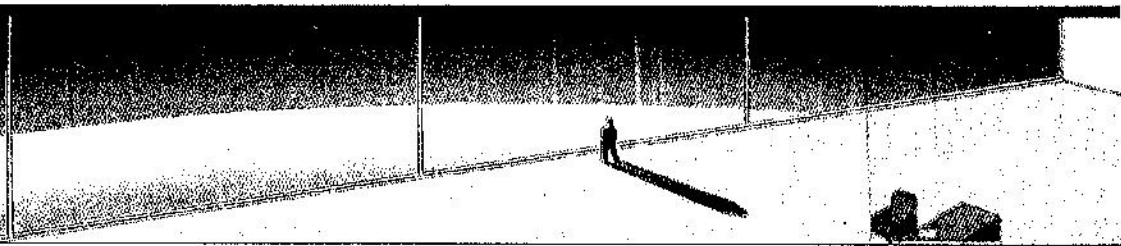


# The Trader



## Market Rallies Despite Katrina's Headwinds

by Kopin Tan



**T**HE IMAGES WERE GRIM AND television's delivery of them unrelenting: Houses submerged, lives lost, New Orleans drowning.

Faced with the misery in Hurricane Katrina's wake, as gasoline prices soared, the stock market managed a rally last week that bucked both expectations and the momentum of its August slide. The ascent was flinching and uneven, but volume was heavy. Among traders searching for an explanation, the word "resilient" came up a lot, while others reached, rather quickly, for the can't-get-much-worse standby. And as the scope of devastation became apparent, hopes emerged that the Federal Reserve will soften the economic blow by halting, at least temporarily, its campaign of steady interest rate hikes.

Such educated wishful thinking was further boosted by reports of a meeting late last week between President Bush and Fed Chairman Alan Greenspan, and as data last week corroborated what recent stock sellers had feared: that the economy, bogged down by high energy costs, saw manufacturing growth slow and prices rise in August. In particular, a measure of August Midwest factory activity fell so sharply it elicited, when the data were released, a gasp heard up and down Wall Street (Wednesday morning, 10 a.m.). Bonds rallied, sending the yield on 10-year Treasuries down toward 4% and its lowest since early July.

**As the scope of the devastation becomes apparent, hopes emerged that the Federal Reserve will soften the economic blow by halting interest-rate hikes, at least temporarily.**

In the weeks to come, Katrina will provide ballast for both bull and bear camps. Early estimates put insured damage north of \$25 billion, with actual damage said to be twice that. Companies will blame Katrina for weak earnings, at least for a quarter or two, and the customary meters for measuring economic health will become harder to read.

For all the devastation, hopefuls argue there is little systemic threat to the stock market, with any dampening of consumer spending offset by the stimulus from Louisiana's reconstruction. Worries of surging oil prices ought to be viewed, bulls say, against the speculative run-up in crude-oil futures even before Katrina, and the marginal increase since. According to Carpenter Analytix, directional hedge-fund exposure to stocks remain near a "mid-dling" level—about the 56th percentile compared with levels over the past 32 months—indicating there's dry powder left to drive further gains.

**This week's VITAL SIGNS, Page M67**

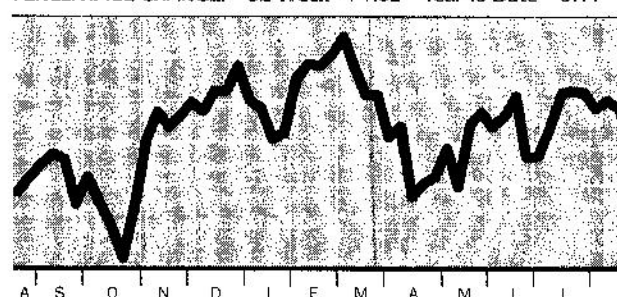
But the damage to the Gulf Coast energy hub, and the effect high gasoline prices could have on consumer spending and job growth, have exacerbated the economic uncertainty. America's Fed-facilitated spending binge has narrowed the margin between the world's oil supply and demand, says Morgan Stanley's chief economist, Stephen Roach, and "Katrina may have been the tipping point for a long simmering endogenous shock." He believes stocks could sag under the "weight of prospective shortfalls to corporate earnings."

