



## FLASH REPORT

### *Hurricane Katrina*

As the days go by since Hurricane Katrina, the sheer scale of this disaster is increasingly apparent. Much of New Orleans remains submerged, the energy infrastructure damaged and the Gulf Coast devastated. It seems clear that the rebuilding of New Orleans is a project to be measured in months, if not years.

Despite the human devastation, we are forced to evaluate the impact on our clients' portfolios. For centuries, the New Orleans economy has depended on trade. What was not widely realized was how vital this trade has become to the global economy. In addition to being the nation's busiest port by tonnage, New Orleans has become the country's most inter-modal, with dozens of truck lines, ocean carriers and barge lines moving approximately 11 million tons of cargo per year.

Newgate launched the Global Resources Portfolio on the belief that the increase in commodity pricing is demand-driven. This is in contrast to many previous spikes in commodity prices that were caused by supply disruptions. Due to Katrina, we now have a confluence of events – continued strong global demand coupled with severe, if temporary, supply disruptions across many vital resources.

**ENERGY.** The Gulf of Mexico plays an integral part in domestic energy infrastructure. Approximately 25% of consumed oil is either transported or refined through the Gulf. The price of crude oil spiked immediately after the hurricane, though now appears to be stable in the high \$60s. Capacity at refineries was very tight even before Katrina. The surprisingly fast recovery of refining capacity, with most refiners fully operational within a few weeks, will only restore the previous precarious inventory situation. Consequently, releases from the federal government's Strategic Petroleum Reserve will have little effect on the price of gasoline or heating oil. The supply/demand imbalance is simply at the wrong end of the nozzle.

Energy stocks have rallied since Katrina struck. For example, two representative energy stocks currently held by Newgate, Valero (VLO), a large refiner, has increased 18%, ConocoPhillips (COP), a diversified energy company, has increased 6%. These stocks have continued to appreciate in price despite the leveling of crude oil prices. We think the message is clear; prices of energy-related companies are wedded to global demand and a structural supply/demand imbalance. Katrina only exacerbated the problem, it did not cause it. Worth noting is that natural gas is produced in the Western Gulf and was therefore largely unaffected by Katrina.

**AGRICULTURE.** New Orleans is a significant port for agricultural products. It is the nation's largest port of entry, warehouse and roaster of coffee. At least 1.6 million sacks are stored there and possibly have been destroyed. Coffee prices have risen over 7.5% since Katrina hit. In addition, 37% of US soybeans and 17% of corn flow down the Mississippi towards their final destination. Spot prices for these commodities have been little changed. Thus far, Katrina has had minimal impact on our portfolio with respect to agricultural resources.

**MATERIALS.** The US imports a vast amount of steel, rubber, plywood and forest products. Nearly half of the London Metal Exchange's (LME) zinc inventories are stored in New Orleans. The LME has suspended the use of New Orleans as a way to deliver zinc, copper and aluminum. Zinc prices have increased over 4.5% since Katrina hit.

There will be a massive cleanup and years of rebuilding. Lumber and building materials will be needed on a grand scale. An already tight energy market is now that much tighter. All this reinforces our belief that commodity stocks represent a rare and important portfolio diversifier in the face of uncertainty. ♦

*Please feel free to contact us with any questions or concerns that you may have.*