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The Sound Investor Series #14

What Should Investors do in the Aftermath of Hurricane Katrina?

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With the death and destruction brought on by Hurricane Katrina, everyone prays the situation will improve along the Gulf coast. Hopefully, the worst is over and people will be able to begin rebuilding their lives in the near future.

After the obvious priorities of saving lives and caring for survivors have passed, people all over the country are thinking of their investments and wonder if they should make any changes to their portfolios. This is understandable since the disruptions and challenges caused by Hurricane Katrina are immense.

Anyone who has visited their local gas station in the last few days knows the Gulf region is home to a significant portion of the country's oil and natural gas production and a large proportion of our refining capacity.

In addition, the national transportation infrastructure has come under stress. The Mississippi River is the drainage basin for over 40% of the US and is the life-line for farmers and manufactures getting products to market. Trade also flows up the rivers, like steel for automobiles.

Some commentators are now expecting the storm's costs to reach over \$100 billion in damage and lost business, causing the whole economy to grow only half as fast as expected for the rest of this year. I can already hear companies (correctly) attributing weak 3rd and 4th quarter results to the Hurricane. It won't be a surprise if automobile companies sell fewer cars or chemical companies get hurt by higher oil prices.

What should investors do? This is obviously a catastrophic event and it would be irresponsible to ignore it and not consider the potential affect on your portfolio.

But while investors should know the issues, this does not mean they should automatically do anything. The key is to understand your reasons and timeframe for being invested in the market; and then make decisions.

To start, think back and remember why you invested in the stock market in the first place. If you are primarily interested in gambling on the market and often trade in and out, you may want to sell. Or maybe you want to buy, based on the amount of economic activity

it will take to rebuild the Gulf Coast. Who knows where the market will go in the short term!

But if you are a long-term investor, you should ask yourself how Katrina will affect the market over your planned investment horizon. If you aim to be invested for the next 10 years, questions you should ask are: Will this storm cause the market to be significantly lower than it would otherwise be in 10 years? And, do I need to change my overall view of being invested in the stock market? My answer to both questions is no and if you agree, you shouldn't sell. It is really that simple.

But some long-term investors, I am sure, are saying to themselves the market has to go lower in the short term. So they want to sell now and buy in at a lower price in a few months. If I KNEW the market would go lower and KNEW when it would bounce back, sure I would sell now and buy later. But you and I don't KNOW; and by selling we are proclaiming that we are smarter than the market.

There are other problems with trying to time the market, even if you get the direction right. First, you have transaction costs such as commissions, although with discount brokers this is less of a problem than it used to be.

Secondly, by selling you might trigger a taxable event, which would make it even more difficult for your trade to be profitable.

Third, if you sell, you will need to put your money into other investments. There are plenty of stories about investors in the late 1990s who sold their houses due to the real estate bubble, and invested in the stock market. Unfortunately for them, most real estate markets keep going higher while stock market's bubble burst.

Finally, how are you going to know when to get back in? What gauges or indicators are you going to rely on to know when to buy?

In summary, investors should pay attention to how significant economic shocks such as Hurricane Katrina can affect their investments. But most will be best off sitting tight and resisting the urge to trade the market. Making money from short-term market swings, requires the confluence of several correct decisions and is not simple nor a sure thing.

Ed Hynes, CFA, is President of Farm Creek Securities, LLC based in Rowayton, CT. (203) 838-1025. This series of articles is available at farmcreeksecurities.com. Before putting money in any investment, you should carefully consider your investment objectives; and the risks, charges and expenses of any investment. Past performance is not an indication of future performance and there are risks to investing including the loss of principal.

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