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SIA RESEARCH DEPARTMENT

Frank A. Fernandez, *Senior Vice President, Chief Economist and Director, Research*
Erin Burke, *Survey Analyst*
Stephen L. Carlson, *Vice President and Director, Surveys*
Judith Chase, *Vice President and Director, Securities Research*
Lenore Dittmar, *Executive Assistant*
Carmen Fernandez, *Research Assistant*
Bella Mardakhaev, *Research Assistant*
George R. Monahan, *Vice President and Director, Industry Studies*
Grace Toto, *Assistant Vice President and Director, Statistics*

SECURITIES INDUSTRY ASSOCIATION ■ info@sia.com, http://www.sia.com
120 Broadway, 35th Floor, New York, NY 10271-0080 ■ 212-608-1500, fax 212-968-0703
1401 Eye Street, NW, Washington, DC 20005-2225 ■ 202-296-9410, fax 202-296-9775

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MERGERS AND ACQUISITIONS – THE NEXT WAVE

I. Introduction

In our October issue of ***Research Reports***, we expressed the view that "two and one-half years into a severe cyclical downturn, clear evidence of a turnaround in the U.S. securities industry is still largely absent, although some hopeful signs have appeared." We went further, suggesting that industry performance was "finding a bottom," and forecast a gradual, but steady resumption of growth in industry revenues, a process we believe is already underway. A recovery in U.S. business investment (which began in Q3 2002) and a restoration of the public's trust and confidence are critical in sustaining the market rally, now eight weeks old, and with it, a rebound in the securities industry's performance. While investor confidence levels have fallen in response to recent events, there are signs that the reforms instituted by Congress, especially the *Sarbanes-Oxley Act*, and the regulators will help to improve public opinion about the industry. However, the prospect of war inducing yet another downturn early next year appears to have brought economic growth to a virtual halt as the summer ended, and has clouded recovery prospects.

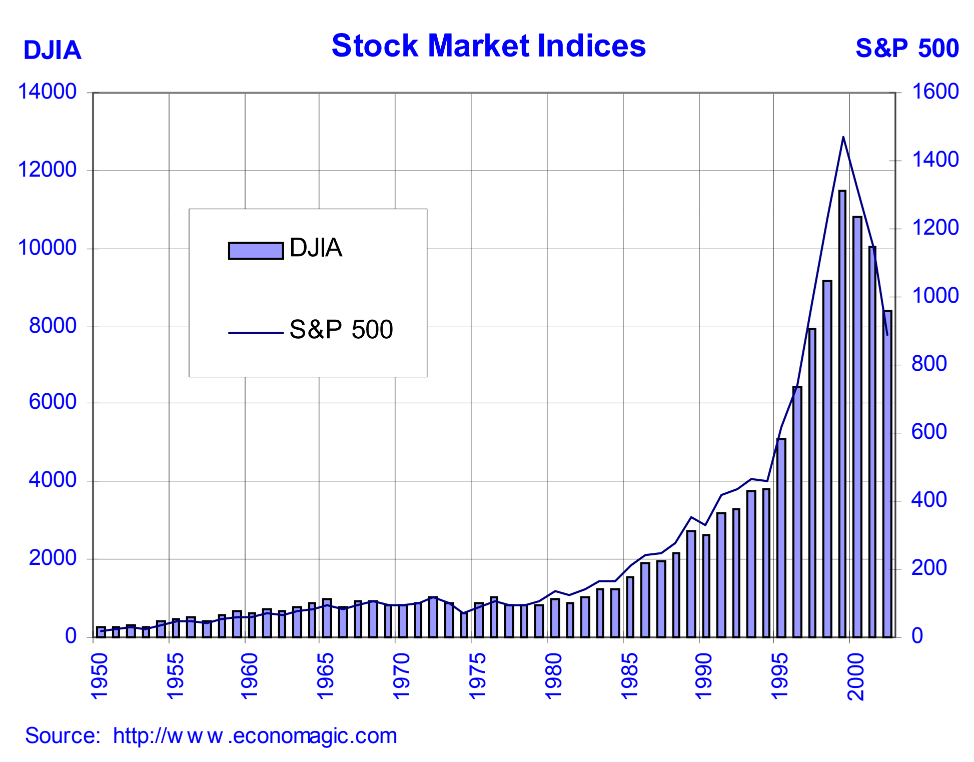
Given our consistently bearish views over the past three years, even this conservative forecast appeared relatively upbeat and raised more than a few eyebrows. Executives at some of our member firms remain unconvinced, while others asked for additional details underlining our industry outlook.

One element in particular sparked interest: the expectation that an upturn in revenues from financial advisory services provided by investment banks will lead the industry recovery. Even more specifically, we see signs of a sharp upturn in fees related to mergers and acquisitions (M&A) and leveraged buy-out (LBO) activity as well as advising on corporate restructuring, even as earnings from securities underwriting activities remain depressed. M&A work has historically been one of the most profitable areas of the investment-banking business, and, like other areas of investment banking (and indeed of the entire financial services industry as well as the stock market itself), the M&A business is highly cyclical. The following report examines past M&A "waves," some of the factors that drive them, and why we believe the next wave is about to begin.

II. Investment-Banking Industry Performance and Stock Market Cyclicality

As noted above, the investment-banking business is cyclical, measured by, among other things, revenues, profitability and employment levels. The cyclicality of the U.S. investment-banking business tends to coincide generally with the cyclicality of the stock market, as measured by the principal market indexes such as the Dow Jones Industrial Average, the S&P 500 Index (shown in **Figure 1**) and the NASDAQ Index. The factors underlying both investment banking and stock market cyclicality include the demand for capital, which in turn reflects the overall level of economic strength and perceived growth prospects in the domestic and overseas markets, the level of interest rates and rates of return on alternative investments.

Figure 1



The U.S. securities markets have exhibited strong long-term growth. Notwithstanding such shocks as global recessions, world wars, regional wars, crises in the savings and loan business, energy and banking industries, global terrorism, and presidential assassinations, the stock market has continued its long-term upward climb. Similarly, the total dollar value of securities industry revenue has increased for decades, reaching record levels in Q1 2000. This resilient, long-term growth is what underpins the long-term prospects of the domestic investment-banking industry.

At times these shocks are severe enough to induce large, sustained declines in the value of equity securities, which are termed "bear markets." While there is no formal strict definition of a bear market, there is general agreement that when one occurs, it usually entails double-digit percentage declines in broad equity market indexes over a period of months.

There have been 10 bear markets, including today's, in the past half century. They are listed chronologically (see **Figure 2**), along with the time period they covered, the duration (or number of months the markets declined), the percentage drop in equity market values (as measured by the change in the S&P 500 Index) and the recovery time (the number of months before the S&P 500 Index returned to levels it attained before the bear market began).

Figure 2

Bear Markets

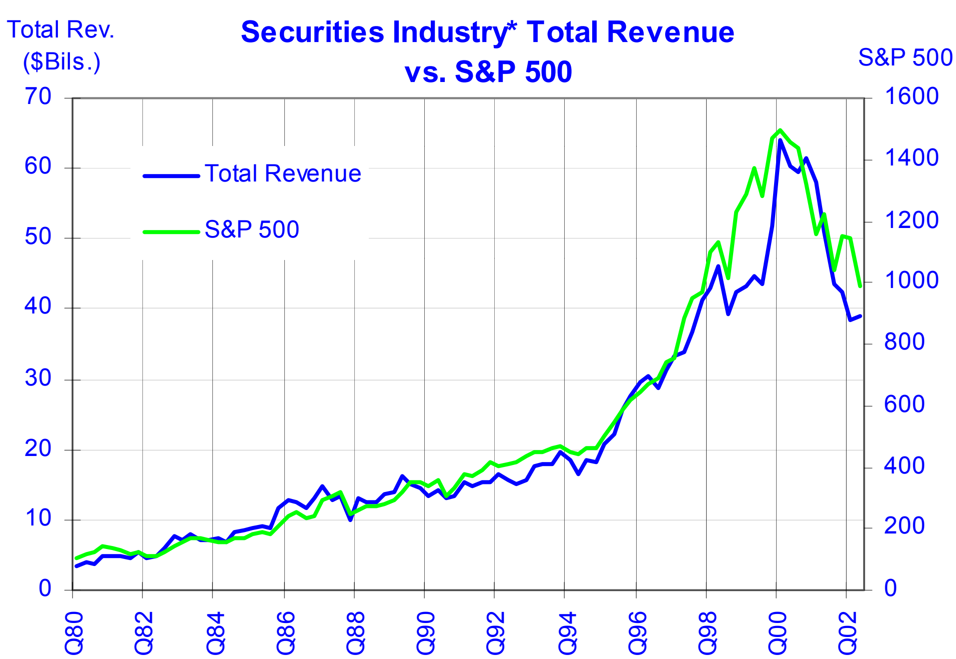
Time Period Covered	Months	% Drop	Months to Recovery
08/25/56 — 10/22/56	14.7	21.6	11.1
12/12/61 — 06/26/62	6.4	28.0	14.3
02/09/66 — 10/07/66	7.9	22.2	6.9
11/29/68 — 05/26/70	17.9	36.1	21.3
01/11/73 — 10/03/74	20.7	48.2	69.4
09/21/76 — 03/06/78	17.5	19.4	7.3
01/06/81 — 08/12/82	19.2	25.8	2.3
08/25/87 — 12/04/87	3.3	33.5	19.7
07/16/90 — 10/11/90	2.9	19.8	4.3
03/24/00 — 10/09/02	32.5	49.1	?

Source: Northwest Mutual Life

So, as measured by the S&P 500 Index, the current bear cycle is both the longest and the steepest in almost half a century. However, the percentage decline in equity values in the current cycle is comparable to the drop that occurred in the early 1970s bear cycle.

Not surprisingly, the performance of the securities industry in general and investment banking specifically are highly correlated with both the business cycle and the ups and downs of the secondary market for equities. As seen in **Figure 3**, the evolution of industry revenues over the last 20 years closely mirrors the movements in broad aggregates of equity prices such as the S&P 500 Index.

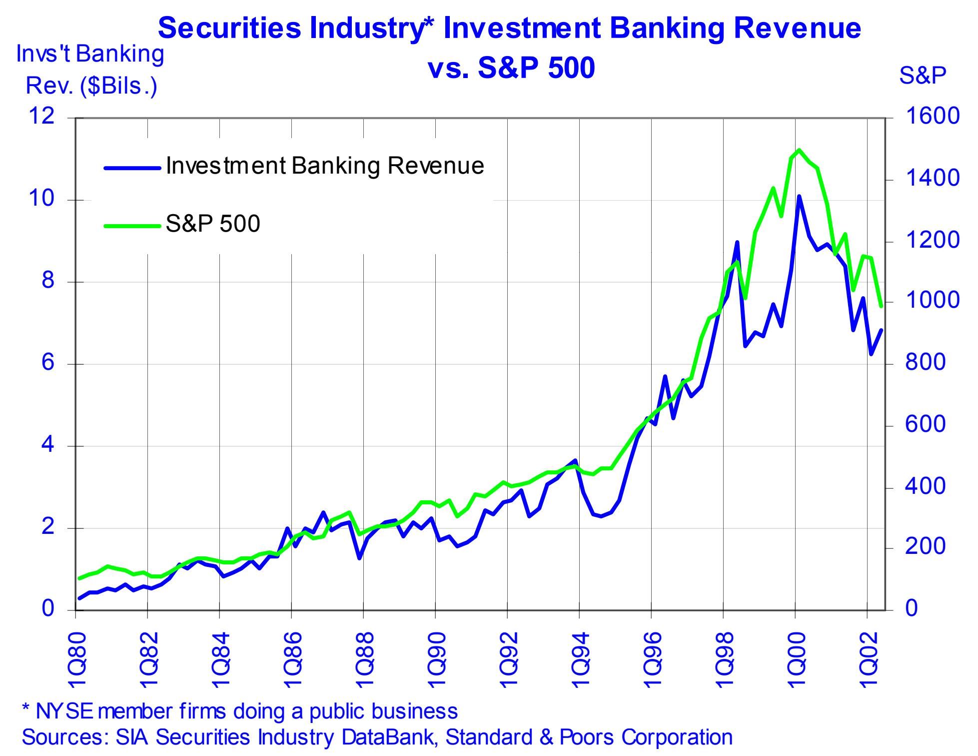
Figure 3



* NYSE member firms doing a public business

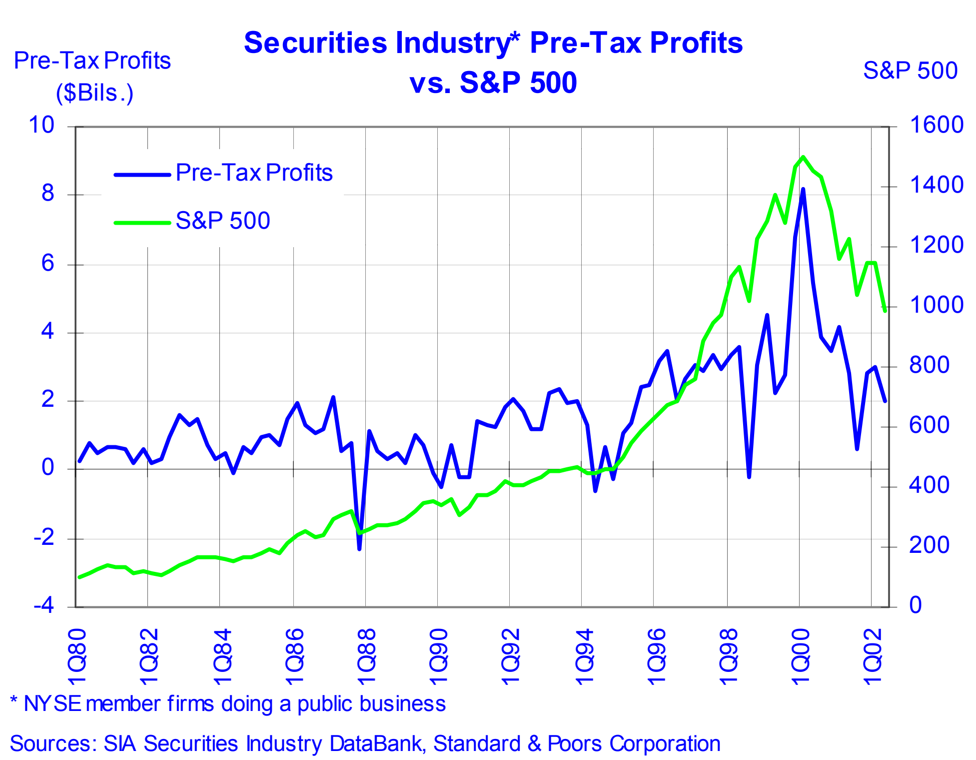
Sources: SIA Securities Industry DataBank, Standard & Poors Corporation

Figure 4



Investment-banking revenues also closely track this broad market index. The demand for investment-banking services reflects institutional investors' and corporate America's capital-raising and restructuring requirements. These needs, in turn, are positively correlated with the same secondary markets as can be seen in the quarterly relationship of investment-banking revenue to the secondary equity markets (**Figure 4**).

