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Sunday, July 8, 2007

Ahead of the earning curve

Vigilance, flexibility urged as investors pass half-year border

By Bob Kievra TELEGRAM & GAZETTE STAFF rkievra@telegram.com

fter gliding along on cruise control, investors now need to adjust their grip on the wheel.

Stocks, as measured by some of the major indices, have posted returns between 18 percent and 20 percent for the past 12 months, fed by a booming world economy, the absence of any inflation, and no slowdown in U.S. consumer spending.

But at the halfway mark of 2007, investment professionals are cautioning vigilance and flexibility, suggesting that an autopilot approach won't work in the second half of the year.

"You've got to be nimble, don't be terribly long and take your gains when you get them," said Thomas J. Bartholomew, president of Bartholomew and Co. Inc., a private Worcester-based investment planning company.

Second-quarter returns met or beat most expectations, and optimism remains prevalent that the stock market will have another positive year. But economic currents are shifting, and investors need to take into account mounting inflation fears and the specter of higher interest rates, developments that could easily trigger pullbacks on Wall Street.

Despite a slumping U.S. economy, which had a gross domestic product of only 0.7 percent in the first quarter, the world economy is booming, marked by record rates of growth in many parts of the globe.

Such robust returns means the end of the current benign cycle of falling interest rates and moderate inflation levels, the ingredients of the so-called "Goldilocks" economy of things being not too hot and not too cold.

"I think Goldilocks is out with the three bears now," said Gary H. Sherr, vice president of the Worcester brokerage Carl P. Sherr & Co. "Things have gotten more complex. You have to be smart and diversified and don't chase the trends."



Mr. Sherr said he would not be surprised of some type of thirdquarter pullback, noting that stocks, which reached record highs in April and May, slumped in June as inflationary concerns took hold, pushing up the yield on the 10-year Treasury note.

"I do anticipate a correction," he said. "It's like a car. If you keep increasing its speed, it increases the chance you might get into an accident."

Acceleration marked the major indices in the second quarter, but the T&G/Bloomberg Central Massachusetts Index of locally based companies didn't show much horsepower.

The price-weighted index rose 1.9 percent based on price appreciation and had a total return of 2.06 percent for the second quarter, as 19 of the 32 companies posted positive returns for the three-month period ending June 29.

For the quarter, the Dow Jones industrial average rose 8.53 percent. The Standard and Poor's 500 Index was up 5.81 percent based on price appreciation and had a total return of 6.28 percent. The Nasdaq Composite Index increased 7.5 percent on price appreciation and finished with a total return of 7.7 percent.

The T&G/Bloomberg Index was weighed down by negative returns among some of its larger companies, including a -8.17 percent return for Framingham-based Staples Inc. Shares of the office products superstore fell after the company in mid-May reduced its yearly forecast as sales at U.S. stores slowed.

Marlboro drug manufacturer Sepracor Inc. also finished in negative territory, as its shares dropped 12.03 percent for the quarter. Analysts downgraded the company after learning the Centers for Medicare and Medicaid Services lowered the reimbursement amount for Sepracor's inhalable asthma drug.

Fitchburg-based Arrhythmia Research Technology Inc. had the biggest second-quarter drop, slumping 55 percent. The company, which does plastics molding and makes computerized medical instruments, topped the T&G/Bloomberg index in 2006 by posting a total return of 176 percent.

But shares fell in mid-May after the company reported lower net income on higher revenues.

No one should hope for a stock uptick because of a cut in interest rates this year, said Mr. Bartholomew. A rate cut, which would lower the cost of borrowings, likely has been shifted into 2008 as the economy improved in the second quarter and there were no visible signs of a weakened labor market, he said.

"2007 is going to be a good year," he said. "The two biggest worries are from terrorism and the subprime mortgage mess and so far, they seem to have been contained."

Positive returns are in the cards but increased volatility will mean greater discrepancies between winners and losers, said Jerome J. Jacobs, chief investment officer at Argent Wealth Management in Weston.

