DREAMWORKS
CAPITAL MANAGEMENT, LLC

What Sets Investors' Results Apart Q2 2012

I can remember various times in the markets over the course of the past few decades where investing looked easy. A situation where rising tides would lift all boats or in these cases all stock prices. The late 90's during the Dotcom bubble, the period after the great recession and to some degree the first quarter of 2012 are all examples.

A decent stock picker can make just as many good picks as a bad stock picker in a bull market. One of the skills that sets a great investor apart from the crowd is the ability to know when and how to diversify one's assets. Knowing when to be invested is just as important as knowing when not to be invested.

Investing is not about trying to time the markets. At DWCM we focus on having a core foundation of assets around which to build a strategy, and then look for pockets of opportunities for investment. People can become their own worst enemy when it comes to investing, which is the basis for our case study this quarter.

Case Study

Client:
Female, mid 40's – Jean (name has been changed for confidentiality)*

Client Situation:
Jean was consistently giving us direction to go in and out of the market. She had recently purchased a house and was worried about her asset situation. Jean would want us to decrease her stock positions every time she heard bad news from Europe. By not staying with the investment strategy we had designed for her, this led to Jean's portfolio to be the worst performing portfolio of "like" client portfolios that we managed at DWCM.

DWCM Objective:
Our goal was to design a strategy that would allow Jean to have confidence in an uneasy market. We had built a core position of "blue chip" companies that paid solid dividends and showed a history of solid dividend payouts through all market cycles, due to their cash positions. We pointed out to Jean that sticking to that strategy would be the most beneficial to her portfolio growing, or at the worst, staying steady during uncertain times. Our next step was to reduce Jean's risk even further by increasing her allocation to various bonds - specifically

short-term bonds - which would reduce her interest rate risk. And finally, we increased her cash position to allow her to sleep better at night.

Client Outcome:
By staying on the strategy that we had designed, Jean's portfolio began to rebound and her core holdings have been able to weather the volatile markets we saw in the first and second quarters of 2012. But most importantly, Jean became comfortable with her investment strategy and was able to start sleeping again in her fabulous new home.

Economic & Market Viewpoint

During the latter part of Q2 we began to see significant weakness in economic data not only in the US but also China, and continued credit issues in Europe. This slow down helped provide fuel for the downward swing in equity prices and the further compression of US Treasury yields - which are at all-time lows.

- US labor markets saw back to back months with unexpected weakness missing job creation expectations. To make matters worse, prior months were revised down which helped increase the unemployment rate to 8.3%.
- The ISM (Institute for Supply Management) manufacturing index showed contraction in June for the first time since July, 2009. New orders, at 47.8, showed contraction for the first time since April, 2009 and the degree of the decline was the steepest since October, 2001. Export orders, reflecting weakness in Europe and China, were a serious negative, at 47.5 for the first contraction since June, 2009 and the lowest reading since April 2009. With a lack of new orders, manufacturers are working down backlogs which are at 44.5.
- China PMI reached a 7 month low in June at 48.1.
- The Fed in its FMOC meeting during June extended "operation twist" but guided GDP down, the unemployment rate up, and inflation projections lower for the period between 2012 thru 2014.

Europe continued to wrangle with uncertainty as the French elected a new President who, from all accounts, is pro-socialist. The Greeks, who still remain in the EU, elected a new President who is pro austerity. We experienced a very volatile Q2 in which most market indices finished lower.
What does this all mean going forward? We expect volatility to continue especially as we head into the corporate earnings season here in the U.S., and a presidential nomination year.

While US corporate earnings have been strong and balance sheets appear relatively solid with excess cash, one has to ask with a slowing China, and Europe already in a recession, how long can the US keep this up? The decoupling economy theory is being debated by some.

The decoupling theory suggests that as one country's economy slows, other economies around the world (and especially developed economies such as the U.S. and Europe) will continue to grow. Or at the very least, muddle through. We at DWCM do not believe in the decoupling theory.