Figure 5



As seen in **Figure 4**, investment-banking revenues tend to be more volatile than the revenue stream for the industry as a whole, and more sensitive to changes in secondary market prices. Industry profitability also closely tracks equity market prices and is even more volatile than revenues (see **Figure 5**), in part because of the relatively thin margins provided by many of the product or service lines pursued by securities firms.

Following the stock market "crash" in October 1987 and the resultant decrease in the number of securities firms and personnel, the management of securities firms tried to reduce this sensitivity to cyclical fluctuations by emphasizing non-cyclical, fee-based businesses such as asset management and financial advisory services offered to institutional investors and corporate customers. This helped reduce earnings volatility somewhat, but these non-cyclical businesses were small in comparison to the contribution to gross revenues made by investment banking, interest income, and secondary trading in both debt and equity securities. However, as the current bear market extended into 2002, virtually every business line experienced sharp revenue declines. These declines extended even to those "non-cyclical areas," such as asset management fees and mutual fund sales revenues.

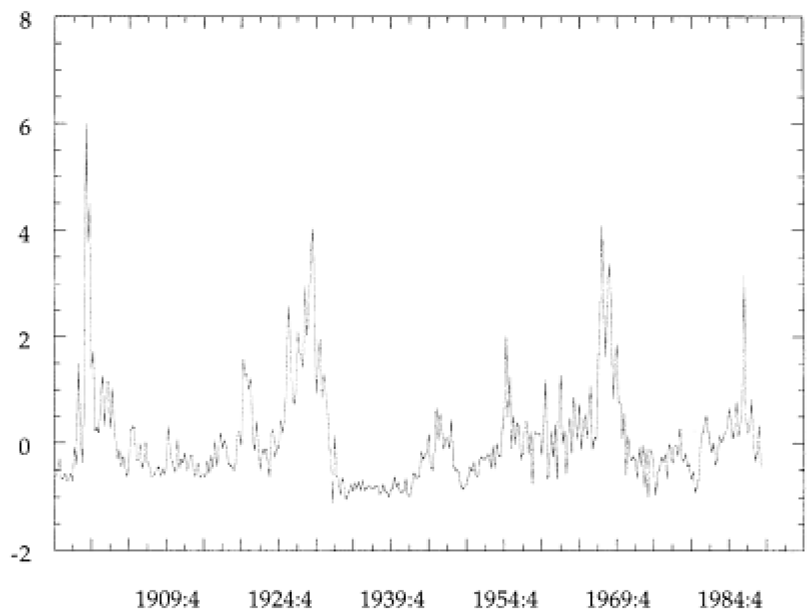
III. The M&A Cycle

Many theories have been advanced as to why mergers occur, and it would appear that no single theory consistently explains the drivers of merger activity over time. Academic studies do indicate that M&A activity (see the charts in **Figures 6**, **7**, and **8**) occurs in waves, or in other words, that there are oscillations between high and low levels of M&A activity.[1] Town (1992), for example, identified nine such periods[2] between 1898 and 1986 (see **Figure 6**). At least one more such wave can be identified in the 1990s. The most recent wave has been subsiding from a peak reached in Q1 2000, and may well be approaching a trough.

Some merger waves have been driven by: efficiency-related concerns (acquirers seeking economies of scale or other "synergies"); market power motivations (attempts to create monopolies or oligopolies); "disciplining" (the removal of incompetent or uninspiring management); agency costs (self-serving attempts by acquirer management to "over-expand"); or, diversification (the desire to exploit internal capital markets, manage risks better, etc.).

Figure 6

Merger & Acquisition Time Series, 1895:1-1989:1



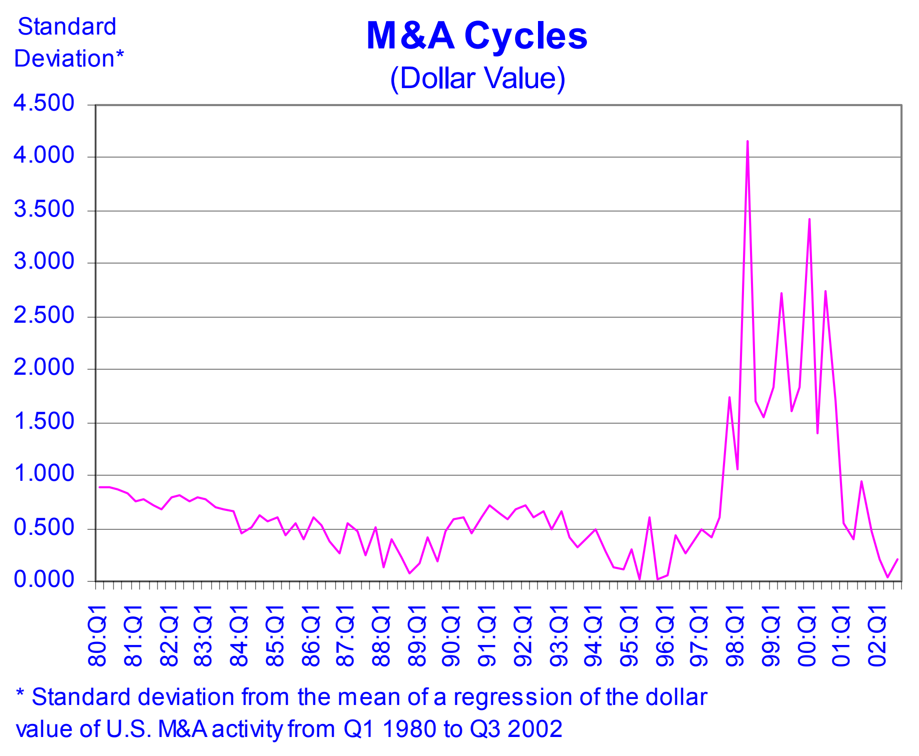
Source: Town, R., "Merger waves and the structure of merger and acquisition time-series," *Journal of Applied Econometrics*, 7, S83-S100, 1992.

Note: The chart shows "intensity" of M&A activity over a quarterly time series from 1895 to 1986. Town estimated a two-state, Markov switching-regime model to capture the wave structure (dichotomous shifts between high and low levels of activity.)

1. See for example: Andrade, G., Mitchell, M. and Stafford, E., "New Evidence and Perspectives on Mergers," *Journal of Economic Perspectives*, AEA, Vol. 15, Issue 2, Spring 2001, pp. 103-120; Barkoulas, J., Baum, C. and Chakraborty, A., "Waves and Persistence in Merger and Acquisition Activity," *Boston College Working Papers in Economics No. 396*, 2001; Kleinert, J. and Klodt, H., "Causes and Consequences of Merger Waves," *Kiel Institute Working Paper No. 1092*, January 2002, and; Rhodes-Kropf, M. and Viswanathan, S., "Market Valuation and Merger Waves" *AFA Paper*, May 2002. Two of the first detailed examinations of the wave behavior of M&A activity were provided by Town, R., "Merger waves and the structure of merger and acquisition time-series," *Journal of Applied Econometrics*, 7, S83-S100, 1992, and by Golbe, D. and White, L., "Catch a wave: The time series behavior of mergers," *Review of Economics and Statistics*, 1993, pp. 493-499.

2. These nine periods were 1898:1-1902:4; 1919:2-1921:4; 1925:3-1932:2; 1945:4-1946:1; 1954:3-1955:3; 1960:1-1960:2; 1962:1-1962:2; 1967:2-1969:4; and 1986:4.

Figure 7


Standard
Deviation*
M&A Cycles
(Dollar Value)
4.500
4.000
3.500
3.000
2.500
2.000
1.500
1.000
0.500
0.000
80:Q1
81:Q1
82:Q1
83:Q1
84:Q1
85:Q1
86:Q1
87:Q1
88:Q1
89:Q1
90:Q1
91:Q1
92:Q1
93:Q1
94:Q1
95:Q1
96:Q1
97:Q1
98:Q1
99:Q1
00:Q1
01:Q1
02:Q1
* Standard deviation from the mean of a regression of the dollar value of U.S. M&A activity from Q1 1980 to Q3 2002

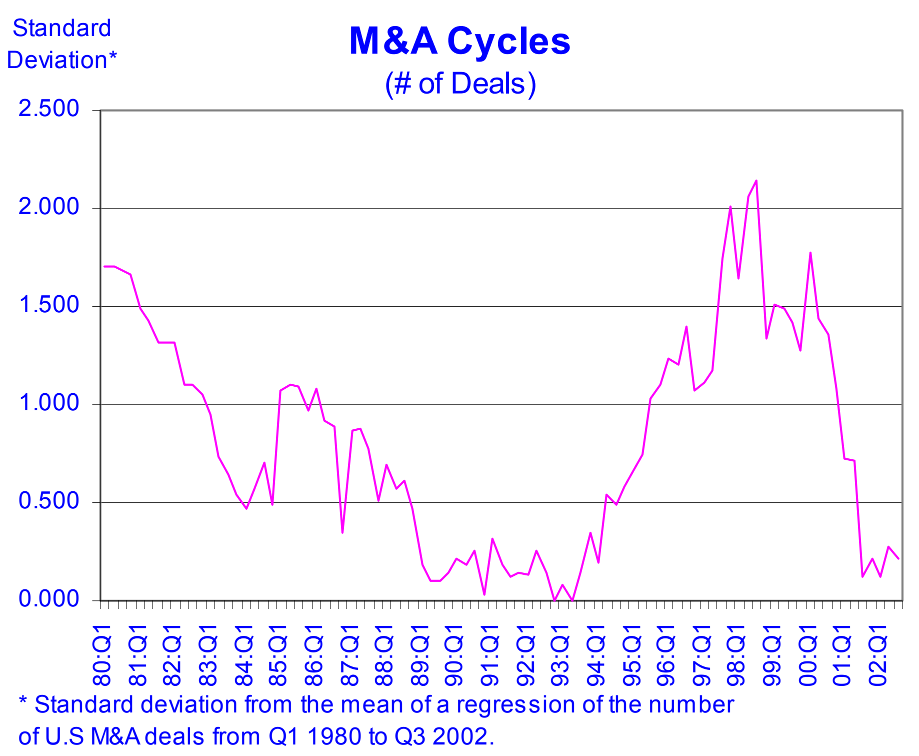
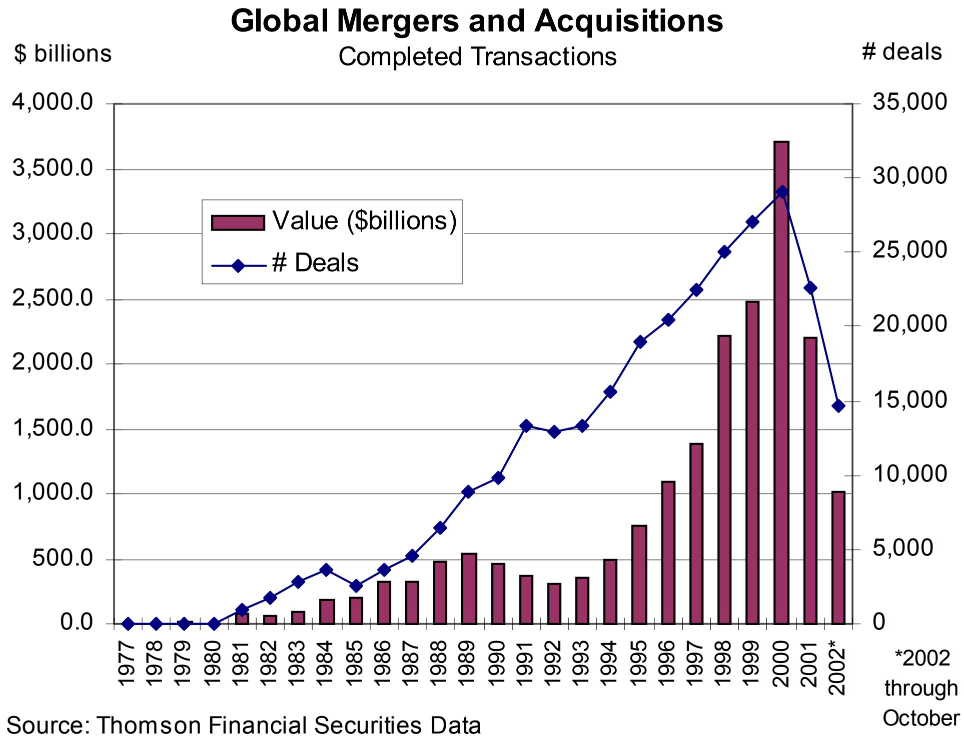
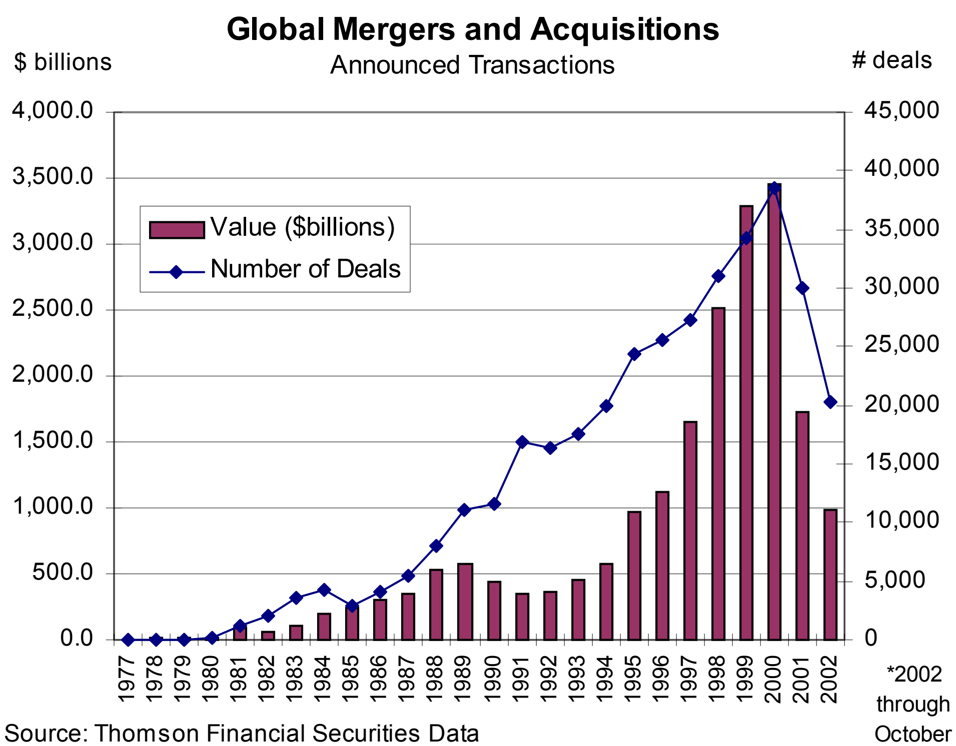

Standard
Deviation*
M&A Cycles
(# of Deals)
2.500
2.000
1.500
1.000
0.500
0.000
80:Q1
81:Q1
82:Q1
83:Q1
84:Q1
85:Q1
86:Q1
87:Q1
88:Q1
89:Q1
90:Q1
91:Q1
92:Q1
93:Q1
94:Q1
95:Q1
96:Q1
97:Q1
98:Q1
99:Q1
00:Q1
01:Q1
02:Q1
* Standard deviation from the mean of a regression of the number of U.S M&A deals from Q1 1980 to Q3 2002.