Interest-rate-sensitive investments and real estate investment trusts lagged in the second quarter, disappointing investors who grew accustomed to positive returns regardless of the sector, he said.

"Investors investing through the rear-view mirror are going to have trouble," Mr. Jacobs said. "Volatility is going to get more normal,

T&G/BLOOMBERG Stock index review

Best to worst performers, second quarter 2007

| Rad/Connec | 6/29/07 | % (24, | 1:10 |
|---|-----------------|-----------|--------------|
| 1. Distrat laterathiad late, Wavenston | 90.75 | 27.06 | 35 tasag |
| Personal career vaccions (DVTI) | 20.13 | 44.00 | Ø. |
| Amerikan Saparcanductur Carp., Westboro Supercanducting products, systems (#MSC) | \$19.31 | 43.36 | * |
| I. EMC Carp., Hopárinos Compolár storage systema, software (EMC) | \$18.10 | 30,69 | 11 |
| . <mark>Cytic Corp., Manitorio</mark> Developer of corvical caracer acreeming products (Cit | \$49.11 | 26.02 | å |
| , Yalpıry Flabus Corp. , Herpéciators | \$5,40 | 25.58 | 3 |
| Guartz crystals and oscillators (VFF) Aliannia Plannia nethods Na., Hopkinton(1) | \$3.07 | 23.20 | 27 |
| Products for carbial neavous system disputers (ALSI Applicias, Westcore | :1 \$16.45 | 22.63 | ô |
| Applications software (APLX) Basille Table Sallware Inc., Southerno | \$16.41 | 21.47 | 18 |
| Data protection software (DBTK) Commerce Group Inc., Welester | \$34.72 | 15.58 | 16 |
| Properly and casualty insures (CG) O BTC Bulburapudica loc., Framingham | \$1,15 | 12.30 | 28 |
| Genetically engineered animals (GTCR) Providence and Worsentie RFI Ca., Worsenson | \$19.34 | 9,27 | 36 |
| Rail beight curies (PVX) : EDACT Sciences Curp., Markono | \$2.89 | 7.84 | 55 |
| Applied generales hethrology (EXAS) 3. Cambra Cary. , Westters | \$ 0.16 | 8.67 | 20) |
| Computer memory groducts (CBEX) 4. WEON Communications Group Inc., Westborn | \$4.98 | 5,98 | 9 |
| fiberoglic autwork survice povider (NGI) S. The Hasarer Roussoca Group Lac., Waxcester | \$48.79 | 5.79 | 23 |
| Property and casualty insures (THG) 6, 3Xett Carp., Machino | \$4,13 | 5.63 | 21 |
| Noticelang systems (COMS) 7. IPS Platanica Corp., Outcod | \$19.95 | 3.91 | 30 |
| Files base and amplifies manufacturer (\$107) L Willia Cirp., Milbed | \$ 59.36 | 23A | 5 |
| Liquid chromotography products (WAT) I LS. Starrett Ca., Arbei | \$18,32 | 1.78 | 8. |
| Tools, precision instruments (50%) Neuthura Financial Servicus Inc., Westborn (2) | | | ************ |
| Banking and facinical services (WFSM) | \$34.91 | -0.96 | 14 |
| t, Cilibana National Bancarg, Protessor (3) Banking and financial services (CT/A) | \$105.75 | ×1.17 | 18 |
| 7. PSB Rubbaya Isc., Primorn Banking and financial neurices (PSRH) | \$10.58 | -2.94 | 18 |
| 3. Energram Saler Inc., MacTuoro Solar power cells and systems (ESCII) | \$9.33 | -4102 | 5 |
| i. Stojan Iv. , Francogben Effice probets superstons (SFLS) | \$2 3.73 | -8:17 | 19: |
| 5. Septem Fac., U nition Enformed terms of existing drugs (SEPR) | \$41.02 | - 12.03 | 31 |
| 6 CNE Fishedid Corp., Wordester Banking and Emoralid bervices (CFRA) | \$10.00 | -14.89 | 28 |
| 7. Precision Optico Carp. Inc., Condien Optical Systems, componente (POCI) | \$0.34 | ~15.00 | 7 |
| B. Mass Mejawalta Wied Power les., Shervestory Wied technics (MM/GW) | \$0.65 | ×16.34 | 15: |
| 9. Caligne Lille Stilleden iber, Hopkinson - Devices and systems for laboratory experiments (ICA | \$4,69 LP) | -15.99 | 17 |
| D. Virjalid Lid. , Soundono Software and services (VIII/AF) | \$2.60 | -20.97 | 25 |
| I. ClearStary Systems Inc., Westbook (4) Document services (CSYS) | \$0.06 | -40.00 | 59 |
| 2: Ambythoia Brassob Teck, Bisc, Fecholog Computerized modical instruments (HBT) | \$11.86 | -54.77 | 10 |
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The Town of Sterling DPW Is accepting applications for Clerk o the ... not scary, but what you own is going to matter a lot more. It's a market of stocks, not a stock market."

