

Terrorist Attack on World Trade Centre – September 11, 2001 – 1:45 p.m. edt

The Event:

This morning, in an apparent terrorist attack, two planes, 18 minutes apart, crashed into the World Trade Centre. One of the planes had apparently been hijacked from Boston Airport. Both planes were commercial airlines, one from American Airlines and the other possibly United Airlines. It is unknown how many passengers were on either plane. There was rumour of a third plane crashing into the WTC, however that was unconfirmed – and indeed, was likely speculation as a result of the noise that was created from the first two crashes and then the eventual collapse of the two towers. In what appears to be a further coordinated event, a report has a passenger plane crashing into the Potomac side of the Pentagon causing extensive smoke, some flame and unknown damage.

Other events are occurring randomly including a crashed airliner in Pittsburgh as well as car bombs in Washington. The events are exceptionally fluid and fast moving with a number of false news reports.

There was originally an announcement out of Abu Dhabi TV that suggested a terrorist organization called DFLP (Democratic Front for the Liberation of Palestine) was accepting responsibility for the events. However, this was later denied by the DFLP. There were other suggestions that Bin Laden (another terrorist organization) stated a week ago that they would be initiating a series of terrorist events; again unconfirmed. The coordinated nature of the action however does convincingly suggest that this was a terrorist effort.

In reaction to these events, President Bush left a scheduled event in Florida and is in Louisiana and will be preparing an appropriate response. All planes within the U.S. have been grounded (and apparently at time of writing, Canada as well). All international flights headed to the U.S. have apparently been diverted. American Airlines has confirmed that they have lost two planes with a total of 158 passengers on board. It has also been confirmed that another commercial airline, United Airlines, has crashed in Pittsburgh.

Markets

The first plane crash occurred at about 8:50 a.m. when futures and European markets were still trading as well as currency and fixed income markets. The initial reaction was muted and accelerated to the down side as the extent of the act was assessed and as the series of events unfolded. Futures markets were halted before the beginning of normal trade at 9:30 and none of the U.S. exchanges were allowed to open. Golds, oil and the U.S. treasuries market rallied sharply. Last seen gold was trading at \$287 (up \$7); crude traded at \$31 and U.S. treasuries were trading a full point higher. (Note these are relatively stale quotes as trading is relatively illiquid). The U.S. dollar however was a target of significant selling pressure while the events were unfolding, trading down against the yen at 118.86 versus 121 prior to the event; the euro rallied to 0.91+ (versus 90.10 prior to the event.)

European markets continued to trade while the events were unfolding. There was some recovery off the bottom – but most markets were down significantly into closes and/or halts. The CAC 40 was down 7.4%; the FTSE down 5.7%; the DAX down 7.75%. In Swiss trading, activity in the global insurance companies was especially negative and the Swiss Market Index was down 7.1%. In Canada, the TSE continued to trade until 10:40 a.m. with golds and oil stocks obviously moving higher on the news while financial services were under pressure, again, especially the insurance stocks.

Bank of Nova Scotia	\$47.60	Down \$1.90	Placer Dome	\$18.60	Up \$1.24
Royal bank	\$47.75	Down \$1.27	Imperial Oil	\$45.25	Up \$1.20
TD	\$40.70	Down \$1.60	PetroCanada	\$42.01	Up \$2.11
Bank of Montreal	\$40.36	Down \$1.80	Am. Barrick	\$27.70	Up \$2.50
CIBC	\$53.75	Down \$2.45			
Manulife	\$41.25	Down \$2.55			
Canada Life	\$41.89	Down \$2.76			
Clarica	\$44.00	Down \$2.10			

As of 11:00 a.m., all North American markets (futures, fixed income and equity) are closed. International markets are generally closed.

The Historical Perspective

While it's too early to draw any conclusion from today's events, we can draw some lessons from history. Typically the initial reaction by the market tends to be an overreaction. If any conclusion can be drawn it is that when definitive action is finally taken it tends to mark the market bottom.

