

Weekly Commentary

September 6, 2005

The Markets

9/11, the war on terror, the tsunami, and now Hurricane Katrina. The list of human suffering continues to grow and our hearts and prayers go out to those affected. We are doing our small part to help the victims and it is gratifying to see the nation rally around and support those who desperately need help. If there is anything certain in this country, it is the will of the American people to stand tall and band together when catastrophe strikes. Like 9/11 before it, this country will do whatever it takes to pull through and persevere. Our hope is this outpouring of support will be long lasting and will help provide the victims with a chance to start anew and make an even better life for themselves.

It seems rather insensitive to talk about the stock market while so many people are still suffering but the wheels of business continue to turn despite the tragedies that take place in the world. Ironically, even in the face of large-scale destruction to homes, industry, and energy infrastructure, the stock market rose last week. On the surface, that may seem very surprising but when placed in the context of history, it is not. Our country has faced other destructive events such as two World Wars, the Korean and Vietnam wars, the war on terror, hurricanes, earthquakes, recessions, depressions, dust bowls, presidential assassinations, an oil embargo, hostage crises, and terrorist attacks. Yet the stock market survived them all by looking past the present and seeing a brighter future. While past performance is no guarantee of future results, we fully expect the current tragedy will be no exception.

Returns through 9/2/05	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrials	0.5%	-3.1%	1.8	7.9%	-1.5%	8.4%
Nasdaq Composite	1.0	-1.6	16.1	19.2	-12.4	7.5
Standard & Poor's 500	1.1	0.5	9.4	11.5	-4.2	7.9

Source: Yahoo! Finance, Barrons

Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly.

3, 5 and 10-year returns are annualized. Assumes dividends are not reinvested.

IT IS STILL TOO EARLY TO GAUGE THE IMPACT of the hurricane on the economy but here are a few thoughts to consider. First, in the immediate aftermath, there will likely be a drop in economic activity. The destruction was so widespread and will last for many months that the drop may show up in nationwide statistics. Second, the economic impact may cause the Federal Reserve to alter its timetable for raising interest rates. The destruction and accompanying rise in oil and gas prices may cause the economy to slow down enough that the Fed will pause to give it time to assess the longer-term implications of the disaster. Third, as federal aid pours in and the rebuilding begins,

it may be a significant boost to the economy. The stock market's rise last week may have been partially based on the thought that the rebuilding phase may provide a big stimulus to the economy. Fourth, the long-term ramifications of relocating hundreds of thousands of people for an extended time are unknown. Fifth, the dramatic rise in gas prices over the past couple weeks may finally be enough to alter Americans' energy consumption habits. If Americans do indeed cut down on how much energy we consume, it will reduce demand and, in theory, reduce pressure on energy prices.

Aiding the situation is the fact that the International Energy Agency (IEA) announced on Friday, September 2 that its 26 industrialized member countries voted to release 2 million barrels of oil per day for an initial period of 30 days. This is the first time since the 1991 Gulf Crisis that the IEA has acted to release government oil inventory. Even though a significant amount of U.S. oil production and refining capacity is offline right now, the additional supply now coming onto the market from the IEA's directive and from the U.S. government's decision to tap the Strategic Petroleum Reserve and temporarily ease environmental rules governing gasoline and diesel fuel, may help calm the energy markets. Ultimately, the best thing we can do to keep energy prices under control is to reduce our energy consumption.

IS THE PRICE OF OIL HIGH ENOUGH to tip us into a recession? One year ago in early September 2004, a barrel of oil was selling for around \$43 according to the Department of Energy. Back then, if you had a crystal ball and could foretell that one year later, oil would be trading at around \$70 per barrel, you might reasonably expect the economy to suffer and perhaps be on the verge of recession. Today, with oil recently touching \$70 a barrel, the economy is still moving forward although the full effect of the hurricane is unknown at this point. How did the economy withstand, up to this point, the surge in energy prices? A few key things have occurred.

First, the real estate boom allowed Americans to pull out about \$140 billion from mortgage refinancing in 2004 according to data from mortgage finance company Freddie Mac. The same firm projects that will rise to about \$160 billion this year. That is a tremendous amount of economic stimulus. Second, despite the Federal Reserve's campaign to raise short-term interest rates, interest rates in general still remain relatively low and are favorable for economic growth. Third, prior to the hurricane, the rise in energy prices was primarily due to a rise in demand driven by economic growth as opposed to a rise driven by a supply disruption like an oil embargo. Yes, some of the price rise was due to a terrorist premium and speculators but their impact was secondary. Fourth, energy prices have risen over a relatively long period of time so that has given businesses and consumers time to adjust.

The Federal Reserve and the government are very cognizant of the potential for energy prices to cause a recession. We are confident that they have the tools at their disposal to manage the economy in such a way that we can avoid an energy-shock induced recession.

Weekly Focus – Working Too Hard?

The average number of weeks worked per year for employed Americans is 46.2 while our counterparts in Western Europe generally work much fewer weeks each year. German, French, and Italian workers all average less than 41 working weeks each year according to data from the Organization for Economic Co-operation and Development. Most of the difference is attributed to federally mandated vacation time in Europe and generous holiday time off. Interestingly, according to a 2004 research paper by MIT economics professor Dr. Olivier Blanchard, France's output per hour worked is actually higher than in the U.S. Therefore, while the typical French worker may put in fewer hours than we may, they get more done while they are working.

Best regards,

Russ Story, CSA

P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you would like us to add them to the list, please reply to this email with their email address and we will ask for their permission to be added.

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* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.

* The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks.

* The Nasdaq Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.

* Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.

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