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SIA UPDATE AND OUTLOOK

Frank A. Fernandez

This report provides an update of recent performance and an outlook for the U.S. securities industry, along with alternative forecasts for U.S. financial markets and the U.S. economy, which drive prospects for the securities industry. Not surprisingly, near term forecasts are proving especially difficult, reflecting a long litany of uncertainties, including the impact of war, the ongoing terrorist threat and persistent weaknesses in the U.S. economy that are expected to retard growth, at least through the first half of this year.

Securities Industry Association ▪ www.sia.com, info@sia.com
120 Broadway, 35th Floor, New York, NY 10271-0080 ▪ 212-618-1500, fax 212-968-0703
1401 Eye Street NW, Washington, DC 20005-2225 ▪ 202-296-9410, fax 202-296-9775

SIA UPDATE AND OUTLOOK

Table of Contents

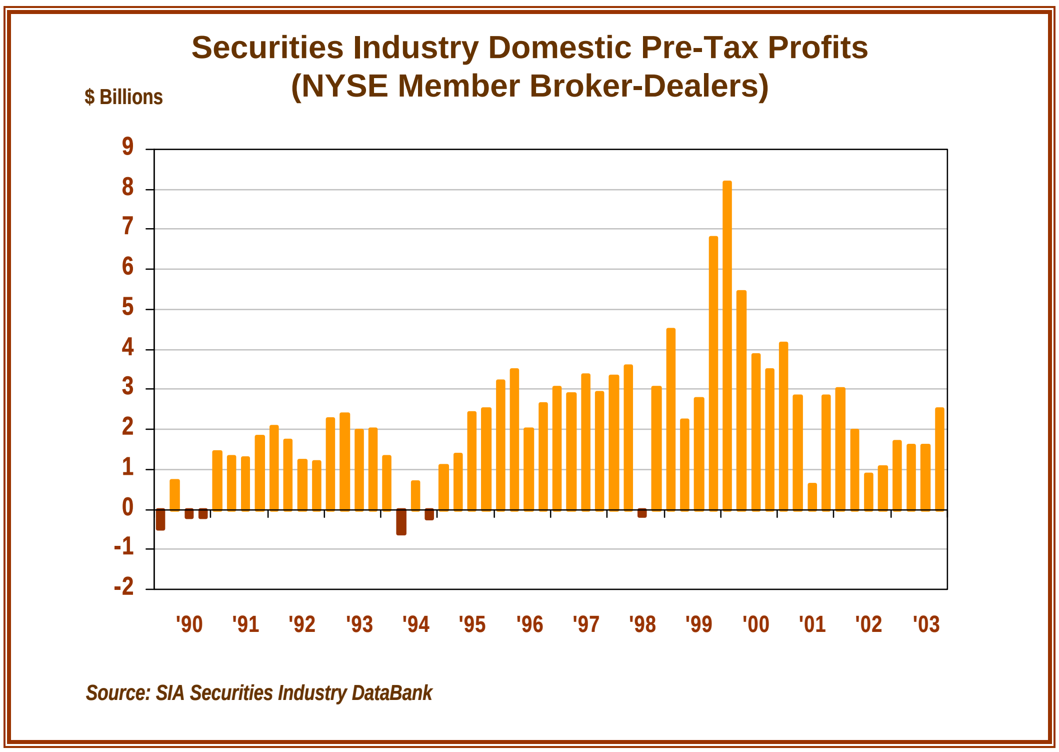
Charts and Tables

Summary

This report provides an update of recent performance and an outlook for the U.S. securities industry, along with alternative forecasts for U.S. financial markets and the U.S. economy, which drive prospects for the securities industry. Not surprisingly, near term forecasts are proving especially difficult, reflecting a long litany of uncertainties, including the impact of war, the ongoing terrorist threat and persistent weaknesses in the U.S. economy that are expected to retard growth, at least through the first half of this year.

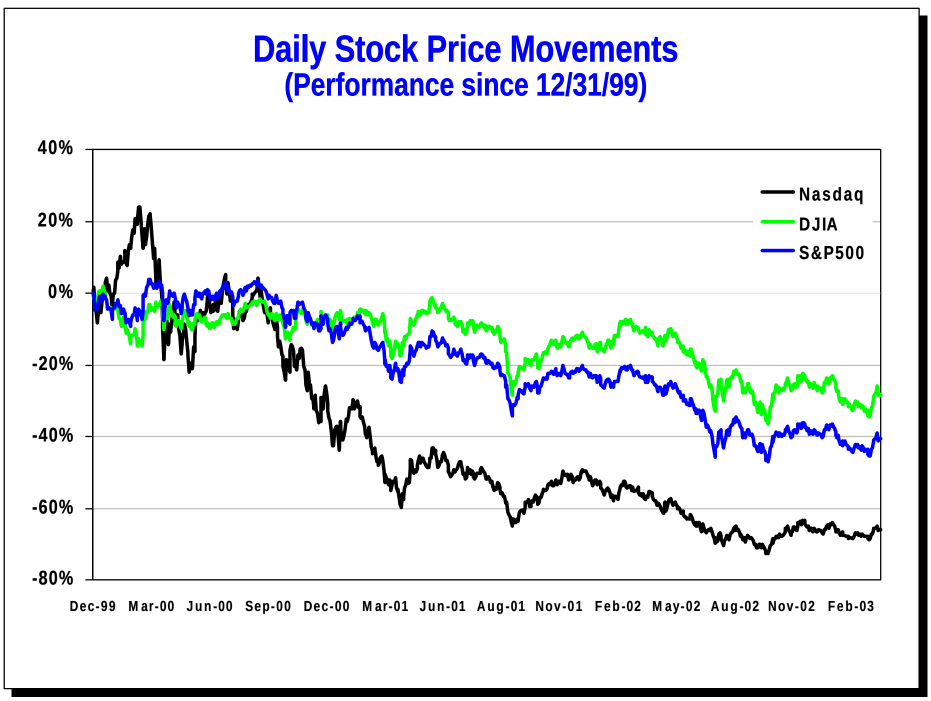
Industry Outlook - The plunge in securities industry revenues and profitability appears to have bottomed out in late 2002, in line with expectations. Although gross revenues in last year's final quarter hit five year lows, half what they were two years ago and 16% below levels in the same quarter a year ago, they were only 0.3% below Q3 2002 levels. Meanwhile, revenues net of interest expense were up 6.2%, and profits which had slumped to just $868 million in Q3 2002 reached $1,069 million in the quarter just ended, despite inclusion by investment banks of substantial costs associated with the settlement and reserves against potential litigation, as cuts in operating expenses continued.

During Q1 2003, industry performance markedly improved, and profits rose to an estimated $1.7 billion, thanks to a surge in trading gains, largely bond trading. However, gross revenues were only 8.4% above Q4 2002 levels and roughly matched results in the same quarter a year earlier, as lower lending rates trimmed interest revenues, offsetting some of the stellar results from the fixed income sector. Interest expenses fell too, down an estimated 10% from Q4 2002 levels and net interest margins continued to improve. More importantly, net revenue (net of interest expense) jumped 17%, and compensation expense rebounded after slumping in the final quarter of last year. This narrowly-based upturn in Q1 2003, after three straight years of declines, is expected to broaden and strengthen across the course of this year as the resumption of growth in revenue and profitability becomes more generalized across individual sectors, service lines and firms.



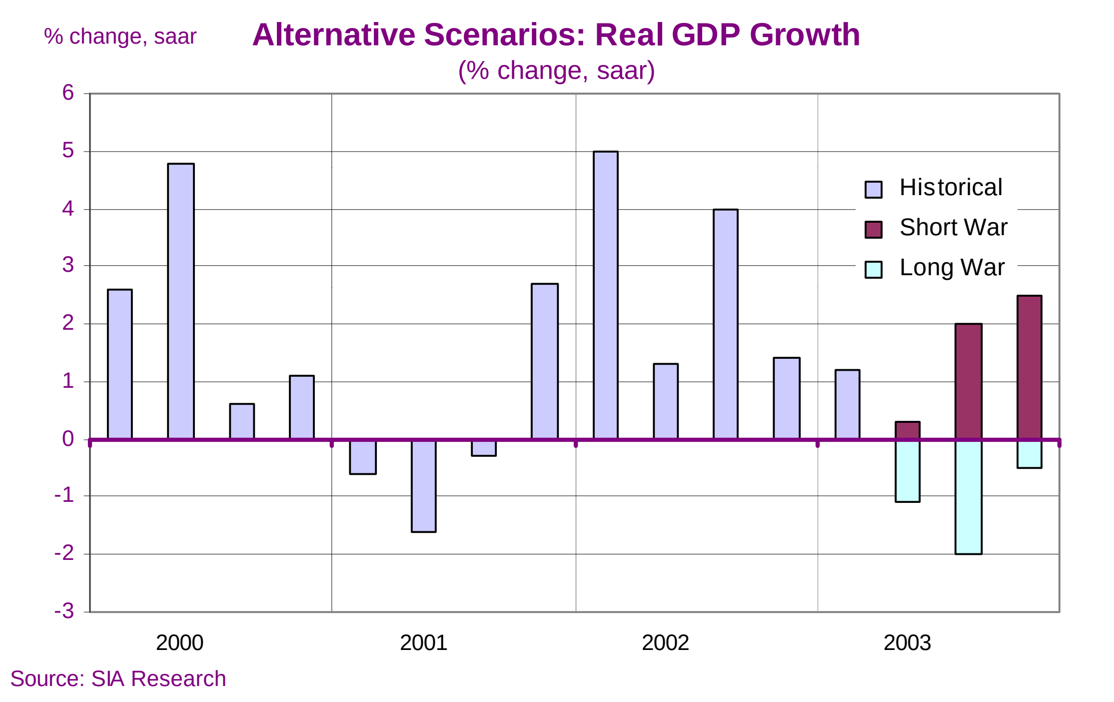
Market Outlook – Over the remainder of this year, we expect equity markets to remain confined within the trading range established over the past nine months, oscillating within a range of roughly 10% on either side of current levels. This view reflects expectations of a continuation of sustained, high volatility witnessed in recent years, as well as the more recent overlay of "global uncertainties". The lows set on October 9, 2002 appear to be a "fundamental" bottom that might be tested, but is unlikely to be breached except under very pessimistic assumptions, such as a long, messy war or a major terrorist incident. Corporate profit growth has resumed, and is expected to reach a 7% annual rate in the first half of this year, as scattered signs of "top line" growth are spreading.

Conversely, continued uncertainties in a post-war environment and persistent economic weaknesses are likely to cap the markets' upside potential until a more robust recovery becomes evident. U.S. equity prices, despite three consecutive years of declines, remain expensive by historical standards when viewed relative to earnings. In addition, it may be some time before individual investors become significantly more active, although they are likely to do so much more rapidly than following the protracted bull market of the 1970's[1]. Public trust and confidence remains weak in the aftermath of corporate governance failures and investor sentiment depressed in the face of past losses.



[1] Marquis, Milton H., "Shifting Household Assets in a Bear Market," Federal Reserve Bank of San Francisco, Economic Letter, Number 20003-9, March 28, 2003.

