

## **SOME THOUGHTS ON THE MARKET**

On the morning of September 11<sup>th</sup>, prior to the World Trade Center tragedies, we as a nation, had experienced more than a year of down markets; we were on the verge of recession; budget surpluses for the quarter ending September 30 were projected to be radically decreased from projections of just a few months previous. For the first time in a fiscal year since 1983 tax receipts were anticipated to decrease on a year over year basis.

Still, there were emerging factors pointing to an economic recovery. There were reports that in many sectors inventories had been depleted. Corporations were planning to increase spending. There were a number of layoffs and consumer spending was anticipated to reduce substantially. But there was significant hope that the corporate sector might replace the consumer as the buoyant factor for the overall economy.

Then came the New York Washington attacks that sought to disrupt our economy. With them a new type of war introducing fear and significant commercial dislocation. Economic loss was astronomical and not just limited to what happened at the attack sites. The world and all its business seemed to stop. Who but Mayor Rudy Guiliani, the Bush Administration officials, the New York and Washington rescue workers and the military could be constructive at such a time. I could not focus on work in the immediate aftermath. Could you?

The world worried about biological, chemical, or nuclear warfare and few could rid themselves of the awful spectacle of the Twin Towers. No one wanted to travel. Transports carried loads with few people and little in the way of goods for industry. Disruption in the transportation industry meant disruption in the supply line. When the manufacturer did not receive the component parts for his finished product, the product was not finished. Part of the chain of industry stopped and significant sums were lost. It was not just the airline and insurance industries that were hard-hit. The world and its business seemed to stop...at least for a time.

Commercial stoppage and fear were two of the goals that the Terrorists sought to achieve. Fear and even temporary commercial paralysis are depressing factors for the financial markets, human health, social stability, and for the way people spend their money. The World Trade Center and Pentagon attacks have begun to fashion a new world of political and military alliances and changed people's assessment of basic values.

Immediately after the Terrorist Attacks, in keeping with prevailing financial wisdom, this office made virtually no moves in client portfolios. In part, this was because the moves we had recommended to date in 2001, have all been toward adopting defensive financial positions. In other part, it was because the virtually unanimous belief of professional money managers is that one is best to just sit pat after such a bruising and unexpected world event.

As a reason policy makers have exercised historically extraordinary measures in a massive effort to staunch the loss of business and consumer confidence. Already, the Congress has passed and the President signed into law emergency relief packages totaling \$55 billion; the lawmakers are negotiating over further economic stimulus packages approximating \$100 billion. The Federal Reserve has injected significant sums into the economy through its open market operations cut the prime rate by fifty basis points and is expected to ease short-term rate even further when its open market committee meets October 2. Alan Greenspan has worried publicly that too large a fiscal shift could trouble bond market investors and cause long term interest rates to rise.

Our leaders have thrown down an ultimatum to the rest of the World. “You are either with us or against us”. Former enemies have suddenly become friends. For example, China, a country that only a year ago threatened on the web to launch missiles against our West Coast, now collaborates with us in the search for Bin Laden and the effort to rid the world of international terrorism. Sudan and Iran have sympathized with us as to the loss of life involved with the terrorist attacks. And Russia has agreed to provide us with military launch sites.

Our military objectives and our defense priorities have radically changed. The military defends the homeland from chemical and biological attack and damage from less technologically significant military equipment not so much from nuclear attack. It is not one that stokes the military industrial machine, as have prior wars. Since the declaration of war, no act of military aggression has actually transpired. Nor, are we told, is one likely to be imminent. Its not a war fought in the conventional manner by conventional forces, the Army, Navy, Marines, and the Air Force. Rather it’s a war of economics and a war requiring intelligence equipment, surveillance, rapid deployment of men and materials, and security equipment to defend the homeland. It’s a war that looks to defend us against biological, chemical and nuclear warfare, against the sabotage of our markets and industry.

The Administration admits to a sea change in some national priorities since the morning of September 11<sup>th</sup>. At home, Democrats and Republican have united in a show of national unity; it is more important to address immediate needs than to promote long vested party interests. Every effort is being made to restore business and consumer confidence and thus to spur the economy. Measures to restore public confidence by improving public security are viewed as being of extreme importance. Tom Rollins has been appointed to a cabinet level position in charge of homeland security. Important new powers are being provided to the FBI, the CIA, the Health and Human Service Department; new welfare provisions are being fashioned for Medicare and the unemployed.

Just as the nation is assessing its national value structure and financial expenditures, it is time for you, the investor to do similarly. Suddenly the vaunted surplus for the fiscal year ending October—at this time estimated to be \$120 -\$130 billion dollars—is in jeopardy of complete loss. The \$120-\$130 billion dollars would even now be a deficit of \$25 billion if it were not for the social security surplus.

As a nation, we have taken a tremendous financial hit. For the quarter ended September 30<sup>th</sup>, the S&P 500 suffered its worst quarterly loss since 1987: sixteen per cent. Other indices fell even more. The Dow fell sixteen percent. The NASDAQ Composite lost thirty-one percent. Since the

morning of September 11<sup>th</sup>, the NASDAQ is down twelve percent, the Dow down 7.9% and the S&P 500 down 5%. That's downward mobility or in the terms of the stockbroker, volatility. Such volatility denotes fear, economic dislocation, and, quite probably indicates that the market is finding new standards for assessing value in the marketplace. After all, 101 companies in the S&P 500 saw their value rise during the third quarter. Among stocks rising for the quarter were such as Raytheon, Nokia, Mine Safety Appliance, and Pharmaceutical Product Development. For each the rise was more than 20%.

New dynamics are awake in the market place. Thus, one must use extreme care in choosing the financial instruments, the market sectors, the industries and the particular companies in which to invest. The factual context providing the foundation for the exercise of that due care has changed most meaningfully. The massive infusions of money into the economy may reduce the value of the dollar. In turn, that could reduce the value of fixed dollar investments such as bonds and fixed contractual guarantees. That's one downside of the new equation. The other downside of the new equation is that a number of companies are experiencing economic dislocation; some may face possible bankruptcy. The upside is that personal and governmental spending patterns are such that during this new war, those correctly predicting the future and its new spending pattern will make fortunes.

Perhaps seeing the future really isn't all that complicated. In the immediate future the value of the dollar isn't going to change that much. If, over the short haul, you are in need of money to pay your day to day living expenses, then you will perhaps find that cash or cash equivalents will have enhanced value. It is for the slightly longer period that real volatility may be faced. With the stock market volatile, many have sought refuge in short to medium term debt instruments. There, returns are lacking as interest rates have plummeted to historically low levels. The short to medium term equity investor faces the real possibility that he must cash out while equity values are down. For the longer term, few doubt the vitality of the domestic market.

But there are several industries where basic concepts of value and worth have changed significantly since the morning of September Eleventh. For example, the value of airline equipment has certainly dipped since the attack. The value of most lodging industry stock has dropped significantly. Its simple: occupancy rates in these industries have fallen precipitously and may remain down for some time. On the other hand, a REIT such as SL Green will find that the value of its New York properties will have increased rather nicely. There just is not the commercial space available in New York City that there was before the attack. This type of analysis must be done afresh for each of your holdings. Companies or industries providing goods or services previously in high demand will find with the new hierarchy of demand extant in the post attack economy their product or service will just not be that valuable. On the other hand, those involved with industries such as intelligence gathering biomedicine, security, surveillance or the new defense structure may suddenly mushroom in value.

This office suggests that it is not only timely but critical to have your financial portfolio reassessed now.

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