



Instant Insight

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What Now?

By Jack Robert Staff

In the immediate aftermath of the World Trade Center/Pentagon attacks, Internet vendors and service firms, like much of the world, are asking, "What now?" Here Sageza outlines its view of the basic givens of the new order of things, offers some estimations about the short-term economic impacts likely to inform the general business environment over the near-term and highlights some tactical issues that Internet firms will want to address in the days ahead.

Analytical Assumptions

For reasons too numerous to detail in a piece this brief, The Sageza Group takes as givens the following assumptions which have constituted the basis for this analysis:

- ◆ The strategic, business and technological climate of the world has changed in fundamental ways.
- ◆ In the 21st century, the new enemies of global capitalism and trade are guerilla terrorist networks.
- ◆ In response to recent events, the U.S. as leader of the free world will act both in concert with its allies and unilaterally in defense of its national interests.
- ◆ When it acts, the U.S. as the world's preeminent military force will use overwhelming and coordinated military and economic power.
- ◆ The U.S. will respond to this crisis by safeguarding its intelligence and informational assets and attacking the new enemy with massive force.
- ◆ The ensuing conflagration will be a hot, not a cold, war.
- ◆ While global in scope, the focus of the future engagement will be in the Middle and Near East, historically the world's most unstable geopolitical area and, for the past half-century, the locus of the greatest concentration of terrorist activity.
- ◆ When a response from the allied side is engaged, it will mean war and, like all wars, all bets are off about subsequent events as great uncertainty prevails.
- ◆ In contrast to the five months of preparation which led to a 24-hour Gulf War, this response will be initiated quickly with the next few days or weeks and may well be of protracted duration.
- ◆ As counter-terrorism events escalate, the new enemy will defend itself with any and all resources available to it, including the Internet.
- ◆ Extensive use of all forms of high technology will be one of the defining aspects of the new war.

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- ◆ The Internet industry can expect to see the Web used in the following ways:
 - Communications will be sent via the Internet by and among terrorists, especially via email and through embedded messages to colleagues hidden in Websites. (Recent evidence suggests considerable use of pornographic sites.)
 - Communications by and among citizens in the midst of armed hostilities will be significant.
 - Attacks against the security and functioning of allied technological forces will escalate.
 - Instability over the near term will reign in general markets and at Internet funding sources.
 - Specific dislocations will occur with Internet-impacting severity in the following industries: defense, financial services, energy, insurance, construction and transportation.
- ◆ Changes in the overall business environment over the near term will include:
 - Greater unknowns and less short-term stability in marketplace conditions.
 - Higher incidence of business, market, industry and sector volatility.
 - Shift from a monthly business focus to daily or hourly focus.
 - Clearer demarcation of which nations are Web friends of the allied forces and which are not.
 - As in any war, personal and corporate freedoms will be abridged to a greater or lesser extent for the good of the war effort – and events which portend great long-term changes when they occur will be proven to be relatively insignificant in the long haul, while others barely noticed when they occur will help define the entire post-war era.

First Wave Economic Impacts

Given these assumptions, Sageza next felt it imperative to try to ascertain for Internet vendors and suppliers what the first wave economic impacts of the current crisis might be. Our analysis proceeded from the assumption that three measures would serve as a proxy for anticipating future economic changes: namely, that the Dow Jones Industrial Average represents the state of confidence in the general economy, the NASDAQ represents the impact directly on high-tech firms, and the price of gold represents the state of confidence in the overall economic and financial system.

We have further assumed that the events at the World Trade Towers and the Pentagon are on an order of magnitude that put them squarely in the arena of past world-changing episodes. For that reason, we have taken the eleven preceding presidential administrations (starting with Franklin Roosevelt and Pearl Harbor) and isolated and dated one attack or crisis for each administration. We then researched the Dow, NASDAQ and gold price for the days preceding the events and the five business days following, and attempted to quantify the percentage change such events had on the functioning of the business climate and confidence in the overall system. The results of this research are shown at Figure 1.

