



September 8, 2005

Dear Clients, Friends and Colleagues:

We all share a deep concern for the devastation and loss of life wrought by Hurricane Katrina. Some investors are beginning to wonder about the potential economic and investment impact, and want to share some thoughts on that aspect of the disaster. Given the magnitude of the destruction and the region's important role in oil refining and shipping, the economic impact is obviously negative. At this stage it is hard to say how negative until more information becomes available. While the average investor historically tends to overstate the risks from these kinds of shocks, this has not been the case so far, at least as reflected by the muted stock market reaction. Nevertheless, this is a major event with potentially significant near-term (and possibly intermediate-term) economic consequences, so we will continue to assess the potential fallout as the situation unfolds.

As we analyze information and learn more about the potential economic and market impact there are several things to keep in mind:

- Generally speaking, it is very difficult to make accurate economic forecasts. It is no easier to *accurately and confidently* assess the economic impact of a specific event like this in a way that can serve as a rational basis for a significant portfolio change. To justify such a change requires making an accurate assessment and doing so before other investors come to the same view. This is typically a loser's game and will not provide an investment edge.
- Though we are unlikely to recommend any action based on an economic assessment of Katrina's fallout, it is important that we think about the possible consequences so that we can determine what might adequately protect against *possible* risks.
- All rational investing activities require an assessment or risk and conclusions based on incomplete information. Because there is always uncertainty, we rely on diversification to provide shorter-term portfolio protection against unforeseen events. This type of event is a good example of why we diversify.

With the above as background the following are some thoughts at this early point in the tragedy:

Beyond our existing diversification, it is unlikely that we will consider recommending investment strategy shifts. There are several reasons for this:

- The intermediate-term economic picture is now more cloudy and equities haven't declined, so as of this writing, no buying opportunity has been created;
- We rely on mutual fund managers for making adjustments at a stock-picking level. Nothing has changed to the extent that we consider recommending style adjustments to stock market exposure;
- Based on our reading and analysis of the information so far, our general conclusion (not a specific forecast) is that the economic risks are not so clearly negative that it makes sense to get more defensive at this time. The triggering of a recession is possible in conjunction with other risk factors—but this seems unlikely at this point. And from a *long-term* (multi-year) standpoint, we believe it is quite unlikely that the disaster will have much impact on the financial markets.
- But there are several short- and intermediate-term risk factors that could threaten the stock market. The biggest risk is a sustained reduction in energy infrastructure—oil refining capacity (which is already stretched), drilling and natural gas—that could result in



sustained higher prices. That would be harmful to the global economy. In addition, the disruption in a major shipping channel is impacting a wide variety of businesses inside and outside the region. Beyond that, many thousands of jobs have disappeared as the result of the physical destruction.

- As dire as this seems, once the rebuilding process starts, as has been the case in past crises (though this one is clearly worse), it's quite likely that there will be an economic stimulus that will offset some or possibly all the economic hit. So again, as bad as the situation appears, at this point we believe it is unlikely that the economic consequences will go beyond a temporary slowdown in the economy. But it is still early and it's possible this early assessment could be wrong.

If the economic impact of Katrina turns out to be significantly negative—which we think is not likely—we expect investment returns to be hurt, but we believe that the well diversified portfolio will very likely moderate any declines.

We will continue to assess the situation and will, of course, keep you informed.

Best regards,

*Lauren*

Lauren S. Klein, CFP®, EA, MBA  
Klein Financial Advisors, Inc.  
4001 MacArthur Boulevard, Suite 102  
Newport Beach, CA 92660  
(949) 477-4990