

Weekly Commentary

September 29, 2005

The Markets

The one-two punch of Hurricane Katrina and Hurricane Rita dealt a tragic blow to the Gulf Coast but the long-term effects on the economy may be minor.

Last week, the Federal Open Market Committee met and announced it was raising its target for the federal funds rate by 25 basis points to 3-3/4 percent. The increase surprised some market watchers who expected the Federal Reserve to pause in raising rates until the aftermath of Hurricane Katrina could be assessed. According to the statement released by the committee, "The widespread devastation in the Gulf region, the associated dislocation of economic activity, and the boost to energy prices imply that spending, production, and employment will be set back in the near term." The Committee went on to say, "While these unfortunate developments have increased uncertainty about near-term economic performance, it is the Committee's view that they do not pose a more persistent threat."

The Committee made their decision before Hurricane Rita slammed ashore so we do not know whether adding Rita to the mix would have changed their decision. While stock prices did decline last week, overall, they have held up very well in the face of these two hurricanes. From August 23, which is the day before Hurricane Katrina became a tropical storm, to September 22, the Dow Jones Industrial Average declined just 1.0 percent. In light of the tragedies, that is a resilient performance. This suggests Wall Street investors are looking past the short-term pain and not seeing many long-term effects.

Returns through 9/23/05	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrials	-2.1%	-3.4%	3.7	9.8%	-0.7%	8.1%
Nasdaq Composite	-2.0	-2.7	12.6	21.3	-10.8	7.3
Standard & Poor's 500	-1.8	0.3	9.5	13.4	-3.3	7.6

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.

ARE SOARING OIL PRICES TELLING US WE ARE RUNNING OUT OF OIL?

Depending on whom you ask, you will likely get a different answer to that question. According to the federal government's Energy Information Administration (EIA), "Oil resources are adequate to meet growing worldwide demand for at least the next 25 years." The EIA's *International Energy Outlook 2004* report predicts worldwide demand for oil will grow from 28 billion barrels a year to 44 billion by 2025. Even under that growth scenario, the EIA says, "...less than half of the world's total oil resources would be exhausted by 2025."

Those who say we are running out of oil point to the fact that oil is a finite resource. As a result, at some point the world will have depleted half of the recoverable oil reserves. This is the so-called “Peak Oil” point. When that happens, the production of oil will decline while the demand for oil—as currently projected—will continue to rise. The result of this scenario is ever-rising prices. Unfortunately, nobody knows when this point of “Peak Oil” will be.

Complicating the matter is the fact that much of the world’s known high-grade oil reserves are located in politically unstable nations. OPEC, potential supply disruptions from terrorism, and now hurricanes also factor into the price of oil story.

Back to our original question . . . are soaring oil prices telling us we are running out of oil? The answer is . . . nobody knows. While we do not know for sure how much of the rise in oil prices is due to concern about long-term supply, we can draw several conclusions from the price rise that may help us make future investment decisions.

First, rising oil prices deflate demand for oil. As oil prices rise ever higher, that encourages consumers to reduce their consumption of oil and oil-related products. As consumption (demand) drops, that may lead to lower prices (and may lead to a recession too). At some point, equilibrium is reached between the price of oil, the demand for oil, and the supply of oil. As the equilibrium price rises, it will lengthen the time before we reach the so-called “Peak Oil.”

Second, rising oil prices encourage the search for more oil deposits. Drilling for oil in hard to reach places may not have been profitable when oil was \$30 a barrel but at \$65 per barrel, it could be a different story. As more wells are drilled that could lead to more supply and help keep a lid on prices.

Third, rising oil prices encourage the search for alternative energy sources. The list of alternative energy sources includes: oil sands, shale oil, geothermal, hydropower, solar energy, wind energy, and wave energy to name a few. Each of these sources has its advantages and disadvantages but as the price of oil rises, some of the disadvantages become less problematic.

At the end of the day, rising oil prices take money out of consumers’ pockets, which is not good for the economy. About the only thing we can take some comfort in is the fact that adjusting for inflation, oil prices are still below the \$90 per barrel peak they reached in 1980, according to data from the World Bank. I know small comfort.

Weekly Focus – “Complex” Work May Lower Alzheimer Risk

Having a lifetime career that involved complex interpersonal relationships reduced the odds of developing Alzheimer’s disease by 22 percent according to a September 2005 study published in the *Journal of Gerontology: Psychological Sciences*. Examples of a “complex” job include teaching, managing people, frequent negotiations, and dealing

with customers. Scientists do not fully understand *why* “complex” jobs may lead to lower rates of Alzheimer’s disease, but the findings do square with earlier research showing a link between mentally challenging leisure activities and lower rates of Alzheimer’s disease. According to a September 23 Reuters article, “...scientists speculate that people who stay mentally engaged throughout their lives may have a greater ‘cognitive reserve’ that allows them to withstand more of the brain damage seen in Alzheimer’s disease before symptoms begin.” Please pass the Rubik’s Cube!

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 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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