

SECURITIES INDUSTRY TRENDS

VERY SLOW GROWTH SEEN
FOR REMAINDER OF 2002

George R. Monahan

THE STUTTERING STATE OF THE ECONOMY

Frank A. Fernandez

MONTHLY STATISTICAL REVIEW

Grace Toto

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Prepared by SIA Research Department Copyright® 2002 Securities Industry Association* ISSN 1532-6667*

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- Page 12 **The Stuttering State of the Economy**, by Frank Fernandez. After a surprisingly brief and shallow recession, and an even more startling jump in growth in 1Q 2002, the prevailing view has been that the US economy has entered a sustainable, if subdued, recovery in activity. However, the assumptions underlying this benign outlook appear increasingly tenuous. Mixed and weakening indicators are emerging across the course of 2Q 2002, and both investor and consumer sentiment slumped in May. We present the consensus view as well as a more moderate, alternative view, highlighting both the existing risks to the forecast as well as potential "shocks" that could precipitate a more discontinuous adjustment of the structural imbalances that the recent short, mild recession failed to correct.
- Page 23 **Monthly Statistical Review**, by Grace Toto. All major market indices posted losses in May. The Nasdaq Composite dropped 4.3%, while the S&P 500 and DJIA slipped 0.9% and 0.2%, respectively. Daily dollar volume on the major exchanges sank to the lowest level of the year. Corporate underwriting activity in the U.S. slowed, primarily due to a cutback in debt offerings. Monthly as well as annual statistics on primary and secondary market activity are provided.

SECURITIES INDUSTRY TRENDS¹

Very Slow Growth Seen for Remainder of 2002

Just-released first quarter financial results confirmed our early April forecast of slow growth for the U.S. securities industry during 2002. NYSE member firms posted \$3.00 billion in pre-tax profits for the quarter ended March 31, 2002, 7.7% below our April forecast of \$3.25 billion. Considering the subsequent dearth of activity in securities markets, we were relieved to see that profits weren't down even further. We've lowered our forecast for second quarter profits marginally by 3% to \$3.1 billion and lowered full-year profit estimates by 1.5% to \$13.0 billion. This downward revision is still warranted despite a few divergent earnings surprises being released at this writing by a handful of May Q2 reporting securities firms.

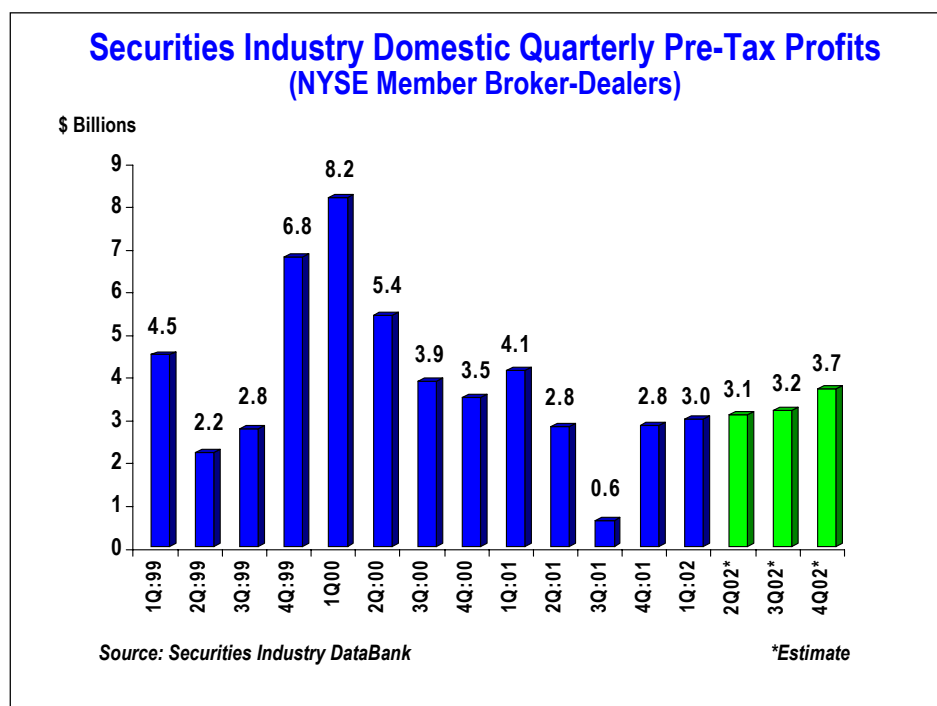
Gross revenue fell for the fifth consecutive quarter to \$38.5 billion in 1Q 2002. This result was 9% below 4Q 2001's revenues of \$42.3 billion and one-third below the \$50.8 billion level achieved a year ago in 1Q 2001. Moreover, in exactly two years time, quarterly gross revenues have shrunk 40% from their peak of \$63 billion in 1Q 2000 and are now back to 1997 levels. Both gross and net revenue will improve only marginally over the near-term with no meaningful gains expected until at least 4Q 2002. If economic conditions and investor sentiment continue to weaken, improvements in profitability will easily recede into late 2003-2004.

Domestic Highlights

First quarter domestic industry profits of \$3.00 billion, reported at the onset of June, were relatively meager, but still managed to exceed by 6% the immediately preceding (4Q 2001) quarter's \$2.83 billion of pre-tax profits. Based on all NYSE member broker-dealers, the widely-used proxy for the domestic securities industry, this \$3.00 billion still disappointingly trailed the \$4.14 billion of profits in the same quarter a year ago (1Q 2001) by a sizeable 27.5%. The current historically low interest rate environment single-handedly saved the quarter from nose-diving toward negative levels. These current low rates drastically reduced interest costs, which condensed another 27% in the first quarter alone, or \$4.1 billion, from the previous quarter's already low levels. Moreover, the first quarter's interest costs were down an amazing 56% from the year-earlier quarter (1Q 2001). These lower rates dovetailed with an \$800 million pick-up in fixed income trading gains in 1Q 2002, the only bright spot for industry revenue during the period.

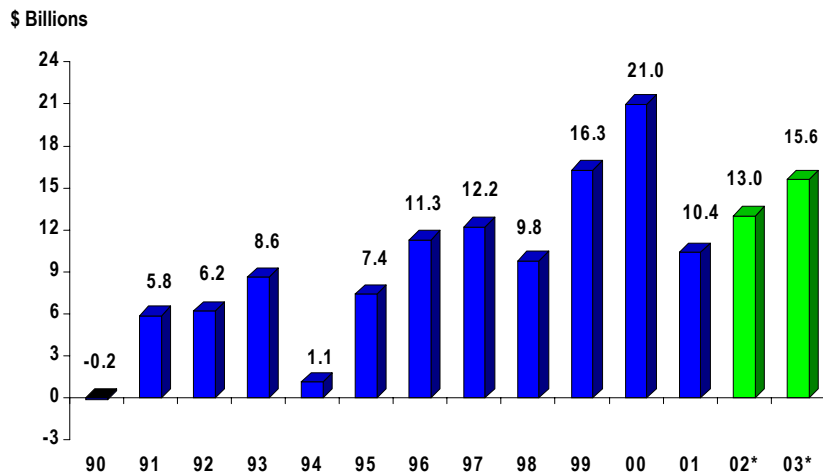
¹ This article features highlights from the upcoming June 2002 issue of *Securities Industry Trends*. The full report will be available for *subscriber* viewing, or for *ordering*, at: http://www.sia.com/reference_materials/html/securities_industrytrends.html
All data for these articles and *Trends* can be obtained from a subscription to the SIA *Securities Industry DataBank*; for further details, visit http://www.sia.com/reference_materials/html/databank.html

Just over two-thirds of the \$3 billion in first quarter pre-tax profits were earned by the National Full Line Firms (NFLs) and the Large Investment Banks (LIBs), two of the 17 categories in SIA's *Securities Industry DataBank* (see footnote above). While the \$1 billion in NFL profits earned in 1Q 2002 was a marked improvement over the mere \$43 million earned in 4Q 2001, the LIBs' \$1 billion in first quarter profits was less than half the \$2.1 billion posted in Q4 2001. There are varying reasons for the differences in profitability between NFLs and LIBs, including capital markets-intensive activities vs. retail-oriented businesses, which are discussed in the upcoming issue of *Securities Industry Trends*.



The New York City-Based Regionals, which includes many bank-owned firms, had the next largest slice of the first quarter's profits with \$351 million, a welcome return to profitability after 4Q01's \$228 billion pre-tax loss. Clearing Firms saw their best quarter in a year with \$204 million in profits; Discounters had their best quarter in a year as well; however, the Discounters' \$66 million in pre-tax profits was still a mere 10% of the quarterly profit earned exactly two years earlier. Regional Firms actually posted less in profits, \$61 million, than the Discounters – a rare occurrence.

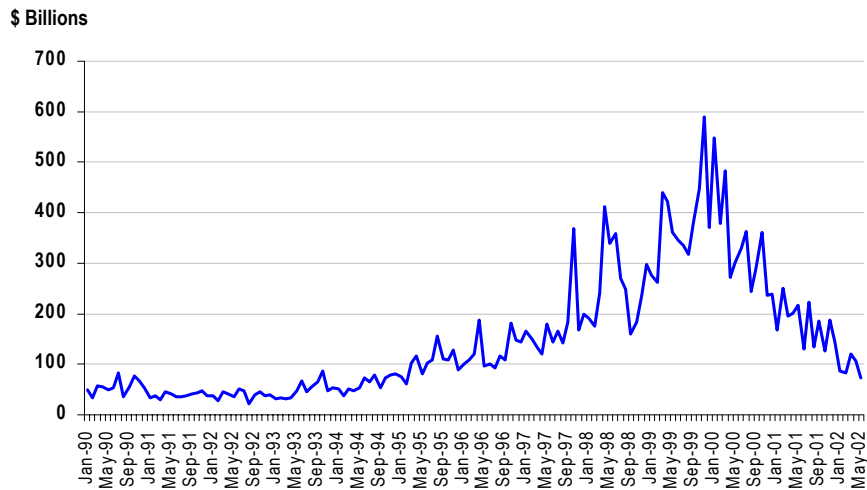
Securities Industry Domestic Annual Pre-Tax Profits (NYSE Member Broker-Dealers)



Source: SIA DataBank

*Estimate

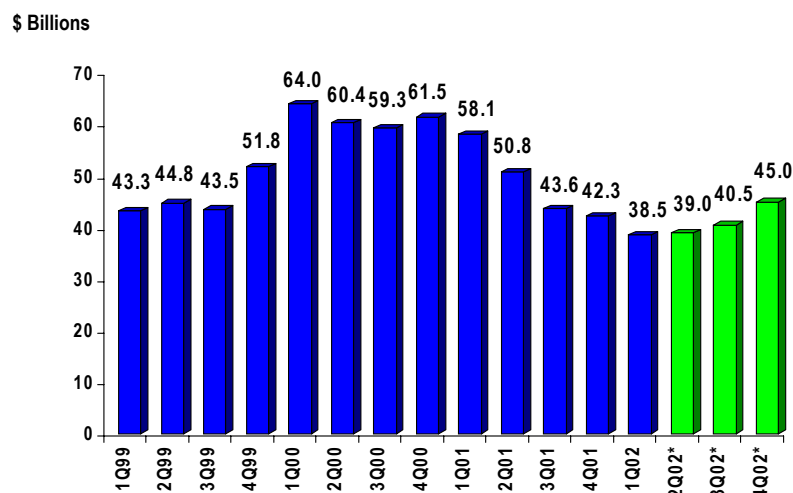
Mergers & Aquisitions (Announced Deals with Monthly Disclosed Dollar Values)



Source: Credit Suisse First Boston Research

Capital markets-intensive firms fared much better than retail-oriented firms in last year's difficult environment, but today are witnessing an extremely sharp decline in their high margin business lines. Mergers and acquisitions (M&A) are practically non-existent, or at best have fallen back to levels not seen in seven years. IPOs are similarly rare.

Securities Industry Domestic Quarterly Gross Revenue (NYSE Member Broker-Dealers)

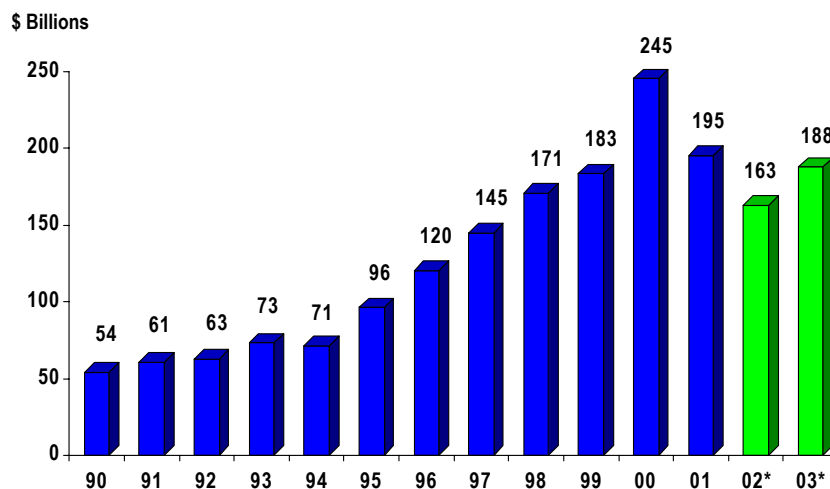


Source: Securities Industry DataBank

*Estimate

Considering the continued dearth of activity in the capital markets, we were relieved to see that first quarter profits didn't come in even lower. Depressed businesses, particularly M&A, underwriting, private placements, structured finance, equity trading (with the exception of derivatives), the sidelined retail investor, continuously falling equity prices, basically everything except fixed income (plus currencies/derivatives for some firms), have combined to make the near-term outlook not so bright, if not downright dim, for most firms.

