the Special Inspector General for the Troubled Asset Relief Program, which is headed by Neil Barofsky who acts as a watchdog for taxpayers over how TARP money is spent, was not optimistic about the future. He warned that, "Even if TARP saved our financial system from driving off a cliff in 2008, absent meaningful reform, we are still driving on the same winding mountain road, but this time in a faster car."

So should we be optimistic or pessimistic? We will choose to be unemotional and continue to follow the disciplined investment methods that we have used in the past.

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Many analysts believe that "as January goes for the stock market, so goes the year," and for those times when January closes higher, we couldn't agree more. Most years end with the market showing a gain, and most months also end with a gain, which means that January is more likely to be up than down, and so is any given year.

But this January, like last January, closed down. Some of you may remember that stocks defied the January indicator and were substantially higher at the end of 2009. Actually the fact that stocks closed down in January contains no forecasting ability. Sam Stovall, chief investment strategist at Standard & Poor's Equity Research, wrote in a recent research report that when the first month of the year is down, that move has correctly forecast the direction of stock prices only 48% of the time. You could probably get the same results by flipping a coin.

Yet the January barometer is still useful, especially from a sector standpoint. Stovall said, "Since 1990, the three best-performing sectors in January went on to post a compound annual growth rate of 8.2% in the following 12 months, vs. a 6.1% return for the S&P 500, and beat the market 70% of the time." Buying the strongest performers is one way to implement a relative strength strategy. This supports using relative strength to identify potential winners. At Dunn Warren Investment Advisors, we have always looked to relative strength as a pillar in our management approach, and are always pleased when other researchers appear to share our belief.

*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, February 18th 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".**