Figure 8



Source: Thomson Financial Securities Data



Source: Thomson Financial Securities Data

Merger waves have historically tended to "cluster" in a single industry or a small number of industries. The fact that a large proportion of mergers in any given wave are accounted for by only a handful of industries, and that the identity of those industries changes over time, strongly suggests that mergers might occur as a reaction to unexpected shocks to industry or market structure. These shocks can be delivered by any number of unexpected events, such as a bout of deregulation, supply shocks (such as commodity price "spikes") or the impact of rapid technological change. The most recent wave, which occurred in the 1990s, was by far the most dramatic and widespread, characterized by both a large number of deals (such as occurred in the 1960s) and high values on individual deals (as occurred in the 1980s). Industries most affected by these shocks respond to them by restructuring often via mergers and acquisitions. The simplified table in **Figure 9** shows the industries where M&A activity "clustered" in the past three decades, as well as a very tentative forecast of those industries where one might expect to see these activities concentrated in the remainder of the current decade.

Figure 9

Top Five Industries Based on Average Annual Merger Activity in the United States

1970s	1980s	1990s	2000s(?)
Metal Mining	Oil and Gas	Metal Mining	Media and Telecom
Real Estate	Textiles	Media and Telecom	Beverages
Oil and Gas	Misc. Manufacturing	Banking	Information Tech
Apparel	Non-Depository Credit	Real Estate	Specialty Retail
Machinery	Food	Hotels	Apparel

Source: Andrade, Mitchell and Stafford, "New Evidence and Perspectives on Mergers," *Journal of Economic Perspectives*, 15 (1), pp. 103-120, 2001 and SIA perspectives on 2000s.

The 1990s exhibited elements of broad-based globalization and deregulation in a number of industries (e.g., energy, telecommunications, financial services, etc.), a rapid pace of adoption of new inventions and of the dissemination of technological change, and significant shifts in the demographic profile of consumer and investor bases. These drivers of structural change are believed to have strong persistence and long-term dynamic impacts on specific industries. As such, they will continue to factor into the next M&A wave.

To this list of drivers must now be added recent and prospective changes in the regulatory, supervisory, tax and accounting practices. These factors, combined with the current slump in economic activity, lackluster growth in corporate profitability, and the displacement of incompetent and/or questionable management, provide adequate incentive to spark another robust wave of M&A activity in the near future. In addition, the U.S. corporate sector has amassed record levels of indebtedness and is generating record levels of bankruptcies and defaults this year, providing still further impetus for a new wave, as access to new financing is limited. It is expected that M&A activity, when it revives from current cyclical lows, will be led by a number of factors, including forced divestitures by over-leveraged firms without adequate access to financing. Further still, tens of billions of investment dollars exist within the private equity marketplace, which can provide a significant stimulus to future M&A market activity as financing becomes more accessible.

Another driver, perhaps the most compelling in the current highly levered environment, is the desire to purchase undervalued cash flows. *Bernstein Research* in its November 2002 report points out that "about 20 percent of large-cap stocks (roughly 10 percent of the total market capitalization) now generate sufficient cash flow to justify a buyout, the highest percentage since the mid-1980s' onset of the LBO and M&A frenzy." Improved access to credit will have to precede any initiation of a new "wave" and this may be underway as historically high credit spreads have begun to narrow. The desire for financial deleveraging by highly indebted companies may also spur these acquisitions, effectively purchasing cash flow to retire debt.

The 1990s wave of M&A activity was characterized by the overwhelming use of stock (as opposed to cash) as a method of payment. Seventy percent of deals involved stock and 58 percent were all stock in the 1990s, compared to 46 percent and 33 percent, respectively, in the 1980s. In the next wave, stock is expected to play a significantly reduced role, and that wave may get underway as soon as access to financing (largely in the form of corporate bond issuance) to complete the deals is restored. Currently, investors are extremely risk-averse given uncertainty over prospects for war with Iraq, the continuing terrorist threat, and the timing and nature of the resolution of corporate governance scandals.

If some of the uncertainty in the business climate is eliminated in early 2003, M&A activity could pick up gradually as a new wave builds up strength. As noted above, M&A activity, when it revives from cyclical lows, will likely be led by forced divestitures by over-leveraged firms without adequate access to financing. Already some valuations are compelling in certain troubled industries, and are attracting the attention of private equity investors and "vulture" hedge funds (the most rapidly growing type of hedge fund, the general class of which has expanded rapidly in recent years). This flourishing area in the financial services industry is driven by so-called "distressed situations": companies in dire financial straits that are the target of strategic or opportunistic acquisitions. As the cycle progresses, this wave is expected to crest rapidly and at high levels given the depth and pervasive nature of the restructurings that will be required in some industries as the competitive landscape is sweepingly redrawn. We expect "clustering" to continue in this next wave. While we do not anticipate an immediate return to late 1990s levels in terms of either the high average value of deals or the large number of deals, fairly rapid growth is expected to resume next year and be sustained into 2004.

Frank A. Fernandez
Senior Vice President,
Chief Economist and Director, Research

UPDATE ON THE DEBATE: MARKET DATA ONE YEAR AFTER SELIGMAN

The SEC recently held Market Structure Hearings on a variety of topics in New York and Washington D.C.; and one of those topics was the rules currently governing the consolidation and dissemination of market data.[1] The SEC focused in particular on three questions. First, what real-time data do retail and institutional investors and market professionals require? Second, how should real-time data from different markets be consolidated, and who should compile and consolidate real-time market data? Third, who should pay for real-time market data? Who should get paid for real-time market data?

Last September 14, 2001, the Report from the SEC's Seligman Advisory Committee on Market Information was released.[2] The Report included five main recommendations that had garnered "varying degrees of majority support." These five included the ideas that: price transparency should be retained as a core market objective; consolidated market information is a key component of our markets; the Commission should permit a regime of competing data consolidators; the Commission should continue to review fees and revenues as they do now; and that the above recommendations can be applied to equity and options markets.

The discussion in the Market Structure Hearings appeared to reconfirm many of these recommendations. However, the idea of multiple competing data consolidators was hardly discussed, possibly as a result of pragmatism induced by the current market environment, and possibly also as a result of the renewed focus on reliability of data streams and business continuity planning.

Participants also appear to continue to believe that the NBBO is a necessary, if currently less useful, benchmark of the market for retail investors, and as such should continue to be provided to everyone under regulatory mandate. Market centers have responded to the buy-side's demand for deeper levels of bids and offers with new trading and display systems as well as new data products. One concern that continues unabated, particularly stemming from established exchanges, is the risk of regulatory arbitrage in the form of market centers that may share the market data revenues but fewer of the regulatory responsibilities of traditional SROs. This article is a summary of the discussion on market data held in Washington D.C. on October 29, 2002.[3]

The discussion began with an introduction from the moderator highlighting several facts. First, the business of market data brings in $400 million a year in revenues to the SROs, a number that represents "a significant portion" of SRO revenues overall. Market centers had begun offering market data rebates to market participants in return for those participants' business. Recently, the SEC halted that practice in order to review whether or not the practice itself created the incentive to trade at a market center merely to receive the rebate. Moreover, some said that the existence of the rebates suggested that market data fees themselves were simply too high.

Second, the implementation of decimalization has increased the demand for deeper levels of information than just the National Best Bid and Offer (NBBO) in order to find pockets of liquidity against which to trade. The exchanges have responded to that need in various ways; Nasdaq recently implemented SuperMontage, and the NYSE has launched its Open Book data product.

The moderator then asked what information should be required to be disseminated to all market participants. The institutional investor representative responded that knowing the price itself was not the problem, so much as knowing the size associated with that price. Also, the quote in the decimal environment has simply become a voluntary advertisement of willingness to trade versus a real price; the quote has therefore become less meaningful.

Another institutional investor representative agreed that they are willing to display orders with protection. They had historically been big users of limit orders, but they have pulled back after decimalization. If their order involves floor trading, it has become more advantageous to use the floor broker to break up their order into smaller pieces.

From the perspective of the retail investor, who trades an average of six times a year and holds twelve stocks, however, the NBBO is a reasonable benchmark provided that there is the assumption that he can potentially receive price improvement on his order.

Another representative of the retail market claimed that the NBBO is meaningful in electronic markets but not in the listed market, because there is a strong profit incentive for suppressing that information in the listed market. The NYSE Open Book for example, is only updated every ten seconds, "a lifetime" for an electronic trader. This representative believes that the NYSE would provide the Open Book for free if it were a competitor in the listed market. When one looks at the deeper book, one sees quotes better than those actually occurring; the NYSE's Direct Plus system executes at the NYSE price, not at prices provided by limit orders on the deeper book. Therefore, the problems with market data are thought to be a direct result of problems with market design.

The NYSE representative responded that the updating of the Open Book every ten seconds has nothing to do with the involvement of specialists on the floor, but it has a lot to do with the amount of data being transmitted and the implications for capacity, particularly for the options markets transmitting series of data based on those quotes. Moreover, the NYSE has filed with the SEC a proposal to provide a "liquidity quote" in tandem with the quotes that are now provided. As for market design, the NYSE maintains that the interests of the crowd on the floor matter in the market of prices.

The Nasdaq representative agreed that the NBBO is no longer as valuable as it used to be, but is still helpful in understanding where the market is and where it is moving. Therefore, there should continue to be regulatory requirement that the NBBO be disseminated. There should also continue to be a lighter regulatory environment surrounding what data is provided outside the NBBO, because market centers compete across those categories.

One buy-side representative proposed getting away from the notion that the data belongs to market centers; everyone should have all information. Moreover, the market should be designed to benefit the investor as opposed to other market participants. He discussed the number of calls that his firm receives every day from investors complaining about flickering quotes, for example. The inherent conflict in the Vendor Display Rule was referenced; as soon as data is required to be disseminated, one has given monopoly power to those who distribute it. If that system were not regulated, then one would be conferring unlimited power to price on that distributor.

In response to the idea that everyone should have access to all information, it was stated that, structurally, what every trader wants is for everyone else to display his or her intention to trade aside from his own. The intention to trade cannot be regulated; one cannot force people to raise their hand signaling their intention to trade. If the system is over-regulated in that way, based on a naïve view of limit orders, there may end up, perversely, actually being less transparency and less liquidity in the market. The ability to innovate needs to be protected, and that is where the transparency argument falls down. The ability to have hidden orders must be protected, or institutional investors will be disadvantaged.

The AMEX representative discussed the fact that the AMEX submitted a proposal to the CTA just the prior week that the market data revenue be shared among exchanges that provide quality markets, based in part on trades, in part on volume, in part on how long a quote remains "up", and those quotes that involve greater size would receive even more credit. This representative felt that the Commission should abolish Regulation ATS that allowed ECNs to flourish. On the whole, data is the critical output of a market for which quality markets that provide regulation and quality services should be compensated.

The question was then asked why market centers received the market data revenue in the first place, and a market-maker representative gave a short history of how that came to be. The exchanges needed a funding process, and the revenues generated by information provided a convenient pool. He said that the problem now boils down to the revenue allocation process. People have no way of reconciling exchanges' checkbooks; how much of the market data revenue goes to funding regulatory services, and how much to competitive ventures? Theoretically exchanges could stop charging for the data and come up with another way of funding their operations. However, this has never been attempted.

The NYSE responded that no one's orders are interesting until those orders interact with others. There is work done when executions are produced. Of the $800 million required to run the NYSE, most goes into market operations. For this, the NYSE asks constituents who benefit from their marketplace to pay. These fees fall into five major categories: listing fees; transaction fees; regulatory fees; market data fees; and facilities fees. Since 1934, market data fees have never contributed more than 20% of the NYSE revenue, and since 1975, that number has hovered between 17% and 18%. Of this, broker-dealers pay 45%, and institutional investors pay 55%. Therefore, investors pay 10% of the cost of running the exchange, which is a good deal.

The Nasdaq representative also added that the selling of market data is more than an artifact of regulation, because more people buy it than those who are required to do so. Moreover, self-regulatory operations are critical to investor protection. The risk of regulatory arbitrage becomes greater and greater as time goes on. Market centers that share in the revenues must also share in those responsibilities.

The moderator asked those who believe that there is too much money in the market data pot whether the pot should be reduced or shared. A participant noted that the Commission is currently in a difficult budget situation and is experiencing an increase in workload. Therefore, we continue to need SROs, and those SROs need to be funded. Changing the system radically is therefore not practical in current environment.

With regard to market rebates, a buy-side representative said that different market participants provide value in the data creation and aggregation process; both executors and investors provide value. Those who provide the "intellectual property" of the information should be compensated. Therefore, either fees should be reduced or allow rebate to go to those who provide that intellectual property, who may be different than those who use the data for various purposes.

The moderator then made a distinction between cost and value. The information in market data clearly has value. However, in a competitive market, the cost of the data declines in line with the cost of its production. Therefore, the guide to allocation is not the value of the data but the cost of producing it. Rebates are more distortionary than they are a valid cost.

One of the SEC Commissioners then asked how one draws a link between what is paid to the SROs to cover the costs of the regulatory apparatus and the services that are delivered. The NYSE representative replied that exchange is a cooperative, and therefore those two things are not allowed to "get out of whack". Moreover, the SEC asks the NYSE to perform a large amount of regulatory tasks.

One representative said that the overlapping regulatory levels are a problem that can be solved. If the SROs are eliminated, and the exchanges' business product is producing trading services, then need to cross subsidize regulation with tape fees would go away. The SEC should do all rulemaking and enforcement. The NYSE responded that most years there is no such cross-subsidy.

Another representative noted that the NYSE data is oxygen for the markets, which is why the NYSE has huge market power in the area of market data. The NYSE representative replied that the exchange has seventy years of history of not exercising that power. The data is priced below both its value and its cost. The Board of Directors has always ensured and continues to ensure that that is the case. In fact, between 1860 and 1975, there was no such requirement to provide that data. The moderator then noted that the data was not sold to the public at that time, only to NYSE members. The NYSE representative stated that the retail investor still pays almost nothing for this data. The CTA Plan does not govern how much the exchange charges for the data. On the topic of barriers to entry for new market centers, one panelist said that there are different types of networks that can compete with established exchanges. The NYSE, for example, has a lot of competing interests that create potential inefficiencies to be exploited by competitors.

Judith Chase
Vice President and Director, Securities Research

Endnotes

1 For information, participants, and archived webcasts of these Hearings on Market Structure, see http://www.sec.gov/news/otherwebcasts.shtml.