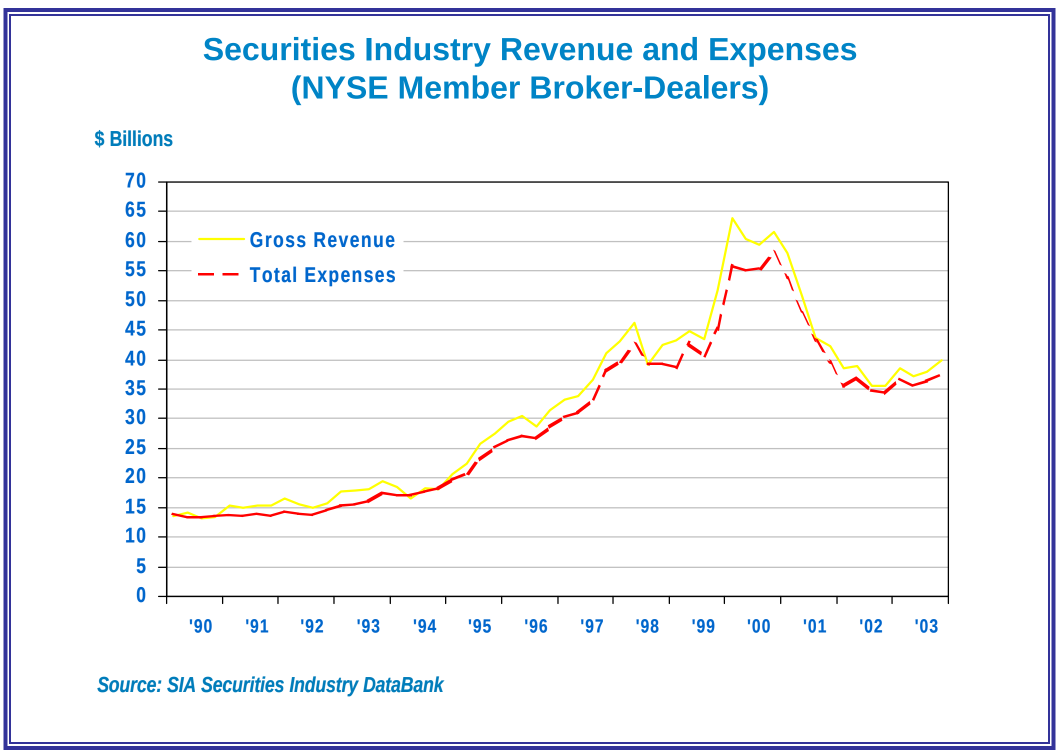
Economic Outlook – Real U.S. G.D.P. growth slowed in Q1 2003 and should decelerate further in Q2 2003 reflecting the impact of war on an already stuttering U.S. economy, as fiscal and monetary stimulus only partially offsets the consumer retrenchment that appears to be underway. The depth and length of the downturn depends upon such interrelated uncertainties as: the length and severity of the war in Iraq; the direction of oil prices; how quickly consumer and investor sentiment, which recently plunged, can recover; and, on whether the recent resumption of growth in business fixed investment will continue.



Introduction: Spitting Into The Wind

It is an old saying that only a fool would predict the course and outcome of a war before it begins. War plans rarely, if ever, survive first contact with the enemy and remain intact. Economists, charged by budget planners and corporate executives whose operations are most affected by "global uncertainties" such as war, must join that company of fools, and provide forecasts: think the unthinkable, plan for the worst case and hope for the best. Despite the difficulties, forecasting, which includes providing scenarios and conducting simulations (along with stress testing and back testing of the predictive models themselves) are integral to contingency planning and risk management practices that are, in turn, essential to both successful investing and the continuous operation of the markets and the industry. In recognition of the importance of the securities industry to the New York City and State economies, indeed, to the nation's economic health as a whole, SIA Research reviews and contributes to city and state budget forecasts. The following report is drawn from submissions prepared for budgetary reviews conducted in March.

Fortunately, some trends are already evident, easing this still difficult task. Both primary and secondary securities markets tend to be good leading indicators of economic activity and have been reflecting for some time the uncertainties that expectations of war bring, and discounting a relatively favorable outcome. Meanwhile, the U.S. economy had already moved to a "war footing" before hostilities began, as surging defense spending became a principal contributor to overall GDP growth, which, along with a nascent recovery in business spending, largely offset stalling consumer spending. Substantially greater clarity is expected in short order, and the next few weeks of the war are expected to define the near term outlook for investors, if not consumers.



Securities Industry Update and Outlook

Finding A Bottom: The long and steep decline in securities industry revenues and profitability appears to be coming to an end in line with expectations. At first glance, Q4 2002 results do not appear encouraging. Total revenue of NYSE member firms in last year's final quarter fell to five and a half year lows and represented just 58% of the record levels reached two years earlier. However, although gross revenues fell to $35.51 billion and were 16% below the results in the same period a year earlier, this represented a decline of only 0.3% from revenues realized in Q3 2002. Sorting out the impact of the declines in interest rates presents a clearer view of recent performance and of near term prospects.

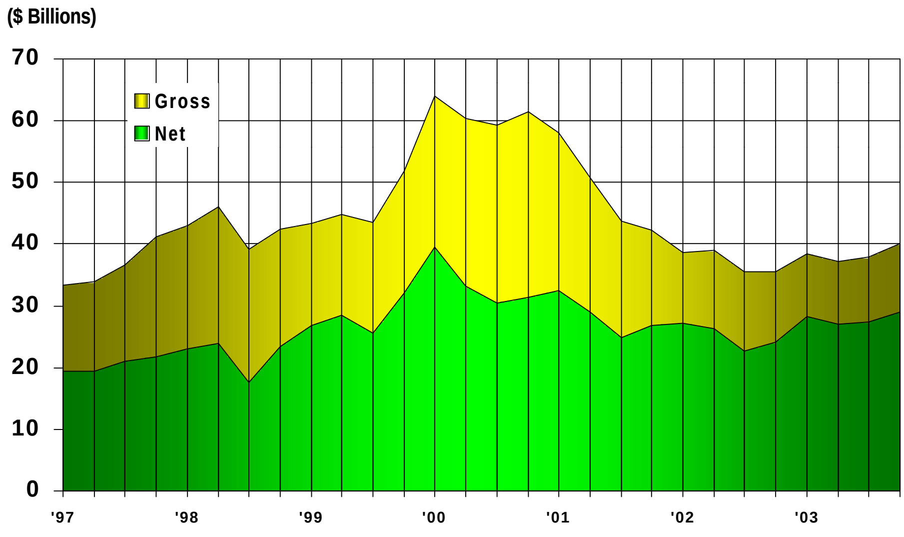
Revenue, net of interest expense, of $24.06 billion in Q4 2002 was 6.2% above levels in the immediately preceding quarter, although still 10.4% below the Q4 2001 results. Profits, which had slumped to just $868 million in Q3 2002, reached $1,069 million in the final three months of last year. This improved performance came despite substantial charges, which are estimated at $2.2 billion during the quarter, which were taken by investment banks for both the so-called "global" research settlement and for anticipated litigation costs.

On December 20, 2002, 10 investment banks reached an "understanding" on a "global settlement" on Wall Street research conflicts and practices with the SEC, NASD, NASAA, NYSE, NYS Attorney General and other state regulators. The agreement, while still not final, called for $1.44 billion in payments by firms party to the settlement. This amount encompassed $900 million in penalties, $450 million to be escrowed for payment for the provision of independent (third party) equity research in coming years and $85 million for investor education. Several of the parties to this "agreement in principle" elected to expense the full amount in their Q4 2002 financial statements as an operating expense, not an extraordinary item, and many went well beyond the proscribed amounts. These additional charges included the anticipated future costs of private sector litigation and payments related to research conflicts and other potential litigation, such as financial advisory work performed for Enron, loan losses, restructuring charges and losses on divestitures of brokerage units.

Although revenue declines continued to extend to almost all the industry's product and service lines in Q4 2002, positive signs began to appear. Commissions, which accounted for 27.5% of total net revenues last year, were 0.6% below Q3 2002, but 1.2% above levels recorded in the same period a year earlier. For last year as whole, commissions were 2.8% higher than in 2001. Trading gains, principally from bond trading activity, showed a sharp jump in Q4 2002, after poor results in the prior quarter. Similarly, underwriting revenue was up relative to Q3 2002 results, but remained at depressed levels, 28.2% below the level a year earlier.

Other trends were less positive. Fund management operations suffered from both the decline in share prices (reflected in lower net asset value of funds under management upon which fees are calculated) and net withdrawals from equity mutual funds (reflected in lower sales revenue) that began last summer. Asset management fees during Q4 2002 were 6.5% below the prior quarter and down 11.3% from the same period a year earlier. Meanwhile, mutual fund sales revenues were off 1.5% from Q3 2002 and 11.6% from Q4 2001. Margin interest, now a relatively small revenue item, amounting to less than $1.3 billion in Q4 2002, continued to slide, reflecting both the fall in interest rates to near-historic lows and sharply reduced use of leverage by individual equity investors. Margin interest was down 11.7% from Q3 2002, 34.7% from year earlier levels and amounted to only about a quarter of what it was just two years ago.

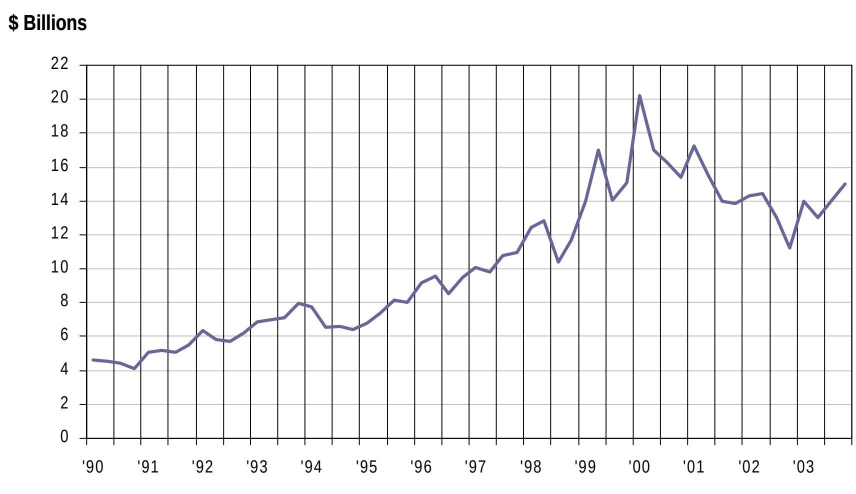
Securities Industry Domestic Quarterly Revenue
(NYSE Member Broker-Dealers)



Source: Securities Industry DataBank

Profitability continued to be maintained by aggressive cost cutting that mirrored the nearly three-year slide in revenues. Securities industry compensation expense, an important bellwether for the local and state economy, continued to fall, reflecting both falling employment and sharply reduced bonuses. Compensation in Q4 2002 was 13.4% below levels in the immediately preceding quarter and 18.9% below results in the same quarter a year ago.

