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Management Report

What is going to happen to the financial markets? What is the best strategy?

You heard me say for many years that crises are good for the markets. The 1987 crash. The 1997 Asian economic and financial crisis. The 1998 Russian and Latin American financial crises, and the collapse of Long-Term Capital Management (a huge hedge fund). Concerns about the collapse of the world economy because of Y2K in late 1999. Going further back in history one finds other major crises such as the Kennedy assassination in 1963, the Gulf War in 1991, and the previous World Trade Center bombing in 1993.

The stock market pattern during each of these periods was quite similar. The first reaction was emotional, resulting in sharp selling at the opening. Declines averaged about 7-9% immediately following the announcement of the crisis.. However, within months the market was substantially ahead of the pre-crisis levels.

Why? I have documented several times in *The Peter Dag Portfolio Strategy and Management* in 1997, 1998, and for the Y2K, and in my book *Profiting in Bull or Bear Markets* that **crises represent a buy opportunity**.

There is no doubt this is a crisis and our leaders are reacting as they did in previous similar occasions. The government is organizing a coalition and will soon launch an attack. Money will be needed to finance this operation.

It is not surprising therefore to see the Fed arranging a massive financial agreement with the European Central Bank, mostly, I believe, to support the dollar. The Fed is also injecting more than 10 times the typical amount of daily liquidity needed by the banking sector. In other words, the system is being flooded with money so that it may continue to work smoothly. **This money will find its way, as in all previous crises, into the stock market, fueling a sharp rise in the coming months.**

As far as the investment strategy is concerned, banks and financial intermediaries will be the main beneficiaries of this largesse. Their profitability will be further enhanced by much lower short-term interest rates. However, eventually inflation will become a problem late in 2002 and 2003. As a result, gold and energy stocks will continue to act well and bonds will perform poorly in this environment.

Sincerely,

Peter Dag & Associates, Inc.