Despite weak sales of existing homes in May, the real estate slump hasn't spread across the economy, investment officials said. The worse may be yet to come for housing, but the decline in sales and home prices hasn't crippled the economy, Mr. Jacobs said.

The slowdown actually enabled the Federal Reserve to pause its rate-hike schedule, a convenient brake on an economy that was overheating, he said.

Under the current conditions, Mr. Jacobs said he likes mid-cap and large-cap companies with international operations and low levels of debt. Investors should own investments that won't be affected by shifting interest rates and ones that can benefit from non-U.S. economic growth. He said he currently recommends global insurer American International Group Inc. and 3M Co., which makes 50,000 products, including Post-it Notes.

"Not everything you buy is going to reward you," he said. "Not everything is going to go up in a smooth, upward line."

One local company took a direct route to the top in the second quarter.

Biovest International Inc., which is developing personalized cancer vaccines, went from last to first. Shares of Biovest rose 47 percent in the quarter, making it the leading gainer. The company had the worst return, at -46.3 percent, in the first quarter.

The share price rose on news that the company would seek conditional approval next year from U.S. and European regulators to begin commercial sales and marketing of its anti-cancer drug in 2009. Also fueling the run-up was the company's announcement of an agreement to distribute its automated cell culture instrument.

Marlboro-based Cytyc Corp. had a robust quarter after the company announced it would be acquired by Bedford-based Hologic Corp. in a \$6.2 billion deal that brings together two companies that make medical devices and equipment related to women's health.

Hologic paid a 33 percent premium for Cytyc in a deal expected to close in the third quarter.

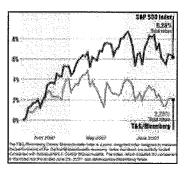
Another local company also was the subject of a merger, as cable operator RCN Corp. agreed to buy NEON Communications Group Inc. of Westboro for about \$260 million. The purchase price represented a 5 percent increase for shares of NEON.

After a long period of little growth, shares of EMC are moving upward. Shares rose 37 percent for the first six months, much of that in the second quarter after the company reported record revenue and a 15 percent profit growth.

Analysts and institutional investors are also eagerly awaiting EMC's initial public offering of 10 percent of its VMware unit, a deal that could bring in more than \$100 million.

Technology stocks had a great second quarter and hardware sales in general have been stronger than expected, said Mr. Sherr.

Acceleration marked the major indices in the second quarter, but the T&G/Bloomberg Central Massachusetts Index of locally based companies didn't show much horsepower.



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TELEGRAM & GAZETTE Bloomberg Index
Second Quarter

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Carl M. Cohen, chief operating officer of Worcester-based Biovest International Inc., the leading gainer for the quarter. Its shares rose 47 percent.

(T&G File Photo/PAUL KAPTEYN)

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