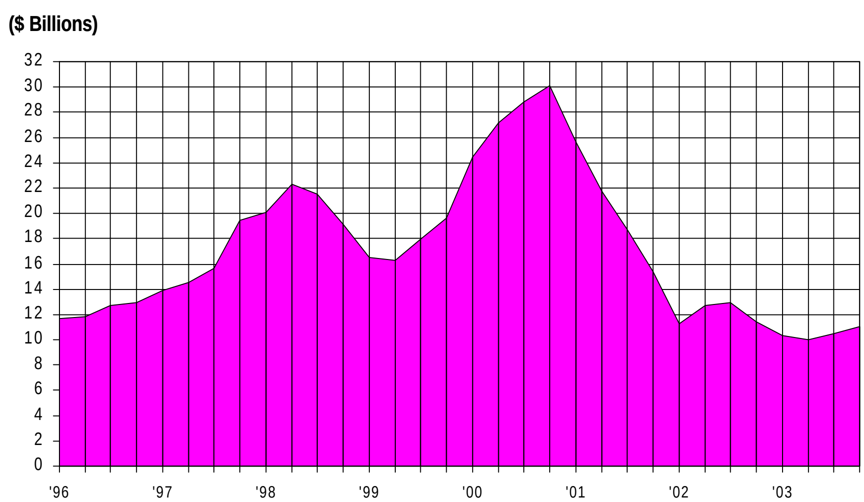
Securities Industry Compensation
(NYSE Member Broker-Dealers)



Source: SIA Securities Industry DataBank

Interest expense continued to tumble and net interest margins improved. Other operating expenses, such as communications, occupancy and equipment costs moved up relative to Q3 2002, but were still well below year earlier levels. What was most remarkable was that total expenses declined despite a sharp increase in "other expenses" (the aggregate of a number of items not specifically "broken out"), reflecting the settlement charges, detailed above. This line item jumped to $6.24 billion in Q4 2002, compared to $3.67 billion in Q3 2002 and an average of $4.3 billion per quarter over the last two years.

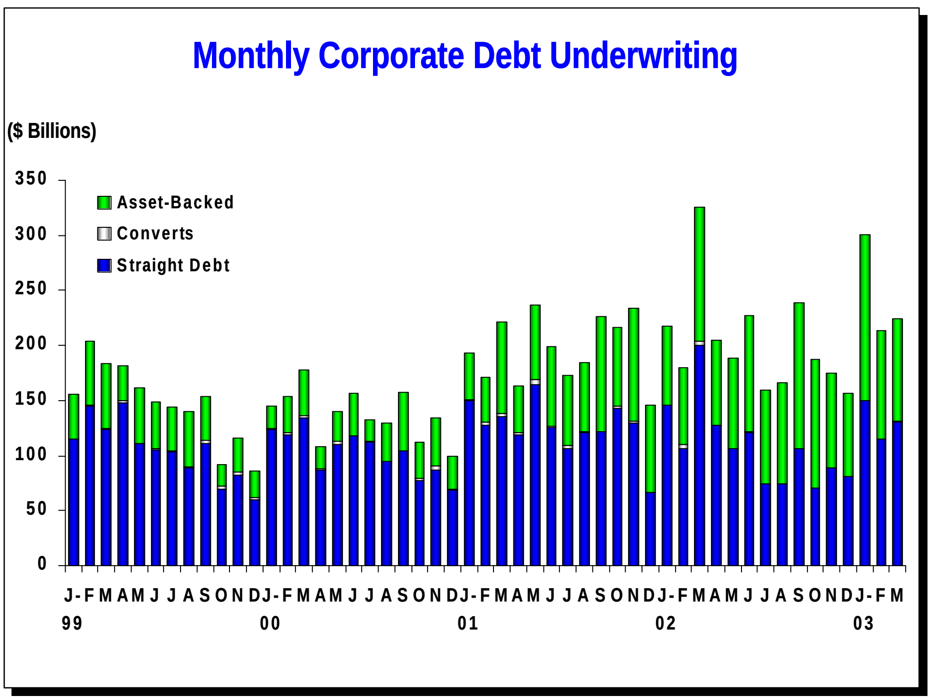
Securities Industry Interest Expense (NYSE Member Broker-Dealers)



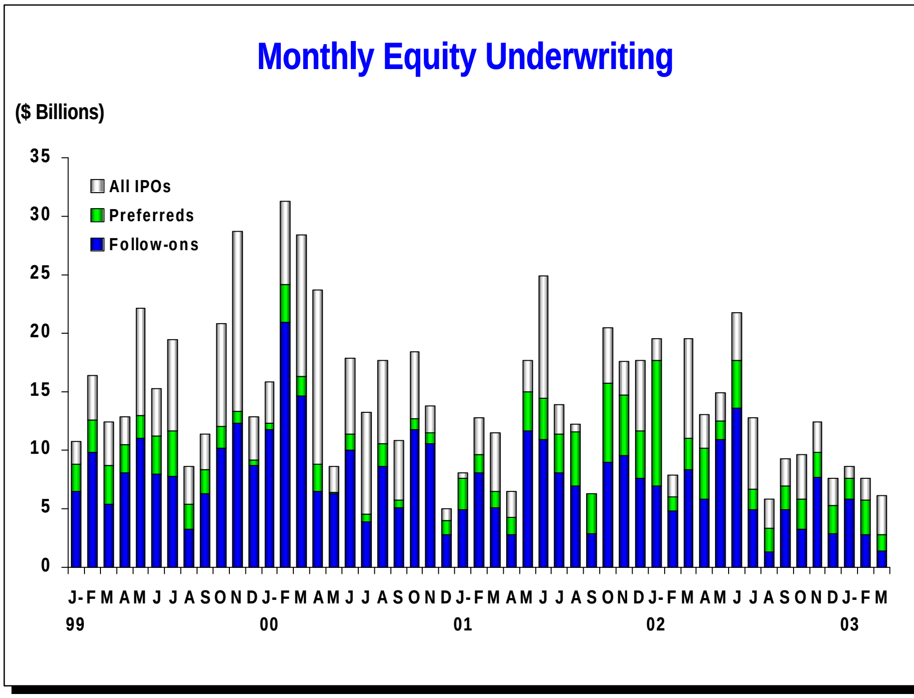
Source: SIA Securities Industry DataBank

Estimated Q1 2003 Performance: A Surge In Trading Profits – During Q1 2003, industry performance markedly improved, and profits rose to an estimated $1.7 billion, thanks to a surge in trading gains, largely bond trading, and higher bond underwriting revenue. However, gross revenues, estimated at $38.5 billion, were only 8.4% above Q4 2002 levels and roughly matched results in the same quarter a year earlier, as lower lending rates trimmed interest revenues, offsetting some of the stellar results from the fixed income sector. However, interest expenses fell too, down an estimated 10% from Q4 2002 levels, and net interest margins improved. More importantly, net revenue (net of interest expense) jumped more than $4 billion or 17%, and compensation expense rebounded after slumping in the final quarter of last year.

Trading gains are estimated to have exceeded $8 billion, up more than $3.5 billion from reported Q4 2002 levels, and the highest since Q2 2001, when trading gains totaled $8.6 billion. Bond trading gains accounted for almost all the improvement. This surge was more than sufficient to offset continued declines in income from asset management operations, margin and stock lending and commissions from stock trading operations as individual investor activity sagged. Other revenue related to securities operations, largely interest revenues, were an estimated $1.0 billion or 7.5% lower than in the final quarter of last year.

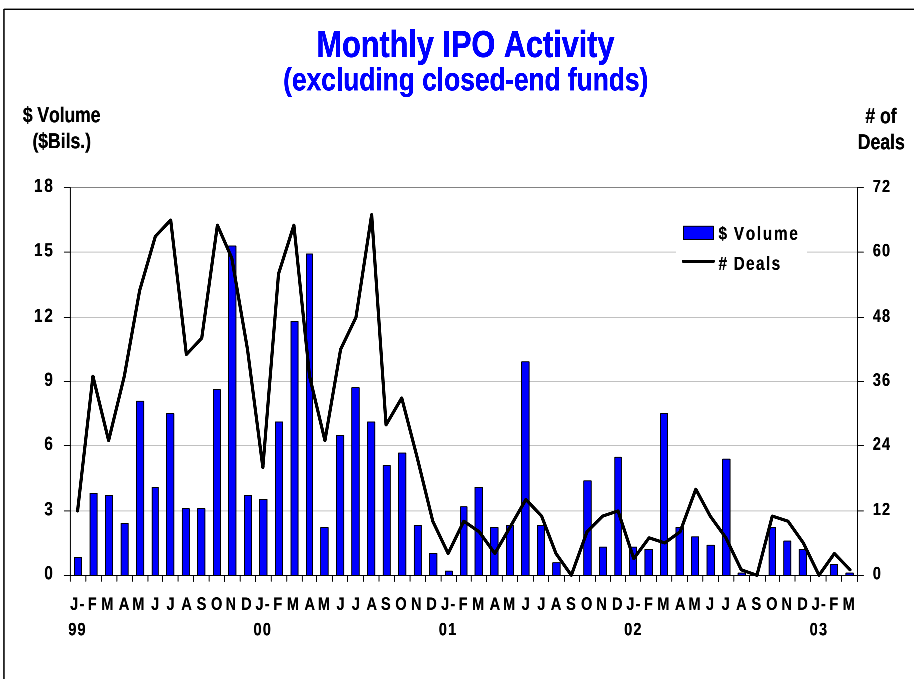


Underwriting revenue bounced back 15.4% in Q1 2003 to $3.5 billion from $3.0 billion in 4Q 2002, but remained 5.3% below levels attained in the same, year earlier period. The increase was driven by a surge in corporate debt underwriting activity, which ballooned by one-third, or $219 billion, to $739 billion in Q1 2003, the highest quarterly level ever, surpassing Q1 2002's $723 billion.



Higher revenue from bond placement activity more than offset the ongoing slump in fees from equity issuance. During Q1 2003, equity underwriting declined $7.2 billion to $22.3 billion in 1Q 2003 from an already dismal $29.5 billion in Q4 2002. The most depressed component of equity underwriting remained IPOs. During Q1 2003, only 5 IPOs were completed with a total value of only $644.3 million, down 87% from the same period last year. Worse yet, the backlog of deals in the pipeline currently is the lowest in 12 years. Still, total underwriting revenue in this year's first quarter was only 5.3% below year-ago levels.

