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Sarbanes-Oxley skews investors' expectations

Richard Welty, who answers this week's questions, is president and chief investment officer of Welty/Solari Capital Advisors, an investment firm registered with the Securities and Exchange Commission and located in Lafayette. He is an independent investment adviser for pension and profit-sharing plans and individuals. He has more than 25 years of experience. Welty can be reached at 925-283-4960 or by e-mail at weltycap@pacbell.net.

Managing Your Money is a regular feature in which members of the Times Investing Panel answer personal finance questions from readers. The answers to these questions are general in scope and do not apply to all situations.

Q: I have most of my retirement money invested in mutual funds from various 401(k) rollovers. I started a Roth IRA and have money invested in various accounts.

I consider myself an informed investor but not knowledgeable in the factors that affect the market. My total investment in my Roth IRA has gone up 35 percent in the past 21/2 years, so I have picked good stocks or just been lucky.

I have a small stake in Google, and some things that happen in the market have me very confused. I know the tech sector has been down, but I don't understand why when Google beats analyst revenue estimates handily, the stock went down. It still seems to be fluctuating lower than I expected. I would expect that when a stock exceeds expectations, it would go up.

Another stock that confuses me is Cheasapeake Energy (CHK). I have a small stake in this one as well, and it would seem to me that when the price of oil goes up, natural gas would go up, too. Instead, it seems the opposite. When the price of oil goes up, CHK goes down – very confusing.

Are there other factors that come into play that I am not seeing? Any information you can provide would be very helpful.

- Rick Kiechhefer,
Brentwood

A: Your confusion over the market is quite understandable. Investment analysis, which might have worked successfully 10 years ago, does not always work today. Strong earnings and revenue growth historically moved stock prices.

But over the past few years, Wall Street investors wanted both good quarterly earnings and revenue growth, and also demanded that corporate management be extremely positive during their quarterly conference calls regarding the earning outlook for the next quarter. As a result of the Sarbanes-Oxley legislation, corporate executives have become overly cautious about "over-promising and under-delivering."

In the case of Google, while revenue and earnings growth have been excellent, during the conference call Google management has been very realistic about the outlook for all its businesses. If the outlook for any part of Google's business is less than perfect, investors tend to sell the stock. Over the long run, steady revenue and profit growth will lead to higher stock prices. Google stock should do well over the next several years, but you have to be willing to put up with a certain level of stock price volatility.

Regarding the Chesapeake Energy, up until the past six months, the stock price did follow the price of natural gas and crude oil. Over the past five years, the stock appreciated from \$5 to \$35. Several months ago, both crude oil and natural gas prices hit record highs. While crude prices stayed high, the price of natural gas fell from \$14 per thousand cubic feet to below \$6 per thousand cubic feet. The price of crude and natural gas usually move in tandem, but different supply and demand pressures can change this correlation. Chesapeake Energy should do well because the earnings are still growing and the price-earnings ratio is quite reasonable.