Late last week, some Wall Street firms trimmed their forecasts for second-half economic growth by between one-half to one percentage point. Goldman Sachs, for instance, said Friday its 5% estimate for third-quarter GDP growth was one-point too high to start with, and Katrina could shave another half to one percentage point off that mark.

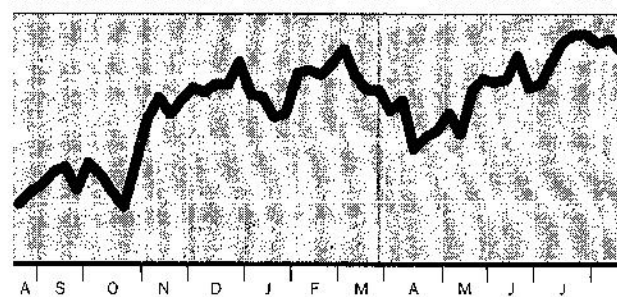
Much will depend on how high energy prices climb and how long they stay that way. Even before Katrina hit, gaso-

*Katrina will provide ballast for bulls and bears. Companies will blame the storm for weak earnings, and the customary meters of economic health will become harder to read.*

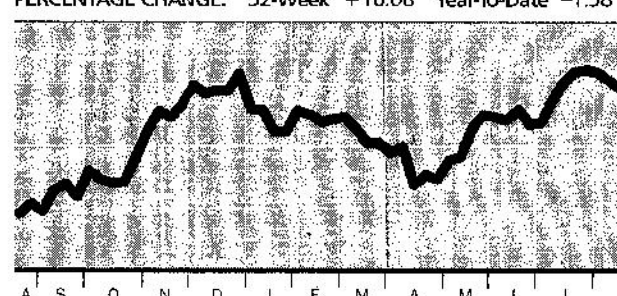
**Dow Jones Industrials** CLOSE 10447.37  
PERCENTAGE CHANGE: 52-Week +1.82 Year-To-Date -3.11



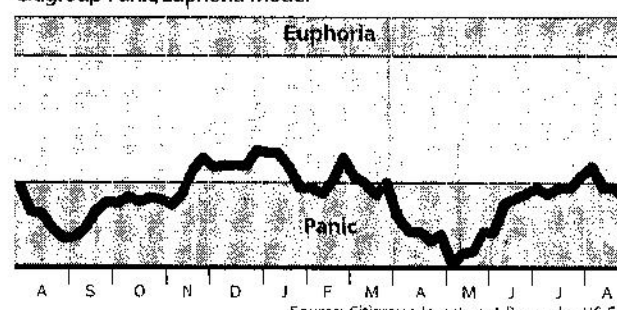
**S&P 500** CLOSE 1218.02  
PERCENTAGE CHANGE: 52-Week +9.37 Year-To-Date +0.50