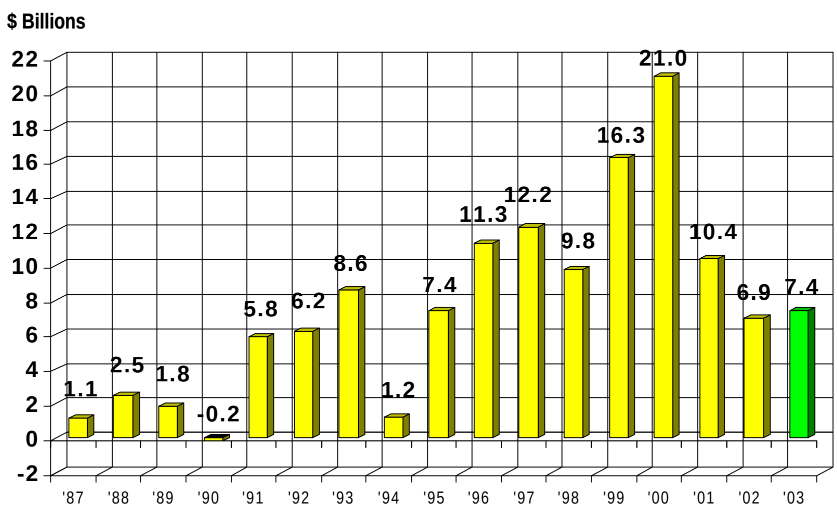
Other investment banking revenues, which include fees from M&A and LBO activity, private placements, financial restructuring advisory work, etc. (which appears in the "other revenue" reporting line, along with interest revenue), remained in the doldrums in Q1 2003, down by $1 billion, or 7.6%, to $2.25 billion, from $2.54 billion in Q4 2002. During the first quarter, the value of global M&A deals rose 9% from the same year earlier period on 11% fewer deals. U.S. M&A volume was 9% below Q1 2002, but appears to be picking up as the second quarter opens.



Expenses, with the exception of compensation and "other expenses," declined across the board. This includes reductions in total floor costs, communications expense, occupancy and equipment costs, data processing costs and promotional costs, reflecting a more austere business environment and reduced headcounts. Compensation expense, estimated at over $14 billion in Q1 2003, was up 24 % from the prior quarter, returning to levels seen in the first half of last year. This reflected a number of developments. First and foremost was higher performance-related pay to bond traders in light of their strong first quarter results. Some annual bonuses and quarterly production payouts, normally paid at year-end, were deferred into the New Year. In addition, severance packages tied to the latest round of layoffs were largely paid in lump sums, rather than stretched out, as was more frequently the case in prior quarters. "Other expenses", which includes items related to the global settlement and reserves taken in anticipation of litigation costs, is believed to have risen from $6.24 billion in Q4 2002 to $7.25 billion.

For 2003 as a whole, gross revenue is expected to rise to $153.5 billion, 3.2% above last year's result, but still 21.2% below the 2001 total as the still relatively narrow-based recovery extends to a broader base of individual product and service lines, sectors and firms. More encouraging is the recovery in net revenues, which is expected to rise to $111.7 billion, 11.4% above 2002 levels and only 1.3% below 2001 results, as net interest margins continue to improve. Total expenses are expected to reach $146.1 billion, 3.1% above last year's result, but still 20.8% below the 2001 total. This reflects the ongoing decline in interest expense, which is expected to fall 13.7% below last year's total, which offsets a rise of $3 billion or 5.5% in compensation and an increase in "other expenses", as was noted above. For more detail on both the recent performance of the industry and on SIA's forecast see the upcoming release of ***Trends***, another SIA Research publication.

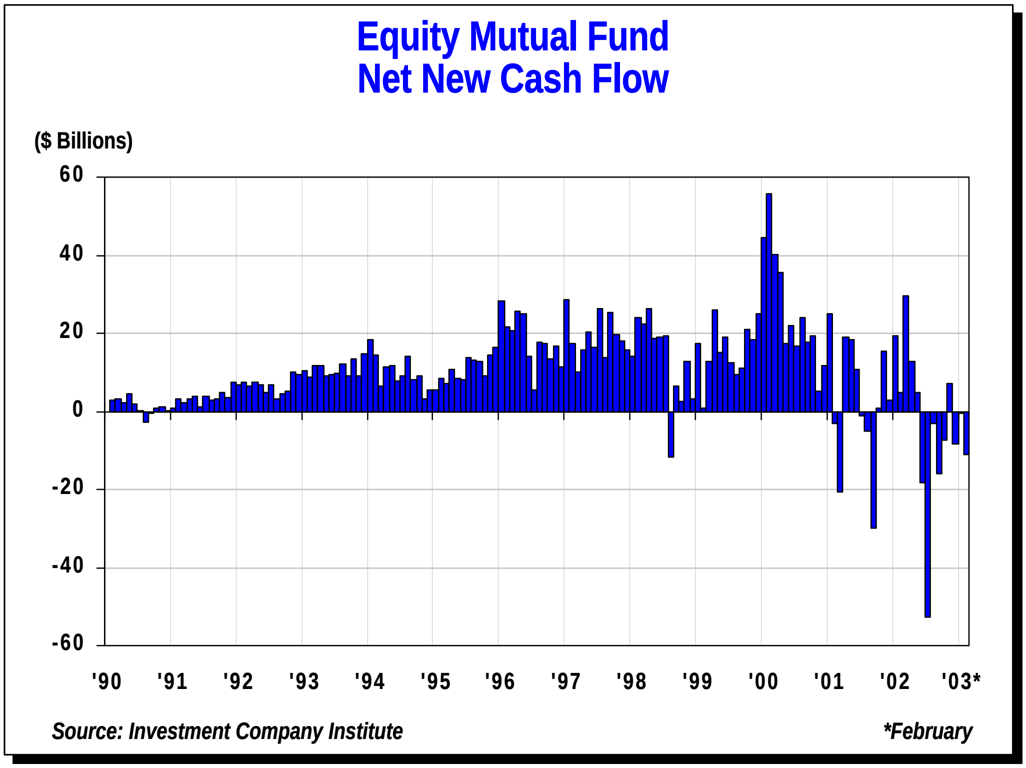
Securities Industry Domestic Annual Pre-Tax Profits
(NYSE Member Broker-Dealers)



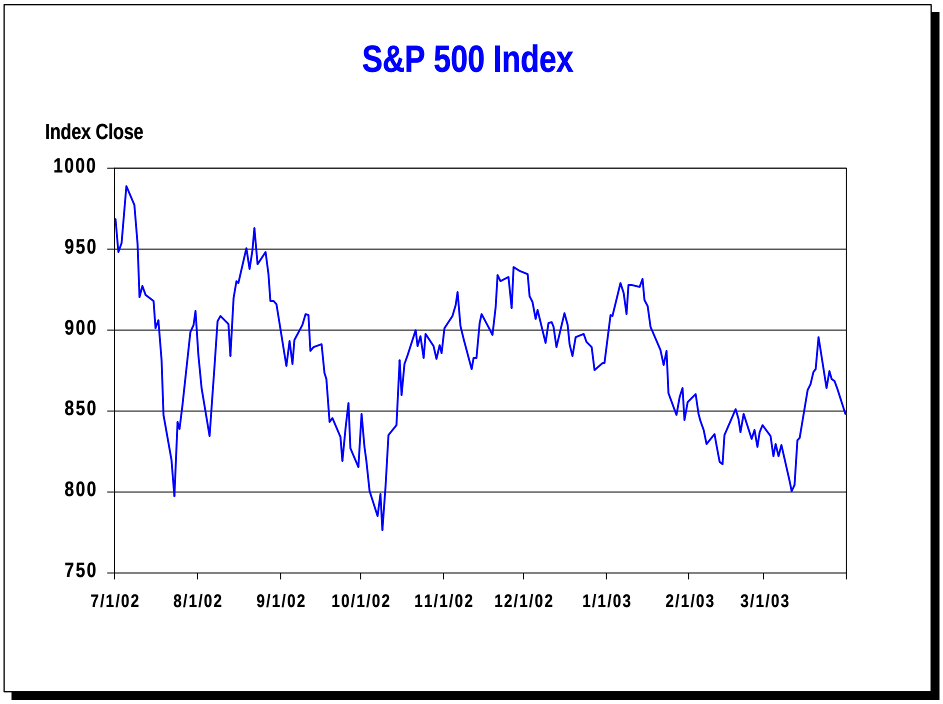
Source: Securities Industry DataBank

Market Update And Outlook

A Relief Rally: Following a brief two-week rise at the start of the New Year, stocks endured near-constant selling pressure for the next two months, driven by intensifying fears of an impending war with Iraq, heightened domestic terrorist threats and a worsening stream of economic news. Net withdrawals from equity mutual funds continued through February with declines in eight of the last nine months and individuals direct holdings of equities continued to slump. Business, consumer and investor sentiment plunged and stock prices mirrored the decline until war began. Removing that uncertainty triggered a "relief rally".



Short covering by institutional investors and a shift in the energy outlook helped push equity prices up 3%, the dollar higher, and oil prices down nearly $3 a barrel in a single day following President Bush's issuance of a 48 hour ultimatum. The rally was sustained by relatively good news from the Front, the expiration of options contracts and positive momentum on rising volume, which helped propel an abrupt reversal of investor sentiment. In the rally that began on March 12, covering the final days of winter, the major equity market indexes each rose 11.7% or more, returning, roughly, to year-end levels. Just in the week ending Friday, March 21, the S&P 500 rose 8.5%, its best weekly performance in 20 years. Meanwhile, the yield on the benchmark 10-year U.S. Treasury bond rose to 4.10% from 3.57%, a 44 year low, as the dollar strengthened. Oil prices, which had soared as high as $38 a barrel as March began, tumbled to just below $27 a barrel, the steepest decline since 1991.



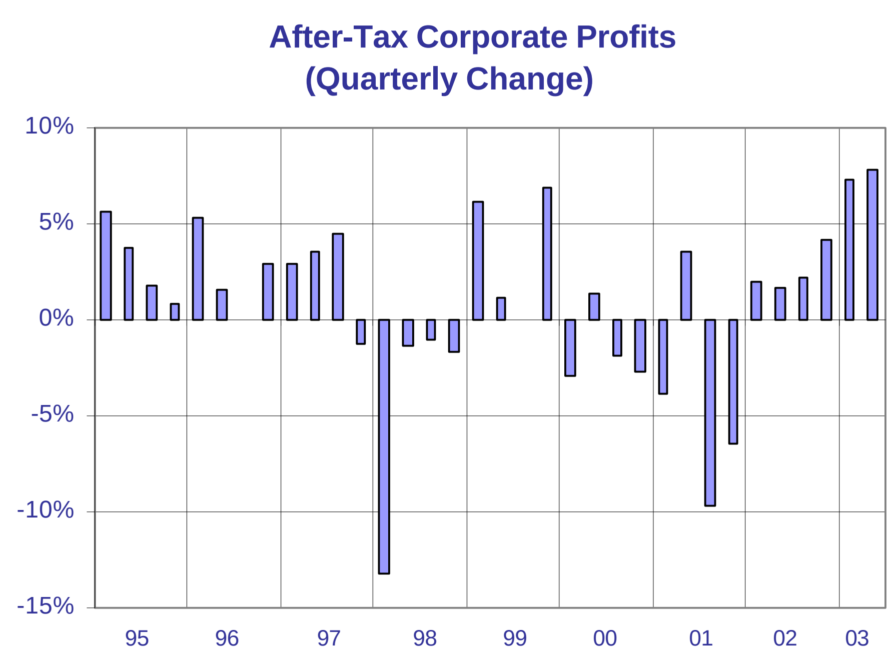
The reversal of sentiment proved short-lived. Over the weekend of March 22-23, fighting in Iraq, though sporadic, was frequently fierce, and the weather uncommonly bad, and the advance of coalition forces slowed, leading some to revise their expectations that the war might not prove to be brief and benign. Oil prices moved back above $30 a barrel with the interruption of Nigerian production (roughly 0.8 mbd[2]) and expectations of at least a three-month delay before production resumes in southern Iraq. Mutual funds and insurers reportedly remained relatively defensive in the relief rally, which was driven more by proprietary traders and hedge funds (principally macro / directional and long / short funds). This later group took profits on the short sharp rally of the previous eight consecutive sessions, and equity prices tumbled 3.5% when markets reopened on March 24, the worst day since last September. Markets then drifted sideways in the remaining days of the week, before slipping lower as the quarter came to a close, and stock prices finished Q1 2003 just below where they started the year. The S&P 500 Index was down 3.6%, the Russell 2000 was off 4.8%, while the Nasdaq Composite rose 0.4% above end-2002 levels.

