

Markets' Next Chapter

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As with so much else, the terrorist attacks have changed the debate about the direction of U.S. stock markets. When trading resumes on the New York Stock Exchange and Nasdaq, prices will have to absorb selling in Europe. Anticipating a bumpy U.S. open, U.K. investors sold off the FTSE-100 3.8%.

"It is important to recognize the stock market has moved into a new chapter, and the context is different than even a few days ago," says Richard Cripps, chief market strategist at Baltimore-based Legg Mason. But the fiscal and monetary easing that will accompany rebuilding should inject momentum into the economy and share prices, he adds.

The U.S. government is likely to boost defense and intelligence spending in response to Tuesday's attack. Congress could unite in stimulating the economy--possibly through a new tax bill that includes a break on capital gains, says Brian Gilmartin, portfolio manager at Chicago-based Trinity Asset Management.

"Democrats could vote for tax cuts, and Republicans could vote for increased spending without feeling political backlash," says Gilmartin. He notes that Federal Reserve Board Chairman Alan Greenspan could react to further declines in consumer spending by an emergency interest-rate cut of one-half of a percentage point, double the quarter-point cuts the Fed has been making.

Greenspan also will testify before the Senate Banking Committee about the economy on Thursday.

A rise in share prices could be led by oil stocks, such as Exxon Mobil. With the possibility of strife in the Middle East interrupting the U.S.'s oil supply, crude oil prices shot up following the attacks. Gilmartin cautions that oil-stock gains will likely be contained, since the economic slowdown has tempered demand.

Investors who are considering the onset of heightened security may be picking up stocks like CompuDyne, which manufactures bombproof glass windows.

Initially, nervous selling is more likely to prevail when the major U.S. markets reopen. Gilmartin says the stocks of property and casualty insurers like AIG will take losses. "[Insurance companies'] earnings will take a hit because they'll be paying out big claims," he says. Initial estimates of the claims on the insurance industry are as high as \$15 billion.

Gilmartin also expects airline stocks, already hurt by the slowing economy, to tumble further as Americans' fears of flying heighten and stringent security checks make delays longer. Stocks of the two parent companies of the airlines that had planes hijacked during yesterday's attacks, AMR and UAL, have fallen 47% and 116%, respectively, since Sept. 13, 1999. Congress is reportedly considering offering funds to help out beleaguered carriers.

Overseas, airlines were pummeled during Friday's session, with Cathay Pacific Airlines slumping 3.6%, and British Airways down more than 33% for the week.

Financial firms like Goldman Sachs and LaBranche, a New York Stock Exchange market maker, are also headed for the downside, he says, since the attack forced them to sacrifice four days' worth of revenue from trading operations.

If a sector selloff turns into a broad-based rout of share prices, the market could find its long-awaited bottom in short order. "This could ring all the angst out of the recession, and if we do get a really sharp drop, that could be the capitulation of the 18-month bear market," Gilmartin says.

Another silver lining could be provided by history. From studying trading patterns following history-shaping events like Pearl Harbor, President John F. Kennedy's assassination, the stock market crash of 1987 and the Persian Gulf War, Legg Mason's Cripps finds that stocks eventually recover from initially tumultuous falls.

"The initial reaction is a 3% to 20% [fall], and then, beginning in three months and more emphatically after six to 12 months, markets recover to end up higher than [where] they were originally," he says.