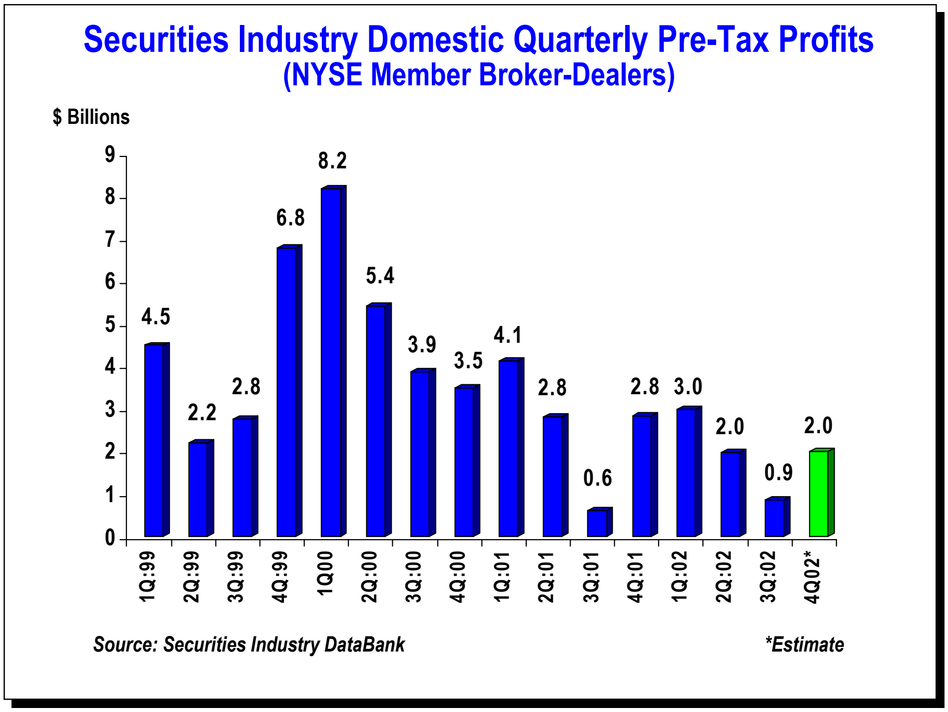
2 Reports on the Seligman meetings and conclusions can be found in prior issues of SIA Research Reports at: http://www.sia.com/reference_materials/html/research_reports.html.

3 This meeting overview is not meant to be an actual transcript of the meeting, and therefore does not reflect direct quotes from participants.

BOTTOM FORMATION: SECURITIES INDUSTRY UPDATE

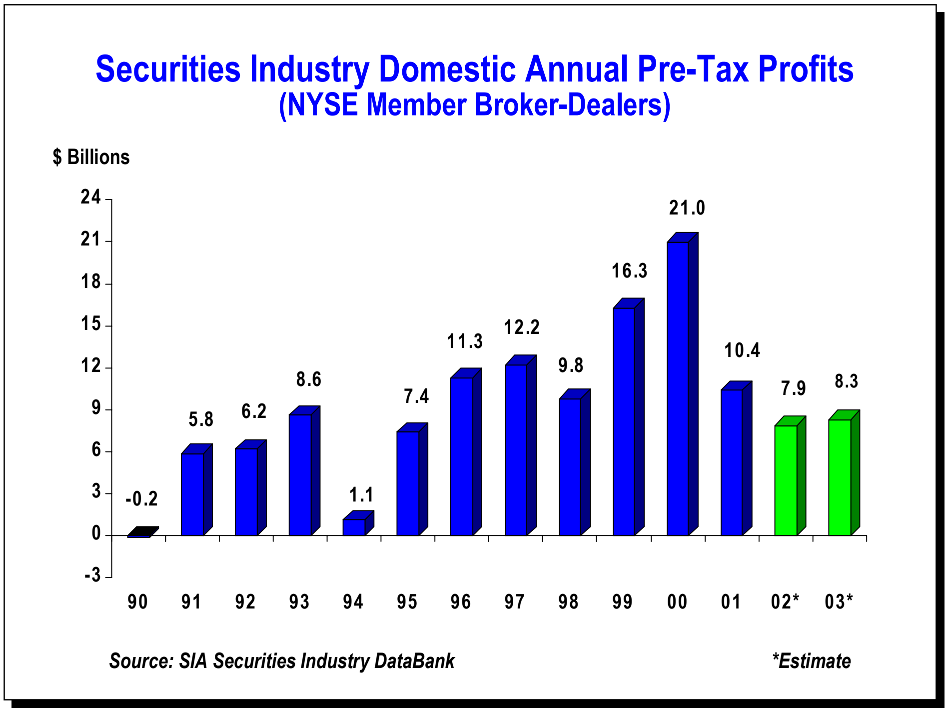
Introduction

New York Stock Exchange (NYSE) member firms[1] reported lower 3Q 2002 pre-tax profits which were more than slashed in half (-57%) to $868 million *(SIA's late September projection for the third quarter was $1.0 billion)* from the second quarter's $2.0 billion, which itself was down by one-third from first quarter's $3.0 billion.

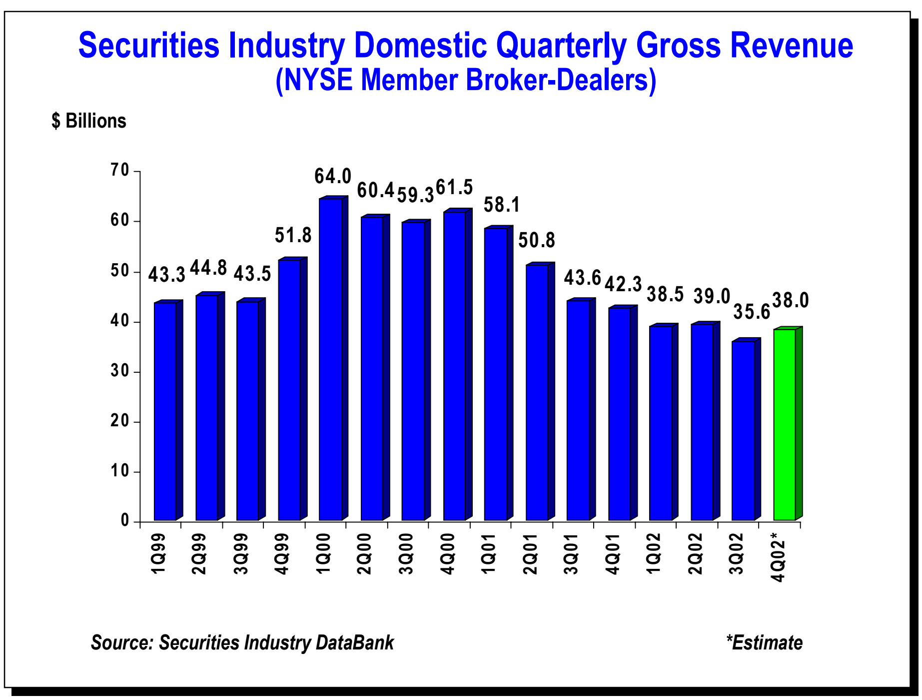


Gross revenues of $35.6 billion were 8.7% below the previous quarter, declining to its lowest level in over five years (2Q 1997's $33.9 billion) as every single revenue line fell from second quarter levels. Profits were higher than the $624 million recorded in 3Q 2001, but quarterly profits are off 90% in just 11 quarters from the record $8.2 billion recorded in 1Q 2000, as industry revenues have been contracting for 2 ½ years. For the first nine months of 2002, gross revenues only reached $113.2 billion, 27% below the $155.2 billion results for the same period last year. Despite a comparable 26% fall in recorded expenses (as all major expense items declined except for interest costs and floor costs), pre-tax profits in the first nine months of 2002 of $5.85 billion, trail the $7.58 billion recorded in the comparable period last year.

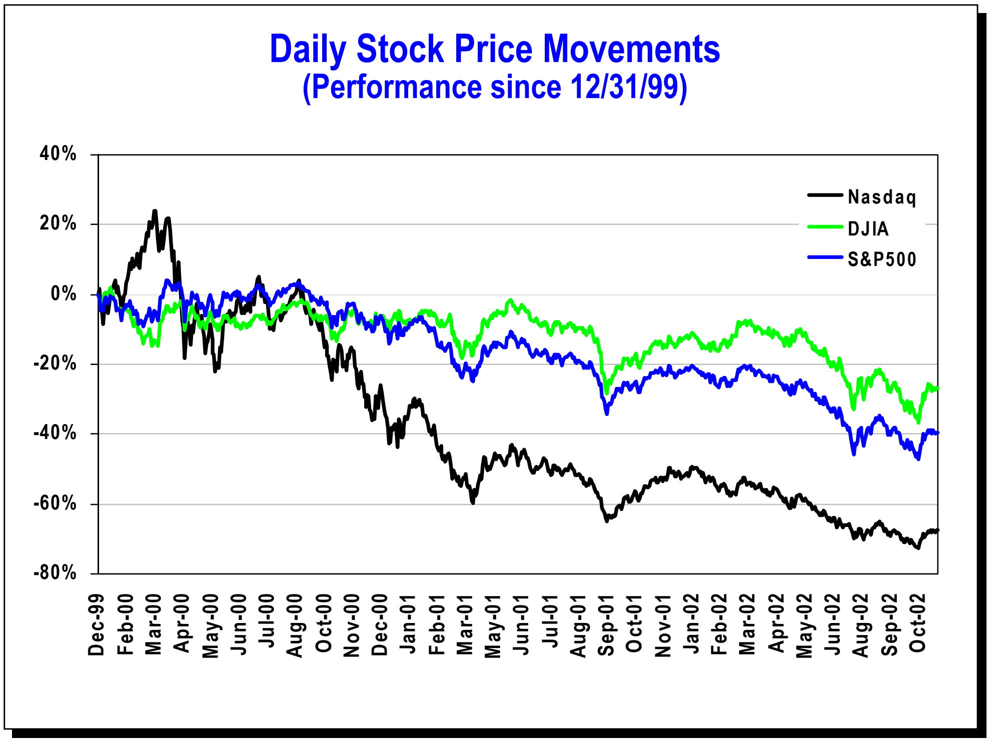
[1] Includes NYSE member firms that conduct a business with the public and account for approximately 80% of the total financials of all broker-dealers in the U.S.. This category generally excludes NYSE specialists, but includes firms that primarily trade for their own account. NYSE specialists recorded $189 million in pre-tax profits in Q3 2002 (twice the outcome in Q3 2001) and $516 million for the first nine months of the year (only 2.1% below the same, year earlier period).



These results were in line with our expectations, as the long decline in revenues became generalized across the summer, extending to virtually all product and service lines. Even with the anticipated improvement in 4Q 2002 profits to $2.0 billion, full-year 2002 profits will still only reach a seven-year low of $7.9 billion, down 24% from last year's $10.4 billion and representing just over one-third of the previous year's record $21.0 billion in 2000 pre-tax profits. We also see only 5% growth in 2003 over full-year 2002 for $8.3 billion in pre-tax profits.



However, some positive signs have emerged, and it appears that industry revenue growth has resumed, albeit from depressed levels and at a very muted pace during 4Q 2002. Investor sentiment, and with it account activity, seems to be stabilizing, if not beginning a partial recovery, aided by perceived progress in dealing with corporate governance issues and eight consecutive weeks of increases in the major equity market price indices. However, a full equity recovery will take much longer than its 2 ½ year fall. From their October 9th lows, the Dow must climb 61%, the S&P 500 must double and the Nasdaq Composite must rise over 350% to merely get back to their early 2000 highs.



A resumption of gross revenue growth in 4Q 2002 is expected to end the long slide in industry revenues. In less than three years, from 1Q 2000 to 3Q 2002, industry revenue fell 44%, or from $64.0 billion to $35.6 billion, respectively, and also a five-year low. Net revenue mirrored this trend.

The recovery is expected to be narrow and gradual, with only a few of the various revenue lines in the securities industry showing any improvement as 4Q 2002 comes to a close. Early beneficiaries include specialists firms, clearing firms, larger firms whose proprietary books were properly positioned for the recent ½ percentage point drop in base interest rates, and firms with expertise in distressed securities and situations. Others likely won't see any immediate improvement. For example, during 3Q 2002, 36% of NYSE member firms reported a quarterly loss. As 2003 progresses, we expect the upturn to broaden, encompassing more firms and more revenue lines.

Recent Industry Shifts

Most, if not all, securities firms are focusing more intensely on core competencies and getting back to Wall Street's business basics – improving customer satisfaction and operational efficiency – in hopes of ensuring an eventual long-term recovery of both margins and ROEs. With hopes of another major bull market unlikely before late 2003 or 2004, firms are expected to continue to reduce controllable expenses, at least sufficiently to offset largely non-controllable items, such as benefit costs per employee, which are still rising at double-digit annual rates. Meanwhile, consolidation will continue in this transforming industry as it has in recent years, with numerous brokerages merging, selling out to a handful of few remaining willing buyers, or simply disappearing as many have already done.

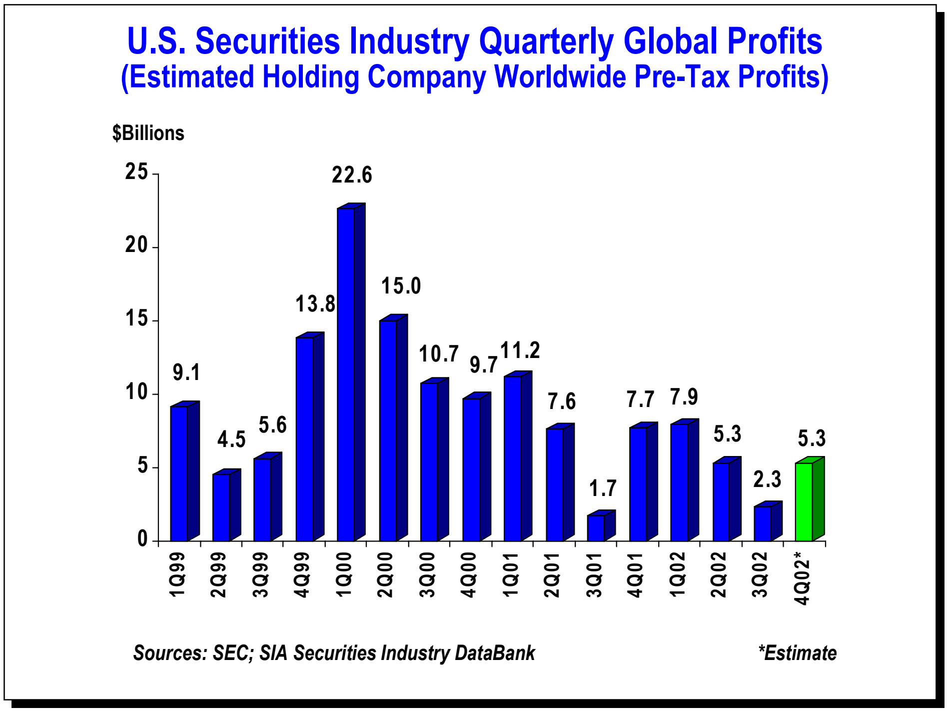
One positive trend that has emerged this year is the end of the decades long decline in the average commission revenue earned by securities firms on each "ticket". Average per-ticket commissions flattened out in recent months as the industry adjusted to the advent of decimal pricing and of compensation based on spreads. Deep discounting practices have also subsided, allowing some restoration of "pricing power".

