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What Lurks Inside Your Index Fund

THE extraordinarily long and wonderfully lucrative decline in interest rates is over. Are you ready for the coming seismic shift?

Tumbling rates have kindled booms in stocks, bonds and real estate in recent years. They have also propelled shares of financial services companies, whose profits exploded as their capital costs sank. While rising rates will probably stop all of these booms, financial services stocks are particularly imperiled. And whether they know it or not, owners of equity index funds that mirror the Standard & Poor's 500 will be pained by the decline in these shares.

While many investors think that a broad market index like the S.& P. reflects an equal weighting of United States industries, the sectors often become highly imbalanced. And in recent years, financial services companies have quietly come to dominate the S.& P. 500.

All those financial stocks looked good until rates rose.

Right now, these companies make up 20.4 percent of the index, up from 12.8 percent 10 years ago. The current weight of financial services is almost double that of industrial company stocks and more than triple that of energy shares.

In the past, whenever one industry dominated the index, that sector was at or near its peak value and soon began a steep decline. For example, in 1980, at the height of the energy crisis, stocks in that industry made up 27.1 percent of the index. Five years later, energy stocks had fallen to 12.8 percent. And in 1999, during the Internet and telecommunications stock nuttiness, technology shares made up 28.2 percent of the index. Now they represent just 16.9 percent.

It is also worth noting that the current weight of financial services companies in the S.& P. is significantly understated because the 82 financial stocks in the index do not include **General Electric**, **General Motors** or **Ford Motor**. All of these companies have big financial operations that have contributed significantly to their earnings in recent years.

The index considers G.E. an industrial stock, for example, but G.E. Capital's contributions to results mean that the parent is at least one-third a financial services company, maybe more.

The retrenchment in financial shares has already begun. Since rates hit a low in March and began climbing, the American Stock Exchange Financial Select Sector index of 82 banks, brokerage firms and insurance companies has lost 2.5 percent of its value.

But Andrew Smithers, the founder of Smithers & Company, an economic consulting firm in London, says he thinks these shares have a lot further to

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Agence France-Presse — Getty Images

A group of Russians protested in Moscow in May, holding pictures of the industrialist Mikhail B. Khodorkovsky and demanding his release from jail.

The Capitalist in the Cage

Russian Tycoon's Prosecution Becomes a Trial of Titans

By TIMOTHY L. O'BRIEN

"They did not know how to judge and could not agree what to consider evil and what good; they did not know whom to blame, whom to justify."
— Dostoevsky, "Crime and Punishment"

SINCE his incarceration eight months ago, Russia's richest man, Mikhail B. Khodorkovsky, has made only fleeting public appearances — behind bars on a prison video screen, hustled from police vans amid a phalanx of security guards, or, as his trial began on Wednesday in a Moscow courtroom, seated inside a cage.

In these glimpses, Mr. Khodorkovsky looks pale, resolute and unemotional, much as he did in the years before the state police arrested him at gunpoint aboard his private jet in October, charging him with looting public assets and evading hundreds of millions of dollars in taxes.

Until shortly after his arrest, Mr. Khodorkovsky, 40, was the chief executive of **Yukos Oil**, which he had transformed into one of Russia's biggest and most shrewdly operated companies. He had amassed a personal fortune of at least $15 billion. Along the way, he jousted politically with Russia's president, Vladimir V. Putin; deftly courted American financiers, legislators and opinion makers; showered money on public relations firms; and played the role of freshly minted capitalist with singular aplomb.

And until his arrest, Mr. Khodorkovsky's past as one of Russia's wiliest and most hard-nosed tycoons seemed a rapidly fading memory. He began his career as a banker who built his fortune on a series of highly criticized privatizations of state-owned companies, like Yukos. Russia's former president, Boris N. Yeltsin, and a senior deputy, Anatoly B. Chubais, spearheaded the privatizations during the 1990's. The deals were plagued by inside maneuvering and fire-sale prices, giving rise to a group of powerful businessmen, including Mr. Khodorkovsky, who became known as oligarchs.

