

1st Quarter of 2003.

The following are some of my observations on the issues related to the economy and stock markets:

The Performance of Stocks in the First Quarter of 2003

War worries and concerns about the economy were the dominant themes during a rocky first quarter on Wall Street. Indeed, save for an initially strong start to the new year and a somewhat better close stocks trended lower for the most part. For the quarter, the Dow Jones Industrial Average lost 4.2%, S&P 500 Index lost 3.6%, while NASDAQ Index went up 0.4%. The declines were broad based, but not particularly deep.

The Success of the War Will Restore Business and Consumer Confidence

Victory in Iraq is near. While some pockets of resistance remain and fighting continues in the North and in Baghdad, the outcome of the campaign to disarm Saddam Hussein is no longer in doubt. The Iraqi dictator is missing, his command and control infrastructure destroyed, and Iraqis are welcoming American soldiers in Baghdad. The Iraqi people have been liberated from one of the most oppressive regimes in history. Statues of the dictator, the most visible symbol of the regime, are toppled and his pictures taken down. While some risks remain in Iraq, such as the incursion of terrorists from across the border in Syria and Iran or a last minute attempt by the collapsing regime to deploy weapons of mass destruction, it is time to start thinking about the time after the war.

With the end of the war near, markets will undergo a structural realignment in the following weeks reflecting the new perception of risk. The risk premium reflected in crude oil prices is diminishing as fears of supply disruption subside while gold prices will fall if investors withdraw their funds from this safe haven in search for better returns. Over the last one-month period, the oil prices have declined by about 30% and will continue to decline with the conclusion of the war. These same forces will allow the dollar to reclaim some previously lost territory from the euro, as the exchange rate will adjust more accurately to reflect the superior prospects for investment on this side of the Atlantic compared with the heavily regulated and rigid euro zone economy. This reevaluation may eventually lead to higher stock prices.

The key question to be answered in coming weeks is whether the imminent victory in the Gulf will lead to a surge in investor and consumer confidence that will set the U.S. economy free in concert with its fundamental strengths, most notably sustained productivity growth and accommodative fiscal and monetary policies. Or will the U.S. economy linger on as weak labor market conditions and the ongoing threat of terrorism continue to take their toll on confidence and spending?

The University of Michigan Consumer Sentiment Survey for April released today provides some reason for optimism. Consumer sentiment improved during the first week of this month after the war with Iraq had begun. Since then progress by the coalition forces has been swift which will make a further boost to confidence in coming weeks even more likely.

Equity Valuations Are Attractive and Reasonable

Over the last two quarters, the corporate earnings are increasing while the interest rates stay historically low. So the equity valuations are more attractive and reasonable. The second-half revival in business activity still seems to be a reasonable expectation; and for all the earnings

doubts expressed, corporate profits still appear headed mostly higher for the year as a whole. Thus, although war news will hold sway in the near term, it is sensed that patience and fortitude will be rewarded over the longer haul.