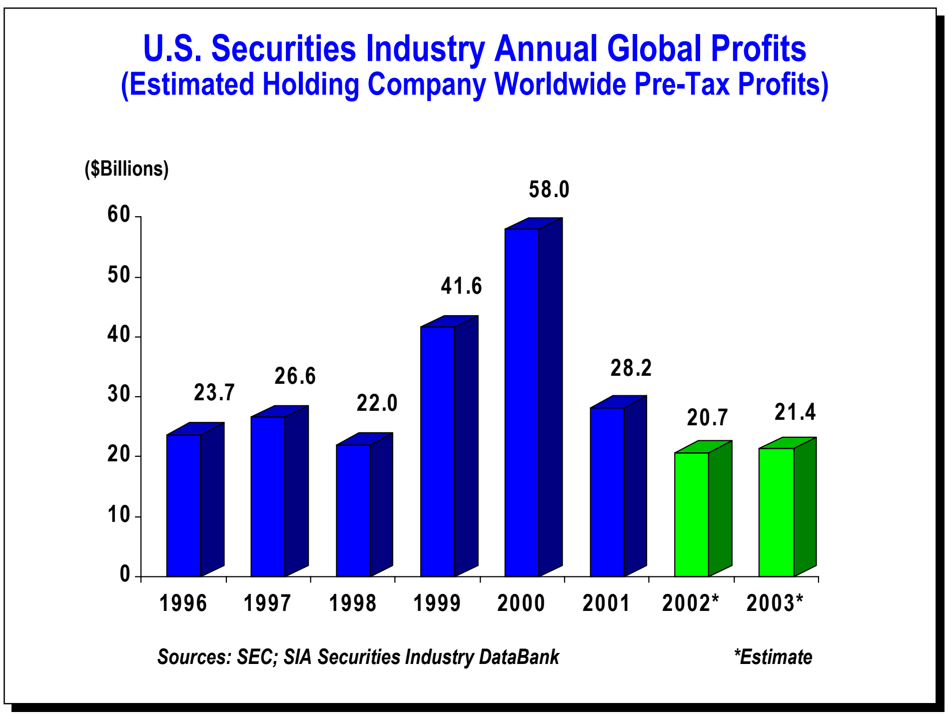
Another positive trend, at least from a very parochial view, is higher clearing revenues, reflecting higher fees charged on still strong volume in secondary markets. A third trend, discussed in more detail in the following article, is higher fees earned for financial advisory services provided to customers engaging in corporate restructuring, mergers and acquisitions and leverage buyouts, all types of activity that are expected to rise as economic activity slows in 4Q 2002 and uncertainty remains high and credit constrained to heavily indebted firms.

Consensus First Call reports around Halloween called for 12% growth in 2003 earnings for publicly owned brokers. Since then, however, a string of 2003 earning downgrades for brokers have occurred and further analysis unfortunately suggests revenue and profit growth for the industry as a whole might be no more than 5%-7%.

Similar Results on Global Operations

The slowdown in U.S. economic activity in late 2002 and the slump in securities market prices and in revenues of securities firms domestically has been mirrored on a global basis. Profits on global operations slumped to just $2.3 billion in 3Q 2002 and for the year as a whole are not expected to exceed $20.7 billion, nearly 27% below last year's result. Greater synchronicity in business cycles internationally is readily apparent as economic activity and securities markets slumped in all major and most minor countries. Although foreign profits have not been repatriated, it did not help the global earnings of U.S. securities firms as the U.S. dollar continued to weaken, now about on parity with the Euro, which has risen 14% in recent months vs. the greenback.



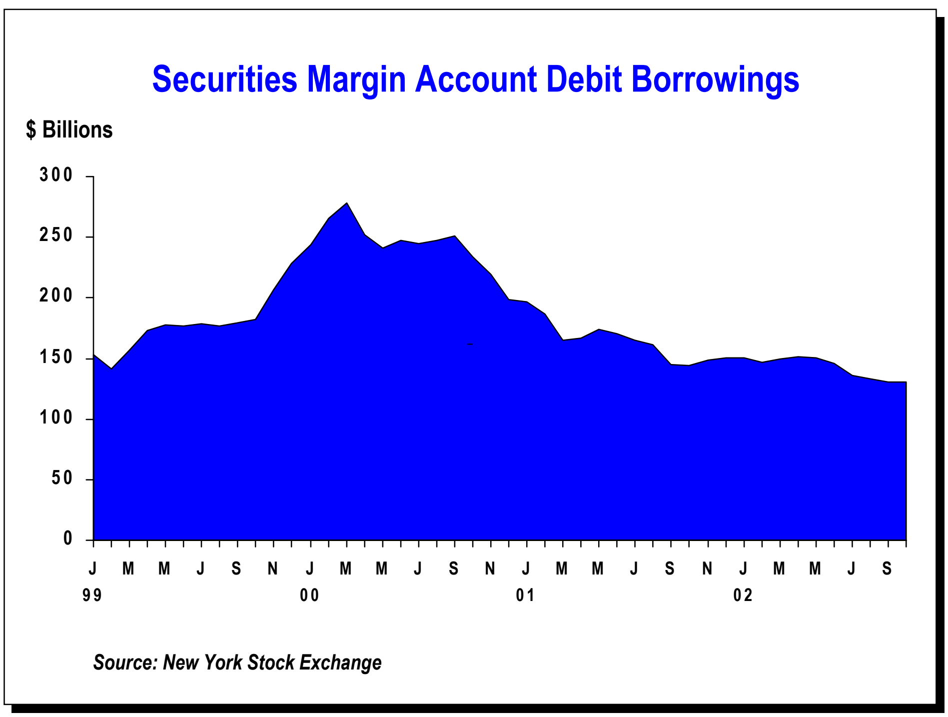


In the current cycle, only certain institutional businesses – fixed income, derivatives, portions of investment banking and net interest income – have been able to ameliorate devastated equities and retail activity that has crashed by two thirds, that is until this summer when even these areas slumped. If not for massive cost cutting in a race to match reeling revenue – compensation costs were cut by one-third and interest expense was halved since 1Q 2000 to 3Q 2002 in the U. S. -- the industry would have posted red ink these past two years.

Domestic Revenue & Expenses

For all the major public firms, as well as the bulk of the industry, every revenue and expense line fell across-the-board in 3Q 2002 – commissions, principal trading, investment banking, asset management fees, mutual fund revenue, compensation costs, promo spending, everything – with the exception of floor costs and gross and net interest revenue and expenses, thanks to the Fed. Other developments worth noting include: clearing and specialist firms revenues and costs rising with higher volumes, and increased accruals for layoffs and reserve costs for legal settlements and investor class action problems on the horizon. (Details of the performance of individual revenue and expense lines and of the industry as a whole are available in the current issue of SIA's ***Securities Industry Trends***.)

The flip side to the huge cost savings in interest expense is that gross interest revenue has fallen to modern day lows as well. For instance, even though margin debt balances finally stabilized late last year at 1999 levels, the revenue from this lending continued to plummet due to low interest rates. Margin debt balances by September 2002 had fallen to 1998 levels of around $130 billion. Quarterly margin interest revenue still plunged 75% in two years – from $5.9 billion in 3Q 2000 to $1.4 billion in 3Q 2002, its lowest showing in 26 quarters. With fourth quarter rates falling again, borrowing will have to rise substantially in the final quarter simply to stem this slide. However, it did not in October, as seen below.

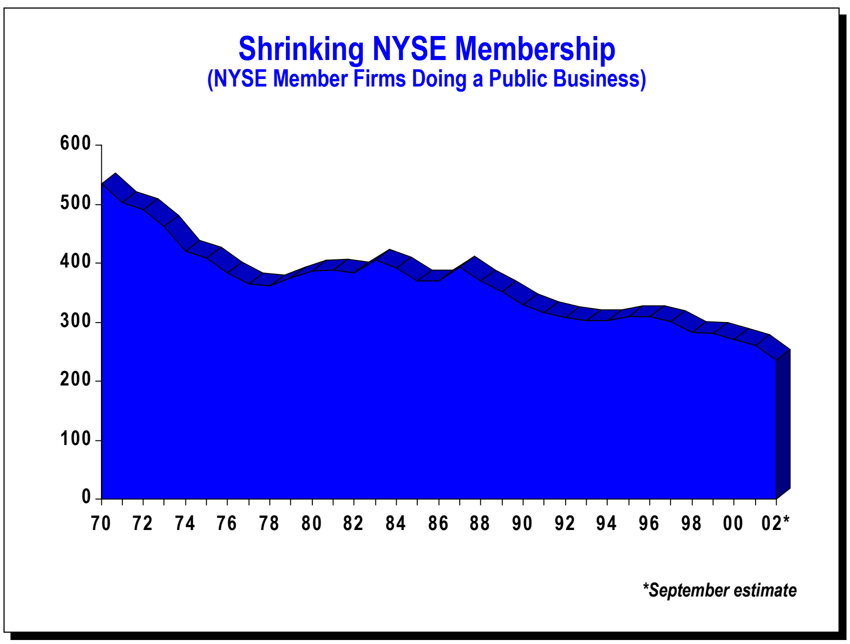


The near-term outlook is marginally better in the current quarter than during the late summer slump, but it will take at least a year before we see any major improvement. A recent Bernstein study observes that historically it takes retail activity twice as long to recover than the overall market. During the last such cycle, post 1987, the S&P 500 took eight quarters to rebound but 17 quarters for retail revenues to recover. Thus, even if a recovery has begun, meaningful retail activity will not be back until 2004 at the earliest.

Beyond retail, institutional businesses, particularly investment banking, will not improve significantly until today's wide fixed-income spreads significantly narrow and badly needed bank willingness to lend finally re-appears. These are prerequisites for any rebound in all institutional businesses and for any M&A funding or fueling any expansion for the industry's corporate clientele.

Expense Reductions: Shrinking Costs in a Shrinking Industry

Given the breadth and depth of the current market and industry, is it little wonder that NYSE member firms have fallen in number to levels not seen since the Great Depression? It is also not surprising that at least a record 75,100 securities industry jobs were wiped out in under two years to a four-year low. Both industry consolidation and job cuts will likely continue to through year-end.



Historically low interest rates and the resultant strong fixed-income origination and trading gains saved 2002 from what would otherwise have been even lower revenue and profits. Also of help was the industry doing what it typically has done in previous down cycles – effectively managing expense reductions in line with revenue declines. Granted, the main cost saving was pure serendipity – the Federal Reserve's lowering of interest rates to levels not seen since the early days of the Kennedy Administration. Because of this, the industry's quarterly interest expense had fallen for five consecutive quarters by 1Q 2002 to its lowest level in seven years, even though the industry's balance sheet had nearly tripled in size. Although interest costs rose slightly in the second and third quarters, with the recent Fed rate cut of another 50 points, this should level off in the fourth quarter, and decline somewhat in early 2003. The beneficial impact would have been greater were it not for reduced levels of margin and stock lending activity.

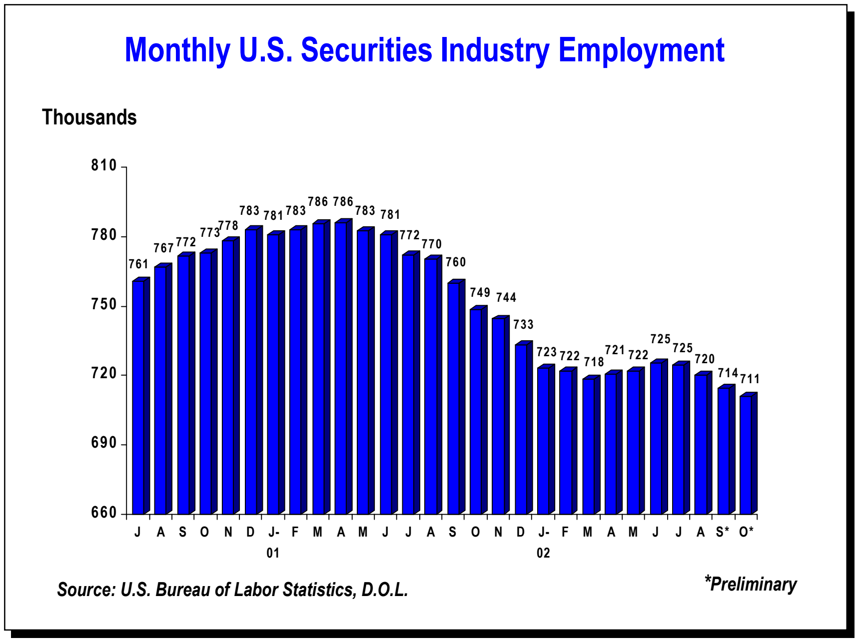
Further, in just 15 months, gross interest expense fell by 62%, from $30.1 billion in 4Q 2000 to just $11.3 billion in this year's first quarter. However, a steepening yield curve finally reversed this trend with interest costs rising 12% in the second quarter to $12.7 billion. Third quarter interest costs are up again, to $13.0 billion, but we see the recent Fed cut stemming this tide in the fourth quarter (back to second quarter levels) and maybe even further early next year.

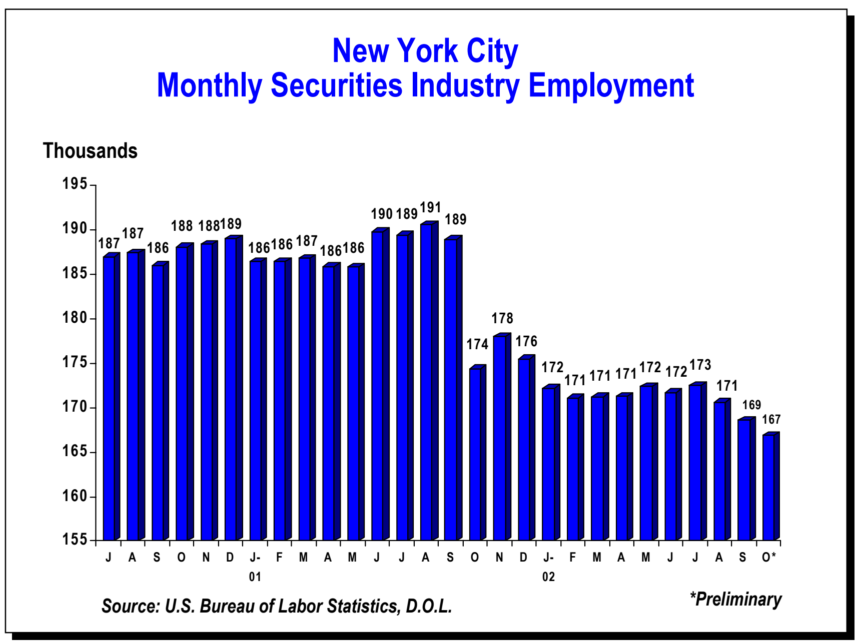
Compensation Costs

Total industry compensation costs (NYSE broker-dealers) dropped nearly one-third or $7.2 billion (-34%) in less than three years from an all-time high of $20.2 billion in the first quarter of 2000 to $13.0 billion in this year's third quarter, its lowest level in four years. Part of the sharp drop-off was simply lower production payouts from vastly poorer markets, but the balance was a concerted effort to reduce headcount, salaries, bonuses and compensation ratios from the record heights they had previously attained, as management kept compensation in check with declining revenues. Compensation dropped from 65% of all operating costs at the bull's height to around 60% this year with further reductions expected for the remainder of this year and next. Total compensation and operation costs have steadily fallen for nearly three years.

