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## Looking for the bottom

### Weary and worried investors await good economic news

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After huffing and puffing through a challenging first quarter, investors were hoping for some flat terrain so they could make up some ground.

What they encountered instead was a series of second quarter road hazards no amount of agility or training could overcome, a three-month stretch that pummeled stocks and left investors wondering if anything else could go wrong.

Soaring oil prices, a prolonged housing slump, a rapid rise in the cost of food and tightened credit markets produced a sharp sell-off on Wall Street in the second quarter, grim reality that many investors will see close when portfolio statements begin arriving this week.

The quarter began on an optimistic note, and through Memorial Day many analysts felt that the worst-case fallout from the collapse of the housing bubble and the credit crisis had ended.

But June cast a pall over the entire market, a month-long decline triggered by oil selling for \$140 a barrel, rising unemployment and falling home prices. Some economists now believe the economy has been in a recession since late 2007 and that equities will have a hard time posting any positive gains for 2008.

**"We were running a victory lap for a while but we got tripped up at the finish line," said Gary H. Sherr, vice president of Carl P. Sherr & Co., a Worcester investment advisory and brokerage service company. "They brought the champagne out a little too early."**

How long the gloom persists may depend on consumers. Many analysts are worried consumers are tapped out from higher gasoline and oil prices and that an earlier stimulus package by the U.S. government won't be enough to overcome the current economic challenges.

Wall Street experts believe housing has not yet hit bottom, citing high inventories and falling home prices. They also fret that inflation has begun to cut into consumer spending, as households pinch pennies at a time of stagnant wage increases.

"It's pushed back our outlook for recovery," said Gary A. Gerulskis, president of Capital Advisors LLC of Framingham. "It's going to be very difficult to have a positive year."

The quarter wasn't without positive news and some Central Massachusetts publicly traded companies had robust returns.

The T&G/Bloomberg Central Massachusetts Index of locally based public companies rebounded from a dismal first quarter. The price-weighted index rose 6.97 percent based on price appreciation and had a total return of 7.11 percent. Sixteen of the 29 companies posted positive returns for the three-month period ending June 30.

Shares of American Superconductor Corp. of Devens rose 54.5 percent for the quarter, moving up after forecasting sales that topped analysts' estimates. The energy technologies company, which hasn't reported an annual profit since it went public in 1991, is benefiting from orders from wind-energy companies and electric utilities and growing interest in energy stocks in general.

"They had a fantastic quarter and all energy-related investors are doing quite well," Mr. Gerulskis said. "Energy should be a big part of anyone's portfolio right now."

Some area companies were in the business of addition and subtraction during the quarter. Staples Inc. of Framingham sealed a \$2.7 billion deal to acquire Corporate Express NV of the Netherlands. Staples raised its offer three times over four months to complete the deal and put further distance between itself and U.S. rivals Office Depot and OfficeMax.

Webster-based Commerce Group Inc., the largest auto insurer in Massachusetts, ceased trading in June when it was acquired for \$2.2 billion by Spanish insurer Mapfre S.A. The property and casualty insurer will retain its name and remain headquartered in Webster.

Energy stocks, particularly alternative energy companies are gaining traction as investors seek out companies that might benefit from the fallout of higher oil prices, Mr. Sherr said. Companies such as American Superconductor, Marlboro-based Evergreen Solar Inc. and Mass Megawatts Wind Power Inc. of Worcester are attracting greater interest than at any other time. Gov. Deval L. Patrick will attend the grand opening Tuesday of Evergreen Solar's 160-megawatt manufacturing plant in Devens.

**"Now suddenly the Birkenstock crowd is making money," Mr. Sherr said. But many alternative energy companies have a limited array of products and there is the potential to buy into something untested, he said.**

"Remember, the world still runs on oil," he said.

That fact weighed on Wall Street and the first half of 2008 was the worst for the Dow Jones industrial average since 1970. The Standard & Poor's 500 Index and the Nasdaq Composite Index had their worst half since 2002.

For the quarter, the Dow fell 7.44 percent. The S&P 500 dipped 3.23 percent based on price appreciation and had a total return of -2.73 percent. The Nasdaq rose .61 percent based on price appreciation and posted a total return of .82 percent.

Some believe the pervasive negativity may produce some momentary upswings as investors are comforted by events that don't turn out as bad as predicted.

"The psychology right now is so bad and fear is so rampant that anything less than draconian could reassure investors," said Mr. Gerulskis. "If there were some better news to materialize, such as unemployment holding steady or a stronger dollar...anything of that nature could be a catalyst."

The Federal Reserve likely won't be a catalyst for Wall Street anytime soon, many believe. The Fed halted its interest rate-cutting campaign last month, ending a string of seven interest rate cuts that saw it reduce the federal funds rate to 2 percent, down from 5.25 percent.

Altering interest rates doesn't have any measurable impact on commodities such as oil, said Thomas J. Bartholomew, president of Bartholomew & Co. Inc., a Worcester-based investment planning company. Higher interest rates might curb some inflation, but doing so kills the housing market, he said.

"We still don't have a shakeout in housing," he said. "There's still room on the downside. "There's going to be a cyclical turn at some point, but God knows where the bottom is."

A stable housing market sets the table for any recovery, analysts believe. When home prices continue dropping, more and more mortgages go delinquent, which causes banks to write off more loans. When that happens, lending dries up, making it harder for others to buy a house or obtain a business loan or line of credit.

Many banks are trying to raise money to offset bad loans and that problem hasn't yet trickled down to small to mid-sized banks, Mr. Bartholomew said. Those banks will be forced to either raise capital or merge with a larger entity.

"Bank consolidation is coming like a train down the track," he said.

**Mr. Sherr said Wall Street can't rebound when banks are trying to add capital to their balance sheets.**

**"It's never a good sign when a blue chip bank is out on the corner with its hat out," he said.**

**Navigating the next few months will be a challenge and investors need to be nimble and flexible and understand their tolerance for risk, according to local experts. The lack of liquidity will have a lingering downdraft on almost every asset class except for cash, treasuries and commodities.**

**"We're definitely taking a more defensive approach," Mr. Sherr said. He is recommending a diversified portfolio and likes value stocks that pay healthy dividends. Those with a long-term investment horizon should consider the current market a good buying opportunity.**

Mr. Bartholomew said he thinks there's ample downside opportunity concerning oil and policymakers and elected officials will try to pull enough levers to temper the current energy spike. The first few weeks of the quarter haven't produced any major earnings disappointments and investors should position their portfolios for 2010, not 2008.

"We're not out of the woods," Mr. Bartholomew said. "But I think a person's portfolio will be worth more at the end of the year than what it is today, but still less than what it was on January 1."