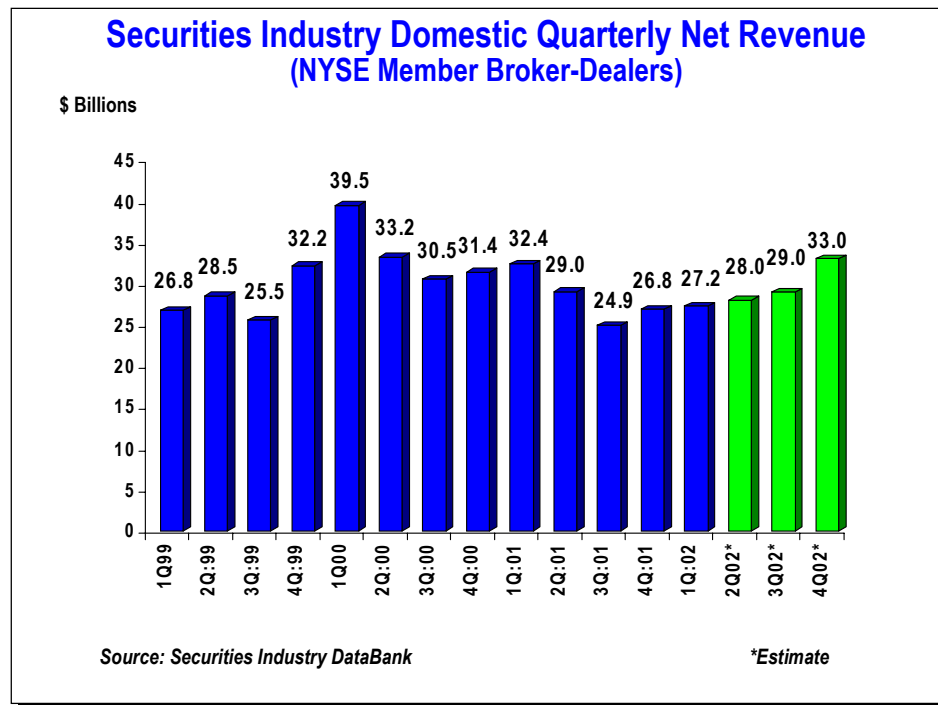
Securities Industry Domestic Annual Gross Revenue (NYSE Member Firms)

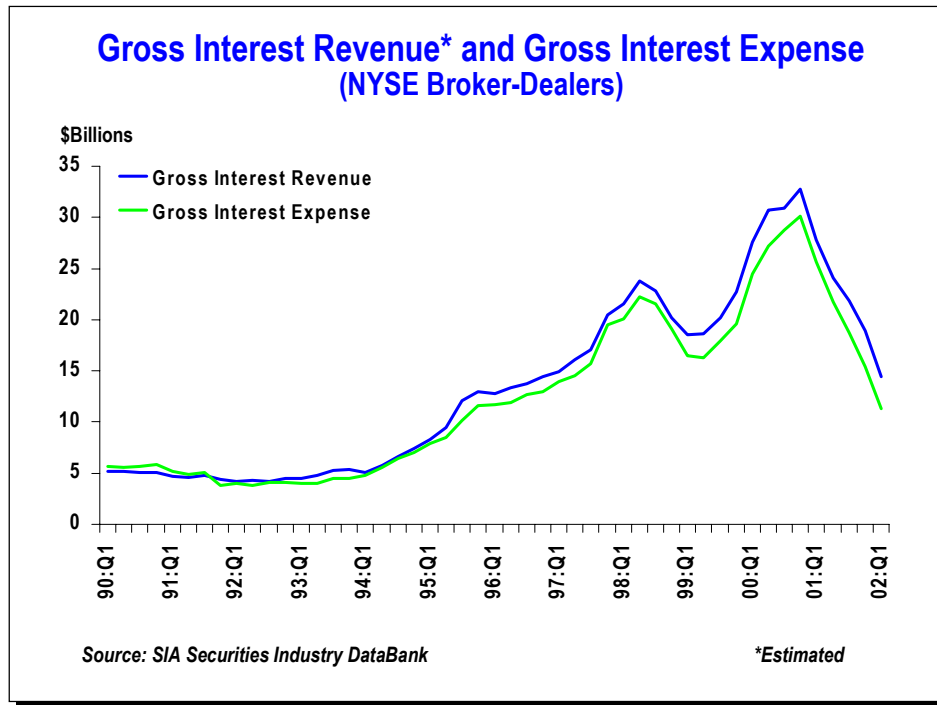


Source: SIA Securities Industry DataBank

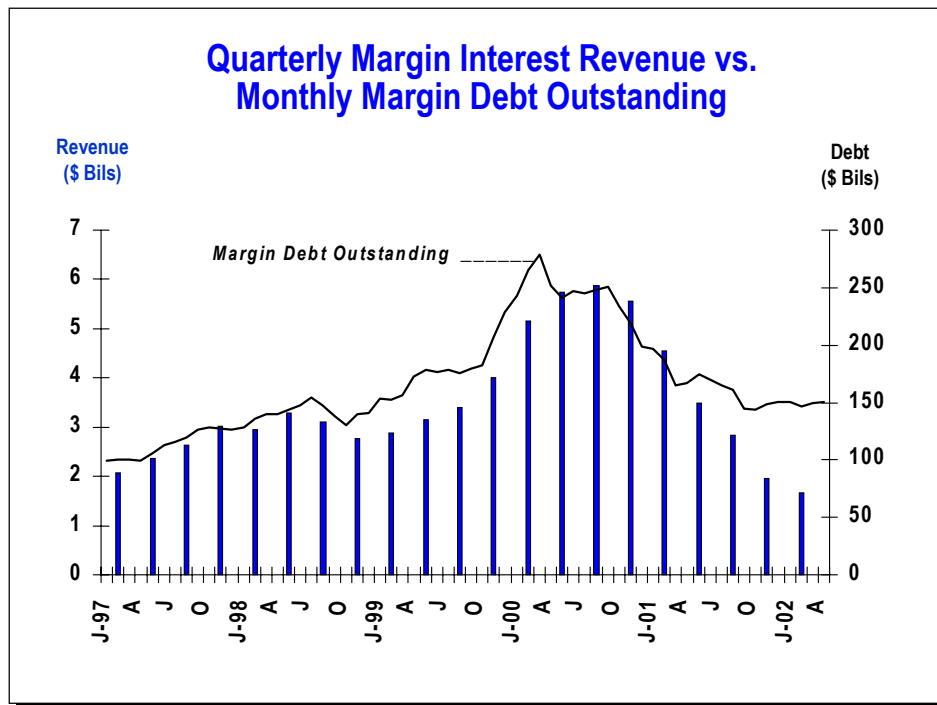
*Estimate

With little good news on any of these fronts (excluding some pick-up in underwriting backlog and an M&A deal here and there for a few firms), we've lowered our forecast for second quarter profits marginally to \$3.1 billion from \$3.2 billion and lowered full-year profit estimates by 1.5% to \$13.0 billion. Again, as of this writing, five firms with fiscal quarters ending in May showed divergent profitability trends from their previous quarter but with the exception of one firm's anomalous investment banking results, all were down substantially from their year-ago quarter ended May 2001. The outlook for both gross and net revenue growth are also muted, about 3% for the current quarter with slightly better growth later in 2002. Further, if a double dip recession should occur, prospects for securities industry profitability will be scant and protracted out to 2003-04. Both gross and net revenue will improve only marginally over the near-term with no meaningful gains expected until at least 4Q 2002. If economic conditions and investor sentiment continue to weaken, improvements in profitability will easily recede into late 2003-2004.

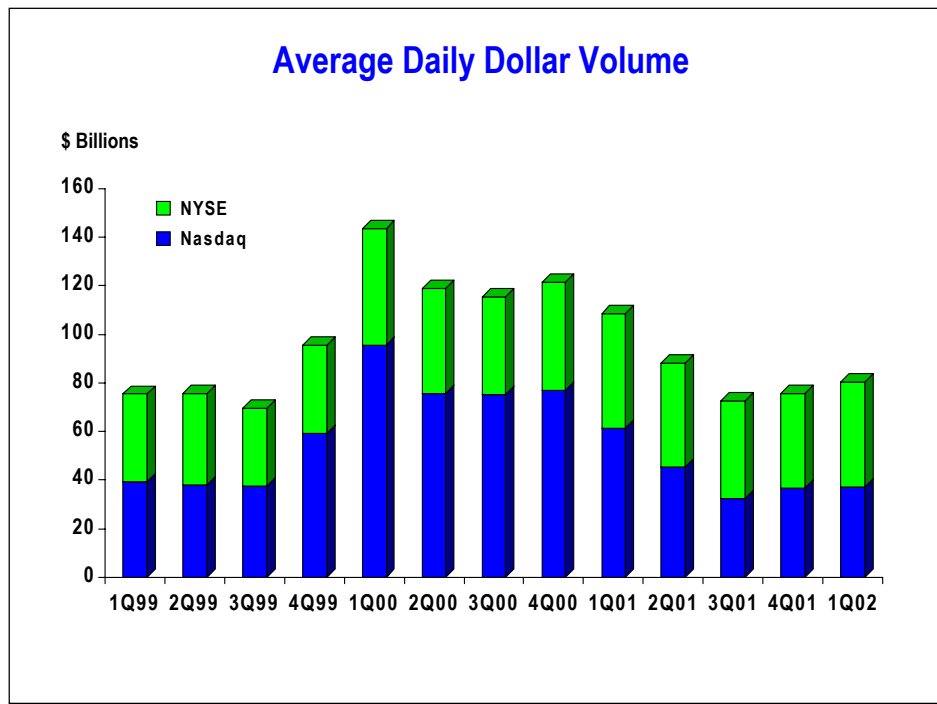




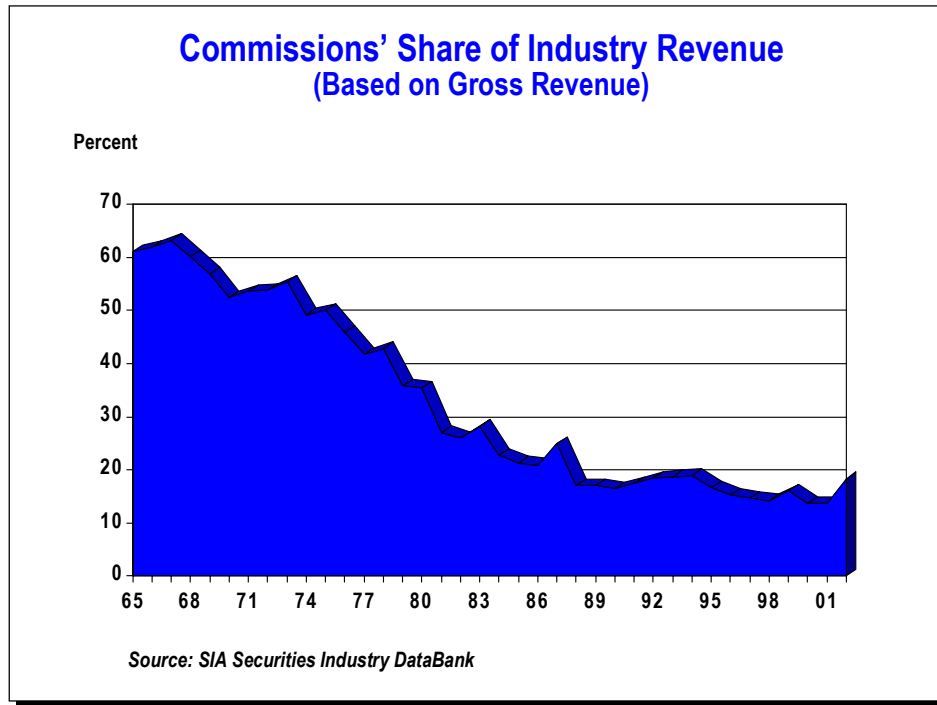
In just the short five quarters since the Fed began reducing interest rates in 1Q 2001, the brokerage industry's interest costs have been slashed by an incredible two-thirds; interest expense is now back to levels not seen in 26 quarters, 3Q 1995, although the industry's balance sheet is nearly three times larger than it was back then.



The flip side is that gross interest revenue has also fallen to modern day lows as well. For instance, even though margin debt balances finally stabilized late last year at 1999 levels (and down nearly 50% from its recent peak), the revenue from this lending continues to plummet due to low interest rates. With margin debt balances hovering around \$150 billion during the past nine months, quarterly margin interest revenue still plunged nearly 50% over the same time frame to \$1.7 billion in 1Q 2002. This is barely above one-quarter the quarterly revenues of two years ago, and the lowest showing in 24 quarters.



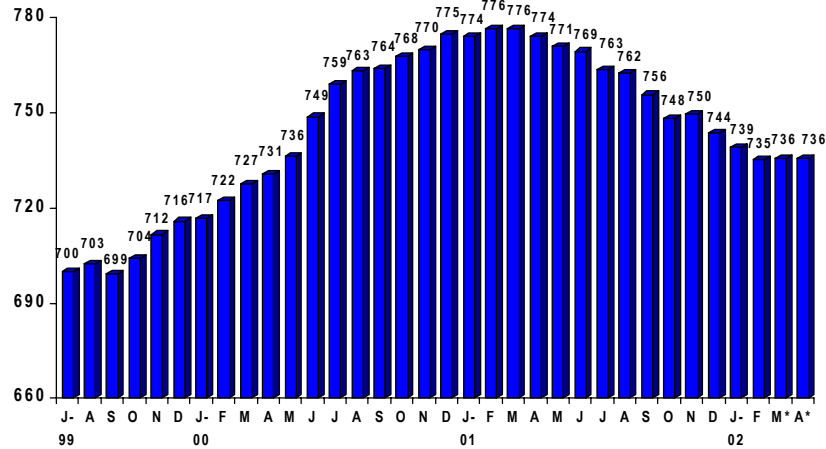
On other revenue fronts, first quarter 2002 commissions were up marginally from fourth quarter levels (6.5%) but down 6% from year-earlier levels. Although still underway, we are likely to see up to 20% growth in 2Q 2002 commissions but then suffer through the seasonal summer doldrums.



With revenues under continued pressure, the only area for profitability improvement, or mere maintenance, is cost cutting. With interest expense already slashed by more than half in two years time, little more can be expected here, particularly since the Fed will likely reverse this trend. Absent interest, compensation is still just over half of all non-interest expenses. Coming in at \$14.4 billion in 1Q 2002, this was a 4% increase over 4Q 2001's \$13.9 billion, was still 83% of year-earlier levels, and was a quite hefty 71% of peak compensation of \$20.2 set two years ago. Clearly, the 5% reduction in overall headcount on Wall Street since its peak last year now appears to be just a precursor of job cutting to come. All of the "easy," or least onerous, compensation cuts have been enacted in bonus reductions of over 50% and hiring freezes.

