

MARKET CALLS

W's Bottom

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The bears get their say this week as the war gets real -- but markets have seen the worst.

The stock market has been worried about more than just the business cycle. It has had to focus on a series of political crises for **George W. Bush** -- each one of which threatened to damage the fundamental stability of the political backdrop on which long-term business decisions depend. There have been three important market declines associated with three political crises over the last nine months. Each decline ended in a panic bottom when the political crisis was resolved, and was followed in each case by a substantial rally. So far each resolution and rally has been followed by another political crisis and another decline. The result has been a persistent economy-wide risk aversion -- at a time when the economy itself has appeared otherwise to be in modest recovery. Hopefully the third time is a charm, and this painful period will turn out to be -- if not a W-shaped bottom -- then at least W's bottom.



With the war underway, the uptick in President Bush's popularity and prestige was sufficient to keep his budget and tax-cut proposals far more intact in **the Senate** than anyone would have thought possible just a month earlier. A movement by so-called "moderates" in the Senate to reduce Bush's proposed tax cuts by \$375 billion was overturned by a substantial majority. A *narrow* majority approved a reduction of \$100 billion, putatively to pay for the war against **Iraq**.

So why the weak opening on Wall Street this morning? Because this week, the same media that hyped the war against Iraq as a swift and easy high-tech strike are hyping it all over again, this time as a bloody and protracted battle. From Pacman to Chechnya in 48 hours. This opens up the prospect of devolving back into political crisis, if it turns out that the American people are as fickle or gullible as the media thinks they are -- if they thought that war didn't involve the death of soldiers, and withdraw support from the President when they find that this one does.

Some polls this morning do suggest that support for the war has dropped sharply since last week, but others contradict that -- yet another symptom of the fog of war. The task now before the Bush administration is to manage perceptions and expectations, and stabilize public support. That is essential to stabilizing the political backdrop of the economy -- a necessary platform for the continued restoration of investor risk tolerance, and the absorption of the deep risk premium still embedded in markets. Our bet is that Bush -- and the war -- will succeed. **TM**