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A Shock to the System

The horrific disasters of Sept. 11 will roil markets and slow a rebound. They'll also become a rallying point for the world's strongest economy.

As the world sorts out the aftermath of the hijacking and crashing of four U.S. passenger planes, two that blasted into the World Trade Center in New York City and one into the Pentagon building in Washington, D.C., Americans need to brace themselves for more bad news: Shock waves could rattle the economy and financial markets for days, perhaps weeks to come.

The tragedy will likely exacerbate Wall Street's jitters over an already sickly economy, drive up oil prices short-term, and further dampen consumer confidence, economists and analysts fear. However, while the horrific disaster adds another obstacle to an economic rebound, over the long term most analysts don't expect the U.S. economy to crumble after these terrorist strikes.

Unexpected shocks to the system are always a wild card that economists and analysts fear -- and this one is beyond anything any of them have ever contemplated, an attack that's being compared to Japan's surprise bombing of Pearl Harbor at the onset of World War II. "Hopefully, people will remain calm, but in the short run things will be dicey," says Mark Loftus, managing director at First Union Securities, based in Itasca, Ill. Loftus and others hope concerted efforts on the part of policymakers will contain any panic. The Federal Reserve has already vowed to make more capital available should markets come unhinged.

SHATTERED OFFICES. Market-watchers are bracing for equities to stumble when stock trading resumes. Indeed, the entire financial-services industry will feel the impact after the destruction of the World Trade Center -- a paragon of American-style capitalism. Many big names in the bond and brokerage-house businesses had offices in the twin towers. Morgan Stanley Dean Witter leased space on dozens of floors in the complex. "Brokerage stocks were already coming under the pressure," says Ascani. "The area [where the disaster happened] is the heartbeat of American capitalism. This will add to the pressure."

Some sectors will be worse hit than others. Among them, insurers and reinsurers, which help shoulder large -scale risks for insurers, says Peter Cardillo, chief strategist at Westfalia Investments. Airline stocks, already depressed from high energy prices, are likely to be shunned by investors in the wake of the attacks. UAL Corp. (UAL), the parent of United Airlines, and AMR Corp. (AMR), which runs American Airlines, both lost planes on Sept. 11. "For sure, airline profits and the airline industry in general are going to be hit by this," says Dan Ascani, president and director of research at Global Market Strategists in Gainseville, Ga.

In such an atmosphere, the attacks could justify a military buildup to combat terrorism, giving a boost to defense, aeropsace, and defense technology stocks, says Alan Ackerman, executive vice-president and market strategist at Fahnestock & Co. in New York. "Defense stocks may find solid support," he says.

ENERGY DEBATE. Richard Babson, president of United Investment Advisors, expects that his more risk-averse clients will move assets toward cash, bonds, Treasury bills, and gold. Commodities, particularly energy and other precious metals, will be viewed as havens. Analysts expect crude-oil prices, now trading in the $29-a-barrel range, to climb over $30 and possibly rise as high as $40.

"There's going to be a bullish impact on oil prices once [oil trading] does reopen," says John Gerde an oil analyst at Raymond James & Associates. He and others expect that the attack will reignite concerns about America's heavy dependence on foreign oil, particularly from the volatile Middle East. The case for domestic drilling in Alaska, "has changed markedly vs. yesterday," Gerdes notes. The tragedy could once again launch a national debate over U.S. reliance on foreign sources of oil.

Currency trading will most likely feel a seismic shift as the imperturbable U.S. dollar weakens on the uncertainty generated by the surprise attack. In recent years, the strong dollar was viewed as the most buoyant and reliable of world currencies, including the Japanese yen and the European Union's euro. As doubts of an economic recovery in the U.S. rose, the greenback in recent weeks had begun to weaken. After the attack, the dollar immediately fell 1% against the euro and 1.5% against the yen.

SEVERE BLOW. The bellwether currency will likely weaken further until more details on the plane crashes become known. "People are going to seek safe-haven currency like the Swiss franc, which is up a lot on this," says Paul Podolsky chief foreign exchange strategist, at Fleet Global Markets. "If the dollar trades down, then [the other major currencies] are going to trade up."

The attack could also finally sour consumer sentiment. Until recently, consumers have weathered the decline in corporate profits and continued bad economic news with aplomb. But the hijackings and suicide attacks, along with already declining numbers on consumer confidence, could deal a severe blow to what has been the most vibrant part of the faltering economy. "If the consumer doesn't feel secure in their future, that will slow down spending," Babson says. He fears "the impact on the national psyche is going to be long-lasting."

Add it all up, and the likelihood is strong that investors who had been patiently waiting for the faltering economy to make a comeback will probably throw their hands up -- at least, for now. "This will try a lot of people's patience," Babson says. "It will cause people to shorten their time horizon as everything seems more risky."

DELAYED REBOUND. There's a historical element as well: September and October are usually the worst-performing months for stocks due in part to tax-loss selling and mutual-fund adjusting. But more important, a surprising rise in unemployment in August and continued decline in corporate profits have been weighing heavily as the economy teeters dangerously close to recession.

"All of this is happening at a point in time when we are starting to see capitulation. With investor confidence shaky at best, this will push a lot of people over the edge emotionally," First Union Securities' Loftus fears. Adds Ackerman of Fahnestock: "Foreign nations have been looking to the U.S. to help lead the world of out of an economic slump. That rebound may be delayed somewhat as a result of what happened today and may be exacerbated by a spike in energy prices, which can be a drain on economies all over the world."

So is a panic about to set in? Not really. Over the long run, the U.S. economy remains far too big and resilient. And the events of Sept. 11 could also become a rallying point. "I don't think consumers are going to run to the hills," says Lloyd Greif, president and CEO of Greif & Co., a Los Angeles investment bank. Like many others, Greif is predicting a unifying effect in the financial world that could ultimately help to stabilize the U.S. economy and markets after the turmoil created by the attacks. "Don’t underestimate our collective pride in the strength and resolve of the U.S. Sure, the economy is weak, but this external threat, in a way, has a good side: It causes people to pull together."

STILL SAFEST. And while the dollar could take some further hits in the days ahead, "I doubt we'll see protracted outflows. Ultimately, if we can't feel safe investing in the U.S., where are else are we going to go?," says Loftus. He notes that parts of Europe carry just as much risk, if not more, for terrorist attacks. "Our currency and financial markets will have to be safer markets to be in for the long run. I doubt anyone will find a safer haven than the U.S."

Once the dust settles and Americans get past the grief of a horrible moment in history, the consensus is that most investors will stick with the notion that the U.S. is the strongest and most stable economy in the world.

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