Monthly U.S. Securities Industry Employment

Thousands



*Preliminary

With little hope for any meaningful revenue improvement in the near-term, cost cutting will be the only area firms may now turn to for maintain what little profitability still exists today. This undoubtedly means resuming employment reductions for those firms that tried to maintain employee talent for the expected rebound which has yet to occur, and is now not likely to occur in any meaningful fashion for the near-term. Those firms that have already made deep cuts may have to cut deeper still. As of this writing, a few announcements and rumors to this effect were already surfacing.

George R. Monahan

Vice President and Director, Industry Studies

THE STUTTERING STATE OF THE ECONOMY¹

Introduction

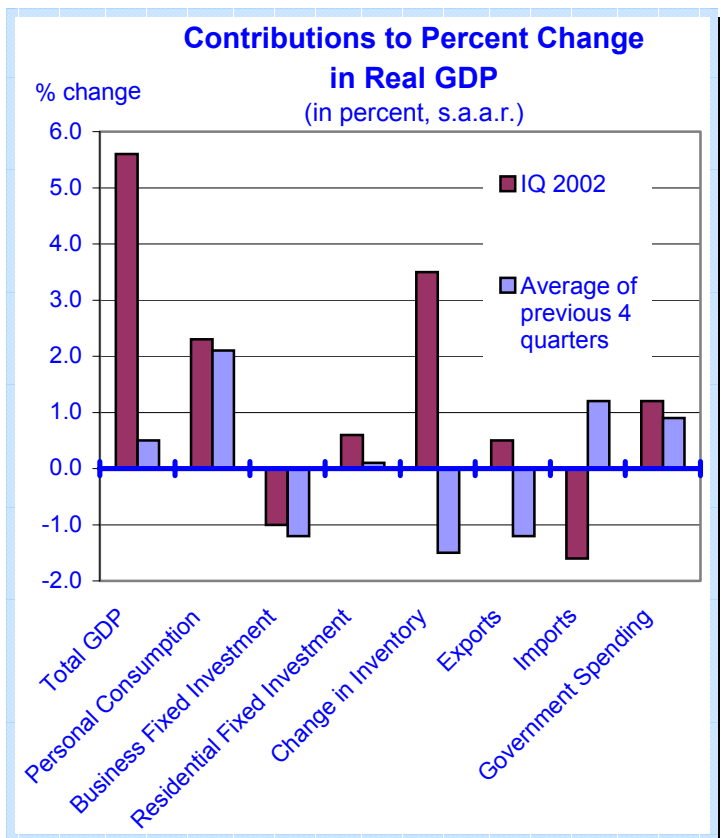
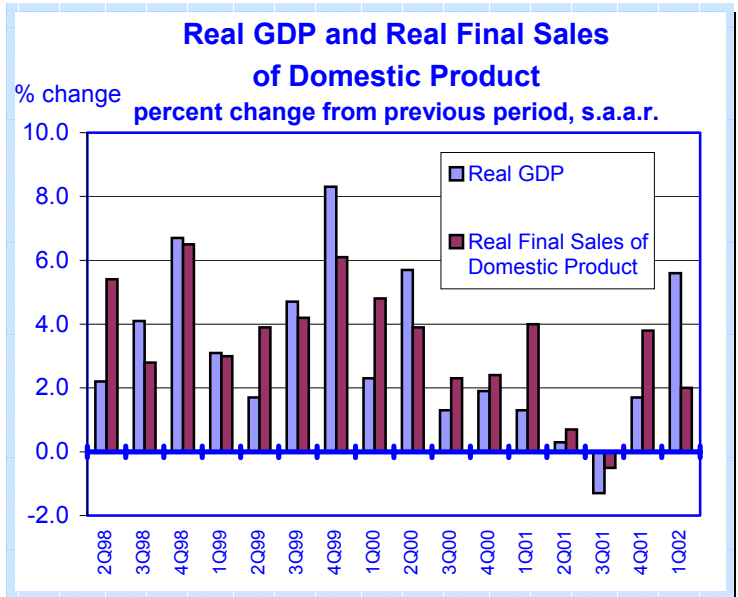
After a surprisingly brief and shallow recession, and an even more startling jump in growth in 1Q 2002, the prevailing view has been that the US economy has entered a sustainable, if subdued, recovery in activity. Optimism resumed as the consensus growth forecast was raised to 2.7% from 0.9% at the start of the year. However, the assumptions underlying this benign outlook appear increasingly tenuous. Mixed and weakening indicators are emerging across the course of 2Q 2002, and both investor and consumer sentiment slumped in May. A more conservative view is also warranted given the number of potential threats to the forecast. Below we present the consensus view as well as a more moderate, alternative view, highlighting both the existing risks to the forecast as well as potential “shocks” that could precipitate a more discontinuous adjustment of the structural imbalances that the recent short, mild recession failed to correct.

Recent Performance

Real gross domestic product (GDP) grew at an annual rate of 5.6% in the first quarter of 2002, largely due to a change in private inventories.² This inventory change accounted for 3.5 percentage points or nearly two-thirds of the overall real GDP growth in 1Q 2002. During 4Q 2001, inventory changes subtracted 2.2 percentage points, cutting real GDP growth to only 1.7%. **Real final sales of domestic product, which is GDP excluding the change in private inventories, increased only 2.0% in 1Q 2002, well below the 3.8% rise recorded in 4Q 2001, and this deceleration has continued in the current quarter.**

¹ Article based on speeches given by Frank Fernandez, SIA's Senior Vice President, Chief Economist and Director of Research, for the SIA Financial Management Division 9th Annual Regional Conference (Chicago, June 3, 2002) and the Credit Division Meeting (New York, May 16, 2002).

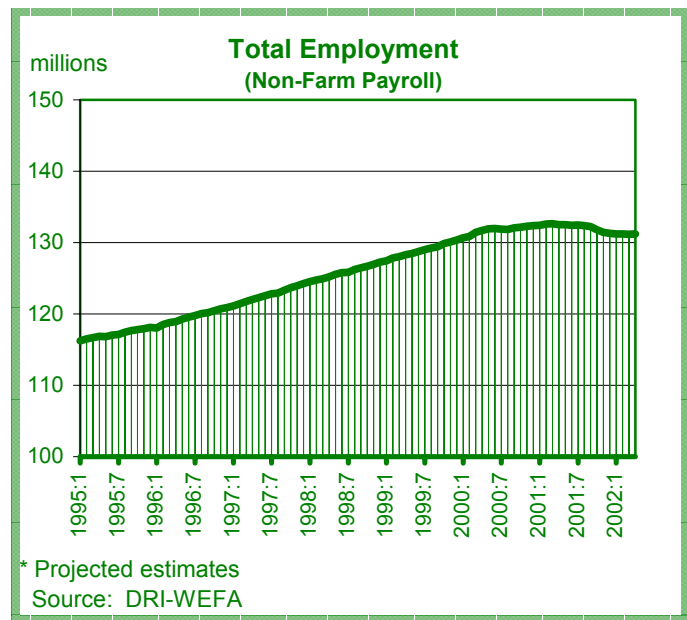
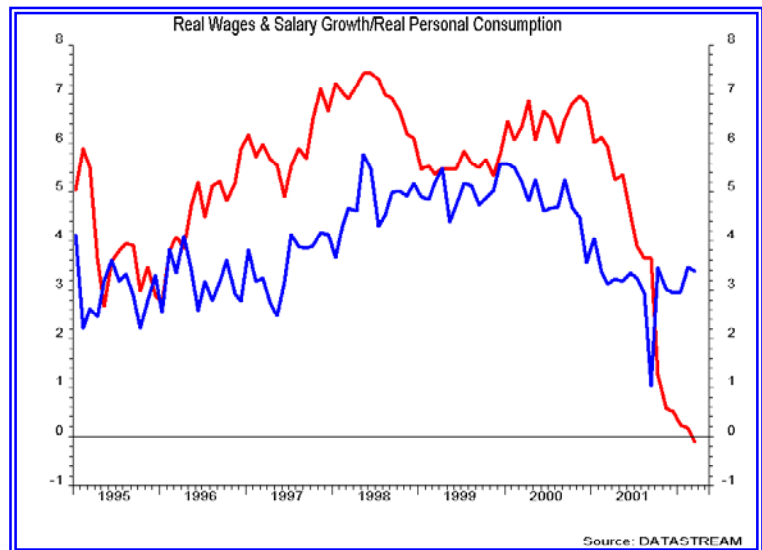
² Note: Quarterly figures are expressed at seasonally adjusted annual rates (s.a.a.r.), unless otherwise specified. “Real” figures are expressed in chained (1996) dollars.



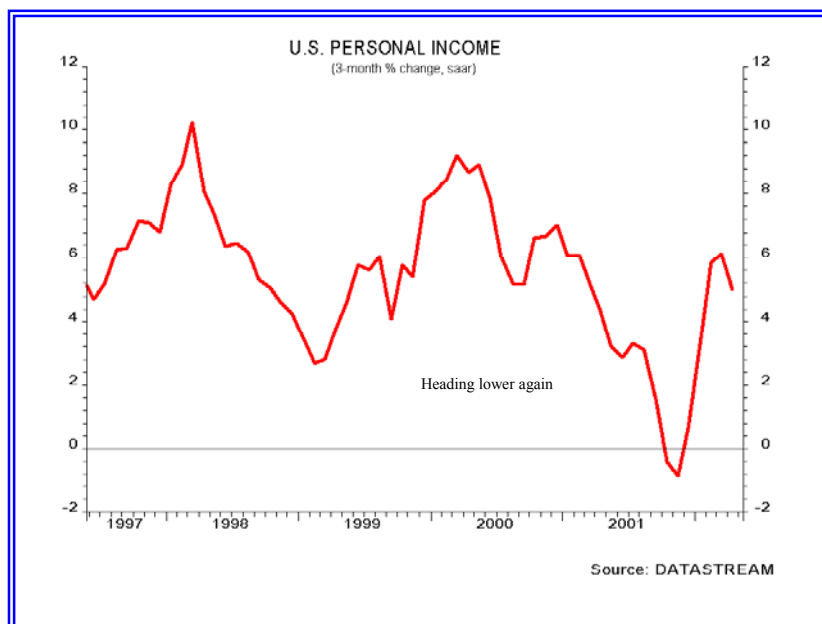
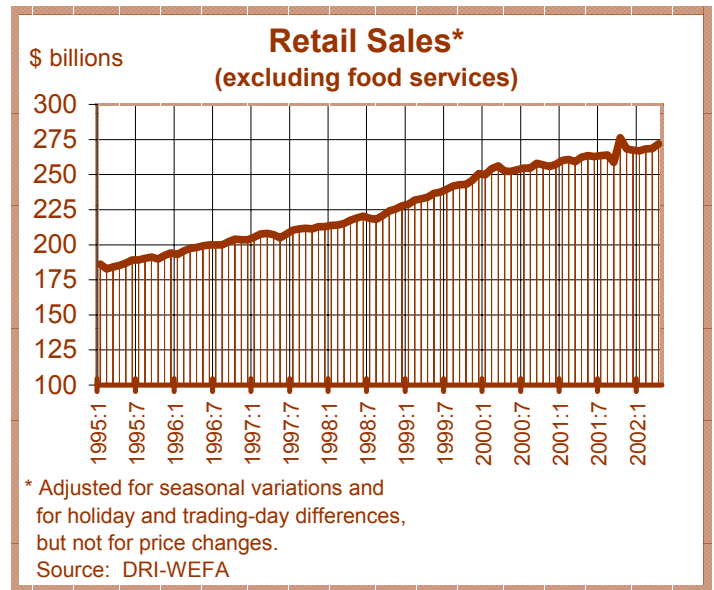
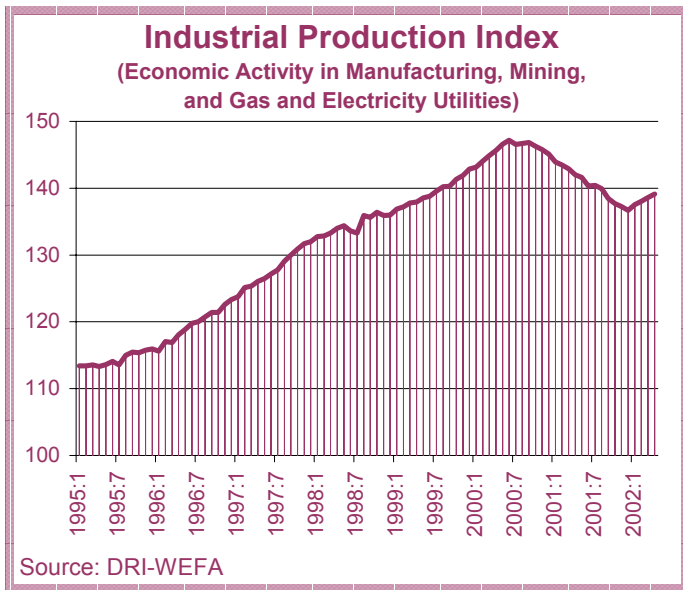
Upturns in exports and residential fixed investment contributed to growth in 1Q 2002, but were largely offset by slowing consumer spending growth and a sharp rise in imports. This pattern is continuing in the current quarter and, absent another large inventory adjustment, “headline” U.S. economic growth will be lower than in 1Q 2002 and below expectations. This is leading some forecasters to question the durability of a recovery based narrowly on home buying and consumer spending growth in excess of the rise in real income.

Encouraged by lax fiscal and monetary policy, overall consumer spending remained relatively strong, rising 3.2%, despite a decline on spending on durable goods. However, this was well off the extraordinary pace of 6.1% registered in 4Q 2001. Durable goods spending fell 9.6% in 1Q 2002, which was anticipated following a whopping 39.4% surge in the final quarter of 2001. Consumers also gave a boost to the economy through the housing sector, as residential private investment grew 14.6%, while non-residential private investment continued to decline, falling 2.3% in 1Q 2002.

While the National Bureau of Economic Research (NBER) has not yet marked the end of the latest recession (which “officially” began in March 2001) many analysts believe the recovery may have begun as early as December 2001. The NBER looks most closely at four monthly indicators of economic activity - employment, industrial production, real manufacturing and trade sales and real personal income (less transfers) - to determine the health of the economy.



