

C *Economic & Market* Commentary

Tragedy and the Markets

It is nearly impossible to find a historical event parallel to yesterday's terrorist attacks on the United States that could be used to draw significant conclusions regarding the financial markets. The United States of America is the backbone of the world economy. What happens here affects the rest of the world. The magnitude of the disaster and the uncertainty of the current situation will most likely lead to a "flight to quality" (money going into the safest investments) in the financial markets. In the aftermath of this American tragedy, at the time of this writing, global equity markets have been mixed. The Asian markets remain generally lower, while European markets have already rebounded from yesterday's sell-off.

With respect to the domestic financial markets, it is important to understand that while our hands have been tied by the Tuesday & Wednesday market closures, we have been able to study some historical tragedies that our country has faced in the past and the effects that they had on the markets:

1. ***WW I** saw the New York Stock Exchange follow the lead of European exchanges and close on July 31, 1914 for a period of 4 ½ months. The market reopened on December 15, 1914 roughly 25 percent lower, but returned to pre-July levels by the end of April 1915.*
2. ***WW II** saw the market drop more than 23 percent in just two weeks as Hitler's armies marched through Europe in May of 1940. On December 8, 1941, the day after the attack on Pearl Harbor, the Dow Jones average dropped 3.5 percent, and stayed on a lower course for five months. After hitting bottom in late April 1942, it finished the year 28 percent higher than the lows, and by the end of 1945 over 107 percent higher than the lows of 1942, at which it was 30 percent higher than when Hitler began his march. During roughly the same period, the intermediate-term government bonds were 5 1/2 percent higher.*
3. ***The Cuban Missile Crisis** in late October 1962 led to a market drop of about 2 percent following President Kennedy's grim speech on the 22nd on top of a 22 percent decline suffered prior to the speech. A year later, and about a month before Kennedy's assassination, the market had gained roughly 35 percent. During 1963, the intermediate-term government bonds gained a little over 4 percent.*
4. ***John F. Kennedy's assassination** on Friday, November 22, 1963 saw the market fall 2.8 percent that day. The markets were closed on the following Monday, and rose 4.5 percent when the markets were reopened on Tuesday. The markets had been given three full days to digest the event prior to the next trading day.*

Add to these monumental events, those more recent in our memories, such as the "**Crash of 1987**," the "**Persian Gulf War**" (1990), and the "**Asian Meltdown**" (1998).

The conclusion that we draw from reviewing these events is that market reaction to major events has been compressed into shorter and shorter periods. This is not intended to make light of our current situation, but to compare the magnitude of this event with others we have experienced in our country and the resulting effect on the financial markets.

We do not believe that this event shares the magnitude of the World Wars, in that organized countries have not declared war on each other, nor are we looking at the prospect of nuclear powers clashing as was the case during the cold war period. Speculation holds that a group of organized extremists have chosen to express themselves at the expense of the American people and the various international organizations that had offices at the World Trade Center in New York City.

We have encountered terrorist activities before, and while this is the most devastating event in our history, it is not the first, nor will it be the last that our country or other world powers will endure over the coming centuries. It is a sad commentary on the realities we must contend with in today's world.

Where do we go from here?

While still disturbed by the events that unfolded yesterday, we draw considerable comfort from the data shown above. The growing solidarity among the industrialized nations (far different from prior periods of war) which is forming may result in an easing of some of the trade barriers that have worked into the system recently. The meetings between the world's political, economic, and military leaders will likely result in coordinated efforts on all fronts to address our most immediate needs as well as future goals. In the short term, the markets may favor low-risk investments or hard commodities. Unless the terrorism recurs, this favoritism should be short-lived, as it has typically been in the past.

Stephen J. Taddie
September 12, 2001