DWCM Performance

Top 5 Holdings

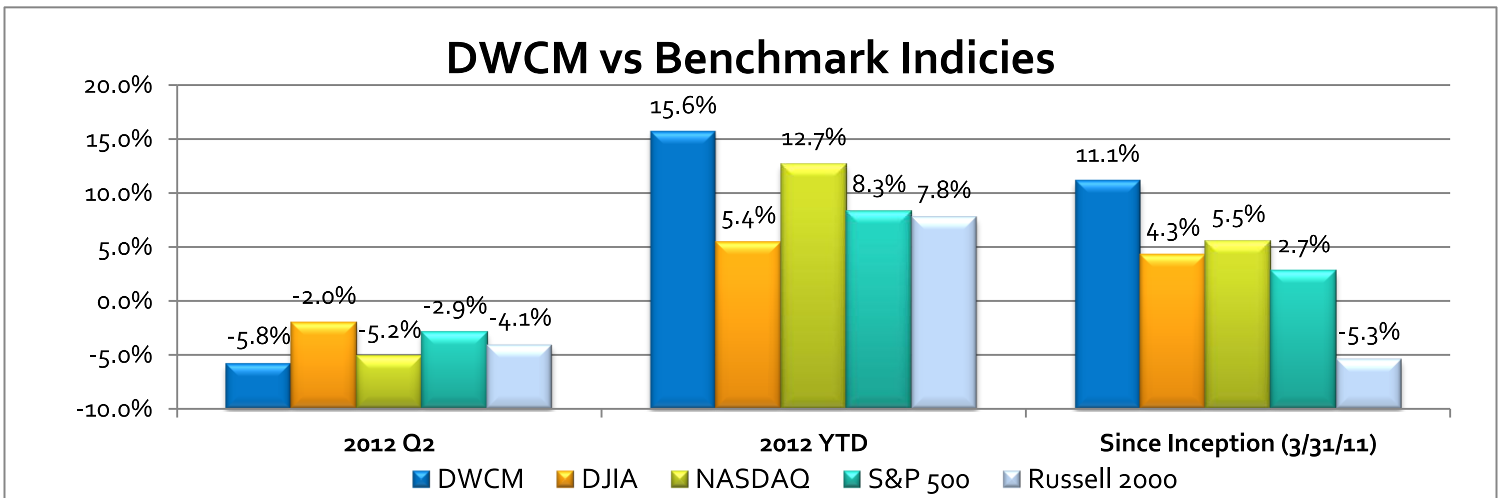
1. CME Group
2. Mosaic
3. Potash
4. Gold
5. Apple

With a slowing global economy the U.S. will eventually start to feel the effect, which should result in lower corporate earnings. We will be watching closely for any signs of weakness with other economies which could affect corporate profits this earnings season.

With lower earnings, stock prices will likely be under pressure for the remainder of the year unless some unforeseen catalyst appears. Possibly a Romney rally if he takes the US presidency away from Obama.

During Q2 the DWCM Fund lagged behind the major market indices, but for the year remains well ahead of the 4 major market benchmarks. Much of the regression in Q2 can be attributed to the weakness in Apple which was our largest holding. We have since taken profits in Apple and reduced our stake, although it continues to be one of our core holdings.

During the quarter we also updated our strategy of holding technology positions. Technology lagged in the second quarter and there doesn't seem to be an end in sight. This is a classic situation where we like the companies but no longer like the stock. We exited several positions but continue to hold Marvel and Riverbed Technology because we feel good about their fundamentals and believe they are set to rebound in Q3. At some point we may revisit adding more shares of these or other technology names when better conditions permit.



We had noted in numerous posts on the DWCM website that we are bearish on; one of them is the housing sector for the following reasons:

1. Weakening jobs picture
2. Housing inventory that appears to be artificially low because banks will not release foreclosure inventories
3. Home builders have been one of the hottest sectors of the year and from a technical perspective we see a reversal in their prices

For these reasons we have implemented a short term strategy consisting of 6 home builder stocks, which in total represent 2.2% of our Fund value. It is a relatively small stake but we believe it will have great potential rewards.

DWCM Quarterly Lecture Update

I want to thank everyone who attended our first finance lecture, *401k and 403b Plans: You have Options* on June 18th at The Community House in Birmingham, MI. We had a very interactive group and we appreciate everyone's support.

FREE LECTURE: Our next finance lecture will be on Tuesday September 18th at the The Community House. The topic will be *Balancing Your Changing Investment Needs: Emergency Fund, Investments, Retirement, Education, and Philanthropy.* We will cover significant points regarding creating, developing, and executing on your wealth management plan. We hope to have another interactive group, so be sure to sign up by emailing me directly at pfenner@dwcmllc.com or by contacting The Community House at 248-644-5832. There is no charge and light refreshments will be served.

Paul Fenner is president and founder of DreamWorks Capital Management, LLC (DWCM). DWCM is a Registered Investment Advisor (RIA servicing individuals, families, and small- and medium-sized businesses.

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