[2] mbd = millions of barrels per day.

Confined To A Trading Range: Over the very near term, the conduct and duration of the war and perceptions of the degree of consumer retrenchment will continue to set the market's direction. While market flow is positive, it is vulnerable to any shift in sentiment. The weakness of expectations of a short, relatively benign conflict was revealed in late March, and sentiment could easily become more bearish. In addition, as researchers noted when releasing the latest University of Michigan consumer sentiment reading, "concerns about job and income prospects" persist in a post-war environment, and "the data now suggests that even after a quick and decisive victory, consumer spending will remain subdued through the balance of 2003". These underlying concerns, along with "geopolitical uncertainties' and the increased impact of highly levered investors with very short trading horizons, are expected to keep volatility high.

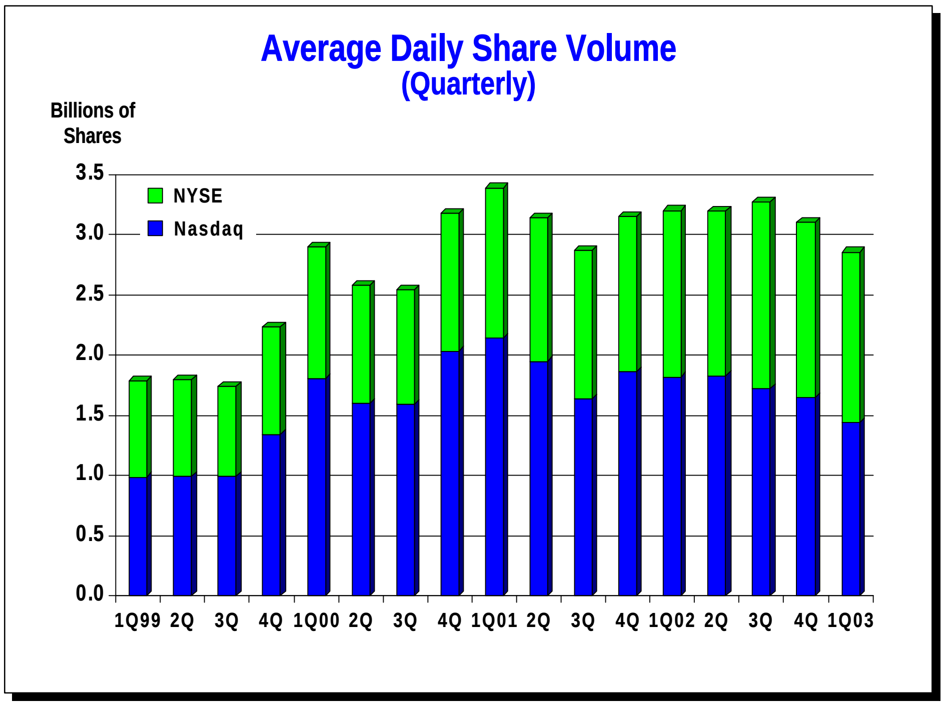
Net outflows from equity mutual funds appear to have slowed, while the long decline in individual account activity may have ended in March. But negative news could render these improvements transient, quickly reversing this marginal improvement in flows. Foreign portfolio investors might be emboldened by a rising dollar, and relatively better prospects for corporate profits in the US than in the EU or Japan. If so, this could provide support for the rally. Conservative institutional investors, who are expected to wait before making any decisions based on the war's progress, hold significant cash balances awaiting allocation, and could drive the market higher on positive news.

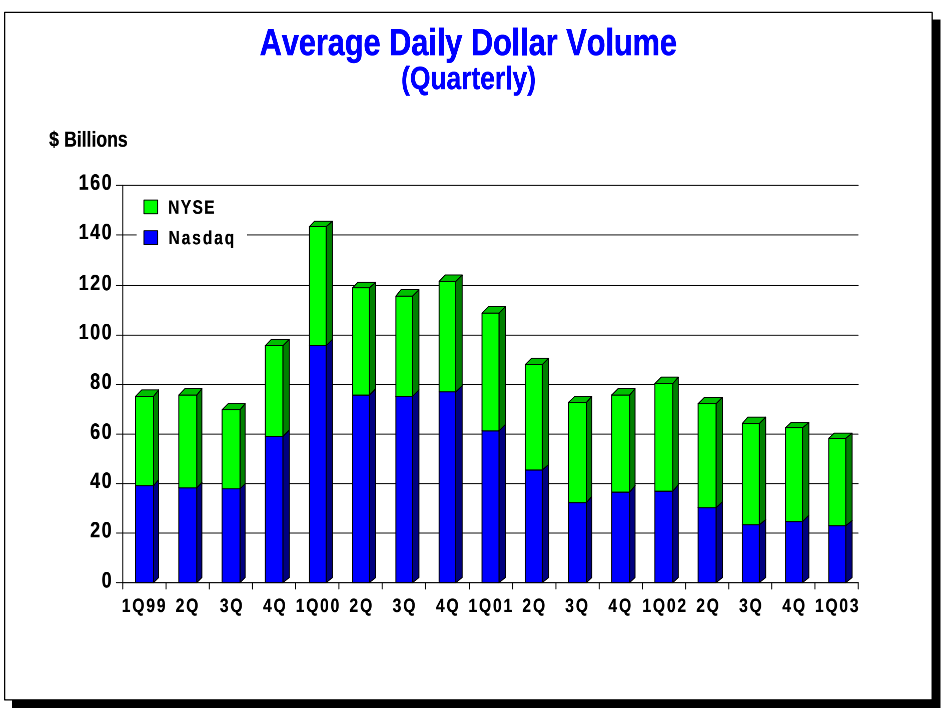
However, signs of economic weakness, in particular news of weakening growth of consumer spending, will likely constrain the markets' advance even after the end of the war and disruptions in oil supply. This, along with only a modest rise in business spending, has been reflected in declining forecast of earnings growth. Last October, the Thompson First Call reported that earnings for the S&P 500 companies were expected to increase 17.4% in Q1 2003 and 16.4% in Q2 2003. By January those estimates fell to 11.7% and 10.9% respectively for the first two quarters of this year. Currently those estimates are 7.6% and 7.3% and expected to be trimmed further as the ratio of negative to positive preannouncements is running well above past levels. Only later in the year is a modest acceleration expected.



Source: Bureau of Economic Analysis, U.S. Department of Commerce; SIA Research

Over the remainder of this year, we expect the markets to remain confined within the trading range established within the past nine months, oscillating (reflecting a continuation of sustained, high volatility) within a range of 10% to 15% on either side of current levels. The lows set on October 9, 2002 appear to be a "fundamental" bottom that might be tested, but is unlikely to be breached except under very pessimistic assumptions, such as a long, messy war or a major terrorist incident. Conversely, continued uncertainties in a post-war environment and persistent economic weaknesses are likely to cap the markets' upside potential until a more robust recovery becomes evident. U.S. equity prices, despite three consecutive years of declines, remain expensive by historical standards when viewed relative to earnings. In addition, it may be some time before individual investors become significantly more active. Public trust and confidence remains weak in the aftermath of corporate governance failures and investor sentiment depressed in the face of past losses.





Economic Update And Outlook

Looking In The Rear View Mirror: Caution! Recessions may appear shorter and shallower than they actually are.

Rarely has uncertainty been greater, sentiment weaker, indicators less reliable or economic forecasting more difficult than it has been during Q1 2003. Before attempting any forecast, a review of recent economic data is always advisable, and the recent release of Q4 2002 economic growth figures, which was accompanied by fairly significant revisions of past data, is a good place to start. Real GDP growth in 2001 was revised from 1.2% to a mere 0.3%, and the current estimate of growth for last year is 2.4%, after the estimate for Q4 2002 was raised to 1.4% at an annual rate, double the initial estimate of 0.7%. While still relatively short and shallow by historical standards, the recession that spanned the first three quarters of 2001 was deeper and began earlier than originally reported.

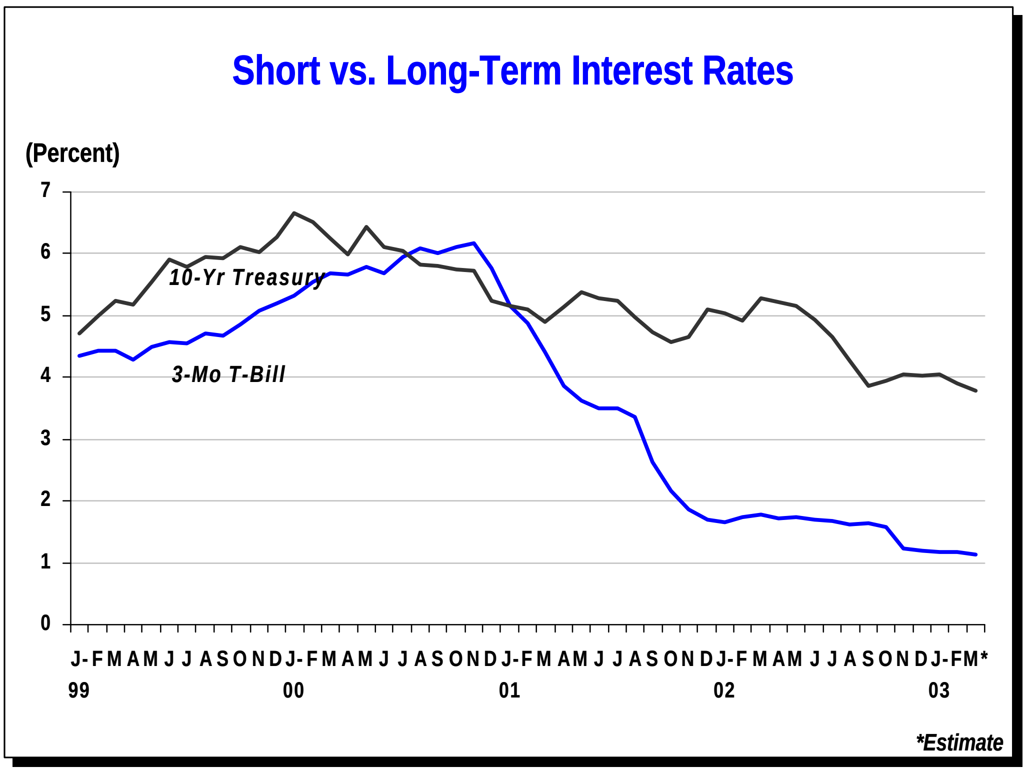
REVISIONS TO NATIONAL INCOME AND PRODUCT ACCOUNTS
(percent change)

	1999	2000	2001
Real Gross Domestic Product			
Current	4.1	3.8	0.3
Previously published	4.1	4.1	1.2
Difference	0.0	(0.4)	(0.9)
Consumption			
Current	4.9	4.3	2.5
Previously published	5.0	4.8	3.1
Difference	(0.1)	(0.5)	(0.6)
Gross Private Domestic Investment			
Current	6.6	6.2	(10.7)
Previously published	6.6	6.8	(8.0)
Difference	0.0	(0.6)	(2.7)
Personal Income			
Current	4.9	8.0	3.3
Previously published	4.7	7.0	4.9
Difference	0.1	1.0	(1.5)
Wage and Salary Disbursements			
Current	6.6	8.2	2.4
Previously published	6.7	8.2	5.4
Difference	(0.0)	0.0	(3.0)
Corporate Profits (Pre-Tax)			
Current	5.7	2.7	(14.3)
Previously published	7.7	8.9	(17.3)
Difference	(2.0)	(6.3)	3.0

Discrepancies are due to rounding.
Sources: U.S. Department of Commerce, Bureau of Economic Analysis for 1999-2002.
Figures for 2003 and 2004 are “consensus” forecasts.