During Q3 2002, total compensation fell 10% from levels in the immediately preceding quarter. With little hope for any meaningful revenue improvement in the near-term, cost-cutting will remain the industry's main tool to maintain what little profitability still exists today. Since interest rates are probably at rock bottom having fallen to levels not seen since Kennedy's first days in office, further cost-cutting undoubtedly means further layoffs and compensation cutting.

Nationwide security/commodity industry employment hit a zenith of 786,100 in April of last year, according to the U.S. Bureau of Labor Statistics data. In the following 18 months, BLS data shows a record loss of 75,100 security/commodity industry jobs, down to 711,000 by October. The massacre was obviously greater worldwide This BLS data (only U.S. employment) lags the real economy, and does not reflect announced layoffs (domestically or globally) until firings actually occur; layoff packages expire, and the former workers formally join the unemployment rolls. Nonetheless, this is a record, by far, in the actual number of job losses for this industry and, double the post-1987 Crash layoffs in just half the time. In percentage terms (down 9.6%), this is slightly worse than the post-1987 period's 8.5% losses, but still shy of the 1973-74's debacle of a 17% decline in industry employment.





New York, particularly the City, took the brunt of these cuts. New York City alone accounts for one-third of nationwide losses, down a record 23,700 (-12.7%, and this is preliminary) industry jobs in just 14 months. The bulk of this, unsurprisingly, immediately followed the WTC attacks but accelerated again since this summer.

Those lucky enough to have avoided pink slips during the recent bear now face another grim prospect of severely reduced salaries and bonuses. A survey conducted by J.H. McCann & Co., a Wall Street recruiting firm, found, not surprisingly, that compensation levels may decline by 30% to 50% for most investment bankers in 2002. Our annual projection for <u>total</u> compensation costs in 2002 is that it will be down a much smaller

9.5%, or $5.8 billion, from last year's level and that includes aforementioned escalating benefit costs, accruals for layoffs and an expected better fourth quarter. Paychecks themselves will be down much further. Compared to 2000, this year's total compensation expenses are expected to be down 20.5%, with the subcomponent, bonus compensation, down as much as 35%. Investment banking and equity analysts, among others, will see sizable reductions in 2002 paychecks.

Clearly, today's environment may mean further cuts beyond the previous 9.6% cut in overall headcount, even if modest revenue growth has resumed. Further cuts will prove more onerous since virtually all the compensation cuts obtainable through hiring freezes, elimination of multi-year guarantees, bonus reductions of over 50%, etc. have already been factored in. Industry executives might feel the industry needs even further decreases in compensation to get back to a time like the early 1980s, when compensation was 42% to 43% of net revenue, as opposed to the mid-50% range today.

Layoff announcements are now occurring among those firms that tried to maintain employee talent for the expected rebound that is now not likely to occur in any meaningful fashion for the near-term. Those firms that had already made deep cuts will have to cut deeper still, although some firms will continue to make strategic hires. Also, firms are even cutting the cost of enacting layoffs by reducing the severance packages they were previously granting. As of this writing, more announcements to this effect were already occurring.

Conclusion

Despite all the cost cutting efforts, there is a limit to what can be achieved from expense control alone. At some point, there must be improvement in core revenue sources for the industry to get back on track with earnings growth and higher multiples if formally experienced. Looking at the major revenue lines, with the exception of commissions and hopefully trading gains, the outlook is for only gradual improvement in other revenue lines across 2003.

George R. Monahan
Vice President and Director, Industry Studies

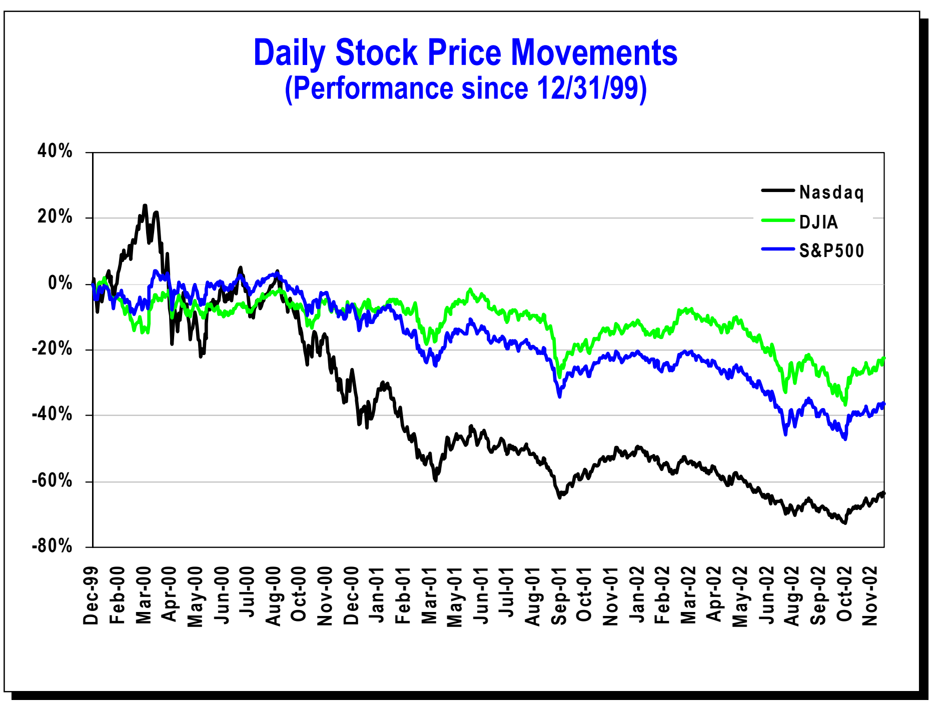
MONTHLY STATISTICAL REVIEW

U.S. Equity Market Activity

Stock Prices – Stocks have rebounded sharply since October 9, when the DJIA and S&P 500 fell to their lowest levels in five years and the Nasdaq Composite sank to a six-year low. The DJIA, S&P 500 and Nasdaq Composite had fallen 38%, 49% and 78%, respectively, from their Spring 2000 all-time highs to their October 9, 2002 lows. By November's close, these three indices had bounced back 22%, 21%, and 33%, respectively. However, to put these figures in perspective, the Dow, S&P 500 and Nasdaq Composite need to recover 61%, 97%, and 353%, respectively, just to return to their 2000 peaks from their October 9, 2002 lows. Thus, we still have a long way to go before we get back to levels reached over 2 ½ years ago.

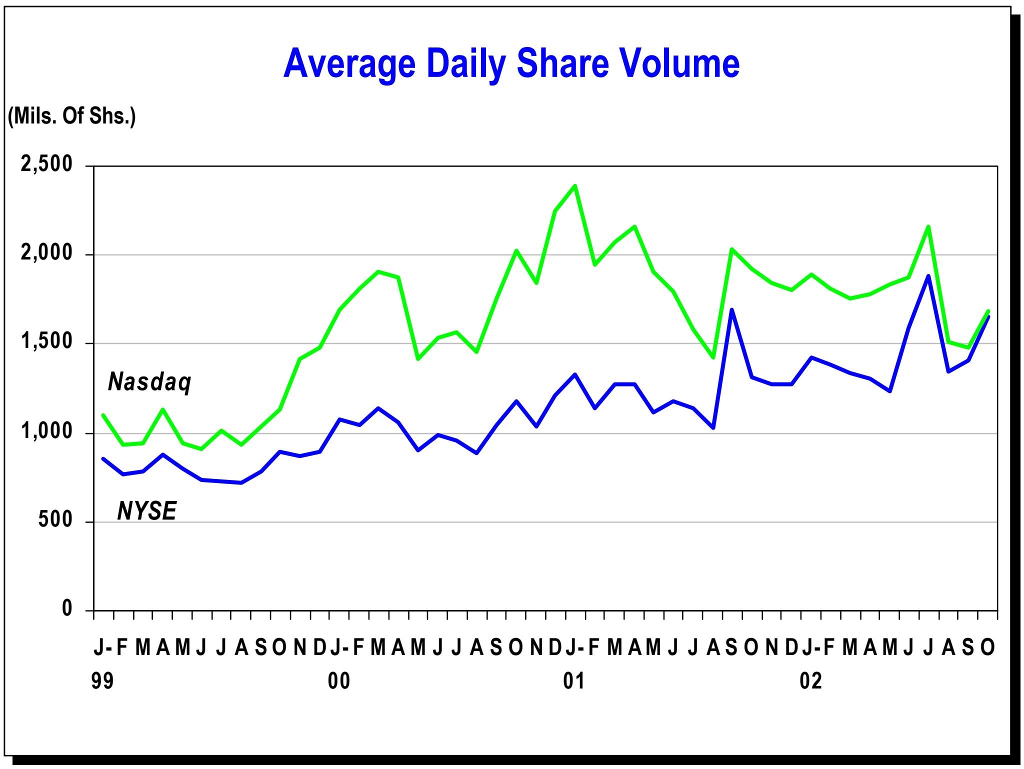
Several factors have contributed to the stock market's turnaround, including: bargain-hunting in an oversold market; short sellers covering their positions; some mutual funds buying to become more fully invested in stocks before finishing their fiscal years; favorable economic reports; and growing investor confidence. For the month of November, the Dow rose 5.9% after climbing 10.6% in October (its second-best October percentage gain ever). The S&P 500 advanced 5.7% in November and 8.6% in October (its best monthly performance since March 2000). Meanwhile, powerful rallies in technology and telecom stocks helped drive the Nasdaq Composite up 11.2% in November and 13.5% in October. In addition, the Nasdaq Composite is now at its highest level since June 2002. But the Dow and S&P 500 remain below their August 22, 2002 highs reached during the late-summer mini-rally.

Despite the recent surge in stock prices, the DJIA still is down 11.2% for the year through November, the S&P 500 is off 18.4% and the Nasdaq Composite is down 24.2% year-to-date.



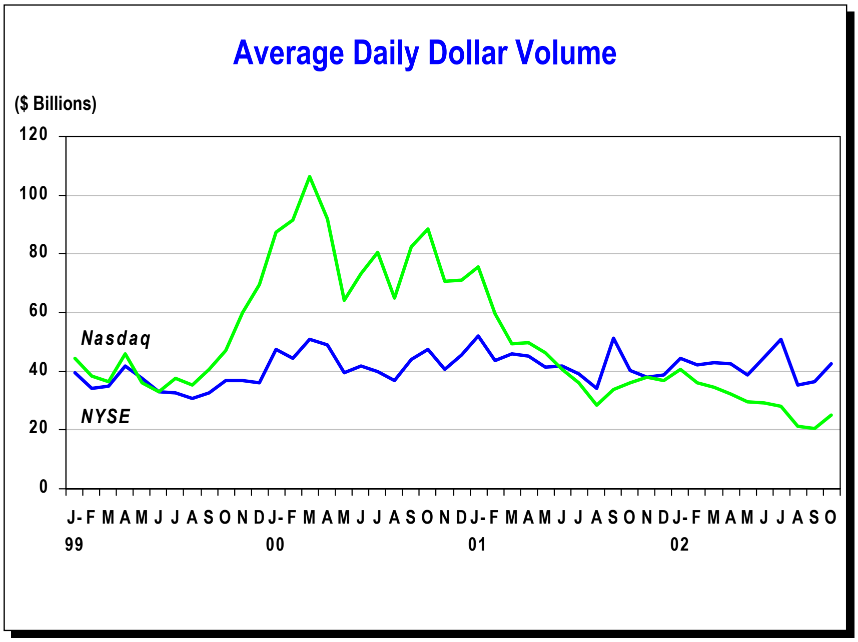
Share Volume – Trading activity picked up in October to its highest level since July amid the sharp stock market rebound. NYSE share volume climbed for the third straight month to 1.65 billion shares daily in October, up 17.0% from a month earlier. For the first 10 months of 2002, NYSE volume averaged 1.46 billion shares daily, a 17.7% increase over the annual record pace of 1.24 billion per day set in 2001.

On Nasdaq, average daily volume jumped 13.5% to 1.68 billion shares daily in October from 1.48 billion daily in September. Despite this increase in activity, Nasdaq volume for the year through October, at 1.78 billion shares daily, was still 6.3% shy of the 1.90 billion daily record set last year. Although Nasdaq volume improved further in November, this market is on track to register its first yearly decline in volume since 1990.

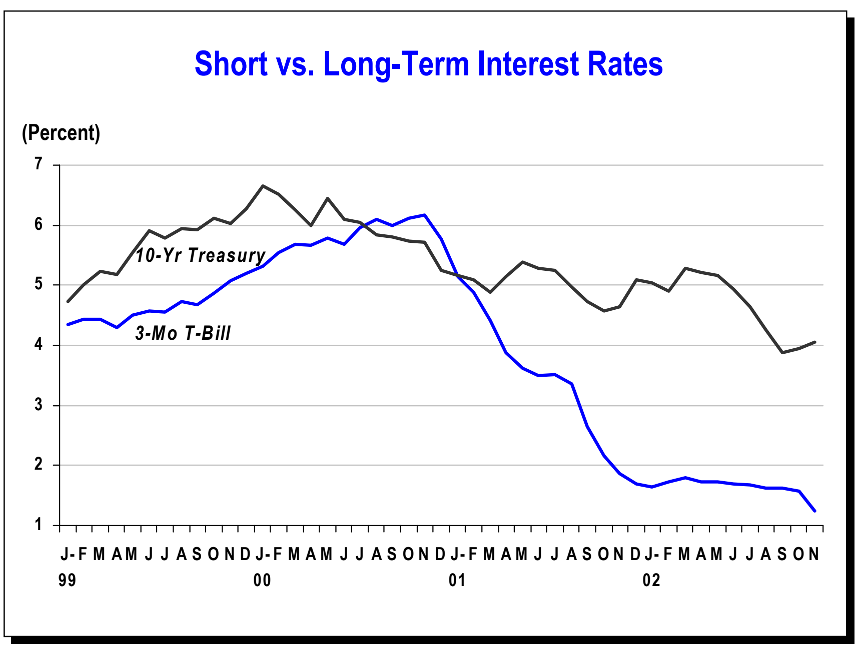


Dollar Volume – In October, Nasdaq dollar volume registered its first monthly increase since January due to heightened trading activity and higher share prices. After sinking to a four-year low of $20.5 billion daily in September, Nasdaq dollar volume surged 22.4% to $25.1 billion daily in October. Yet, year-to-date, the value of trading in Nasdaq stocks remains one-third below last year's pace, averaging $29.6 billion daily through November compared with $44.1 billion per day in 2001.

NYSE dollar volume jumped 17.1% from September's level to $42.5 billion daily in October. Through the first 10 months of 2002, NYSE dollar volume averaged $42.1 billion, just shy of 2001's $42.3 billion daily average.