Each of the four has rebounded from last year's declines and the latter two have surpassed previous peaks, meeting one of the criteria for declaring the recession over.



Conventional Wisdom: Why the Optimism?

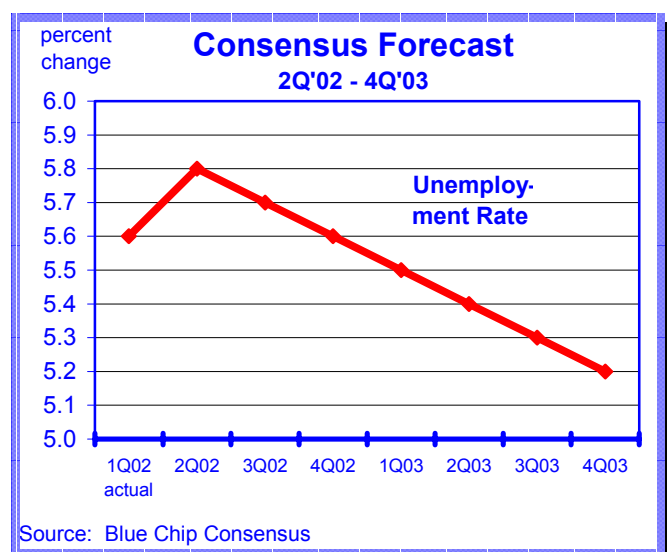
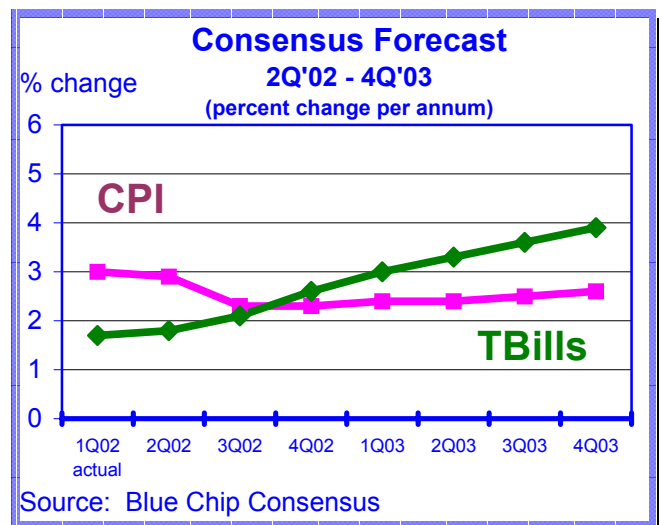
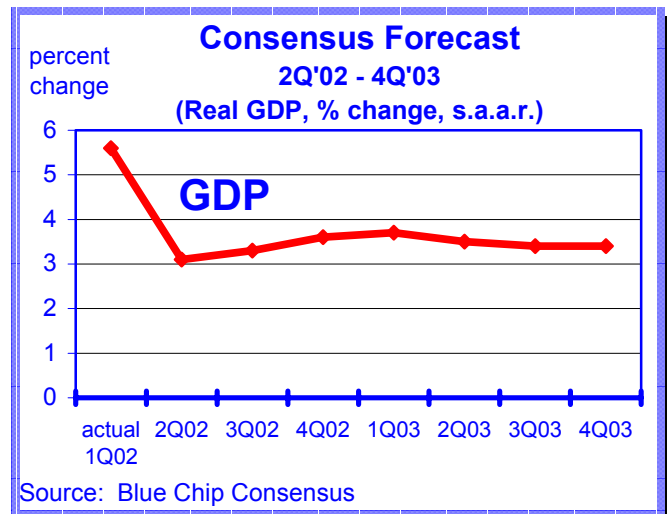
The “consensus” or “baseline” economic outlook foresees the recovery continuing at a stable, more moderate 3-3¼ % rate through end-year. Retail spending and housing are expected to continue to lead the rebound. Despite gathering signs that such a judgment may be premature as weakness in private sector final demand becomes more apparent, forecasters are still looking for a moderate recovery extending through the second half of 2002 and into 2003.

Growth is expected to slacken in the current quarter to roughly half the rate prevailing in 1Q 2002, before a slowly strengthening expansion ensues in the second half of the year and extends across the course of 2003, as business investment resumes. Threats to the forecast, while acknowledged, are not thought to be severe.

Higher import and energy prices are expected in the second half of this year, but will push general inflation only moderately higher. Higher interest rates are also not expected to pose much of a threat. Originally short-term interest rates, which had reached 40-year lows, were expected to begin rising earlier this year. This expectation was revised and revised again, and now only a quarter point rise in the Fed funds rate is anticipated before year-end. Equity markets, which are retesting last September’s lows, are forecast to remain range bound (if not move higher late this year) despite price/earnings multiples remaining near historic highs.

A recovery, albeit one that is relatively “jobless” and “profitless”, is expected to slowly strengthen. The strength of productivity gains in 1Q 2002 and the fact that productivity continued to grow during the recession (the first time that has occurred) have helped support this optimistic view as the benefits of a revolution in information and communications technology are expected to become even more widely disseminated.

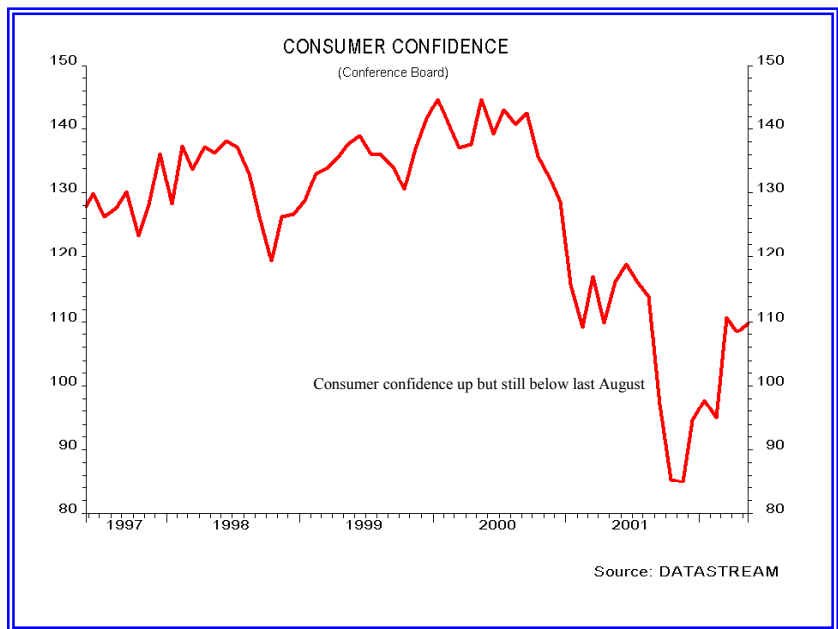
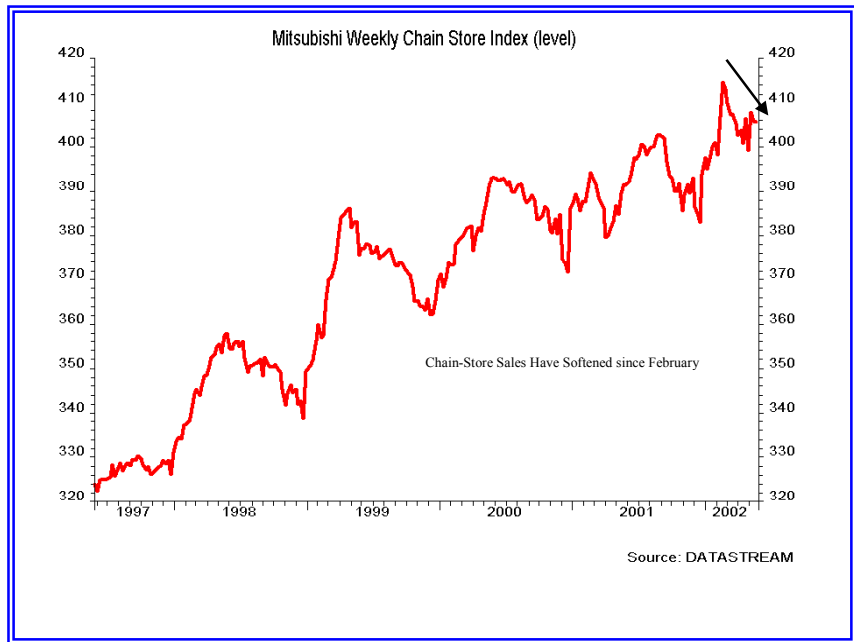
Justifiable reasons for this optimism include expectations that **surprisingly robust productivity growth** during the recent downturn, which jumped in 1Q 2002, **will continue for some time and might even accelerate further**. Rising productivity allows the economy to grow faster than its labor force, thereby potentially increasing both real personal income and corporate profitability. Lower mortgage rates in 2Q 2002 have boosted the housing sector and, along with a stable interest rate outlook, also support this optimism.



Alternative View: Practicing Prudence

The majority of forecasters continue to hold to this optimistic scenario despite:

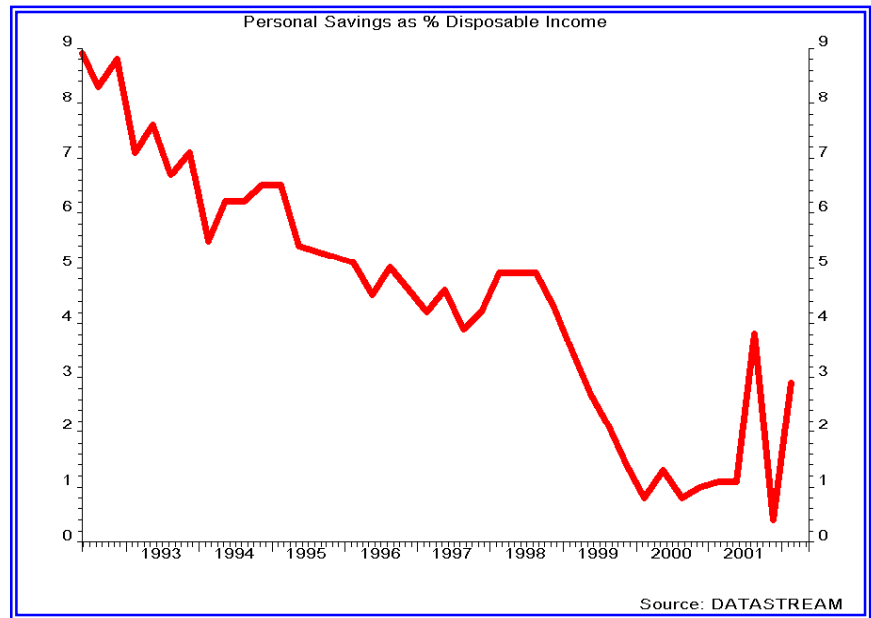
- **Revisions of past data**, such as those that accompanied the May employment report, that indicate that the impact of the recession is greater than previously thought;
- **Weaker-than-expected monthly figures emerging in 2Q 2002**, such as May retail sales figures and those found in the recent Beige Book. The latter report (an assessment of economic conditions reported by the 12 regional Federal Reserve Banks) showed less robust recovery than was believed in the previous report released on April 24;
- **A slump in consumer and investor sentiment** in recent weeks. Stock prices fell for the fourth consecutive week after the University of Michigan's consumer confidence index reading for June fell 6.3% from May levels, the steepest drop since the 9.7% plunge last September, and;
- **Persistent structural imbalances**, in particular on the foreign balance, the private savings balance and an emerging structural public sector deficit. The greatest danger posed by these macroeconomic imbalances is that their adjustment will be sudden and sharp; take for example the roughly 10% de-



cline in the value of the dollar from highs reached late last year. Although the dollar is now at two-year lows, by most measures it remains "overvalued". If the dollar's decline continues and accelerates, it could weaken growth prospects while a gradual adjustment might enhance them.

Investing can be seen as an exercise in risk management. Employing scenario analysis and “stress testing” by altering underlying assumptions are essential to that effort. SIA Research prepares alternative forecasts to assist state and local budget planning and strategic planning, and our view of the most likely scenario for the US economy is generally more conservative, or pessimistic, than the majority of forecasters.

Most economists still see little risk of a “double-dip” or “W-shaped” downturn that has characterized five of the last six US recessions, and

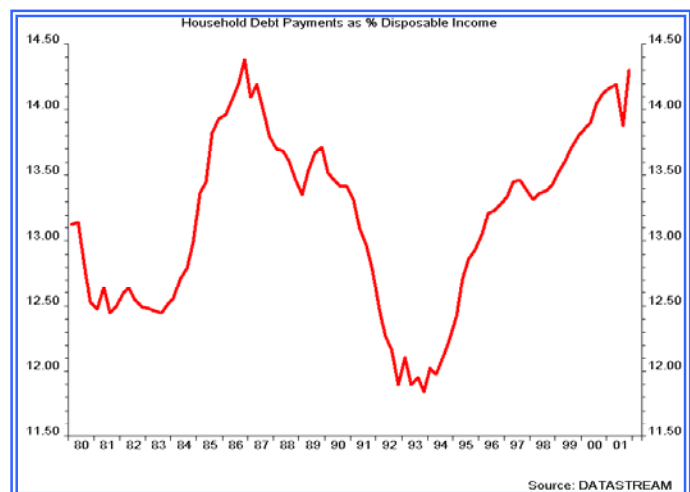
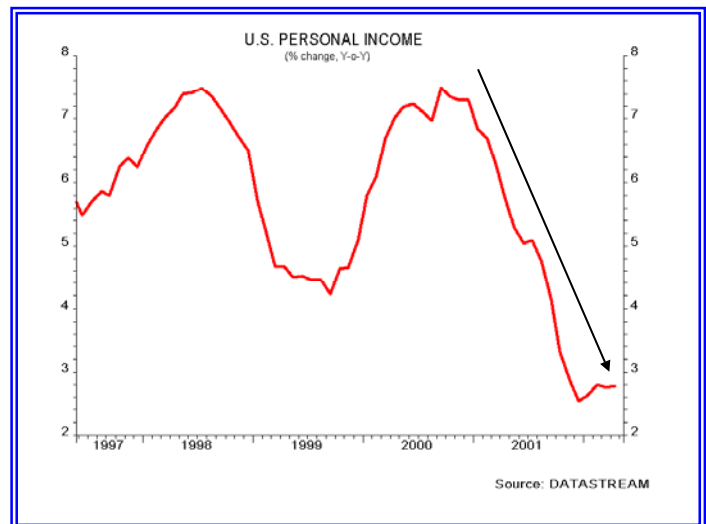
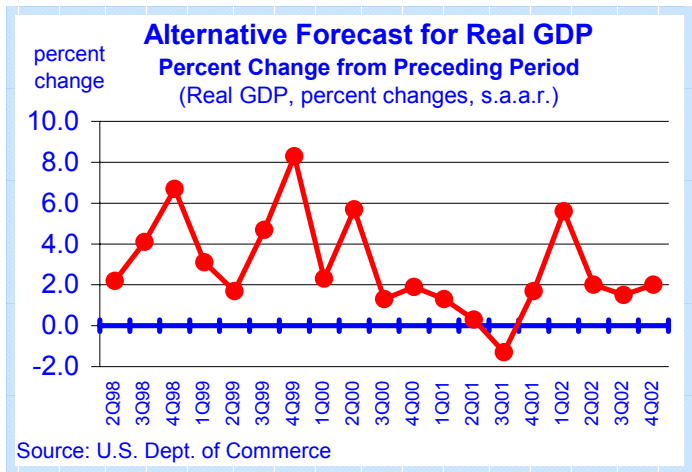


they may be correct. However, it would be prudent to consider a slower growth scenario: a summer swoon in economic activity followed by a stuttering, subdued recovery.