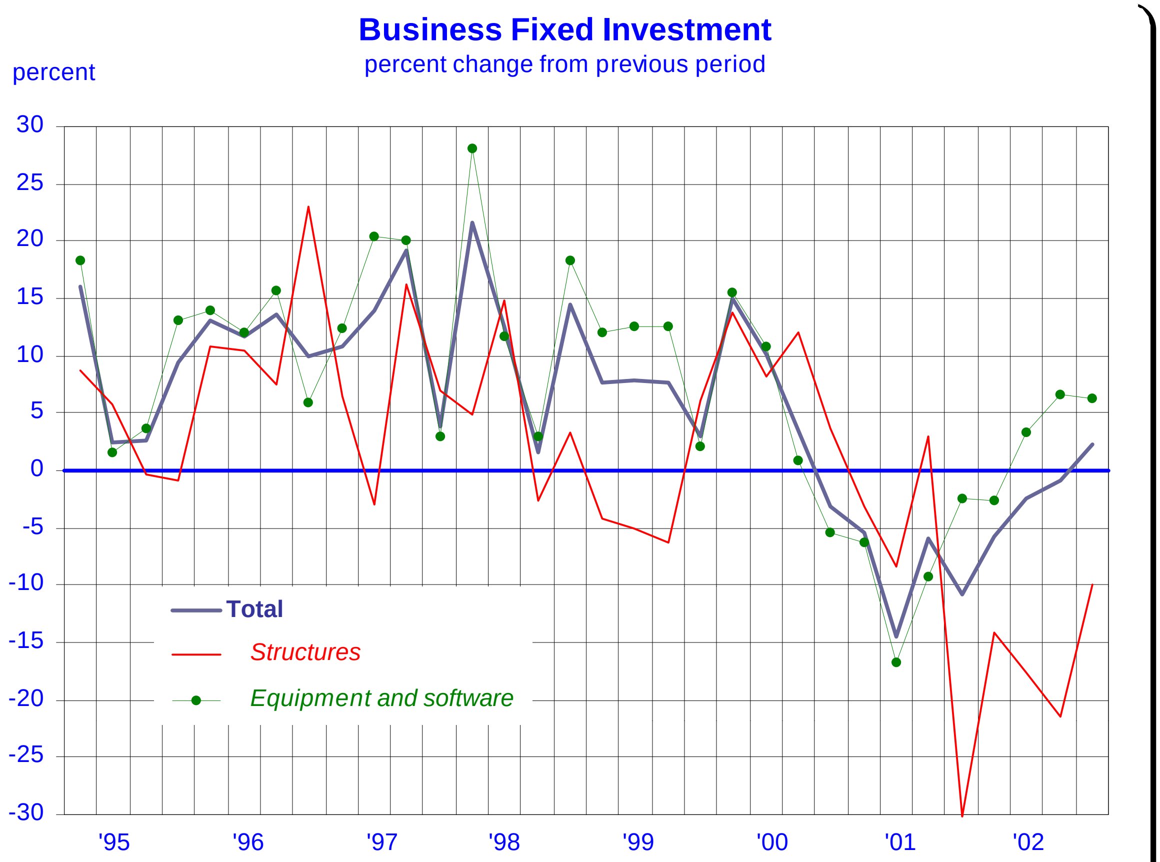
Growth did accelerate in early 2002 in response to monetary and fiscal stimulus and was led by stronger consumer spending, a pickup in private inventory accumulation, smaller decreases in investment in equipment and software and in exports. In Q3 2002, real GDP jumped 4.0% s.a.a.r., powered by another wave of mortgage equity withdrawal as interest rates hit 40 year lows and by concessionary auto financing, with the latter reflected in a 22.8% surge in durable goods consumption.

However, most of this activity was concentrated in July and early August, and by late summer growth had faded. Corporate profitability was reappearing, but margins were thin and were achieved more by cost cutting than by revenue growth. Business fixed investment was reviving, but it was unclear whether it would happen soon enough and be robust enough to offset an inevitable retrenchment in consumption.



Economic weakness persisted into the fall. Real GDP growth slowed to 1.4% in Q4 2002. The deceleration was primarily due to slower growth in personal consumption spending, which slipped to 1.7% from 4.2% in the prior quarter, and to a lesser extent, because exports were lower, imports were higher, and inventory accumulation slowed. The wider trade deficit shaved 1.6 percentage points from overall GDP growth. Partially offsetting this was a strong acceleration in government spending, a 9.4% increase in residential fixed investment and renewed growth in non-residential fixed investment after a full two-year absence.

A 6.2% rise in business spending on equipment and software marked the third straight quarter of growth in this area, after six consecutive quarterly declines. This, combined with a smaller decrease in spending on non-residential structures (down 9.9% compared to a drop of 21.4% in Q3 2002), produced a long awaited increase in overall business fixed investment, which rose 2.3% in Q4 2002 after a 0.8% decline in the prior quarter.



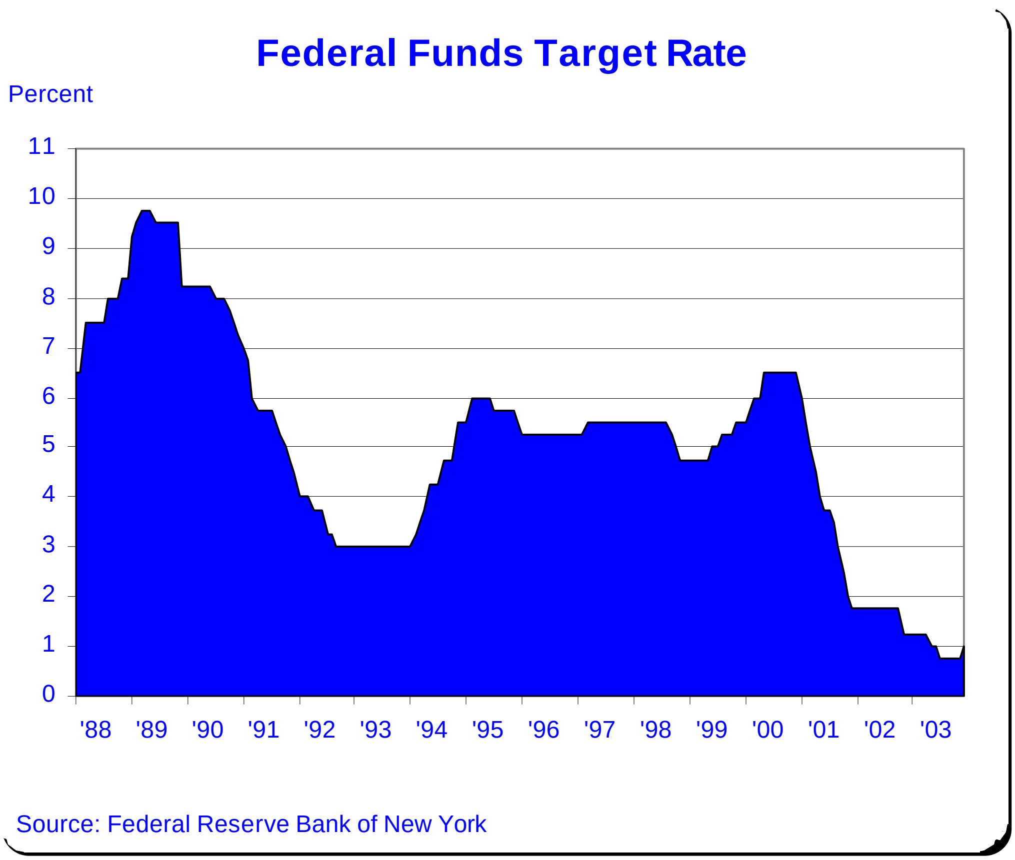
Source: Bureau of Economic Analysis, U.S. Department of Commerce

First Quarter Estimates: A War Economy And The Value Of MEW

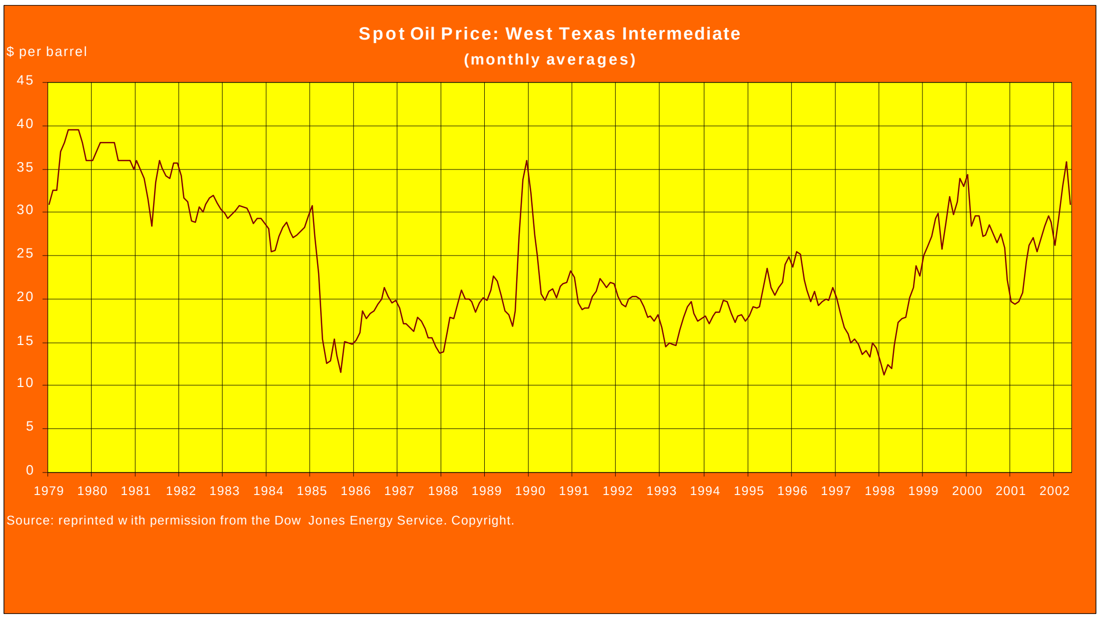
The principal drivers of the near term outlook were already in place as 2002 came to an end. Federal spending, in particular defense spending, will be an increasingly important contributor to overall growth in the U.S. economy and account for a rising share of GDP over the medium term. For last year as a whole, federal spending rose 7.5%, with the defense component up 9.3%, capped by a surge in Q4 2002. An 11.2% jump in federal government consumption contributed half, or 0.7% of the 1.4% growth in Q4 2002 real GDP. Higher defense spending (also up 11%) alone contributed a third (0.46%) of overall fourth quarter growth, as the U.S. began to shift to a "war economy". Non-defense spending also surged in 4Q 2002, up 11.1% and state and local government spending rose 1.2%.