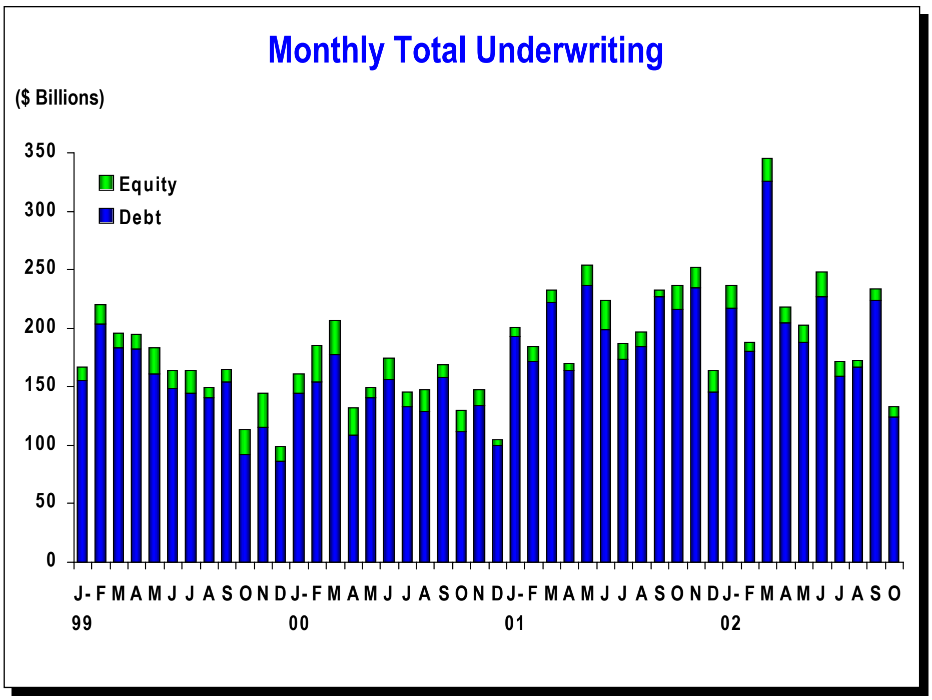
Interest Rates – The six-month rally in Treasuries ended in October as investors shifted money out of bonds to stocks. Although long-term Treasury prices shot up briefly after the Federal Reserve lowered short-term interest rates by 50 basis points on November 6 (its first rate cut in 11 months), they have since fallen back amid some better-than-expected economic news. The 10-year Treasury yield, which moves inversely to price, rose to 4.05% in November from 3.94% in October, but stood 60 basis points below its year-earlier level. The Fed's easing helped push the yield on 3-month T-bills to 1.24% in November, down 34 basis points from the previous month and 63 basis points since last November. As a result, the yield spread between 3-month and 10-year Treasuries widened to 236 basis points in November from 224 bps in October.



U.S. Underwriting Activity

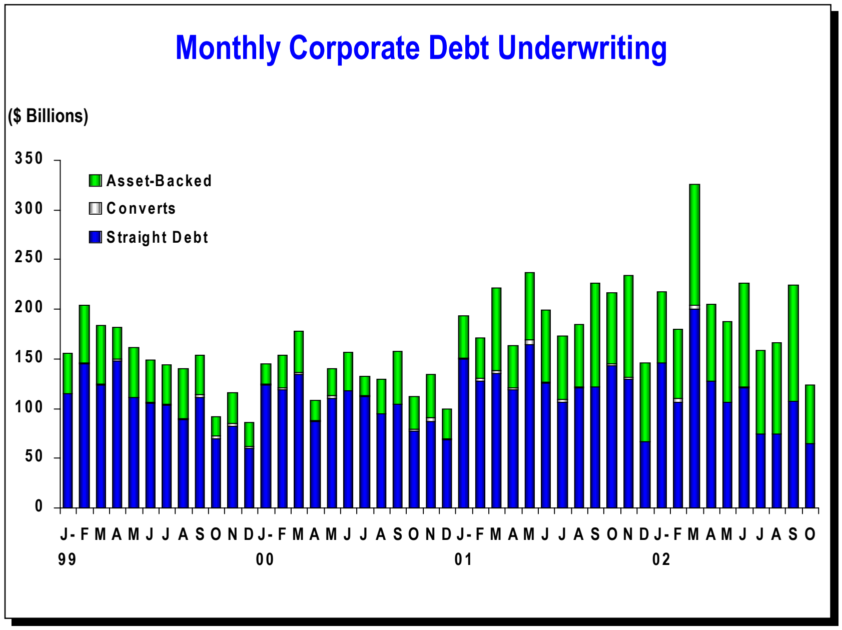
Total Underwriting – New issuance of corporate securities in the U.S. market fell sharply in October. A steep plunge in corporate debt offerings drove total underwritten dollar volume to its lowest level since December 2000 and deal volume to levels last seen in December 1995. Dollar proceeds plunged 43.2% from September's level to $132.8 billion in October, while deal volume sank 30.1% to 578 deals.

Through the first 10 months of 2002, overall volume of stock and bond underwriting totaled $2.15 trillion, slightly above the $2.12 trillion raised during the same period last year. However, the number of deals completed so far this year, at 9,238, is 28.2% lower than the 12,875 deals offering a year ago.

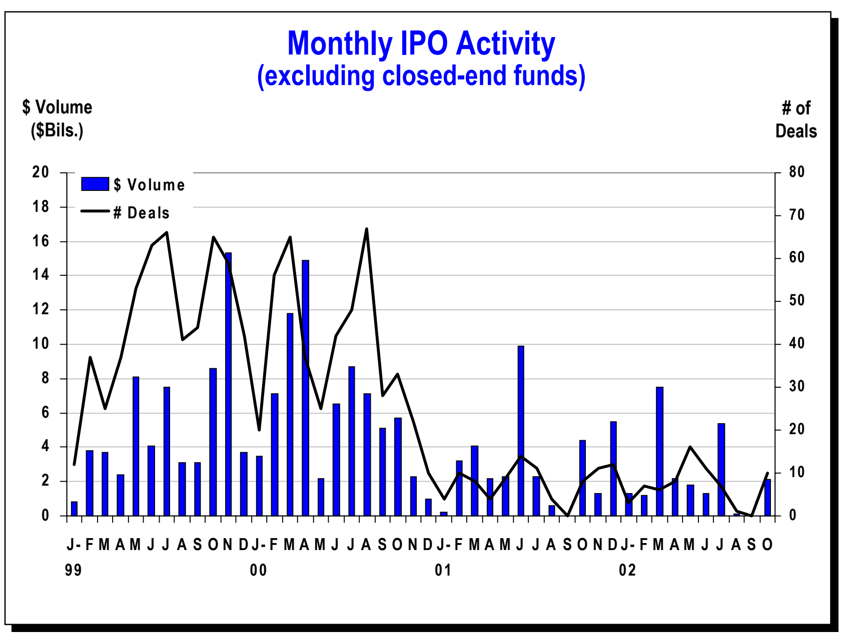


Corporate Bond Underwriting – Falling credit quality continues to plague the corporate bond market. In October, Moody's Investors Services cut the credit ratings of 69 U.S. companies, the third highest monthly total since 1986. This was one of the factors contributing to a 39.6% plunge in straight corporate debt offerings, from $107.2 billion in September to $64.7 billion in October. Further, October's figure represented the lowest monthly volume since December 1999. The year-to-date total of $1.13 trillion is 14% below the $1.32 trillion issued in the same year-earlier period.

Activity in asset-backed securities fell to $59.1 billion in October. That's down 49.6% from $117.2 billion in September and the lowest dollar volume in 18 months. Despite the monthly decrease, asset-backed issuance year-to-date, at $879.1 billion, already exceeds 2001's full-year record total of $832.5 billion.



Equity Underwriting – Improved conditions in the equity market during October led to a pickup in "true" IPO activity (excluding closed-end funds). Ten IPOs were brought to market in October, raising $2.1 billion. In comparison, no deals were offered in September, and just one deal was completed in August, which raised a paltry $0.1 billion. Through the first 10 months of 2002, IPO activity is down 21.6% to $22.9 billion from $29.2 billion in the same period last year. Only a handful of issues in the backlog are expected to be completed before the end of December, which is typically the slowest month of the year for the IPO market.



Grace Toto
Vice President and Director, Statistics

U.S. CORPORATE UNDERWRITING ACTIVITY

(In $ Billions)

	Straight Corporate Debt	Con-vertible Debt	Asset-Backed Debt	**TOTAL DEBT**	Common Stock	Preferred Stock	**TOTAL EQUITY**	All IPOs	"True" IPOs	Follow-Ons	**TOTAL UNDER-WRITINGS**
1985	76.4	7.5	20.8	104.7	24.7	8.6	33.3	8.5	8.4	16.2	138.0
1986	149.8	10.1	67.8	227.7	43.2	13.9	57.1	22.3	18.1	20.9	284.8
1987	117.8	9.9	91.7	219.4	41.5	11.4	52.9	24.0	14.3	17.5	272.3
1988	120.3	3.1	113.8	237.2	29.7	7.6	37.3	23.6	5.7	6.1	274.5
1989	134.1	5.5	135.3	274.9	22.9	7.7	30.6	13.7	6.1	9.2	305.5
1990	107.7	4.7	176.1	288.4	19.2	4.7	23.9	10.1	4.5	9.0	312.3
1991	203.6	7.8	300.0	511.5	56.0	19.9	75.9	25.1	16.4	30.9	587.4
1992	319.8	7.1	427.0	753.8	72.5	29.3	101.8	39.6	24.1	32.9	855.7
1993	448.4	9.3	474.8	932.5	102.4	28.4	130.8	57.4	41.3	45.0	1,063.4
1994	381.2	4.8	253.5	639.5	61.4	15.5	76.9	33.7	28.3	27.7	716.4
1995	466.0	6.9	152.4	625.3	82.0	15.1	97.1	30.2	30.0	51.8	722.4
1996	564.8	9.3	252.9	827.0	115.5	36.5	151.9	50.0	49.9	65.5	979.0
1997	769.8	8.5	385.6	1,163.9	120.2	33.3	153.4	44.2	43.2	75.9	1,317.3
1998	1,142.5	6.3	566.8	1,715.6	115.0	37.8	152.7	43.7	36.6	71.2	1,868.3
1999	1,264.8	16.1	487.1	1,768.0	164.3	27.5	191.7	66.8	64.3	97.5	1,959.8
2000	1,236.2	17.0	393.4	1,646.6	189.1	15.4	204.5	76.1	75.8	112.9	1,851.0
2001	1,511.2	21.6	832.5	2,365.4	128.4	41.3	169.7	40.8	36.0	87.6	2,535.1
<u>2001</u>											
Jan	149.6	1.7	41.7	193.0	5.4	2.7	8.1	0.5	0.2	4.9	201.1
Feb	127.5	3.3	40.5	171.3	11.3	1.5	12.8	3.2	3.2	8.1	184.1
Mar	135.5	2.3	83.8	221.6	10.1	1.4	11.5	5.0	4.1	5.1	233.1
Apr	119.3	1.1	42.9	163.4	5.0	1.5	6.5	2.2	2.2	2.8	169.9
May	164.8	4.8	67.0	236.6	14.4	3.3	17.8	2.7	2.3	11.7	254.4
June	126.1	1.0	71.9	199.0	21.4	3.5	24.9	10.5	9.9	10.9	223.8
July	106.8	2.6	63.9	173.3	10.6	3.3	13.9	2.5	2.3	8.1	187.2
Aug	121.2	0.2	63.0	184.4	7.6	4.7	12.3	0.6	0.6	6.9	196.7
Sept	121.8	0.0	104.6	226.5	2.9	3.4	6.3	0.0	0.0	2.9	232.8
Oct	142.8	2.7	70.8	216.4	13.7	6.7	20.4	4.8	4.4	9.0	236.8
Nov	129.3	1.9	102.9	234.2	12.4	5.2	17.6	2.9	1.3	9.5	251.8
Dec	66.4	0.0	79.4	145.8	13.6	4.1	17.7	6.0	5.5	7.6	163.4
<u>2002</u>											
Jan	145.9	0.2	71.2	217.3	8.6	10.8	19.4	1.8	1.3	6.9	236.7
Feb	106.2	3.8	70.2	180.1	6.7	1.2	8.0	1.9	1.2	4.8	188.0
Mar	200.5	3.2	121.7	325.4	16.9	2.7	19.6	8.5	7.5	8.3	344.9
Apr	127.2	0.0	77.5	204.8	8.7	4.4	13.1	2.9	2.2	5.8	217.9
May	106.5	0.1	81.4	188.0	13.3	1.6	14.9	2.4	1.8	10.9	202.9
June	121.2	0.4	105.1	226.7	17.7	4.1	21.8	4.1	1.4	13.6	248.5
July	74.1	0.4	84.2	158.6	11.0	1.8	12.8	6.1	5.4	4.9	171.4
Aug	74.9	0.0	91.6	166.5	3.8	2.0	5.7	2.5	0.1	1.3	172.3
Sept	107.2	0.0	117.2	224.4	7.3	2.0	9.3	2.4	0.0	4.9	233.7
Oct	64.7	0.1	59.1	123.9	6.6	2.3	8.9	3.4	2.1	3.1	132.8
Nov											
Dec											
YTD '01	1,315.6	19.7	650.2	1,985.5	102.4	32.0	134.4	31.9	29.2	70.5	2,119.9
YTD '02	1,128.4	8.2	879.1	2,015.6	100.5	32.8	133.4	36.0	22.9	64.5	2,148.9
% Change	-14.2%	-58.6%	35.2%	1.5%	-1.9%	2.8%	-0.8%	12.9%	-21.6%	-8.5%	1.4%

Note: IPOs and follow-ons are subsets of common stock. "True" IPOs exclude closed-end funds.
Source: Thomson Financial Securities Data.