In this “alternative” scenario:

- **The recovery steadily weakens into the summer**, with real GDP growth slipping to 2% or less in 2Q-3Q 2002;
- **Corporate profits remain depressed.** Limited improvement in margins reflects cost cutting rather than revenue growth;
- **Consumer spending stagnates** as sentiment slumps. Real income growth falters, layoffs persist, housing prices soften and debt levels become more worrisome as defaults rise and/or credit is constrained. Negative wealth effects from the more than two year decline in financial asset values encourage more prudence in household budgeting;
- **Business investment remains weak** and largely focused on productivity enhancements/efficiency gains rather than expansion. Risk spreads rise and credit availability contracts;
- **Inflation rises slightly.** The inflationary impact of recent and expected declines in the dollar is largely offset by weak domestic demand, as producers fail to regain “pricing power”, and;
- Dollar weakness and more cautious consumers help major **macroeconomic imbalances gradually adjust.** Net exports rise (sizable deficits on the current account of the balance of payments begin to contract/ the use of foreign savings declines) and the household savings rate is lifted from historic lows. The sum of these two changes matches the magnitude of a sharp rise in public sector deficits.

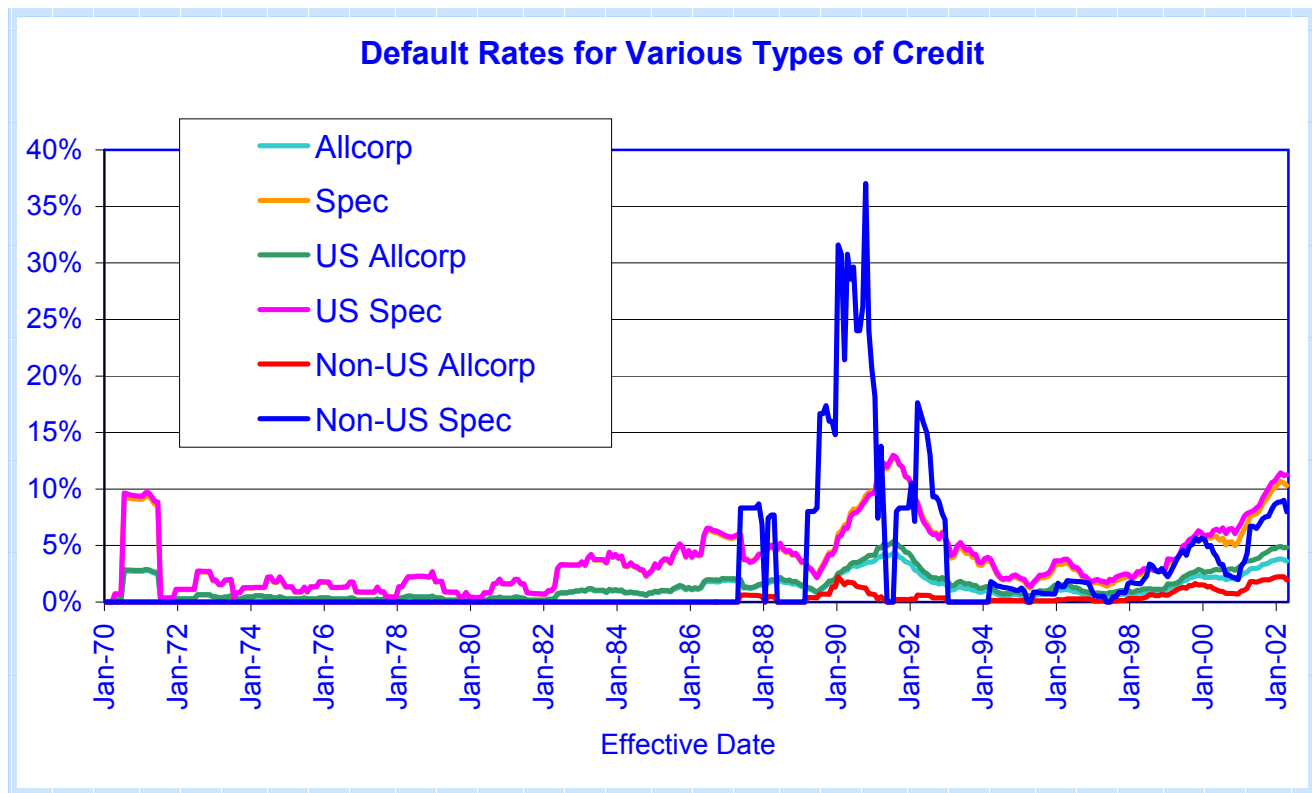
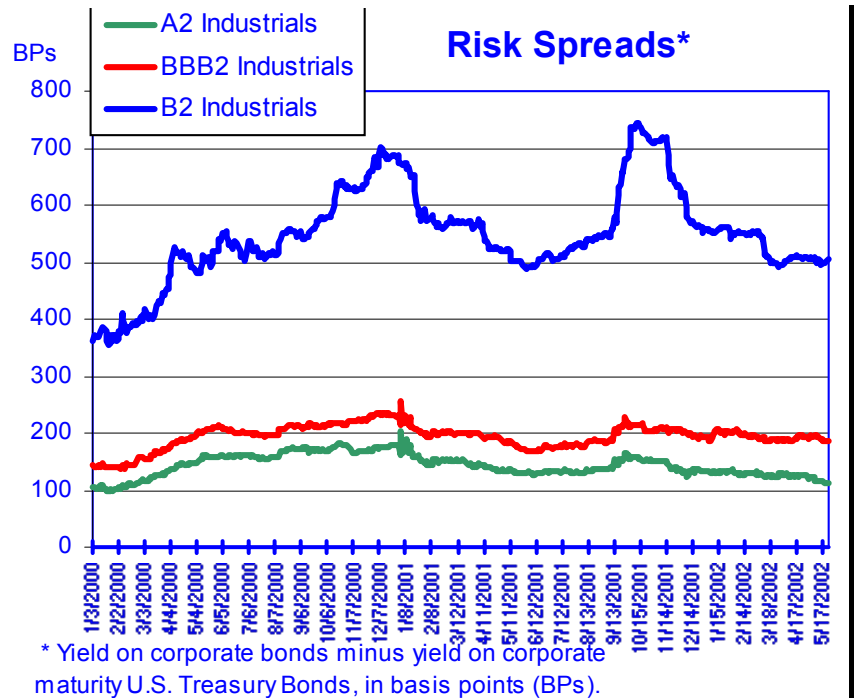
This alternative scenario, while less optimistic than the consensus, is still relatively favorable. An economic recovery continues, albeit at moribund pace, but there is little prospect for any significant upturn in US equity markets in 2002. Indeed, significant downside risks exist even before considering significant threats to the near term outlook.



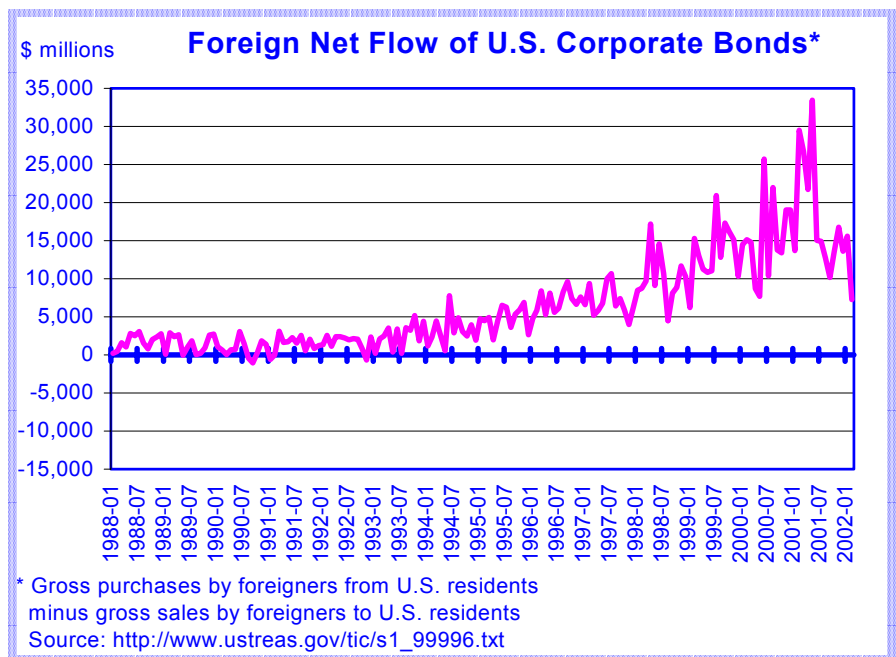
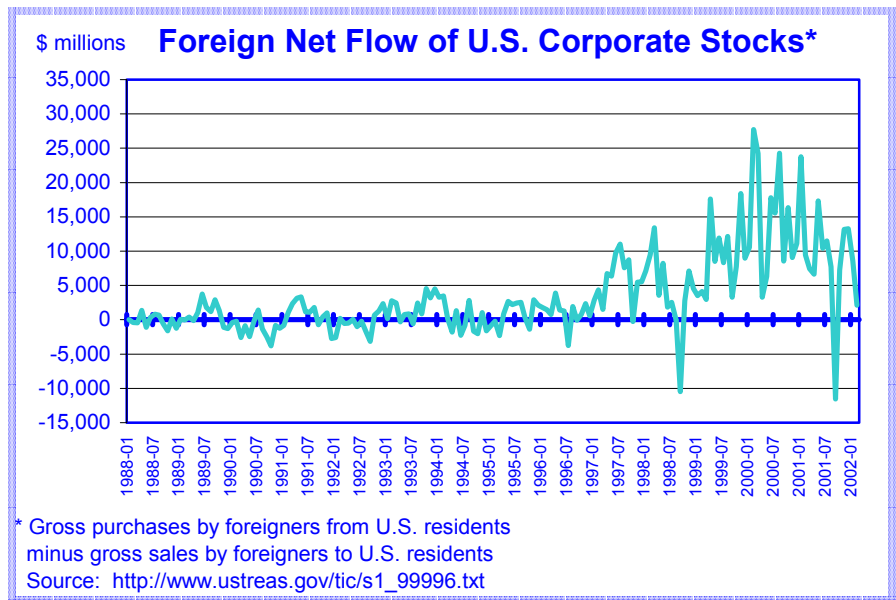
The Gathering Gloom: Moderate Threats to the Outlook

While optimists may be a happier lot, recently pessimists have been more often right. Any number of things could still go wrong. Moderate threats to the forecast include:

- **Renewed declines in corporate profits and substantial, ongoing restatement of past corporate financials** which undermines confidence and exacerbates valuations. Some estimates are that restatements of 2001 results alone will exceed \$100 billion;
- **A "cluster" of corporate bankruptcies and bond defaults**, both of which rose sharply in 1Q 2002, occurs. Downgrades of Collateralized Debt Obligations (CDOs) that contain defaulted corporate bonds prompt still greater risk aversion;