During the first half of 2003, defense spending is expected to continue to grow at double-digit rates reflecting preparations for war, the cost of deploying a quarter of million troops, and maintaining them. While some of the impact of federal stimulus will be muted by cuts in spending at state and local levels, total government spending is expected to continued to grow at real rates of 5% or higher this year and next, offsetting some of the weakening contribution to growth from slumping private consumption.

In addition to fiscal stimulus, monetary policy is expected to remain accommodative. Persistent economic weakness prompted a cut in the Fed Funds rate by a half percentage point to 1 ¼% on November 6, and another cut of ¼% or ½% is expected by this summer. While short-term interest rates are expected to remain low, long-term rates are expected to move higher in the second half of this year, with the greatest steepening coming at the ten-year point in the yield curve.

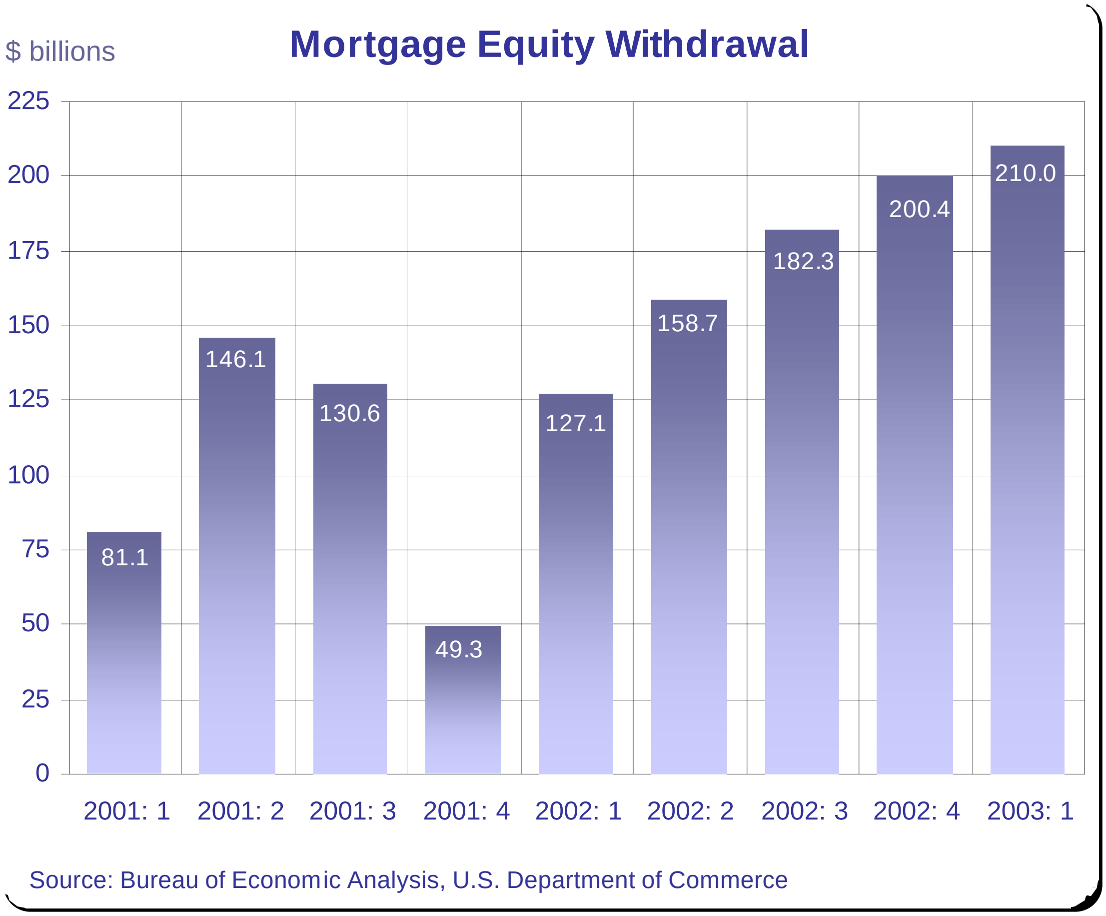


Continued easing is appropriate given how much the outlook has darkened since 2003 began. The threat of war with Iraq (and other "geopolitical uncertainties") sent investor, business and consumer sentiment plunging to ten year lows, and spending slowed.[3] Stock prices slid further, completing three consecutive years of declines. Energy prices jumped as supply contracted (largely due to disruptions in Venezuela) and an unusually harsh winter (particularly in the Northeast U.S. where consumption is highest) boosted demand. Higher prices at the pump and bigger home heating bills are expected to shave as much as 0.3% of GDP from Q1 2003 growth. Low inventories and prospects for continued disruption of Iraqi (and some Kuwaiti) oil production should keep prices high in Q2 2003.



Retail sales slumped in February, as winter storms and heightened terrorist alerts kept shoppers at home. A weak February jobs report pointed to higher unemployment and decelerating wage gains in the months ahead. This and the onset of war in March should restrain consumers further. Indicators of sentiment and activity remain weak despite financial markets shifting direction in mid-March, as war became a certainty. Equity markets, in broad decline since early January, reversed direction, and bond yields lifted from lows last seen in 1959, but, as noted above, this proved transient.

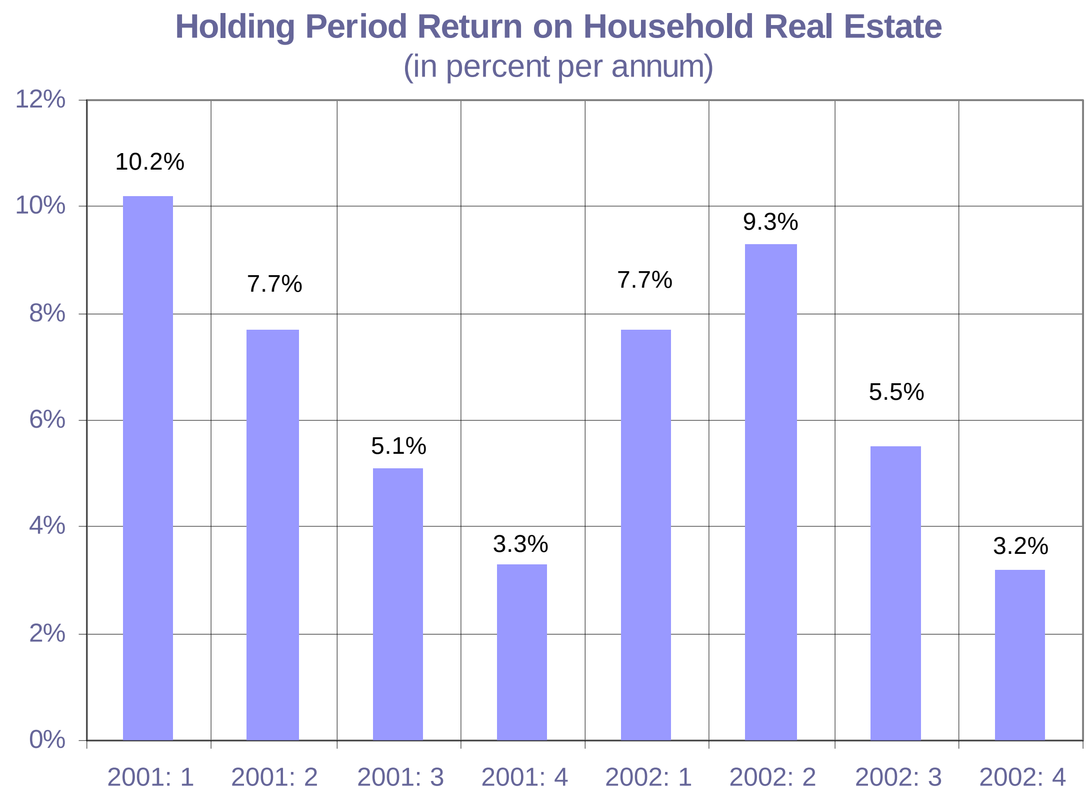
[3] Major sentiment indicators plunged in February. For example: the Conference Board's Consumer Confidence Index dropped sharply to levels last seen in October 1993; the University of Michigan's Consumer Sentiment Index also plunged, reaching September 1993 lows, and the UBS Index of Investor Optimism hit its lowest level since the index began in 1996.



Despite the negative sentiment prevailing, another wave of mortgage equity withdrawal or MEW(the value extracted from household equity through refinancings, home equity loans and net sales) is expected to keep consumption growing in the first half of 2003, but this support is expected to dissipate as the year progresses. Although Fed Chairman Greenspan expects the pace of home equity withdrawal to slow appreciably in 2003, possibly noticeably reducing support to household buying of goods and services, there are no signs of it as yet.[4] American households extracted $200 billion from the equity in their homes in Q4 2002 and appear on a similar pace in the current quarter, despite signs of a cooling real estate market and concern over the rapid growth of mortgage debt. The value of MEW in Q4 2002 alone matched the growth in personal consumption expenditures for all of 2002 of $198.8 billion, equivalent to 1.9% of GDP.

[4] The level of revolving home equity loans continues to grow rapidly, setting successive records for this measure begun in June 1987, and refinancing applications are also up thus far in 2003.

However, this latest substantial cash infusion to households has yet to lift consumer spending. Although personal income continued to grow, real personal consumption expenditures fell 0.2% in January and 0.4% in February, reflecting declines in durable goods sales (largely motor vehicles and parts), as non-durable goods purchases are flat thus far this year and spending on services continue to expand at a 2% s.a.a.r. Instead the personal savings rate[5] rose from 3.8% in January to 4.0% in February 2003. This weakness could continue if, as expected, real estate prices grow only modestly this year. The Office of Federal Housing Enterprise Oversight reported that house prices nationwide were up just 0.8% in Q4 2002 over Q3 levels, although still 6.9% above year earlier levels. An even smaller increase is estimated for Q1 2003.



Source: Bureau of Economic Analysis, U.S. Department of Commerce

[5] Personal savings is equal to disposable personal income (personal income less personal tax and non-tax payments) less personal outlays. The personal savings rate is personal savings expressed as a percent of personal income.