- The Doolittle Raid over Tokyo on April 18th, 1942 following the Japanese bombing of Pearl Harbor marked the market bottom. The raid indicated that the US was on the offensive. On April 28th, 1943 the Dow Jones Industrial Average bottomed and rallied for the remainder of the war.
- During the Gulf War a similar pattern played out. The market sold off on the announcement of the invasion of Kuwait in August of 1991. Subsequently the market rallied on the commencement of the air campaign over Iraq in January of 1992.
- During the Cuban Missile Crisis the market bottomed on October 23rd, 1962 the day after President Kennedy's speech to the nation. From that day on the market rallied sharply for the next month.

The table below provides some perspective on how the Dow Jones Industrial Average has responded historically.

		Market Low	Decline	One Year After Low	
Attack on Pearl Harbor	Dec. 7/41 115.9	Apr. 28/42 92.92	-20%	Apr. 28/43 135.27	46%
Cuban Missile Crisis	Oct. 23/62 558.06	Oct. 23/62* 558.06	0%	Oct. 23/63 746.47	34%
Gulf War	Aug. 2/90 2898.8	Jan. 16/91 2508.91	-13%	Jan.16/92 3249.55	30%

*Market Bottomed as Kennedy made news public.

The Aftermath

At the time of writing, obviously, there are a significant number of unknown factors related to these events including who was responsible, what other events are yet to unfold and what is the response of the Bush Administration. However, history and common sense can provide some guidelines as to what industries/sectors will be affected the most from this event, and indeed, could have a longer lasting impact. It is important to note that at the time of writing, this appears to be a terrorist action – and unlike Pearl Harbour, the Cuban Missile Crisis, etc. – not an act of a specific country or group of nations. It is likely that the Americans will be supported in any retaliation

First, historically, during market disruptions as occurred today, the treasury market is considered a safe haven. Today's action in the U.S. treasury market (with the long bond up 24/32 to yield 5.38% and the two-year bond up 3/8 to yield 3.29%) was consistent with this. It is expected that domestic investors will maintain a focus on the safe-haven aspect of the treasury market at the expense of equities until some clear response is evident. However, the U.S. dollar, usually a safe haven bet during unrest, suffered during early trading activity after these events as foreign investors retrenched to the yen and the euro. The Canadian dollar also came under pressure (following its U.S. counterpart lower). Recent weakness in the U.S. dollar could be exacerbated by these events with international currency traders focusing on the yen and the euro at the expense of the dollar. It is likely that the Canadian dollar will also remain under pressure.

Second, commodities have reacted strongly to the events with gold and oil (as noted above) up significantly prior to the shut down of various exchanges. From a longer term perspective, it is unlikely (depending upon subsequent events) that this strength will hold. Oil price direction will be determined by the retaliation events and what disruptions in supply actually occur. Gold will continue to maintain a safe haven, again, until a more clear direction for events is determined.

From a longer term perspective, a number of sectors will have actual business disruptions and economic losses related to these events. Examples of industries and companies that could be affected over the short term include:

- Insurance companies (due to liabilities associated with the physical damage in the two towers, the human casualties as well as the damage elsewhere),
- Banking and brokerage companies (including those who operated offices within the World Trade Centre such as American Express and Merrill Lynch)
- Leisure companies including airlines, cruise companies or theme park operators such as Disney (as the consumer concern and fears result in reduced interest in these activities).
- Other areas for possible negative impact include those companies directly exposed to the Manhattan area including construction, real estate.

Some sectors will react positively to these events (when markets re-open) but likely on a short term knee-jerk reaction basis including defense, energy and gold stocks. As well, more defensive oriented sectors such as consumer staples and healthcare may rally. Consumer cyclicals will react negatively on a short term basis as the impact on American consumer confidence, already soft, could be affected further.

Conclusion

At the time of writing, there are a number of unconfirmed events as well as little knowledge as to the response of the Americans. We also do not know when American exchanges will re-open (although Frankfurt and London are continuing to trade and are planning to close at regular times). At this time, we would not expect U.S. exchanges to open tomorrow. Historical context suggests the early response by capital markets to these kinds of events is an over reaction. The reaction will largely be determined by both the military response and coincidentally, the likely coordinated efforts of the international banking community to maintain stability in the face of these events. Further information on industry/sector impact, and full details will be provided as available. It goes without saying that the tragedy of the loss of life as a result of this event and the discussion of the apparent new vulnerability of the world's super power will be the topic of discussion in most homes globally tonight

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