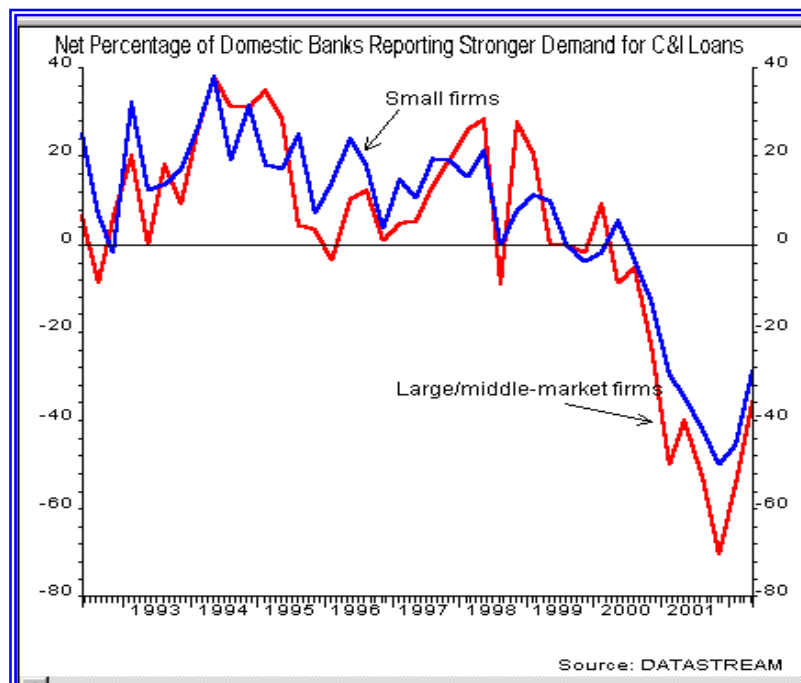
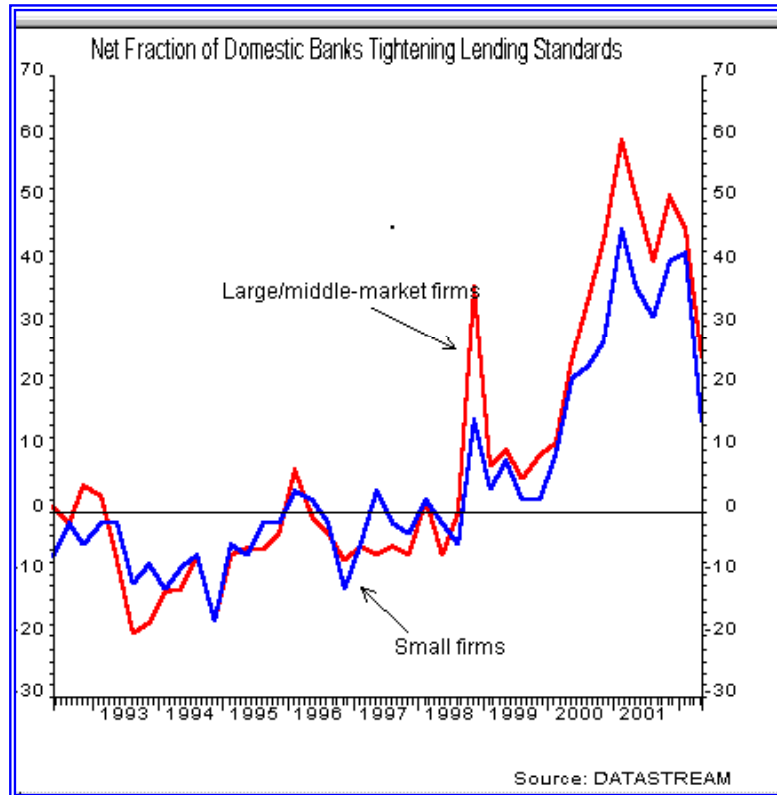
- **Credit losses**, particularly to “conservative” investors, leads to questioning of credit ratings and erosion of confidence in ratings agencies;
- **Consumer “retrenchment”**. Sentiment erodes unexpectedly and inventories rise again, further delaying a recovery in business investment;
- **Scandals further erode public trust and confidence**. Lack of faith in financial reporting, analysis, accounting and corporate ethics further reduces investor activity. This in turn constrains market liquidity, heightening volatility and depressing valuations;
- **Market flow declines as float rises**. Growth in equity market participation by both foreign and domestic investors (that peaked in late 1999) falters and net inflows of capital to the market turn negative, while the float (the number of shares freely available for purchase or sale) continues to increase. Foreign portfolio investors, particularly European financial institutions, who have been steady suppliers of capital to US equity markets, begin, in net terms, to withdraw funds as relative valuations and prospects look better at home. US retail investors continue to with-



draw funds, while credit losses reduce market-making activities and the capital assigned to proprietary books further;

- **Threat of a “credit crunch” becomes a self-fulfilling prophecy.** Earlier this year issuance of commercial paper to non-financial corporations plunged by more than a third. Reduced risk appetites are reflected in widening spreads and further declines in lending, exacerbating credit problems, and fueling defaults and bankruptcies. Some “gapping” occurs and talk of liquidity “black holes” prompts more herding behavior;
- **Supply and/or trade disruptions, sharply higher energy prices, and continued dollar declines resurrect threat of inflation.** Interest rates rise more than expected.

The realization of any one or some combination of these threats could derail the narrowly based recovery and prompt a renewed recession, as well as a continuing slide in financial valuations.



A Look At the Dark Side: Severe Threats to the Outlook

In assessing the risks they might confront, knowledgeable investors weigh the probabilities and possible effects of various “shocks” which could lead to market “breaks,” or sharp, discontinuous falls in asset prices. Sophisticated institutional investors perform “stress tests” of their risk management models by altering fundamental assumptions to reflect these potential negative events. Examining market behavior during earlier periods of financial stress or crises and “back testing” of models using historical information gives insight into what might happen in response to various unanticipated events.

This research has revealed a number of useful insights. Market participants exhibit increased herding behavior during such times, and gradual or continuous adjustments to drastically changed conditions are less likely to occur. More likely to occur are “punctuated equilibrium” conditions: a discontinuous or cascading fall in prices as risk “thresholds” are reached or exceeded. As risk tolerances are breached, investors seek safe havens and pull back or withdraw from participation in the markets en masse. It is believed that this is more likely to occur when investor and consumer confidence has been steadily eroded and market values have been in an extended decline, as is now the case.

Financial crises can be triggered by any number of events. When extreme events occur, different types of risk tend to become mutually reinforcing, compounding the impact of the original event and denigrating the value of various investment approaches, such as portfolio diversification strategies. This occurred in the fall of 1998, as sovereign risk and credit risk quickly translated into liquidity risk and market risk. It occurred again after last September 11, as business continuity interruptions and realized operational risk generated immediate market

and credit risk problems. One of the lessons learned from these severe crises is that consideration of “worse case” assumptions is critical, and that there is substantial value in disaster recovery and business continuity planning efforts.

Among the “dark scenarios” currently considered are:

- **New and wider wars.** While prospects for a conflict between Pakistan and India over Kashmir appears to be receding, prospects for US preemptive action against Iraq have not. A broadening Mid-East conflict remains a dire threat, while an expanding engagement in Central Asia is thought probable;
- **The next terrorist attack.** Cabinet level officials have publicly said that this is a “virtual certainty”. Planning now for this probability would mitigate its potential impact;
- **Falling world trade volume combined with a surge in protectionism** leads to further reduction in access to external financing to all but the most creditworthy international borrowers. This triggers a “wave” of sovereign defaults and domestic banking crises similar to the Asian “contagion” that swept financial markets in 1997-98;
- **A market “break”** occurs due to some other systemic shock. For example, the unanticipated failure of a major multinational corporation produces credit concerns so severe as to induce a market liquidity risk event.

While we pray none of these dire events come to pass, we believe it prudent to plan for the worst, while hoping for the best.

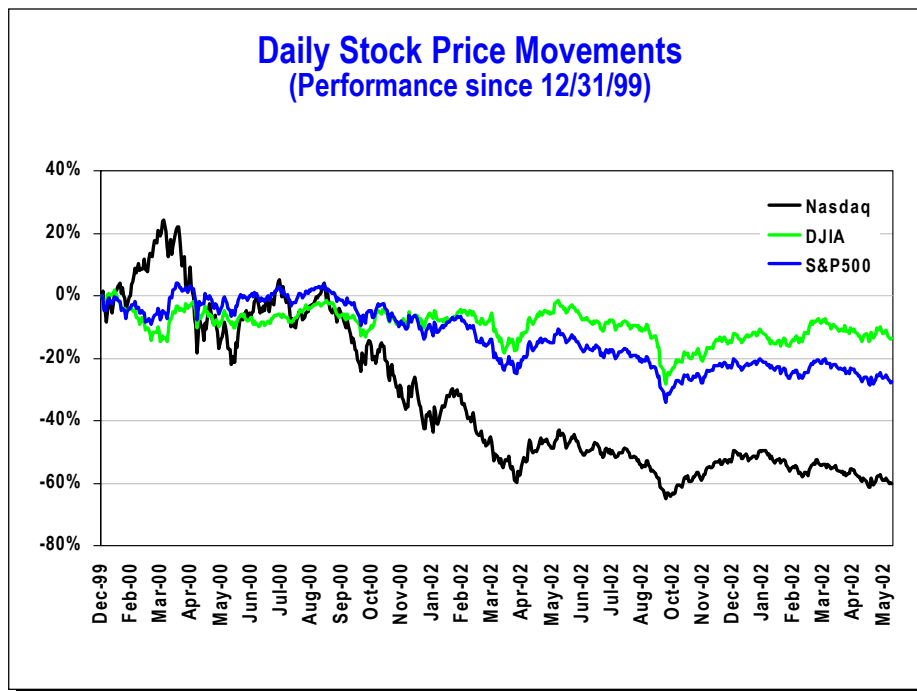
Frank A. Fernandez
*Senior Vice President, Chief Economist and
Director of Research*

MONTHLY STATISTICAL REVIEW

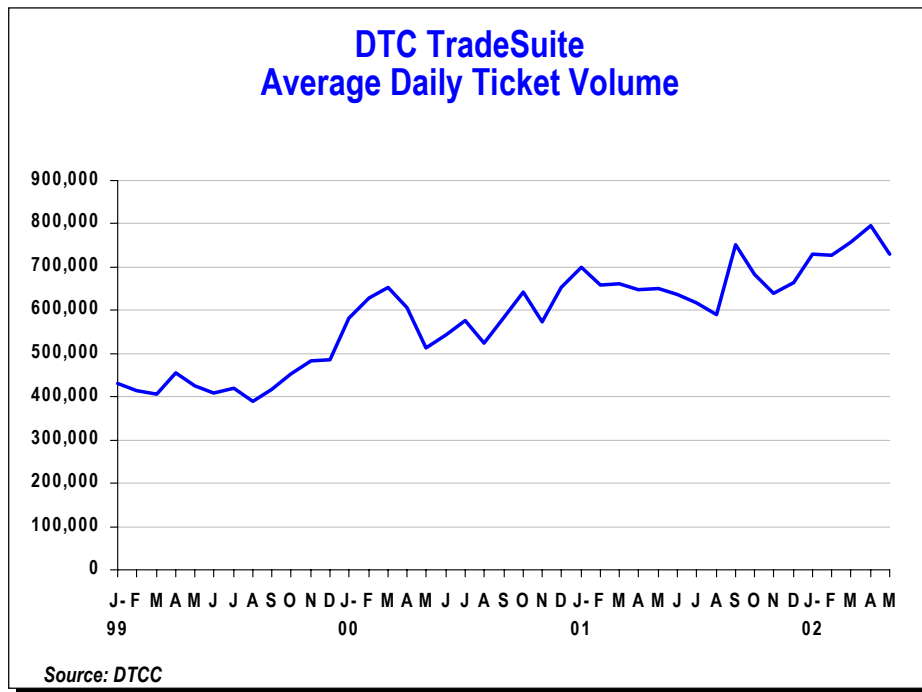
U.S. Equity Market Activity

Stock Prices – All major stock market barometers posted their second straight monthly losses in May. Continued weakness in the tech sector pushed the Nasdaq Composite Index to a seven-month low of 1573.82 on May 7th. The very next day, the index soared 7.8%, its eighth largest percent increase ever, triggered by better-than-expected profits posted by Cisco Systems and aided by short-covering and bargain-hunting. The rally was short-lived, however, as stock prices seesawed throughout the remainder of the month. Equity prices ended on a down note in May, as investors discounted some upbeat economic news, and instead focused on corporate misconduct, weakness in the tech sector, terrorist threats, rising tensions between India and Pakistan, and continued violence between Israel and the Palestinians.

For the month of May, the Nasdaq Composite Index dropped 4.3% and is down 17.2% so far this year. The S&P 500 lost 0.9% for the month and is off 7.1% for the year. Meanwhile, the Dow Jones Industrial Average edged down 0.2% in May, bringing its year-to-date decline to 1.0%.

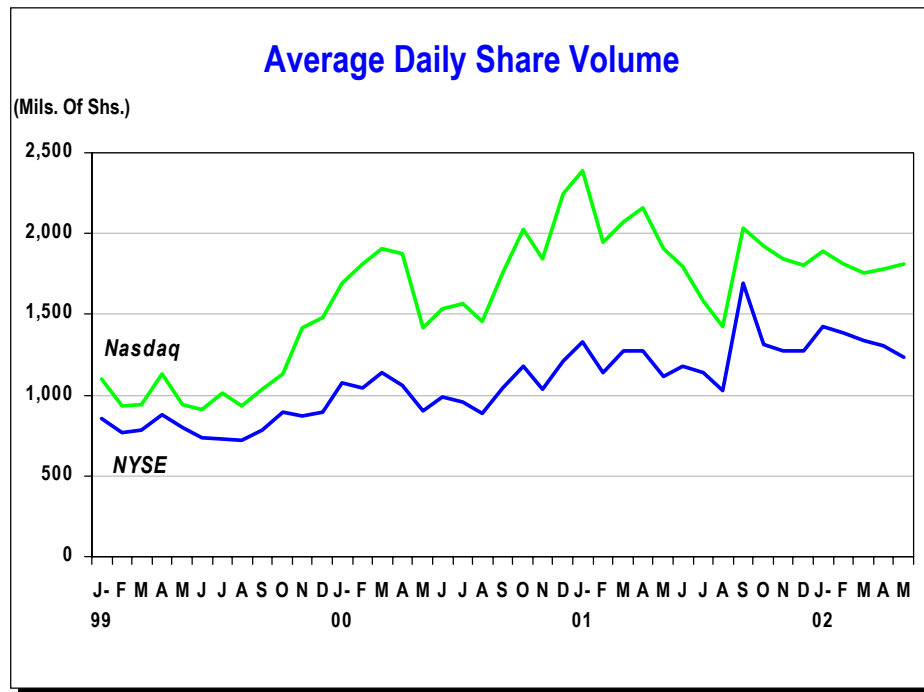


Trading Volume – May marked the first monthly decline in institutional trading so far in 2002. After climbing steadily through the first four months of the year to a record 795,621 trades per day in April, institutional trading activity fell back in May to 730,765 daily trades. Nevertheless, year-to-date, the number of institutional trades processed daily through DTC TradeSuite remains 14.0% ahead of the record annual level reached in 2001.