**Nasdaq Composite** CLOSE 2141.07  
PERCENTAGE CHANGE: 52-Week +16.08 Year-To-Date -1.58



**Market Sentiment** LAST -0.48  
Citigroup Panic/Euphoria Model



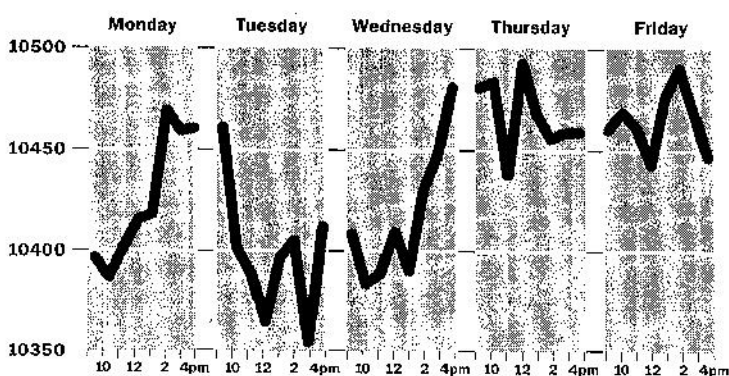
### Industry Action

Performance of Dow Jones U.S. Industries, ranked by weekly % ch

Oil & Gas	2.64
Utilities	2.00
Health Care	1.26
Basic Materials	0.88
Financials	0.87
Industrials	0.80
Consumer Goods	0.73
Technology	0.35
Telecommunications	-1.07
Consumer Services	

\* For breakdown see page M65. Source: Dow Jones

**Against the Wind:** The blue-chip benchmark clung to small gains, despite Hurricane Katrina's destruction and weakness in Boeing as striking machinists walked off the job late last week. One factor supporting shares: the widespread belief that the Fed will ease off on its tightening, perhaps boosting rates just once more this year.



### Dow 30 and Their Weekly Market Change

Alcoa	-0.37	Exxon Mobil	2.27	McDonalds	-1.58
Altria	0.58	General Electric	-0.05	Merck	1.17
American Express	0.35	General Motors	-1.23	Microsoft	0.05
American Intl Group	0.06	Hewlett-Packard	0.59	Pfizer	0.44
Boeing	-1.97	Home Depot	0.52	Procter & Gamble	1.03
Caterpillar	4.76	Honeywell Intl	-0.05	SBC Communications	0.16
CitiGroup	0.78	IBM	-0.92	3M	0.51
Coca-Cola	0.33	Intel	-0.13	United Technologies	0.31
Disney	-0.57	J.P. Morgan Chase	0.46	Verizon	-0.13
DuPont	-0.89	Johnson & Johnson	0.96	Wal-Mart Stores	-1.15

line inventories already were stretched by the long, hot summer, and Katrina knocked out 16% of natural-gas production, 26% of crude-oil output and about 20% of petroleum-refining capacity. Last week crude-oil futures flirted with \$70 but fell Friday to \$67.57 a barrel.

Against this backdrop, the Standard & Poor's 500 Index and Dow Jones Industrial Average both snapped two-week losing streaks, while technology and small stocks reversed four-week declines.

After a 1.1% drop last month, the S&P 500 last week gained 13 points, or 1.1%, to 1218. The blue-chip Industrial Average closed up 50, or 0.5%, to 10447. The Nasdaq Composite Index gained 20, or 1%, to 2141, while the Russell 2000 Index of small-cap stocks outperformed the field and tacked on 15, or 2.3%, to 663.

Trading the hurricane's economic impact even as the devastation unfolds might strike some as a tall—and callous—task, but Katrina sent waves through most segments of the market. Prices rose for coffee, sugar, bananas, grains—a reminder that many goods still sail on ships and through ports, and the Gulf Coast is a major crossroad for the country's calories. Steel and homebuilder stocks rallied, the latter lifted also by hopes of continually low interest rates. **Hilton Hotels (HLT)** and **Marriott International (MAR)** fell more than 6%, while some casinos and airlines were hit.

Hospital stocks also struggled, and the concerns go beyond closures of affected facilities. Goldman Sachs estimates that **Universal Health (UHS)** and **Tenet Healthcare (THC)** have 10% and 7% of their acute care beds, respectively, in the region, and the massive dislocation of residents and firms will crimp business, particularly for non-emergency surgeries. For instance, **Health Management (HMA)** did not see volume return to prehurricane norms until three quarters after 2004's Florida hurricane season—and Katrina had inflicted greater harm on Louisiana.

