



# Dunn Warren Investment Advisors

## The Portfolio Reporter

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

January 2010

## 2010: The Year Ahead

This is the time of year when fearless analysts make bold forecasts announcing what they think stocks will do over the next twelve months. We generally choose not to participate in this exercise because we think it is more guesswork than analysis. But we do review the work of others, and in general we see a lack of consensus among the experts in their outlooks for 2010. There are a number of bulls and bears, with some predicting gains in the markets while others foresee losses. Economic prognosticators are also split with some predicting good times ahead and others not so sure that we have sidestepped another depression. Instead of joining those making guesses, we will simply stick with analysis and use our time-tested indicators to make investment decisions.

The S&P 500 closed 2009 at 1115.10, a level that was 23% higher (excluding dividends) than it was a year ago. This sounds like a good year to the buy-and-hold investor, if they were able to forget the 26% decline in the index which occurred in the first nine weeks of the year. While the index remains nearly 30% below its all time high, since bottoming in March, the S&P 500 has risen by 65%. We can find only three other times in history when the market raised that much in such a short amount of time. Significant moves like we have recently seen have occurred after major stock market bottoms in 1932, 1974, and 1982. In those three cases, the market went sideways for some time after the initial up move.

Each year we review what analysts expected for the past year and report their accuracy and then review their expectations for the year ahead. We collect our data each year from Barron's annual outlook, "Buckle Up for 2010" Barron's December 21, 2009. The average estimate was for the S&P 500 to increase 17% in 2009. Of the 12 analysts polled last year in Barron's, three correctly estimated a 20% to 25% increase. Eight expected returns of 5% to 20% and one analyst expected the S&P 500 to reach 1,250. Overall, analysts were only 25% accurate, which was a decline in accuracy from 2008 of 41%. This emphasizes why it is not worth forecasting the stock market. There are just too many variables to determine where the S&P 500, or any other market index, will be next year. (You can read our historical analysis from past January editions of "The Portfolio Reporter" on our website). For 2010, the median projection of the 12 analysts is for the S&P 500 to reach 1250, or a 12% increase. The range is flat to up 21% in 2010.

As far as stocks are concerned, history says that we are likely to see a trading range develop where prices move back and forth for some time. While in a range it is possible to see sharp, large moves to the upside and downside. This makes it a challenging environment for investors, but one in which relative strength analysis may help identify potential winners and, more importantly, avoid significant losers. That is what we will focus on in 2010 - using our methodology to find potential gains while avoiding long-term losers. We will not rely on predictions.

We will probably see that the economy ended 2009 with gains in GDP when the data is reported over the next few months. In the third quarter, we found that most, if not all, the economy's gains resulted from government spending. This demonstrates that the unprecedented interventions we saw last year very likely had the desired effect of avoiding a possible depression. In 2010, we think that the continued recovery depends upon an increase of spending by the private sector. In this respect, we are encouraged by the reports that consumers returned to the mall in the days before and after Christmas. If these initial indicators of strong sales continue, a

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consumer willing to spend is very good news for the economy.

Since we are talking about economics, it is very important to balance potential good news with possible bad news. This unfortunate reality of economics is what prompted President Harry S. Truman to say that he wanted an economist who was one-handed, because his economic advisors always gave him economic advice which included the caveats, "On the one hand...and on the other..." In this case, good economic news on the one hand might be balanced by higher interest rates on the other hand.

Interest rates have been falling since 1981, so we would not be surprised to see the trend reverse after nearly thirty years. An increase in interest rates would actually confirm the economic recovery since it would indicate that the demand for investment capital is exceeding the available supply. To go back to our analysts' projections from the Barron's article, the 12 analysts see the average interest rate on the 10-year government bond to be about 4.25%. However there is some variation. Three analysts expect rates to decline while three analysts expect rates to be greater than 4.5%. For a variety of reasons, we do believe it is possible to see higher interest rates in the next year. Although we are prepared for the possibility that inflation may stay where it is and not push interest rates higher, since economic growth could remain relatively slow.

That summarizes our outlook for 2010 - we are looking for stock prices to fluctuate amid uncertain economic growth. Rather than forecasting, we will react to the news events that impact the economy and the market. In 2010, we see the possibility that the PIGS (Portugal, Italy, Greece, and Spain) could fuel an international economic crisis while real estate (both residential and commercial) will threaten the recovery in the U.S. Actively managing equity investments may help avoid these problems and profit from the opportunities we see in the year ahead.

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### **MONTHLY CONFERENCE CALL**

**Our next monthly conference call will occur Thursday, January 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".**