As can be seen in this table, if the subsequent fallout from recent events follows the pattern of all prior such events or the full scope of Mideast-related ones, we believe the outcome for the Dow, NASDAQ and Gold will be modest. However, we believe there is sufficient evidence to suggest the Trade Tower/Pentagon attacks will ultimately be defined as a world-changing and perhaps even panic situation. (Note: we consider as world-changing the Pearl Harbor attack that kicked off the globalization of World War II, the Cuban Missile Crisis that brought nuclear annihilation to the forefront of daily life, and the Gulf War that had far-reaching implications for world energy prices and balance of power geopolitics.)

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Figure 1: Changes to Dow, NASDAQ & Gold in First Week After Selected U.S. Crises

President	Attack or Crisis	Date	Dow	1Wk	% Chg	NASDAQ	1Wk	% Chg	Gold	1Wk	% Chg
Roosevelt	Pearl Harbor Attack	12/07/41	117	111	-5.15%				~35.00	~35.00	Fixed
Truman	First Atomic Bomb at Hiroshima	08/06/45	163	165	1.23%				~35.00	~35.00	Fixed
Eisenhower	Suez Canal Closing	10/29/56	486	491	0.91%				~35.00	~35.00	Fixed
Kennedy	Cuban Missile Crisis	10/16/62	589	558	-5.31%				~35.00	~35.00	Fixed
Johnson	JFK Assassination	11/22/63	733	752	2.62%				~35.00	~35.00	Fixed
Nixon	Yom Kippur War and Gas Hikes	10/06/73	971	979	0.75%				98.50	103.50	5.08%
Ford	Attack on Spyship Mayaguez	05/12/75	850	838	-1.47%				165.75	166.00	0.15%
Carter	Seizure of U.S. Hostages in Iran	11/04/79	819	807	-1.51%				372.80	389.50	4.48%
Reagan	Retaliatory Raid on Qaddafi's Libya	04/14/86	1790	1840	2.80%	379	390	2.96%	341.90	342.70	0.23%
Bush1	Iraq Invasion of Kuwait/Gulf War	08/02/90	2899	2735	-5.67%	436	408	-6.47%	370.60	384.70	3.80%
Clinton	Attack on Iraq during Impeachment	12/16/98	8823	9045	2.51%	2,013	2,121	5.38%	292.50	287.20	-1.81%
Bush2	Trade Tower/Pentagon Attacks	09/11/01	9606	???	???	1,695	???	???	271.50	???	???
<i>Averages of All Prior Events</i>					-0.75%				0.62%		1.99%
<i>Averages of MidEast-Related Events Only</i>					-0.04%				0.62%		2.36%
<i>Averages of World-Changing Events Only</i>					-5.38%				-6.47%		3.80%
Estimates Of Possible Economic Outcomes In First Week After:											
If Follows Pattern of ALL PRIOR Events			9533	-72		1706	11		276.90	5.40	
If Follows Pattern of MIDEAST-RELATED Events			9602	-3		1706	11		277.90	6.40	
If Follows Pattern of WORLD-CHANGING Events			9089	-516		1585	-110		281.83	10.33	
If Generates CUMULATIVE PANIC (All+Mideast+World-Chg)			9013	-592		1606	-89		293.63	22.13	

Note: Quotes Start at Close 1 Trading Day Before Event -- and End at Market Close 5 Business Days Later

In the case of such world-changing events, then, we might expect to see the Dow fall 500-600 points (5-6%) and gold to rise substantially over the first week after the incidents. These predictions are further borne out by the fact that many world markets have seen 5-6% declines in the past 36 hours – and the price of gold, after initially rising \$5-6 as predicted above, has now been driven up to levels consistent with a \$20-30 short-term increase. Naturally, once U.S. markets reopen in the upcoming days, resurgent patriotism and caution may forestall a large sell-off of equities – and automatic caps that kick in at the

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London Gold Fix may limit upward price pressures to some degree though we expect to see gold demand be very strong for the foreseeable future as global tensions continue.

It is also of note that the limited data available for the NASDAQ during the incidents cited suggests a potential mixed bag of results. While the Libya Raid and Iraqi Attack during the Reagan and Clinton Administration produced an upward short-term result for the NASDAQ, the world-changing nature of the Gulf War and Iraq's invasion of Kuwait and seizing of certain oil fields pushed the NASDAQ down over 5% in a week. Since we believe the recent events are of similar world-changing scope, we expect a fall in the Nasdaq of perhaps 5-6% over the course of the first week after the Trade Towers/Pentagon incidents. Longer term, since considerable high-tech is used in all manner of defense, transportation, energy, and global trade venues, we expect to see upward price pressure on some key related NASDAQ issues.