Perhaps inevitably, given the arc of his career, Mr. Khodorkovsky's showcase trial — freighted with the possibility of a lengthy prison term and a Yukos bankruptcy — promises to offer one of the first public referendums on the state of Russia's riches. Its outcome could help shape for years the nature of the country's experiments in capitalism.

"This should be Russia's O. J. trial and should be the most public and most important bit of jurisprudence in modern Russian history," said Bernard Sucher, a Moscow investment banker, referring to the attention on the trial of O. J. Simpson in the United States. "Most people want to look deeply at what happened here in the 1990's, and this is a chance to come to terms with how the country ended up the way it did at the end of the Yeltsin years."

Mr. Khodorkovsky and his lawyers have disput-

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No Use Crying Over Spilled Billions

Rescuing Time Warner From a Merger's Ruins

By DAVID CARR

Stephanie Diani for The New York Times

Richard D. Parsons, the voice of perseverance: "I was confident that I would one day end up running Time Warner."

WHEN he became chief executive and, a year later, chairman of **Time Warner**, Richard D. Parsons was dismissed as a politician who just happened to run the biggest media company in the world. His performance since then suggests that he has a few other skills, but it's the politician in him that has a gift for making an entrance.

Appearing before a gathering of employees at the Warner Brothers Studio in Burbank, Calif., two weeks ago, he walked to the edge of the stage, stretched his 6-foot-4-inch frame to full height and smiled demurely as applause several decibels past polite enveloped him. He wisecracked about the cheesy audiovisuals and quickly acknowledged various people in the audience.

Two years earlier, shortly after he succeeded Gerald M. Levin as chief executive, he appeared before the same audience as the stock of AOL Time Warner, as the company was known then, was sinking toward a record low, making America Online's 2001 purchase of Time Warner one of the worst mergers in American business history. He escaped unscathed from that unhappy gathering, maybe only because of the absence of fruit markets on the film lot. This time, the road show had fewer bumps and even fewer hard questions.

Mr. Parsons, a former banker and lawyer who loves jazz, projects a brand of corporate cool that seems unforced. Barry M. Meyer, who as the chief of Time Warner's Warner Brothers movie studio has shipped bags and bags of loot from the Harry Potter series to corporate headquarters in New York, introduced Mr. Parsons by playing a snippet of Johnny Nash's optimistic "I Can See Clearly Now," but reminded him that, two years earlier, "Yesterday," the Beatles' sung tale of regret, would have been appropriate.

Mr. Parsons, 56, recalled the day. "When we were here in '02, Barry said that people were disappointed and somber," he said, then paused a beat for effect. "They were sullen, bordering on mutinous, is what they were."

Having gently validated the brutal realities of the past, Mr. Parsons took notice of the lectern that had been adjusted for the diminutive Mr. Meyer. "I'm not going to use the podium," he said, standing a bit straighter to express the disconnect between his frame and the dais. "This is like the hobbit podium here." He immediately segued into a state-of-the-company stump speech, including a prediction that "Harry Potter and the Prisoner of Azkaban" would gross $94 million in its opening weekend. His sanguinity was met with skepticism by the crowd. (He turned out to be exactly correct.)

As a public personality, Mr. Parsons has range. High/low, black/white, streetwise/wise to the Street. Immediately after the merger, some incoming executives dismissed him as a drab banker whose presence was a nod to diversity, but Mr. Parsons emerged from the later wreckage as a seasoned Time Warner executive who knew the company but had enough deniability to run it after things went wrong.

He cashed in stock for $35 million in a merger that all but obliterated the stock-based retirement accounts of many Warner Brothers employees, yet the studio workers at the meeting guffawed at his jokes. It was apparent that they believed in Mr. Parsons more than they ever did in those who went before him.

After it became clear that the merger, intended to create a sum greater than its parts, instead had sent $100 billion in value down a rathole, the two chief architects of the deal — Mr. Levin and Stephen M. Case, co-

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