Real GDP growth in Q1 2003 it expected to be 1.2%, down slightly from the prior quarter as higher government spending and, to a lesser extent, higher exports, nearly offset further deceleration in consumer spending and slower growth in both business and residential investment and in inventories. Only modest growth, but not bad considering the degree of uncertainty and shocks that have beset the U.S. economy as it continues to recover from one of its worst financial bubbles. Not bad considering the alternatives.

The Near Term Outlook

Considering the alternatives has taken on added importance in the budgetary process, given both the deterioration in the outlook and the need to prepare for contingencies. Starkly different paths lie before us and it is extremely difficult, if not impossible, to accurately assign probabilities to particular outcomes. This is why, when the semi-annual outlook was prepared in October for the previous budget review, there were two alternative scenarios explicitly incorporating war, for a short war (six to ten weeks in length) and a long war (which extends across the summer), along with a "baseline" scenario in which war does not occur.[6] Over the next six months such scenarios became commonplace and even extended to some interesting simulations that fully articulated these scenarios.[7]

That exercise was repeated for the current budget forecasting round and incorporated some of the expectations drawn from earlier forecasting efforts and from simulations. These included expectations that fiscal and monetary stimulus would be greater, the yield curve steeper, and the retrenchment in consumer and investment spending more marked, the longer the war persists. The fiscal costs of the war were set at 0.75% and 1.0% of GDP respectively in the two scenarios, adding to an expected federal deficit of $307 billion (3.0% of GDP), excluding the costs associated with Iraq. Overall government spending rises at a real rate of 6% and contributes more than a full percentage point to overall GDP growth in 2003 and 2004. Monetary policy remains accommodative under either scenario, varying only in the size (0.25% and 0.75%) and timing of further interest rate cuts, with the Fed this week taking no action but leaving the door open for a cut before the next scheduled meeting May 18th of the FOMC.

Consumer spending growth slows but remains positive in the short war scenario and rebounds quickly in the second half of the year. In a recent survey only 14% of consumers expected to spend more this spring than last, while 41% expected to spend less. Similarly, the majority of firms have slowed or postponed capital spending plans until after the outcome of the war is clearer, which, interestingly, most executives thought would be quickly. This deceleration is largely offset by growth in Federal spending and a continued, modest recovery in business investment, as overall real GDP growth slips to 1.5% this year from 2.4% in 2002. Oil prices remain above $30 a barrel in Q2 2003, before slipping lower to average $24 a barrel in the second half of this year.

6 Frank Fernandez, "The Wall Street Business Outlook," SIA *Research Reports,* October 25, 2002, Vol. 3, No. 9.

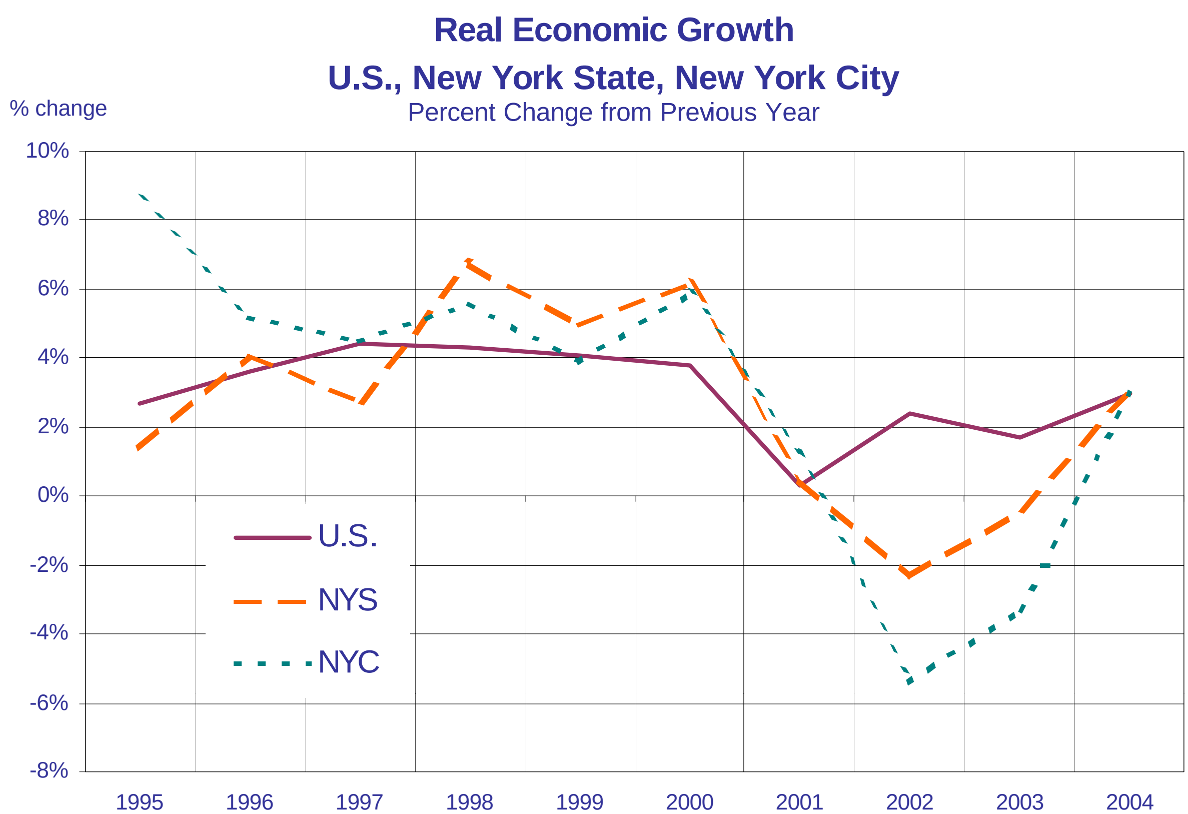
7 Centra Risk Analysis Service, "A Simulation About the Global Economy", February 2003, http://www.centratechnology.com/risk/.

In a longer war scenario, real GDP expands less than 1.0%, with a short, shallow downturn similar in size and shape to what was originally estimated for 2001 (see above) expected to play out. Consumer and business spending stall in Q2 2003 as expectations of a brief, benign conflict are disappointed. Oil prices remain above $30 a barrel into Q3 2003 before gradually declining near year-end. The market which reversed its recent "relief" rally, goes on to retest last October 9 lows and proves much slower to rebound when the war actually does end.

Implications For NYC And NYS

Although the national economy appears to have exited from the recession in 2001, the New York City economy has remained mired in a slump that is expected to extend throughout 2003. Our next issue of *Research Reports* will address the outlook for the state and local economy.

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



Sources: For U.S. (real GDP) and for NYS (real GSP) for 1995-2002 and SIA forecast for 2003-2004: Bureau of Economic Analysis, U.S. Department of Commerce. For NYC (real GCP): NYC Office of Management and Budget 3/19/2003 for all years.

SIA Economic and Industry Outlook: Base Case

INDICATOR	(annual average % change, unless noted)			
US OUTPUT	2000	2001	2002	2003
Real GDP	3.8	0.3	2.4	1.5
Private Consumption	4.4	2.5	3.1	1.4
Business Investment	7.8	-5.2	-5.7	1.5
Residential Investment	1.1	0.3	3.9	0.8
Government Spending	2.7	3.7	4.4	5.5
Exports	9.7	-5.4	-1.6	5.4
Imports	13.2	-2.9	3.2	6.8

Net Exports (1996 $ billions)	-398.8	-415.9	-488.5	-531.5
Change in Inventories '96 $ bn)	65.0	-61.4	5.2	34.0

SECURITIES INDUSTRY

NYSE-member firms ($ billions)	2000	2001	2002	2003
Pre-Tax Profits	21.0	10.4	6.9	7.4
Gross Revenue	245.2	194.8	148.7	153.5
Total Compensation	69.0	60.6	53.1	56.0
- Base Compensation	46.8	41.6	40.5	42.5
- Variable Compensation	22.2	19.0	12.6	13.4

INFLATION & EMPLOYMENT	2000	2001	2002	2003
CPI	3.4	2.8	1.6	2.6
Core CPI	2.4	2.7	2.3	2.7
Employment Cost Index	4.3	3.8	2.6	3.1
Unemployment Rate	4.0	4.8	5.8	6.0

FINANCIAL INDICATORS	2000	2001	2002	2003
3-Mo. Treasury Bills (% p.a.)	5.8	3.4	1.6	1.5
10 Year T-Bond Yield (% p.a.)	6.0	5.0	4.6	4.7
S&P 500 Index (end of period)	1320.3	1148.1	879.8	880.0
(% change v. prev. period)	-10.1	-13.0	-23.4	0.0
Pre-Tax Corporate Profits(%ch)	2.7	-14.3	-1.9	6.5
Economic Profits (% change)	-2.2	-7.2	6.5	7.5

SIA Economic and Industry Outlook: Base Case

INDICATOR: US OUTPUT

(% change vs. prev.per., saar)	Q1 2002	Q2 2002	Q3 2002	Q4 2002	Q1 2003	Q2 2003	Q3 2003	Q4 2003
Real GDP	5.0	1.3	4.0	1.4	1.2	0.3	2.0	2.5
Private Consumption	3.1	1.8	4.2	1.7	1.1	0.5	1.9	2.2
Business Investment	-5.8	-2.4	-0.8	2.3	1.2	-1.0	1.0	3.0
Residential Construction	14.2	2.7	1.1	9.4	0.0	1.0	0.0	1.0
Government Spending	5.6	1.4	2.9	4.6	5.6	5.5	3.5	3.0
Exports	3.5	14.3	4.6	-5.8	3.5	2.0	5.0	4.5
Imports	8.5	22.2	3.3	7.4	4.0	1.0	7.0	7.5
Net Exports (1996 $ billions)	-446.6	-487.4	-488.5	-532.2	-542.8	-555.0	-565.0	-575.0
Change in Inventories (1996 $ billions)	-28.9	4.9	18.8	25.8	12.0	30.0	40.0	50.0

SECURITIES INDUSTRY

NYSE Member Firms ($ billions)	Q1 2002	Q2 2002	Q3 2002	Q4 2002	Q1 2003	Q2 2003	Q3 2003	Q4 2003
Pre-Tax Profits	3.0	2.0	0.9	1.1	1.7	1.6	1.6	2.5
Gross Revenue	38.5	39.0	35.6	35.5	38.5	37.1	37.9	40.0
Total Expenses	35.5	37.0	34.7	34.4	36.8	33.2	36.3	37.5
Interest Expense	11.3	12.7	13.0	11.4	10.3	10.0	10.5	11.0
Total Compensation	14.4	14.5	13.0	11.3	14.0	13.0	14.0	15.0
- Base Compensation	10.5	10.5	10.0	9.3	9.6	9.8	10.3	10.8
- Variable Compensation	3.9	4.0	3.0	2.0	4.4	3.3	3.8	4.2
Revenue Net of Interest Expense	27.2	26.3	22.6	24.1	28.2	27.1	26.9	28.5

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