



Friends,

This is intended as an update to our most recent *Commentary* for our friends, as similar information was disseminated to our clients a few days ago.

Before the events of September 11, the underlying economic data we have spoken about were improving, and were edging closer to producing better headline data. The shock to the system has obviously affected the revenue flow of many industries and consumer confidence. The extent of the damage to consumer confidence is the topic of conversation amongst economists, as it is an important measure in determining the depth and length of the downturn. It now seems much more likely that the economy will post negative growth in the third and fourth quarter of 2001. The wild cards in the above forecast will likely be how much government spending makes its way into the economy, and what role inflation will play in calculating “real” Gross Domestic Product for these quarters.

Policy makers expect consumers to retrench, and will take a more active role in managing the economy by using a combination of government spending and targeted incentives to boost both corporate and personal spending and investment. They will continue to implement the appropriate monetary policy, and have begun discussions on other means at their disposal. The speed and accuracy of the stimuli will determine when the economy returns to its potential growth rate. We could see deficit spending for a period as policy makers do what is necessary to stimulate the economy. This may lead to a weaker U.S. dollar, which could lead to rising long-term interest rates as the economy recovers and perceived inflationary risks emerge. In our opinion, the economy handles inflation better than recession and policy makers will not mind erring on the side of inflation to avoid a deep and prolonged recession.

As our most recent *Commentary* pointed out, after the attacks we expected a quick drop in the equity markets and a rush to perceived safe havens, followed by a return to the prior levels in the following months. While there may well be a bumpy road ahead, the markets seem to be following the course, albeit faster than we expected. The future will depend on the resolve of the Congress, the Administration, and the coalition of global economic and military powers to restore confidence in the global economies.

This has been a rough year for the markets and investors. After a negative first quarter, a positive second quarter, and a negative third quarter, major stock market indices are lower for the year. The S&P 500 and the Dow Jones Industrial Average were down a little over 20 percent each, the NASDAQ down a little over 39 percent, while major bond indices look to be up a little over 10 percent for the year-to-date period. When consumer and investor confidence have been

restored, and we are ready to resume a decent economic growth rate, the market, serving in its role as a leading indicator, will begin to show both stability and growth.

**Stephen J. Taddie**

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