Worries of an oil shock also threw a spotlight on an unexpected area. The Wilderhill Clean Energy Index tracks 36 stocks—mostly small upstarts advocating

oil conservation and the use of cleaner energy sources. As individual companies, these are too young and, well, green to attract serious investor attention. But an exchange-traded fund tracking the index—known as **Powershares Wilderhill Clean Energy (PBW)**—allows investors to more easily trade the collective group, and this little-known ETF has rallied 13% over the past two weeks.

Curiously, one of strongest performing segments may prove to be more vulnerable than thought. Despite some uncertainty about potential damage to rigs and equipment, energy stocks rallied hard as the market anticipated higher oil prices. After all, steadily climbing crude prices had lifted energy profits and shares over more than two years.

But the tight correlation between crude oil and energy stocks has a tendency to weaken in the aftermath of natural disasters. Marko Kolanovic, Bear Stearns' quantitative strategist, examined the link between the Amex Energy Select sector index and crude-oil prices after 13 hurricanes over the past 20 years, and found that correlation declining markedly two to five weeks after the hurricanes—often as crude oil rose on supply concerns while stocks stayed range-bound. While the supply shock had driven crude prices up, he explains, hurricane damage to pipelines and facilities may prevent companies from fully benefiting from the disruption.

The correlation among energy stocks also tends to break down, since their geographic exposure to the hurricane will vary. Translation: It now pays to pick and choose among energy stocks. Boosted by analyst upgrades, refiners led the oil pack last week—**Valero (VLO)**, for example, rose 21%—while the **Oil Service Holdrs Trust (OIH)** increased 4.7%.

Examining how various sectors performed after previous hurricanes, Kolanovic noted discernible outperformance in health-care services, retail (which includes home-improvement stocks) and household products (see chart).

Last week Morgan Stanley advocated shifting more money toward health-care equipment and services and away from

## Fund Scope: Hardcore Values

► Small-cap core funds have fared well this year, with an average return of 4.78% through Thursday, versus the average diversified fund's 3.58%, according to Lipper. Over three years, the group is up 19.96%, compared with 13.90% for the average fund. Three-year stars include Fidelity Small Cap Stock (ticker: FSLCX), ahead 20.22%, and Royce Fund Total Return (RYTRX), up 16.96%.

Fund Name/Manager	Phone Number	Load	Assets (millions)	YTD Return	3 Year Return*
<b>iShares Russ 2000 Idx</b>	800-474-2737	None	\$7,863.1	3.31%	20.47%
Team Managed					
<b>T Rowe Price SC St Shs</b>	800-638-5660	None	6,753.7	3.96	17.68
Gregory A. McCrickard					
<b>Vanguard Sm-Cp Indx Inv</b>	800-662-7447	None	6,245.6	5.75	21.63
George U. Sauter					
<b>T Rowe Price SC VI Sh</b>	800-638-5660	None	4,747.0	6.31	22.44
Preston G. Athey					
<b>Fidelity Sm Cap Stock</b>	800-544-8544	None	4,332.6	5.33	20.22
Collins/Thompson					
<b>Royce Fd Tot Ret Inv</b>	800-221-4268	None	4,179.2	5.32	16.96
Charles M. Royce					
<b>iShares S&amp;P SC 600 Idx</b>	800-474-2737	None	4,153.6	6.54	20.93
Team Managed					
<b>Royce Fd Low-Prd Inv</b>	800-221-4268	None	4,075.1	3.13	18.61
George/Skinner					
<b>DFA US Micro Cap</b>		None	3,835.0	3.48	24.98
Team Managed					
<b>Managers Spec Eq Inv</b>	800-835-3879	None	3,252.5	1.32	17.83
Team-managed					

\*Annualized. All data through Thursday.

Source: Lipper

## Scoreboard: Balancing Act

► The stock market remained flat in the week ended Thursday, balancing the bearishness fostered by Hurricane Katrina with the hope inspired by improved consumer spending. U.S. diversified equity funds gained, on average, 1.10%, even though the S&P 500 fell 0.05%. Among the 25 biggest funds, Fidelity Diversified International (FDIVX) jumped 2.55% and Fidelity Contrafund (FCNTX) rose 2.02%.