MUNICIPAL BOND UNDERWRITINGS
(In $ Billions)

INTEREST RATES
(Averages)

	Compet. Rev. Bonds	Nego. Rev. Bonds	**TOTAL REVENUE BONDS**	Compet. G.O.s	Nego. G.O.s	**TOTAL G.O.s**	**TOTAL MUNICIPAL BONDS**	3-Mo. T Bills	10-Year Treasuries	SPREAD
1985	10.2	150.8	161.0	17.6	22.8	40.4	201.4	7.47	10.62	3.15
1986	10.0	92.6	102.6	23.1	22.6	45.7	148.3	5.97	7.68	1.71
1987	7.1	64.4	71.5	16.3	14.2	30.5	102.0	5.78	8.39	2.61
1988	7.6	78.1	85.7	19.2	12.7	31.9	117.6	6.67	8.85	2.18
1989	9.2	75.8	85.0	20.7	17.2	37.9	122.9	8.11	8.49	0.38
1990	7.6	78.4	86.0	22.7	17.5	40.2	126.2	7.50	8.55	1.05
1991	11.0	102.1	113.1	29.8	28.1	57.9	171.0	5.38	7.86	2.48
1992	12.5	139.0	151.6	32.5	49.0	81.5	233.1	3.43	7.01	3.58
1993	20.0	175.6	195.6	35.6	56.7	92.4	287.9	3.00	5.87	2.87
1994	15.0	89.2	104.2	34.5	23.2	57.7	161.9	4.25	7.09	2.84
1995	13.5	81.7	95.2	27.6	32.2	59.8	155.0	5.49	6.57	1.08
1996	15.6	100.1	115.7	31.3	33.2	64.5	180.2	5.01	6.44	1.43
1997	12.3	130.2	142.6	35.5	36.5	72.0	214.6	5.06	6.35	1.29
1998	21.4	165.6	187.0	43.7	49.0	92.8	279.8	4.78	5.26	0.48
1999	14.3	134.9	149.2	38.5	31.3	69.8	219.0	4.64	5.65	1.01
2000	13.6	116.2	129.7	35.0	29.3	64.3	194.0	5.82	6.03	0.21
2001	17.6	164.2	181.8	45.5	56.3	101.8	283.5	3.39	5.02	1.63
2001										
Jan	1.2	4.9	6.1	4.4	1.9	6.3	12.4	5.15	5.16	0.01
Feb	0.9	10.3	11.2	4.7	5.1	9.8	21.0	4.88	5.10	0.22
Mar	1.2	16.2	17.4	2.7	5.1	7.8	25.1	4.42	4.89	0.47
Apr	1.0	10.5	11.5	3.6	3.5	7.1	18.6	3.87	5.14	1.27
May	1.2	18.5	19.7	4.4	4.5	8.9	28.6	3.62	5.39	1.77
June	1.8	18.1	19.9	5.1	4.8	9.9	29.9	3.49	5.28	1.79
July	1.5	13.1	14.7	3.8	2.3	6.1	20.8	3.51	5.24	1.73
Aug	1.6	12.6	14.2	3.9	5.8	9.7	23.9	3.36	4.97	1.61
Sept	0.9	9.1	10.0	2.2	2.0	4.2	14.1	2.64	4.73	2.09
Oct	3.1	15.1	18.2	4.8	9.0	13.8	32.0	2.16	4.57	2.41
Nov	2.0	18.2	20.2	3.4	5.8	9.2	29.4	1.87	4.65	2.78
Dec	1.1	17.6	18.8	2.5	6.5	9.0	27.8	1.69	5.09	3.40
2002										
Jan	1.1	12.3	13.4	4.3	3.8	8.1	21.5	1.65	5.04	3.39
Feb	1.5	10.6	12.1	4.9	3.9	8.9	20.9	1.73	4.91	3.18
Mar	1.7	13.0	14.6	4.9	5.5	10.5	25.1	1.79	5.28	3.49
Apr	2.3	14.4	16.7	4.4	4.0	8.5	25.2	1.72	5.21	3.49
May	2.4	20.7	23.1	4.0	6.9	10.9	33.9	1.73	5.16	3.43
June	1.5	20.2	21.7	5.2	11.5	16.7	38.4	1.70	4.93	3.23
July	1.1	15.7	16.8	4.8	6.1	10.8	27.7	1.68	4.65	2.97
Aug	0.6	20.2	20.9	3.8	6.6	10.4	31.3	1.62	4.26	2.64
Sept	1.1	16.6	17.7	4.1	5.5	9.6	27.3	1.63	3.87	2.24
Oct	1.9	21.0	22.9	6.3	8.0	14.3	37.2	1.58	3.94	2.36
Nov										
Dec										
YTD '01	14.5	128.4	142.8	39.6	44.0	83.5	226.4	3.71	5.05	1.34
YTD '02	15.1	164.6	179.8	46.7	61.9	108.6	288.4	1.68	4.73	3.04
% Change	4.6%	28.2%	25.8%	18.1%	40.7%	30.0%	27.4%	-54.6%	-6.4%	127.5%

Sources: Thomson Financial Securities Data; Federal Reserve

	STOCK MARKET PERFORMANCE INDICES (End of Period)				STOCK MARKET VOLUME (Daily Avg., Mils. of Shs.)			VALUE TRADED (Daily Avg., $ Bils.)	
	Dow Jones Industrial Average	S&P 500	NYSE Composite	Nasdaq Composite	NYSE	AMEX	Nasdaq	NYSE	Nasdaq
1985	1,546.67	211.28	121.58	324.93	109.2	8.3	82.1	3.9	0.9
1986	1,895.95	242.17	138.58	348.83	141.0	11.8	113.6	5.4	1.5
1987	1,938.83	247.08	138.23	330.47	188.9	13.9	149.8	7.4	2.0
1988	2,168.57	277.72	156.26	381.38	161.5	9.9	122.8	5.4	1.4
1989	2,753.20	353.40	195.04	454.82	165.5	12.4	133.1	6.1	1.7
1990	2,633.66	330.22	180.49	373.84	156.8	13.2	131.9	5.2	1.8
1991	3,168.83	417.09	229.44	586.34	178.9	13.3	163.3	6.0	2.7
1992	3,301.11	435.71	240.21	676.95	202.3	14.2	190.8	6.9	3.5
1993	3,754.09	466.45	259.08	776.80	264.5	18.1	263.0	9.0	5.3
1994	3,834.44	459.27	250.94	751.96	291.4	17.9	295.1	9.7	5.8
1995	5,117.12	615.93	329.51	1,052.13	346.1	20.1	401.4	12.2	9.5
1996	6,448.27	740.74	392.30	1,291.03	412.0	22.1	543.7	16.0	13.0
1997	7,908.25	970.43	511.19	1,570.35	526.9	24.4	647.8	22.8	17.7
1998	9,181.43	1,229.23	595.81	2,192.69	673.6	28.9	801.7	29.0	22.9
1999	11,497.12	1,469.25	650.30	4,069.31	808.9	32.7	1,081.8	35.5	43.7
2000	10,786.85	1,320.28	656.87	2,470.52	1,041.6	52.9	1,757.0	43.9	80.9
2001	10,021.50	1,148.08	589.80	1,950.40	1,240.0	65.8	1,900.1	42.3	44.1
<u>2001</u>									
Jan	10,887.36	1,366.01	663.64	2,772.73	1,325.9	72.5	2,387.3	52.0	75.6
Feb	10,495.28	1,239.94	626.94	2,151.83	1,138.5	70.9	1,947.6	43.8	59.7
Mar	9,878.78	1,160.33	595.66	1,840.26	1,271.4	82.5	2,071.4	45.9	49.2
Apr	10,734.97	1,249.46	634.83	2,116.24	1,276.5	78.4	2,162.8	45.1	49.6
May	10,911.94	1,255.82	641.67	2,110.49	1,116.7	66.7	1,909.1	41.4	46.4
June	10,502.40	1,224.42	621.76	2,160.54	1,175.0	63.8	1,793.9	41.6	40.6
July	10,522.81	1,211.23	616.94	2,027.13	1,137.1	56.0	1,580.7	39.0	36.0
Aug	9,949.75	1,133.58	587.84	1,805.43	1,025.7	49.1	1,426.4	34.0	28.4
Sept	8,847.56	1,040.94	543.84	1,498.80	1,694.4	72.8	2,033.0	51.2	33.9
Oct	9,075.14	1,059.78	546.34	1,690.20	1,314.3	67.8	1,926.0	40.1	36.1
Nov	9,851.56	1,139.45	579.27	1,930.58	1,270.1	57.8	1,840.3	38.1	37.8
Dec	10,021.50	1,148.08	589.80	1,950.40	1,275.3	54.1	1,807.0	38.8	36.2
<u>2002</u>									
Jan	9,920.00	1,130.20	578.50	1,934.03	1,425.9	56.1	1,888.7	44.5	40.8
Feb	10,106.13	1,106.73	578.60	1,731.49	1,381.8	56.3	1,812.8	42.1	35.9
Mar	10,403.94	1,147.39	600.43	1,845.35	1,337.1	57.1	1,756.8	42.9	34.5
Apr	9,946.22	1,076.92	574.18	1,688.23	1,307.3	55.4	1,779.0	42.4	32.1
May	9,925.25	1,067.14	570.78	1,615.73	1,234.2	61.5	1,834.2	38.9	29.8
June	9,243.26	989.82	533.07	1,463.21	1,587.0	66.9	1,877.1	44.8	29.4
July	8,736.59	911.62	491.37	1,328.26	1,886.3	79.0	2,158.2	50.9	28.1
Aug	8,663.50	916.07	495.55	1,314.85	1,341.4	58.4	1,509.0	35.5	21.2
Sept	7,591.93	815.28	445.44	1,172.06	1,409.0	90.3	1,477.3	36.3	20.5
Oct	8,397.03	885.77	472.90	1,329.75	1,654.8	68.3	1,683.9	42.5	25.1
Nov									
Dec									
YTD '01	9,075.14	1,059.78	546.34	1,690.20	1,233.5	67.7	1,915.1	43.1	45.5
YTD '02	8,397.03	885.77	472.90	1,329.75	1,459.0	64.9	1,778.3	42.1	29.6
% Change	-7.5%	-16.4%	-13.4%	-21.3%	18.3%	-4.1%	-7.1%	-2.3%	-34.9%

MUTUAL FUND ASSETS
($ Billions)

	Equity	Hybrid	Bond	Money Market	**TOTAL ASSETS**
1985	116.9	12.0	122.6	243.8	495.4
1986	161.4	18.8	243.3	292.2	715.7
1987	180.5	24.2	248.4	316.1	769.2
1988	194.7	21.1	255.7	338.0	809.4
1989	248.8	31.8	271.9	428.1	980.7
1990	239.5	36.1	291.3	498.3	1,065.2
1991	404.7	52.2	393.8	542.5	1,393.2
1992	514.1	78.0	504.2	546.2	1,642.5
1993	740.7	144.5	619.5	565.3	2,070.0
1994	852.8	164.5	527.1	611.0	2,155.4
1995	1,249.1	210.5	598.9	753.0	2,811.5
1996	1,726.1	252.9	645.4	901.8	3,526.3
1997	2,368.0	317.1	724.2	1,058.9	4,468.2
1998	2,978.2	364.7	830.6	1,351.7	5,525.2
1999	4,041.9	383.2	808.1	1,613.1	6,846.3
2000	3,962.0	346.3	811.1	1,845.2	6,964.7
2001	3,418.2	346.3	925.1	2,285.3	6,975.0
2001					
Jan	4,093.5	354.9	833.3	1,954.8	7,236.5
Feb	3,688.9	344.9	844.5	2,018.7	6,897.0
Mar	3,402.9	333.7	852.1	2,035.5	6,624.2
Apr	3,715.7	348.0	846.0	2,031.5	6,941.2
May	3,744.6	352.6	858.4	2,070.9	7,026.5
June	3,677.2	349.9	860.8	2,052.5	6,940.4
July	3,589.3	351.7	882.3	2,069.8	6,893.1
Aug	3,382.7	342.6	908.3	2,104.3	6,737.9
Sept	3,018.9	324.1	909.6	2,161.7	6,414.3
Oct	3,111.2	330.3	935.2	2,239.7	6,616.4
Nov	3,348.6	343.0	934.1	2,306.5	6,932.2
Dec	3,418.2	346.3	925.1	2,285.3	6,975.0
2002					
Jan	3,373.5	347.2	947.0	2,303.5	6,971.2
Feb	3,312.0	348.4	962.7	2,301.2	6,924.3
Mar	3,497.4	359.2	958.4	2,247.2	7,062.2
Apr	3,369.5	354.5	980.8	2,230.8	6,935.7
May	3,343.3	356.4	994.3	2,229.8	6,923.8
June	3,089.6	341.4	1,003.6	2,196.5	6,631.1
July	2,770.3	320.7	1,033.2	2,254.6	6,378.8
Aug	2,781.8	324.9	1,063.9	2,217.5	6,388.1
Sept	2,505.5	305.4	1,089.0	2,155.7	6,055.6
Oct	2,660.0	316.7	1,083.2	2,169.8	6,229.7
Nov					
Dec					
YTD '01	3,111.2	330.3	935.2	2,239.7	6,616.4
YTD '02	2,660.0	316.7	1,083.2	2,169.8	6,229.7
% Change	-14.5%	-4.1%	15.8%	-3.1%	-5.8%

MUTUAL FUND NET NEW CASH FLOW*
($ Billions)

	Equity	Hybrid	Bond	Money Market	**TOTAL**	Total Long-Term Funds
1985	8.5	1.9	63.2	-5.4	68.2	73.6
1986	21.7	5.6	102.6	33.9	163.8	129.9
1987	19.0	4.0	6.8	10.2	40.0	29.8
1988	-16.1	-2.5	-4.5	0.1	-23.0	-23.1
1989	5.8	4.2	-1.2	64.1	72.8	8.8
1990	12.8	2.2	6.2	23.2	44.4	21.2
1991	39.4	8.0	58.9	5.5	111.8	106.3
1992	78.9	21.8	71.0	-16.3	155.4	171.7
1993	129.4	39.4	73.3	-14.1	228.0	242.1
1994	118.9	20.9	-64.6	8.8	84.1	75.2
1995	127.6	5.3	-10.5	89.4	211.8	122.4
1996	216.9	12.3	2.8	89.4	321.3	232.0
1997	227.1	16.5	28.4	102.1	374.1	272.0
1998	157.0	10.2	74.6	235.3	477.1	241.8
1999	187.7	-12.4	-5.5	193.6	363.4	169.8
2000	309.4	-30.7	-49.8	159.6	388.6	228.9
2001	32.2	9.5	87.8	375.3	504.8	129.6
2001						
Jan	24.9	2.5	9.0	103.5	139.9	36.4
Feb	-3.3	1.3	8.9	58.2	65.1	6.8
Mar	-20.7	-0.4	7.7	13.7	0.4	-13.3
Apr	19.1	1.2	1.4	-10.5	11.2	21.7
May	18.4	0.9	6.3	34.3	59.8	25.6
June	10.9	1.2	2.3	-24.2	-9.8	14.3
July	-1.3	1.3	9.3	12.2	21.5	9.3
Aug	-5.0	-0.7	16.7	26.1	37.2	11.0
Sept	-30.0	-1.3	7.7	52.9	29.3	-23.6
Oct	0.9	1.6	13.6	74.2	90.2	16.0
Nov	15.3	1.0	6.9	60.3	83.5	23.2
Dec	2.9	1.0	-1.9	-25.4	-23.3	2.1
2002						
Jan	20.0	2.2	10.5	14.0	46.7	32.7
Feb	5.4	2.3	10.7	-5.5	12.9	18.4
Mar	29.6	3.3	6.7	-53.1	-13.4	39.7
Apr	12.9	3.3	7.8	-19.5	4.5	24.0
May	4.9	1.5	10.6	-4.3	12.6	16.9
June	-18.3	0.4	12.2	-43.6	-49.2	-5.6
July	-52.6	-4.7	28.1	54.6	25.4	-29.2
Aug	-3.1	0.6	17.4	-38.7	-23.8	14.9
Sept	-16.1	-0.7	15.4	-61.9	-63.2	-1.4
Oct	-7.7	-1.0	6.3	11.2	8.7	-2.4
Nov						
Dec						
YTD '01	14.0	7.5	82.8	340.4	444.7	104.3
YTD '02	-24.9	7.3	125.7	-146.8	-38.9	108.0
% Change	-278.5%	-3.5%	51.7%	-143.1%	-108.7%	3.5%

* New sales (excluding reinvested dividends) minus redemptions, combined with net exchanges
Source: Investment Company Institute

Securities Industry Association
120 Broadway, New York, NY 10271-0080
(212) 608-1500, Fax (212) 608-1604
info@sia.com, www.sia.com