

Weekly Commentary

October 21, 2005

The Markets

The final quarter of the year did not exactly get off to a great start.

After meandering around the unchanged mark for the first nine months of the year, the major market indices quickly dropped between 2.6% and 2.9% the first week of the new quarter as indicated below. Most pundits pin the blame on hawkish comments from three Federal Reserve officials last week who insisted that the Fed is squarely focused on keeping inflation in check. Fed watchers interpret that to mean the Federal Reserve will continue to raise interest rates for the near future. Higher rates could put a chill on corporate earnings and lead to stagnant stock prices.

One of the four main functions of the Federal Reserve, according to its website, is to, "...conduct the nation's monetary policy by influencing money and credit conditions in the economy in pursuit of full employment and stable prices." Those last two words, "stable prices", means it is part of the Federal Reserve's responsibility to keep inflation low and not disruptive to the economy. William Poole, president of the St. Louis Federal Reserve Bank, said the Fed aims to keep core inflation in the 1% to 2% range as reported by www.marketwatch.com. Richard Fisher, president of the Dallas Federal Reserve Bank, said in a speech on October 4 that inflation is now at the high end of the Fed's comfort zone.

For the economy, a little inflation is good because it allows firms to raise prices and increase profits. However, too much inflation can be bad for the economy. Walking that fine line between too much and too little inflation is a delicate balancing act that the Fed constantly monitors.

Returns through 10/7/05	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrials	-2.6%	-4.6%	2.4%	11.5%	-0.6%	8.0%
Nasdaq Composite	-2.9	-3.9	8.9	23.1	-9.1	7.5
Standard & Poor's 500	-2.7	-1.3	6.6	15.1	-3.2	7.5

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.

GOLD IS MORE COMMONLY THOUGHT OF as an expensive accessory that is worn rather than a metal that is purchased as an investment. However, last week gold prices hit a 17-year high according to www.thestreet.com, so if you are wearing some gold, you can feel a little wealthier than usual.

From time to time, gold captures the consciousness of the investing public, but that usually only happens when there is high inflation or great fear in the geopolitical

environment. In light of terrorism, creeping inflation, and the fury of Mother Nature, people are apparently turning to the shiny metal for comfort. Comfort is really the key word here because intrinsically, gold is not that valuable. It has few industrial uses and its main source of demand is from well-heeled people seeking to fashionably-adorn themselves.

Despite the lack of intrinsic value, there is no shortage of explanations for the rise in gold prices. You can take your pick from the following, according to newsletter editor, Peter Grandich, as reported by www.marketwatch.com: "...double-digit jewelry demand growth, abundant investment demands (from speculators?), mine supply falling short of demand, and a 'lessening negative effect of central bank sales or the talk of them.'" Whether gold continues to rise or not will probably depend on investors' forecast for inflation and the worldwide geopolitical situation.

HAPPY BIRTHDAY TO THE THREE-YEAR OLD BULL MARKET. Three years ago, on October 9, 2002, the S&P 500 closed at 776.76 and that marked the bottom of the bear market, which began with the collapse of the tech stocks in early 2000, according to data from Yahoo! Finance. Just six weeks later on November 21, 2002, the S&P 500 had soared 20 percent and ushered in a new bull market. It then took about another two years for the index to rise an additional 30% bringing the total gain from the bear market low to 50% on November 5, 2004, according to data from Yahoo! Finance. Since that 50% surge, the S&P has only risen about 2.5% between November 5, 2004, and October 7, 2005.

In total, the S&P 500 has risen about 52.5% over the past three years. Yet 20 percentage points of that gain came in just a six-week period following the bear market low. If somebody was trying to "time" the market, what do you think the odds are that they would have been out of the market leading up to the low on October 9, 2002, and then presciently gotten back in that day to catch the ensuing 20% rise? Probably pretty low. This low probability is one reason why you do not see market timers on the Forbes 400 List of the Richest Americans.

Weekly Focus – The Coffee-Trust Connection?

You may think Americans drink a lot of coffee, but according to the Global Market Information Database, published by Euromonitor, Americans are only the twelfth largest per capita consumers of coffee in the world. The top five countries are Norway, Finland, Denmark, Sweden, and the Netherlands. Norwegians, Finns, and Danes all drink at least three times as much coffee, per capita, as Americans, according to the report.

Interestingly, the World Values Survey identified the countries that had the highest percentage of the population who agreed with the statement, "People can be trusted." Well guess what? The top five coffee drinking countries are also the top five "people can be trusted" countries! Apparently, people who drink coffee are also very trusting. Is there some rational connection between drinking coffee and trusting people, or is this just

a big coincidence? If you have an opinion on this, let us know. In the meantime, it is time for another cup of java.

Best regards,

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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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