	One Week	Year-to-Date
<b>U.S. STOCK FUNDS</b>	1.10%	3.58%
<b>U.S. BOND FUNDS</b>	0.52	2.25
<b>TOP SECTOR / Natural Resources Funds</b>	6.28	36.81
<b>BOTTOM SECTOR / Specialty/Miscellaneous Funds</b>	- 0.24	- 0.85

### THE WEEK'S TOP 10

Fund	Investment Objective	One Week	Year-to-Date
<b>ProFunds Oil &amp; Gas Inv</b>	Natural Resources	9.52%	57.07%
<b>PowerShares WidHill CE</b>	Small Cap Core	9.47	NA
<b>Fidelity Sel Energy</b>	Natural Resources	8.13	50.77
<b>Fidelity Sel Nat Gas</b>	Natural Resources	8.10	43.77
<b>Oppenheimer RI Asset A</b>	Spec Dvsfd Equity	7.92	44.79
<b>Fidelity Adv NRes T</b>	Natural Resources	7.91	40.66
<b>Fidelity Sel Nat Res</b>	Natural Resources	7.85	40.73
<b>Guinn Atkin GI Energy</b>	Natural Resources	7.73	64.46
<b>Merrill Real Invest C</b>	Spec Dvsfd Equity	7.65	40.50
<b>ProFunds Prec Metals Inv</b>	Gold Oriented	7.64	- 2.27

### THE WEEK'S BOTTOM 10

Fund	Investment Objective	One Week	Year-to-Date
<b>PowerShares Dyn Laisre</b>	Specialty & Misc	- 3.77%	NA
<b>Fidelity Sel Retailing</b>	Specialty & Misc	- 3.60	2.58
<b>ProFunds UItSh Sm-Cp Inv</b>	Spec Dvsfd Equity	- 3.21	- 7.35
<b>iShares Taiwan</b>	China Region	- 2.77	- 3.58
<b>Retail HOLDERS Tr</b>	Specialty & Misc	- 2.52	- 4.20
<b>Rydex Retailing Inv</b>	Specialty & Misc	- 2.46	0.98
<b>Potomac Contrabond Inv</b>	Flexible	- 2.18	- 4.44
<b>ProFunds Cnsmr Svcs Inv</b>	Specialty & Misc	- 2.05	- 8.53
<b>Rydex Leisure Adv</b>	Specialty & Misc	- 2.04	- 6.93
<b>ProFunds UItSh Md-Cp Inv</b>	Spec Dvsfd Equity	- 1.87	- 13.76

### THE LARGEST 10

Fund	Net Assets (billions)	Investment Objective	3-Year* Return	1-Week Return	YTD Return
<b>Vanguard 500 Index Inv</b>	\$79.482	S&P 500 Funds	11.81%	0.81%	1.96%
<b>American Funds Gro A</b>	66.641	Multi Cap Growth	16.81	1.20	7.96
<b>American Funds ICA A</b>	66.273	Large Cap Value	11.98	0.89	3.93
<b>American Funds Wsh A</b>	64.110	Large Cap Value	10.57	0.75	1.96
<b>Fidelity Magellan Fund</b>	55.956	Large Cap Core	9.36	0.88	1.69
<b>Fidelity Contrafund</b>	52.331	Multi Cap Growth	16.18	2.02	9.54
<b>PIMCO Tot Rtn Inst</b>	51.295	Intmd Inv Grade	6.04	0.91	3.69
<b>SPDR Trust 1</b>	49.412	S&P 500 Funds	11.80	0.81	1.98
<b>Dodge &amp; Cox Stock</b>	48.073	Multi Cap Value	17.44	0.58	5.19
<b>American Funds Inc A</b>	47.196	Income	13.71	0.93	3.11

\*Annualized. Through Thursday.

Source: Lipper