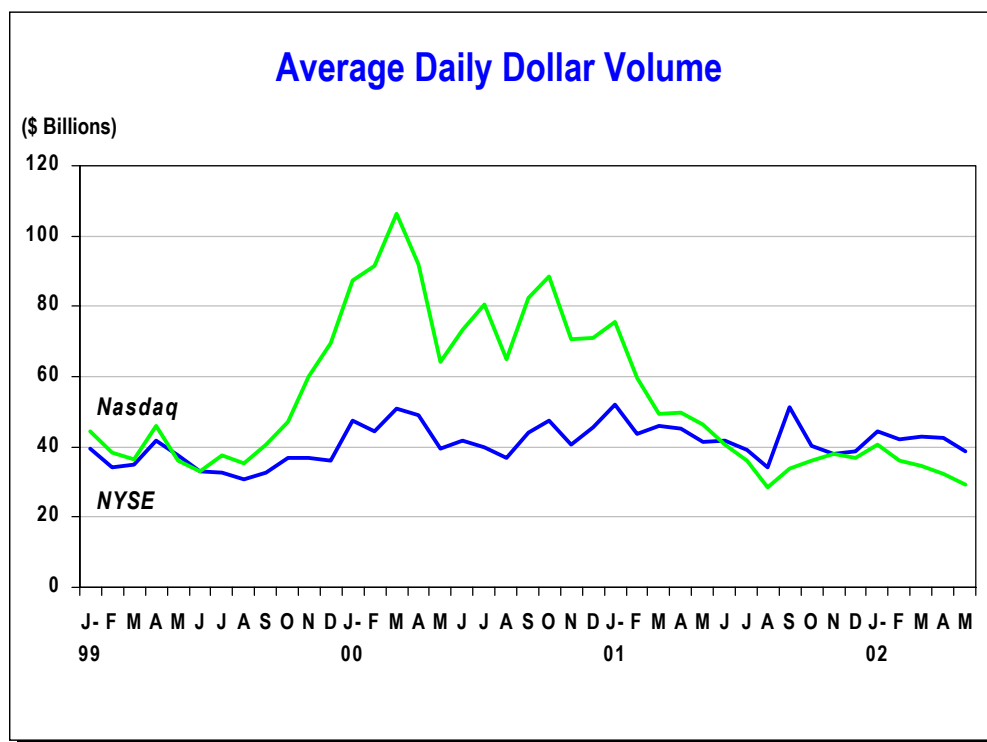
Share Volume – In May, average daily share volume on the NYSE slid to its lowest level in nine months as gloomy market conditions persisted. Since peaking at 1.43 billion shares daily in January 2002, NYSE volume has cascaded downward to 1.23 billion in May. Despite the slowdown in trading, the NYSE's average daily volume of 1.4 billion shares daily on a year-to-date basis is 7.7% higher than last year's annual record pace of 1.24 billion per day.

On Nasdaq, volume inched up for the second consecutive month, reaching 1.81 billion daily in May compared with 1.78 billion per day in April. However, Nasdaq volume year-to-date of 1.81 billion shares per day is still 4.8% short of the 1.9 billion daily record set last year.

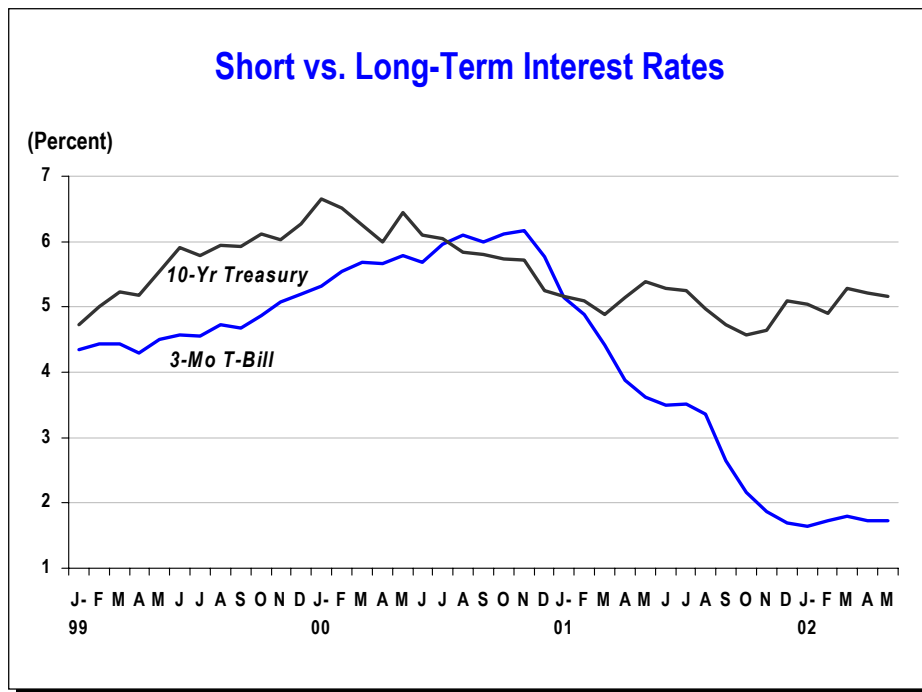


Dollar Volume – The dollar value of trading on the major stock exchanges fell to the lowest level of the year in May amid falling stock prices. Average daily dollar volume in Nasdaq stocks declined 8.4% from April's level to a nine-month low of \$29.4 billion in May. That dragged down the year-to-date average to \$34.4 billion daily, a 22.0% drop from 2001's \$44.1 billion daily average and less than half the record \$80.9 billion daily pace set in 2000.

Daily dollar volume on the NYSE slipped to a new 2002 monthly low of \$38.9 billion daily in May, an 8.2% decrease from the prior month. At \$42.1 billion daily year-to-date, dollar volume in NYSE stocks is now just shy of 2001's \$42.3 billion daily pace and trails the \$43.9 billion daily record set two years ago.

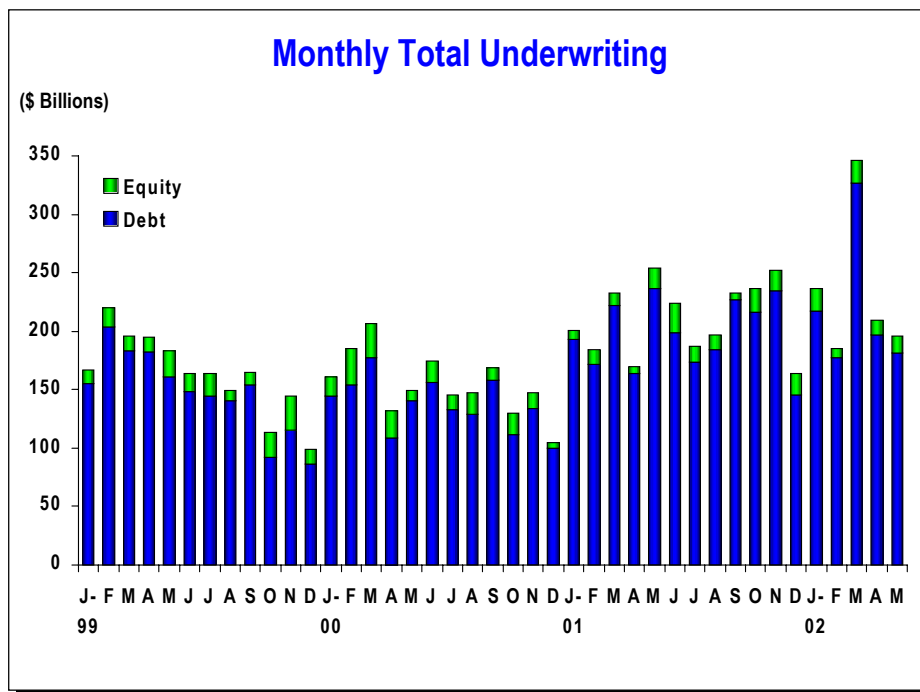


Interest Rates – Treasuries rallied in May as stock declines led nervous investors to embrace less risky government-backed securities. The benchmark 10-year Treasury bond yield, which moves inversely to price, fell to 5.16% in May, down 5 basis points (bps) from the previous month and 23 bps below where it stood a year ago. On the short-end, 3-month T-bills averaged 1.73% in May, just 1 bp above April's average but 189 bps below its year-earlier level in the early stages of the Fed's aggressive easing. As a result, the yield spread between the 10-year Treasury and the 3-month T-bill narrowed to 343 bps in May.

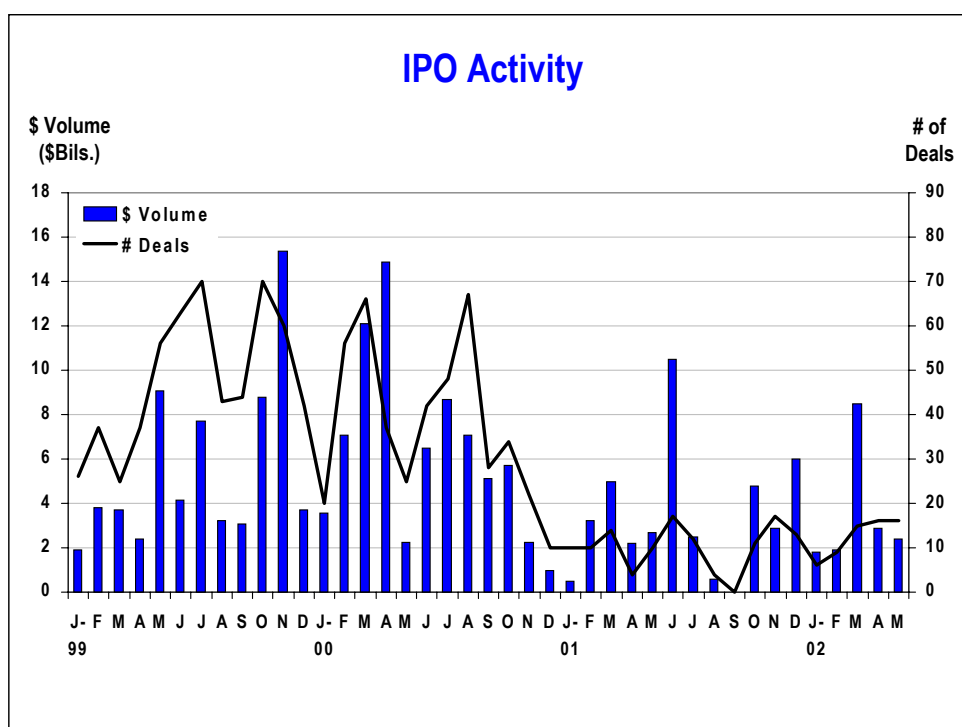


U.S. Underwriting Activity

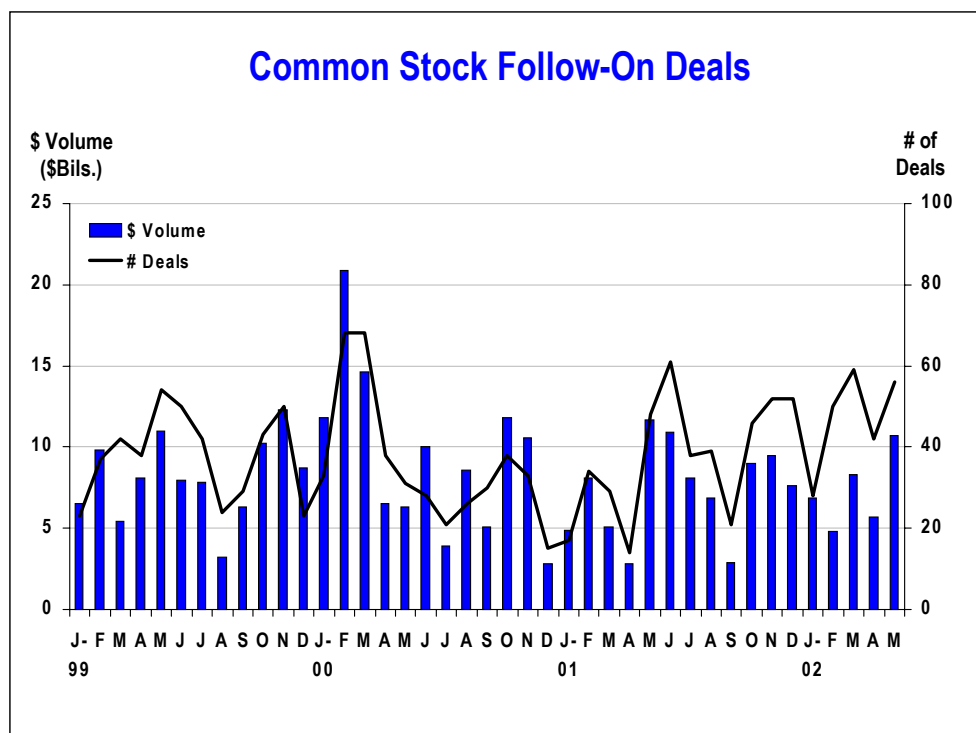
Total underwriting activity in the U.S. slowed in May primarily due to a cutback in debt offerings. Dollar proceeds fell 6.7% from April's level to \$195.5 billion in May, its lowest level in three months. Nevertheless, dollar volume is running 12.6% ahead of last year's pace, as issuance stood at \$1.2 trillion year-to-date compared with \$1.04 trillion in the same five-month period last year. However, the number of deals completed so far this year, at 5,306, is down 21.9% from the 6,795 deals offering during the same period last year.



Equity Underwriting – Dollar proceeds from IPOs (including closed-end funds) totaled \$2.4 billion in May, down 17.2% from \$2.9 billion in April. Through the first five months of 2002, IPO proceeds totaled \$17.4 billion, representing a 29.6% increase over the \$13.5 billion raised in last year's comparable period. It should be remembered, though, that just two mega-deals alone in March (totaling \$6.2 billion) accounted for over one-third of the total amount raised via IPOs so far this year.



