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Via E-mail to Our Clients

This morning the focus of our nation and the world will shift a few blocks southeast, to Wall Street. The opening bell rings at 9:33 Eastern Time, then trading will begin. It is hard to overstate the importance of this event as a symbol of the power of the U.S. economy and durability of our way of life.

The human toll of this great tragedy has deeply affected us all. As the market opens, the condition of the economy and performance of the stock market may be additional sources of worry for many of your employees. If overseas stock markets are any indication, we are in for a choppy ride over the next few weeks. For many participants, their retirement account is their largest store of wealth and only major investment in the stock market. During chaotic times they may turn to your staff for guidance and moral support.

Normally we believe it's enough to stress the virtues of patient, long-term investing. That's still true, but there's simply no way an investor can remain detached from an event of this magnitude; it defies human nature. If participants can't focus on the long-term, perhaps they can gain some comfort by studying factors shaping the 6-month outlook for the economy, as we understand those factors today.

I've attached a very brief talking paper summarizing our views for your information. You won't find any brilliant formulae to predict the market's course, but we hope the points help you find a perspective you can share with nervous investors. Please feel free to use it as you see fit, and let me know if you have any questions or feedback.

We wish you and your participants good fortune today.

Attachment (2 pages)

The Federal Reserve has managed the crisis extremely well so far.

- Through the first 2 days, major central banks injected more than $80 billion of capital into financial markets; the Federal Reserve alone injected nearly $40 billion, and continues to add liquidity.
- The Fed immediately relaxed lending through the discount window, allowing banks to finance uncleared checks and meet demands for cash.
- The worldwide banking system functioned throughout the attack except for branches in New York which closed.

Global recession is likely in the near-term.

- The economy was already weak going into the crisis:
  - Growth in Gross Domestic Product (the nation's income) fell to 0.2% for the second quarter.
  - Initial jobless claims rose from 410,000 to 431,000 the week before the attack.
  - The University of Michigan index of consumer sentiment fell to 83.6 in early September from 91.5 in August; however retail sales figures improved.
  - As of Monday the 10th, the S&P 500 was off more than 17% for the year; the NASDAQ was down more than 30%.
- Practically shutting down the U.S. economy for 4 days will by itself lead to negative GDP growth for this quarter and next.
- Longer-term recovery depends on the willingness and ability of consumers and businesses to resume spending at more normal levels.

Steps taken before and after the attack should help mitigate the effects of recession.

- Four things were at work before the attack which should continue to help the economy:
  - Lower interest rates: the Fed was increasing liquidity prior to the attack, and has already cut rates 7 times this year.
  - Tax cuts: timing of the tax rebate couldn't have been better.
  - Lower commodity prices: particularly declining oil prices.
  - Mortgage refinancing: lower payments mean more spendable cash for consumers.
- Nearly $50 billion in relief spending has been authorized between the federal and state governments.
- Analysts expect another rate cut, possibly before the October 2 meeting, and probably by more than the previously anticipated 25 basis points.

We believe and hope consumer spending will recover more quickly than expected.

- Overall demand for goods and services will be depressed in the near-term, due to practical reasons and "shell shock".
- Bleak scenarios are primarily based on the recession of 1990-1991:
  - Consumer confidence fell nearly 18% after the Gulf War commenced (Conference Board's statistic).
  - Consumer spending fell as much due to distraction (the "CNN effect") as to fear of a protracted ground war.
- We cannot ignore Gulf War experience, but the current situation is different:
  - Many scenarios do not include a protracted high-intensity conflict; rather, we may see long periods without highly dramatic events.
  - Millions of Americans became investors after the 1991 recession, and may rally around the markets as a patriotic cause.
- Time will allow investors to place the financial magnitude of the attack into perspective.
  - Insurers facing greatest claims losses in history; total damage may top $20 billion.
  - The last 10 years witnessed at least two disasters on that scale: Hurricane Andrew, 1992 ($15.5 billion), and the Northridge earthquake, 1994 ($12.5 billion).

Continued on next page.

Consumption patterns are likely to shift.

- Consumers may spend less on big-ticket items (e.g. automobiles) and areas directly affected (e.g., air travel, entertainment & sporting events).
- The devastating impact on airlines will probably be partially offset by government aid.
- Alternatives to travel include phone, video and internet conferencing, ASPs and subscription services; spending on related hardware and software may increase.
- Spending on security of all kinds (hardware, software, and physical security) will increase.
- Increases in defense spending will find broad bipartisan support.

Supply-side factors are favorable for now.

- Economists watch the supply of three critical factors: money, labor, and materials. When supply runs low, growth is impeded and prices rise.
- Recent higher unemployment means that surplus labor is available.
- Oil spiked to $31 a barrel on Tuesday but prices moderated quickly, closing at $29 in Europe that day.
- OPEC reiterated a long-term price target of $25/barrel, committed to increasing production to prevent prices from spiking.
- Oil production was cut by about 3.5 million barrels/day earlier this year, creating excess capacity.

We expect U.S. stock markets to be volatile but orderly in the near-term

- World stock and bond markets were volatile last week, but trading was orderly.
- The SEC has taken steps to ease the re-opening, such as relaxing restrictions on buyback programs.
- Already excellent backup systems for the exchanges, member firms, and money managers were recently hardened for possible Y2K disruption. That investment in technology finally paid off.

Prudent investors should avoid knee-jerk reactions.

- Investors should expect the unexpected, at least for several weeks:
  - Overseas markets ended the week off sharply, but there were definitely strong rallies.
  - After a two-day halt, the Toronto market rose 0.77%; oil and gold stocks fell while riskier technology and banking stocks rose.
  - In the short-term we will probably experience both dramatic sell-offs and rallies.
- Investors are rarely successful market timers even under normal conditions.
  - The markets digest new information much too quickly for individuals to profit by trading stocks. Mutual funds in retirement accounts trade daily, and are even more ineffective as market timing vehicles.
  - Investors should avoid dramatic strategy changes (e.g., overweighting gold or oil stocks).
- Investors waiting for less uncertain times to invest in stocks and bonds will probably never see that day.
  - Yields on cash are very low and likely to go lower.
  - New strategies should be carefully considered, not rushed into.
  - Investors should also consider the price of more conservative strategies (saving more, spending less, working longer, adjusting retirement lifestyle expectations).

We remain watchful for problems ahead.

- Primary risk factors center around misjudging demand and supply:
  - The focus now is to encourage productive spending. Recession could deepen if confidence is shaken by serious setbacks.
  - An equally likely scenario is that spending proves stronger than expected, and loose monetary policy creates inflationary pressure.
  - Finally, disruption to the oil flow or other supply factors could lead to inflationary recession. That would be a mess.
- If our national leadership maintains the vigilance and prudence demonstrated last week, we should be OK.