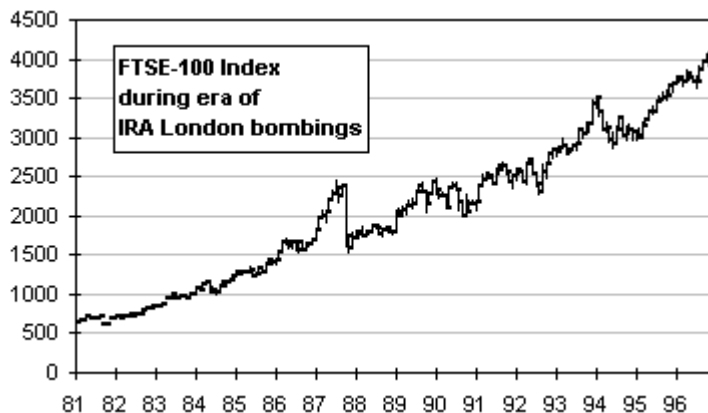
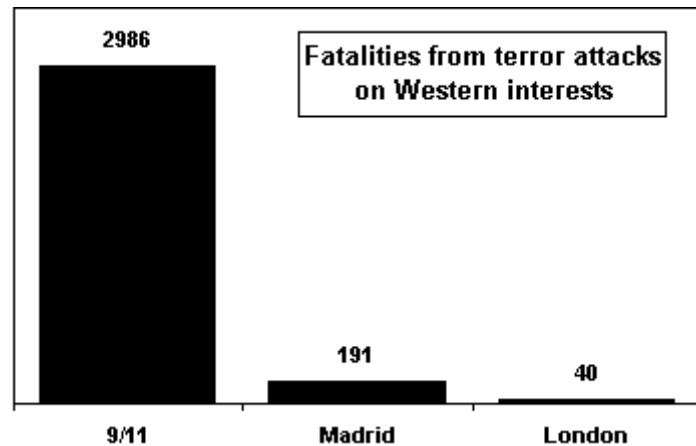


TRENDMACRO LIVE!

On the London Bombings

Thursday, July 7, 2005
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The minor reaction by **world markets** to this morning's **London bombings** suggests that the economic impact of **terrorist attacks** at this level are some combination of trivial and already discounted. We certainly don't mean to minimize the personal tragedy of the loss of lives in today's unconscionable acts. But the fact is that fatalities from attacks on **Western interests** have fallen by an order of magnitude with each incident since **9/11**. If this trend were to continue, the next attack would kill fewer than five people. If that is the best they can do, we should declare victory in the **war on terror**. Yes, even low-fatality events -- if they are persistent -- would be costly and disruptive, at least versus an ideal in which the **global economy** didn't have to deal with such things. But it's encouraging to remember that 16 years of political kidnappings and attacks on London by the **Irish Republican Army** between 1981 and 1997 didn't hold back the **macro growth factors** that drove **market cap** of the **UK's FTSE-100 Index** to multiply by a factor of eight.



Yes, this morning's events do raise the levels of both perceived **risk** and felt **risk aversion** (two separate but related things). But as far as **US markets** are concerned, this is occurring at a time when the **equity risk premium** is already at near record levels -- roughly what it was on the day of the panic bottom in October 2002, and greater than it was after the markets re-opened following the 9/11. To give you a rough-and-ready sense of the **valuation** differences between

then and now, consider that **S&P 500** market cap has grown 19% since month-end September, 2001 -- but **forward earnings** have grown 50%. That makes **stocks** very robust to all but the most major shocks. It was this kind of dynamic that **Baron Rothschild** had in mind when he said to "buy when there is blood in the streets." Symmetrically, **bonds** are already very richly priced -- both relative to stocks and in absolute terms -- and are unlikely to appreciate as much from **safe haven** demand as they might have otherwise. And if there's a bump in **dollar**

demand here, that would be a good thing, all else equal -- it would help **the Fed** to sop up some of the **excess liquidity** in which the world is now awash, and put it a little less behind the curve.

In our view the riskiest wild-card here is **politics**. So far heightened awareness of terrorism has always enhanced **the President's** political capital, and has facilitated his **pro-growth economic agenda**. If it happens that way this time, this morning's tragedy may prove to be a good thing for the economy. But that's far from certain. After a brief period of respect for the dead, **the Left** will no doubt blame **Bush** for this morning's events. Of course **the Right** will say they demonstrate the need to continue the President's policies. No matter what happens, it will be more grist for the mill of bitterness and divisiveness, and the already tenuous political consensus for **economic freedom** and **growth** could be put in play. **TM**