In any case, what the foregoing data suggest is that Internet vendors and suppliers may expect to see some short-term softening of marketplace conditions and increasing worries about the solidity of the system – but that the order of magnitude of such changes is unlikely to be catastrophic. While “business as usual” will be a long time in returning to the marketplace, there will be sufficient overall stability to enable Internet firms to conduct business in relatively near-normal terms.

Second Wave Operational Impacts

Mid-term, we expect the business climate for Internet vendors and suppliers to change markedly as a result of recent events. Some of the changes that we believe may be coming include:

- ◆ Increased scrutiny of corporate operations by government agents in search of strategic information, e.g., recent seizures of some records of ISPs in search of terrorist-related emails and Web activities.
- ◆ More self-policing by Internet firms of potentially strategic information, e.g., America Online's recent turnover of data and documents relating to possible terrorist use of its network.
- ◆ More thorough investigation of Internet employees, particularly from known terrorist-affiliated nations, and sequestering of sensitive data and technologies from such employees.
- ◆ Increasing need for Internet firms to monitor the potential internal harassment of its Islamic employees and to watch for incidences of hate-related retaliatory measures (which could have far-reaching and expensive legal ramifications for Web firms in addition to the human impacts).
- ◆ More likelihood that greater protective measures will be called for in the U.S. Congress aimed at safeguarding American technology.
- ◆ In such a climate, U.S. firms may be required to show cause why its subsidiaries in even non-terrorist nations should have access to such technology.
- ◆ Increased and immediate dangers to some offshore Internet facilities, especially in Israel and India, which are located closer to potential hostilities.
- ◆ Deteriorating and unstable travel conditions worldwide and immediate effects on international flights and conferences.

Long-Term Internet Business Impacts

As the events of the coming months unfold, we also expect to see a number of longer-term fundamental changes in the business climate for Internet technologies and services. These include:

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- ◆ More downward price pressures as nations experiencing declining demand and consumer flights to financial safety emerge as less able to shoulder higher technology and service prices.
- ◆ Increased delays in purchasing decisions as buyers wait to see how world events evolve before committing their resources.
- ◆ Greater emphasis on and power devolving to Internet technology groups who have common sets of security tools, closer ties with government agencies, integrated Internet products and delivery mechanisms, and greater economic clout to weather difficult demand and supply conditions.
- ◆ If the Internet is used for future terrorist attacks, there may also be a widespread backlash against the Internet and a perception that the Web is too ubiquitous and vulnerable to be trusted with consumer and corporate commercial activities.

Final Thoughts

The Sageza Group believes Internet vendors and suppliers would do well in the current climate to remember that conventional wisdom and views derived under the stress of world-changing events often do not emerge over the long-term as initially anticipated. For instance, in the Gulf War, conventional wisdom suggested oil prices were tremendously volatile and likely to continue going through the roof so locking-in contracts was thought to be the wisest, most economical course. In retrospect, however, users who continued to buy at spot prices on a daily basis were rewarded with much lower costs overall. Prices fell back to normal levels much more quickly than initially anticipated and supply and demand reached equilibrium rather rapidly and safely. Similarly, for Internet vendors and suppliers, many of the anticipated outcomes suggested here may not in fact occur – or may occur in very much truncated or altered fashion.

Similarly, while we have here briefly touched upon a number of negative concerns for Internet vendors and suppliers, the overall prognosis could be surprisingly upbeat in the long term. With the dawn of a new era of global concern and assuming the eventual demise of volatile terrorist networks, we believe Web firms may eventually see a day when greater security, stability, demand, supply and profits will be forthcoming. Though the near-term implications of recent events suggest a “bunker mentality” may emerge at many firms, we believe such efforts will ultimately prove less than wise. While great changes are occurring and at lightning-like speeds, we believe the opportunities of the current challenges suggest considerable upside for well-positioned, far-seeing firms. In the same way that Pearl Harbor and WWII led to the great Post-War boom on the late 1940s, we believe the current circumstances give many hopeful hints about the future.

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