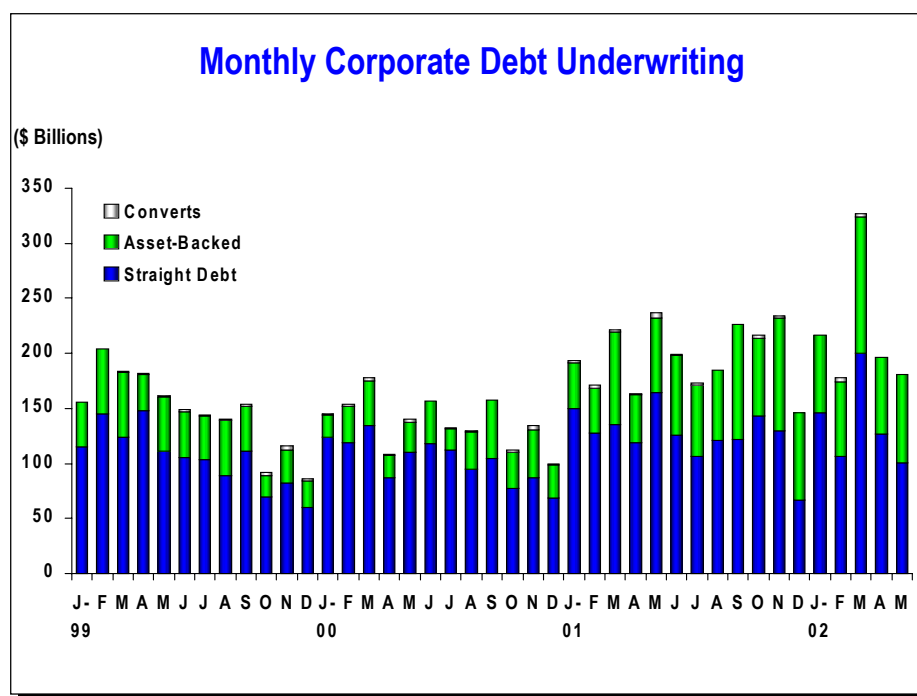
Follow-on common stock offerings have been popular this year as investors turn to companies with established track records instead of unseasoned IPOs. In May, follow-on volume climbed to a 2002 monthly high of \$10.7 billion, up from \$5.7 billion in April. Lifting May's total was Accenture's \$1.87 billion deal on May 16, the second largest so far this year behind the June 5th follow-on offering by AT&T Corp. which raised \$2.25 billion. Follow-on volume year-to-date through May, at \$36.3 billion, is up 11.0% from the same period last year.



Corporate Bond Underwriting – New issuance of corporate debt securities slipped 8.0% to \$181.0 billion in May from \$196.7 billion in April. Still, the amount of corporate debt deals underwritten so far this year, at \$1.1 trillion, is up 11.5% from the \$986 billion issued during the same period last year.

Straight corporate bond issuance, which surged to a record \$200.4 billion in March, has fallen off during the ensuing two months to a 2002 yearly low of \$100.1 billion in May. That brought the year-to-date total to \$679.7 billion, just short of the \$696.8 billion raised in last year's comparable period.

Proceeds from asset-backed bond offerings rebounded to \$80.7 billion in May, a 15.9% increase from the \$69.6 billion raised in April. Year-to-date dollar volume of \$412.3 billion is up 49.4% from where it stood a year ago.



Grace Toto

Assistant Vice President and Director, Statistics

U.S. CORPORATE UNDERWRITING ACTIVITY

(In \$ Billions)

	Straight Corporate Debt	Con- vertible Debt	Asset- Backed Debt	TOTAL DEBT	High- Yield Bonds	Common Stock	Preferred Stock	TOTAL EQUITY	All IPOs	Follow-Ons	TOTAL UNDER- WRITINGS
1985	76.4	7.5	20.8	104.7	14.2	24.7	8.6	33.3	8.5	16.2	138.0
1986	149.8	10.1	67.8	227.7	31.9	43.2	13.9	57.1	22.3	20.9	284.8
1987	117.8	9.9	91.7	219.4	28.1	41.5	11.4	52.9	24.0	17.5	272.3
1988	120.3	3.1	113.8	237.2	27.7	29.7	7.6	37.3	23.6	6.1	274.5
1989	134.1	5.5	135.3	274.9	25.3	22.9	7.7	30.6	13.7	9.2	305.5
1990	107.7	4.7	176.1	288.4	1.4	19.2	4.7	23.9	10.1	9.0	312.3
1991	203.6	7.8	300.0	511.5	10.0	56.0	19.9	75.9	25.1	30.9	587.4
1992	319.8	7.1	427.0	753.8	37.8	72.5	29.3	101.8	39.6	32.9	855.7
1993	448.4	9.3	474.8	932.5	55.2	102.4	28.4	130.8	57.4	45.0	1,063.4
1994	381.2	4.8	253.5	639.5	33.3	61.4	15.5	76.9	33.7	27.7	716.4
1995	466.0	6.9	152.4	625.3	28.9	82.0	15.1	97.1	30.2	51.8	722.4
1996	564.8	9.3	252.9	827.0	37.2	115.5	36.5	151.9	50.0	65.5	979.0
1997	769.8	8.5	385.6	1,163.9	31.4	120.2	33.3	153.4	44.2	75.9	1,317.3
1998	1,142.5	6.3	566.8	1,715.6	42.9	115.0	37.8	152.7	43.7	71.2	1,868.3
1999	1,264.8	16.1	487.1	1,768.0	36.6	164.3	27.5	191.7	66.8	97.5	1,959.8
2000	1,236.2	17.0	393.4	1,646.6	25.2	189.1	15.4	204.5	76.1	112.9	1,851.0
2001	1,511.2	21.6	832.5	2,365.4	30.6	128.4	41.3	169.7	40.8	87.6	2,535.1
<u>2001</u>											
Jan	149.6	1.7	41.7	193.0	5.9	5.4	2.7	8.1	0.5	4.9	201.1
Feb	127.5	3.3	40.5	171.3	4.1	11.3	1.5	12.8	3.2	8.1	184.1
Mar	135.5	2.3	83.8	221.6	1.3	10.1	1.4	11.5	5.0	5.1	233.1
Apr	119.3	1.1	42.9	163.4	3.1	5.0	1.5	6.5	2.2	2.8	169.9
May	164.8	4.8	67.0	236.6	3.1	14.4	3.3	17.8	2.7	11.7	254.4
June	126.1	1.0	71.9	199.0	3.6	21.4	3.5	24.9	10.5	10.9	223.8
July	106.8	2.6	63.9	173.3	0.2	10.6	3.3	13.9	2.5	8.1	187.2
Aug	121.2	0.2	63.0	184.4	2.7	7.6	4.7	12.3	0.6	6.9	196.7
Sept	121.8	0.0	104.6	226.5	0.2	2.9	3.4	6.3	0.0	2.9	232.8
Oct	142.8	2.7	70.8	216.4	1.9	13.7	6.7	20.4	4.8	9.0	236.8
Nov	129.3	1.9	102.9	234.2	3.1	12.4	5.2	17.6	2.9	9.5	251.8
Dec	66.4	0.0	79.4	145.8	1.4	13.6	4.1	17.7	6.0	7.6	163.4
<u>2002</u>											
Jan	145.9	0.2	70.7	216.9	4.8	8.6	10.8	19.4	1.8	6.9	236.3
Feb	106.1	3.8	67.7	177.6	1.2	6.7	1.2	7.9	1.9	4.8	185.5
Mar	200.4	3.2	123.5	327.1	4.5	16.8	2.7	19.5	8.5	8.3	346.6
Apr	127.1	0.0	69.6	196.7	2.6	8.6	4.3	12.8	2.9	5.7	209.5
May	100.1	0.1	80.7	181.0	0.5	13.1	1.5	14.5	2.4	10.7	195.5
June											
July											
Aug											
Sept											
Oct											
Nov											
Dec											
YTD '01	696.8	13.3	275.9	986.0	17.4	46.2	10.4	56.6	13.5	32.7	1,042.6
YTD '02	679.7	7.3	412.3	1,099.3	13.6	53.7	20.4	74.2	17.4	36.3	1,173.4
% Change	-2.4%	-45.0%	49.4%	11.5%	-21.7%	16.4%	96.1%	31.1%	29.6%	11.0%	12.6%

Note: High-yield bonds is a subset of straight corporate debt. IPOs and follow-ons are subsets of common stock.

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
<u>2001</u>										
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
<u>2002</u>										
Jan	1.1	12.2	13.3	4.3	3.8	8.1	21.4	1.65	5.04	3.39
Feb	1.5	10.4	11.9	4.9	3.9	8.8	20.7	1.73	4.91	3.18
Mar	1.7	12.8	14.4	5.0	5.5	10.5	24.9	1.79	5.28	3.49
Apr	2.3	14.0	16.3	4.4	3.8	8.2	24.5	1.72	5.21	3.49
May	2.4	19.3	21.7	4.0	6.3	10.3	32.0	1.73	5.16	3.43
June										
July										
Aug										
Sept										
Oct										
Nov										
Dec										
YTD '01	5.4	60.4	65.8	19.7	20.1	39.8	105.6	4.39	5.14	0.75
YTD '02	8.9	68.7	77.5	22.6	23.3	45.9	123.5	1.72	5.12	3.40
% Change	62.5%	13.8%	17.8%	14.8%	15.9%	15.3%	16.9%	-60.7%	-0.3%	354.0%

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
2001R	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	1,808.3	38.9	29.4
June									
July									
Aug									
Sept									
Oct									
Nov									
Dec									
YTD '01	10,911.94	1,255.82	641.67	2,110.49	1,226.4	74.2	2,095.8	45.7	55.9
YTD '02	9,925.25	1,067.14	570.78	1,615.73	1,335.1	57.3	1,809.3	42.1	34.4
% Change	-9.0%	-15.0%	-11.0%	-23.4%	8.9%	-22.8%	-13.7%	-7.8%	-38.4%

MUTUAL FUND ASSETS

(\$ Billions)

MUTUAL FUND NET NEW CASH FLOW*

(\$ Billions)

	Equity	Hybrid	Bond	Money Market	TOTAL ASSETS	Equity	Hybrid	Bond	Money Market	TOTAL	Total Long- Term Funds
1985	116.9	12.0	122.6	243.8	495.4	8.5	1.9	63.2	-5.4	68.2	73.6
1986	161.4	18.8	243.3	292.2	715.7	21.7	5.6	102.6	33.9	163.8	129.9
1987	180.5	24.2	248.4	316.1	769.2	19.0	4.0	6.8	10.2	40.0	29.8
1988	194.7	21.1	255.7	338.0	809.4	-16.1	-2.5	-4.5	0.1	-23.0	-23.1
1989	248.8	31.8	271.9	428.1	980.7	5.8	4.2	-1.2	64.1	72.8	8.8
1990	239.5	36.1	291.3	498.3	1,065.2	12.8	2.2	6.2	23.2	44.4	21.2
1991	404.7	52.2	393.8	542.5	1,393.2	39.4	8.0	58.9	5.5	111.8	106.3
1992	514.1	78.0	504.2	546.2	1,642.5	78.9	21.8	71.0	-16.3	155.4	171.7
1993	740.7	144.5	619.5	565.3	2,070.0	129.4	39.4	73.3	-14.1	228.0	242.1
1994	852.8	164.5	527.1	611.0	2,155.4	118.9	20.9	-64.6	8.8	84.1	75.2
1995	1,249.1	210.5	598.9	753.0	2,811.5	127.6	5.3	-10.5	89.4	211.8	122.4
1996	1,726.1	252.9	645.4	901.8	3,526.3	216.9	12.3	2.8	89.4	321.3	232.0
1997	2,368.0	317.1	724.2	1,058.9	4,468.2	227.1	16.5	28.4	102.1	374.1	272.0
1998	2,978.2	364.7	830.6	1,351.7	5,525.2	157.0	10.2	74.6	235.3	477.1	241.8
1999	4,041.9	383.2	808.1	1,613.1	6,846.3	187.7	-12.4	-5.5	193.6	363.4	169.8
2000	3,962.0	346.3	811.1	1,845.2	6,964.7	309.4	-30.7	-49.8	159.6	388.6	228.9
2001R	3,418.2	346.3	925.1	2,285.3	6,975.0	32.2	9.5	87.8	375.3	504.8	129.6
<u>2001</u>											
Jan	4,093.5	354.9	833.3	1,954.8	7,236.5	24.9	2.5	9.0	103.5	139.9	36.4
Feb	3,688.9	344.9	844.5	2,018.7	6,897.0	-3.3	1.3	8.9	58.2	65.1	6.8
Mar	3,402.9	333.7	852.1	2,035.5	6,624.2	-20.7	-0.4	7.7	13.7	0.4	-13.3
Apr	3,715.7	348.0	846.0	2,031.5	6,941.2	19.1	1.2	1.4	-10.5	11.2	21.7
May	3,744.6	352.6	858.4	2,070.9	7,026.5	18.4	0.9	6.3	34.3	59.8	25.6
June	3,677.2	349.9	860.8	2,052.5	6,940.4	10.9	1.2	2.3	-24.2	-9.8	14.3
July	3,589.3	351.7	882.3	2,069.8	6,893.1	-1.3	1.3	9.3	12.2	21.5	9.3
Aug	3,382.7	342.6	908.3	2,104.3	6,737.9	-5.0	-0.7	16.7	26.1	37.2	11.0
Sept	3,018.9	324.1	909.6	2,161.7	6,414.3	-30.0	-1.3	7.7	52.9	29.3	-23.6
Oct	3,111.2	330.3	935.2	2,239.7	6,616.4	0.9	1.6	13.6	74.2	90.2	16.0
Nov	3,348.6	343.0	934.1	2,306.5	6,932.2	15.3	1.0	6.9	60.3	83.5	23.2
Dec	3,418.2	346.3	925.1	2,285.3	6,975.0	2.9	1.0	-1.9	-25.4	-23.3	2.1
<u>2002</u>											
Jan	3,373.5	347.2	947.0	2,303.5	6,971.2	20.0	2.2	10.5	14.0	46.7	32.7
Feb	3,312.0	348.4	962.7	2,301.2	6,924.3	5.4	2.3	10.7	-5.5	12.9	18.4
Mar	3,497.4	359.2	958.4	2,247.2	7,062.2	29.6	3.3	6.7	-53.1	-13.4	39.7
Apr	3,368.8	354.4	980.4	2,230.9	6,934.5	11.8	3.2	7.8	-19.6	3.2	22.7
May											
June											
July											
Aug											
Sept											
Oct											
Nov											
Dec											
YTD '01	3,715.7	348.0	846.0	2,031.5	6,941.2	20.1	4.6	27.0	164.9	216.5	51.6
YTD '02	3,368.8	354.4	980.4	2,230.9	6,934.5	66.8	11.0	35.7	-64.2	49.3	113.5
% Change	-9.3%	1.8%	15.9%	9.8%	-0.1%	232.9%	139.7%	32.4%	-138.9%	-77.2%	119.9%

* New sales (excluding reinvested dividends) minus redemptions, combined with net exchanges

Source: Investment Company Institute



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