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Markets should be going up, unless . . .

If Iraq war goes badly, stocks could take hit

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Now that the market-stifling question of whether the United States would invade Iraq has been answered, the near-term fortunes of stocks probably will rise or fall with the nature of news from the battlefield, investment experts say.

But even a war with a seemingly predictable ending raises concern about what comes next, and the potential impact of the new Iraqi war on investment markets over the long run is not yet clear.

So far, positive news from the Iraq war has fueled a surge in stock prices.

The Dow Jones industrial average had its biggest weekly gain since 1982 last week, climbing 8.4%. The Standard & Poor's 500 index rose 7.5% for the week, and the Nasdaq Composite Index increased 6%.

Because stock investors hate uncertainty, the resolve to go to war and its actual launch last week was a boost for the forward-looking equities market. The belief among many investors is that the conflict will be short and it will spark a recovery in consumer and business spending.

"The market is expecting this to be swift and successful," said Maureen Busby Oster, president of MBO Advisors in Milwaukee.

But war can take unexpected turns, she cautioned.

"If you look beyond the short run, the risks are that it isn't short, that something goes dreadfully wrong - which isn't currently anticipated - and whether that would really derail the economy and consumer confidence," Oster said.

'Ready to move on'

Still, some investment professionals believe the stage may be set for a sustained recovery and rise in stock prices,

with the Iraq war being perhaps the last hurdle to overcome.

"The fundamentals are there," said Clare W. Zempel, chief economist for Robert W. Baird & Co. in Milwaukee.

The market is undervalued relative to interest rates, tax cuts are coming, oil prices are heading down and capital spending is poised to grow, he said.

"It's now three years and counting since the tech stocks started to fall - since the correction started in that category - and I think we're ready to move on," Zempel said.

Zempel cited three times in the last three years that the recovery was starting to gain steam, only to be stalled by a major, anxiety-causing news event that became an impediment: the Sept. 11, 2001, terrorist attacks, the Enron scandal and the "intense rhetoric" from the Bush administration in late summer about the possibility of war with Iraq.

"Everything is ready to go," Zempel said. "It's been uncertainty that's restraining it. Therefore, if uncertainty declines, if the risk declines, things should take off."

That's a big "if," said Varun Mehta, director of public fixed income for Mason Street Advisors, a subsidiary of Northwestern Mutual Life Insurance Co. in Milwaukee.

While acknowledging in an interview Friday that "the war so far seems to be going reasonably well," Mehta said he wonders whether it will continue that way. The advance to Baghdad probably will go smoothly, he said, but he expects Saddam Hussein to stage a bitter and perhaps well-orchestrated last stand.

"I am skeptical about whether it will continue to be as good as it has been," Mehta said.

He said an "optimistic scenario" for war has been priced into the stock market.

"If the situation turns out to be more complicated, we could see a fairly sharp and quick decline again in the stock market," Mehta said.

Investors focus on war

University of Wisconsin-Madison professor Werner De Bondt, an investor psychology expert, said that right now, most investors are focused on one thing - how the war is going.

"If you look at history, it's clear the wars that have gone well - like, say, the second world war - resulted in a big gain in wealth for stock holders," De Bondt said.

As the tide of World War II turned for the U.S. and its allies, investors became bullish, and the Dow Jones industrial average doubled in three years.

The first Gulf War also helped boost the stock market. Markets rallied in 1991 when the U.S. and allies began to bomb Iraq. The Dow ended the year with a gain of 20.3%, and the S&P 500 index rose 26.3%.

"Wars that haven't gone so well, like the Vietnam War, if you look at the late '60s and early '70s, it created a lot of unhappiness in the markets," De Bondt said.

The decade ending Dec. 31, 1974, was one of the worst 10-year spans for stocks since the Depression, with the Dow losing 36.4% and the S&P 500 off 19.1%.

De Bondt said investors would be unwise to make a move revolving entirely around the day-to-day progress of the new war with Iraq, De Bondt said.

"If you're talking about investors, not short-term speculators, the implication is do nothing," De Bondt said.

What could go wrong

Mehta said several things could go wrong in the war with Iraq. Among them:

- Other nations, such as China or Russia, might argue that, if the U.S. can violate the concept of absolute sovereignty by invading Iraq, they can, too.
- North Korea could use the situation to "do something rash."
- If the Iraq war drags on, it may be viewed by more Arab nations as Americans vs. Arabs. He said there is "a rising wave of anger" among Arabs toward the U.S.

"The geopolitical problems we have don't begin or end with Iraq," Mehta said.

Even the more-optimistic Zempel said it is important for the markets that the war not last too long.

"I think an extended occupation is expected," he said. "An extended war beyond a few weeks isn't."

Oster said the aftermath will have economic impacts to consider.

"What do we do in terms of rebuilding? It's going to cost a lot of money. There is going to be more competition for capital. Interest rates are more likely to go up than down," she said.

Kenneth Brusda, president of North Star Asset Management in Menasha, has been saying for months that a quick victory over Iraq could be the start of a happier times for the beleaguered stock market. Now that war has begun, he said he still feels that way.

A lot of money is on the sidelines right now - money earning less than 1% in money markets - that could come back into the stock market as investors grow more confident that the war will turn out as planned, he said.

"It's not over yet, but it's going the right way," Brusda said.

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