

DISASTERS AND THEIR INFLUENCE ON THE INVESTORS BEHAVIOUR ON THE WORLD STOCK MARKETS

A terrorist attack, tropical storms, earthquakes and many other kinds of catastrophes are the headlines of yesterday's, today's and tomorrow's newspapers. The frightening regularity of such disasters beyond our control has exposed our vulnerability to adversity. Individual investors, in particular, gravitate toward the worst-possible scenario, believing that any unprecedented risk will bring economic growth to a crashing halt. Unanticipated state of affairs sends stock prices plunging as panicking investors order to sell, sell and sell. But do these risks mean we should completely avoid the stock market and keep our money under our mattresses? And if not, how can we mitigate our financial outfall as the market crashes in the aftermath of another disaster? In my following report I have shown three disasters as the example, which are: the earthquake in Japan (17 January 1995); the terrorist attack in New York (11 September 2001) the Katrina Hurricane (August 2005).

Заголовки вчерашних, сегодняшних и завтрашних газет пестрят сообщениями об атаках террористов, тропических ураганах, землетрясениях и прочих катастрофах. Пугающая регулярность таких бедствий, не поддающихся человеческому контролю, демонстрирует нашу уязвимость перед такими неблагоприятными внешними факторами. Частные инвесторы склонны верить в неблагоприятное развитие событий, считая, что любой беспрецедентный риск приведет к катастрофическому прекращению экономического роста. Непредвиденное изменение состояния дел приводит к обвалу цен на биржах, так как паникующие инвесторы начинают в массовом порядке продавать акции. Но означает ли наличие таких рисков, что мы должны бояться фондовых рынков и держать наши деньги «под матрасом?» Как мы можем смягчить свои финансовые потери, если рынок обваливается в результате последствий очередного бедствия? В статье рассмотрены три примера катастроф: землетрясение в Японии (17 января 1995); террористическая атака на Нью-Йорк (11 сентября 2001); ураган Катрина (август 2005).

Earthquake Effects

The effects of any earthquake depend on a number of widely varying factors. One can count the number of deaths caused by large earthquakes to compare the results of all these disparate factors in combination.

The worst earthquake catastrophe in years occurred on western Honshu Island early this year. More than 5000 people perished in southern Hyogo prefecture, most in the city of Kobe, Japan's most important port. The loss of so many lives, in a country where so much effort had been made to prepare for earthquakes, shocked observers worldwide. However, the magnitude of this catastrophe is probably due to a terrible coincidence of a few simple seismological and societal factors.

More than 150,000 buildings were destroyed, major highways and bridges failed, rail-

roads and subways were made non-operational, and water, sewage, gas, electric power, and telephone systems were extensively damaged and out of service for varying periods of time. Kobe was one of the six largest container cargo ports in the world and the major one in Japan.

Total damage and destruction is estimated at more than \$100 billion.

The major economic consequences of earthquakes result from damage to elements of the built environment that are essential to the operation of the economic activities in the impacted region. Some sectors will even find an increase in their activity because of demands placed on them by the disaster. Some activities will be winners while others will be losers. There may be both winners and losers in a particular sector. Factors that will cause businesses to lose include the direct damage they entail to

their facilities because of their location in the area that was stricken. Other factors include their dependency on damaged or destroyed support systems of transport and communication for workers, customers, supplies, shipments, water, electricity, gas, telephone, and other services.

Businesses that may benefit are ones for which there is an increased demand for their products or services for relief, clearing and removing debris, repair and restoration, and reconstruction.

Investors behavior: share prices that days, drop insensibly. Only shares from building sector growth awhile. I can say that investors reaction was delayed because of lack of strict information about a total size of disaster.

World Trade Centre

Another catastrophe I analyzed, had place in USA.

The events of September 11 shocked the world. There is no doubt that it means we live in uncertain and dangerous times. However, international commerce will continue and will potentially help rebuild the fragile world economic environment.

Of course, the events from New York have rattles the US most of all. American society is feeling a little less secure and impenetrable now.

The direct economic effects of September 11 occurred mainly in the USA. There has been considerable business disruption especially in the financial markets in the Wall Street district and with IT systems. Some economists estimate the financial cost of the destruction to be the equivalent of a natural disaster like an earthquake or a hurricane. For instance, the International Monetary Fund notes that the direct economic damage to the US economy is much smaller than that resulting from Kobe earthquake in Japan in 1995. Macroeconomic Associates has estimated the attack to have destroyed US\$13 billion of private and government capital. The Institute of International Economics has also noted the direct impact on the airlines, hotel, insurance and industries. Many also anticipated a spike in oil prices and a flight to bonds. Whilst this has not occurred to the extent it was anticipated there is fear of some oil supply shock in the future if the conflict in Afghanistan continues.

Market response after the 9.11 terrorist attacks was driven by sheer panic. Stock prices plummeted as traders sought the security of bonds and all indicators pointed towards deeper economic recession. Sectors associated with discretionary consumer spending, such as airlines, hotels and retailers, took the brunt of the price collapse. But the market recovered. Only for a couple days the stock exchanges in US were stop with their activity. While airline traffic spiraled to new lows, Americans began to drive and the automobile industry flourished. The drop in hotel occupancy was negated by an increase in family functions. Stocks recouped their losses one month later and by the end of the year, they were 20 percent higher than their post 9.11 lows. In fact, U.S. indexes increased in the next quarter and continued its growth the following year.

Hurricane Katrina

Hurricane Katrina was the eleventh named storm, fifth hurricane, third major hurricane, and second Category 5 hurricane of the 2005 Atlantic hurricane season. It was the third most powerful storm of the season, and the sixth-strongest Atlantic hurricane ever recorded. Katrina formed over the Bahamas on August 23, 2005, and crossed southern Florida at Category 1 intensity before strengthening rapidly in the Gulf of Mexico, becoming, at that time, the strongest hurricane ever recorded in the Gulf (Hurricane Rita broke this record later in the season). The storm weakened considerably before making its second landfall as an extremely large Category 3 storm on the morning of August 29 along the Central Gulf Coast near Buras-Triumph, Louisiana. The storm surge from Katrina caused catastrophic damage along the coastlines of Louisiana, Mississippi, and Alabama. Levees separating Lake Pontchartrain from New Orleans were breached by the surge, ultimately flooding about 80 % of the city, all of St. Bernard Parish, and portions of St. Tammany Parish, as well as Plaquemines Parish. Wind damage was reported well inland, impeding relief efforts. Katrina is estimated to be responsible for \$75 billion in damages, making it the costliest hurricane in United States history. The storm has killed 1,422 people, becoming the deadliest U.S. hurricane since the 1928 Okeechobee Hurricane.

More recently, hurricanes seemed poised to create a bear market in equities. The economic repercussion seemed formidable with insured losses approaching \$25 billion and a short-term hit to consumer spending. In New Orleans alone, it is estimated that 600,000 people would become temporarily unemployed. Hurricane Katrina massively handicapped the country's energy infrastructure, with damage to production platforms and refineries possibly cutting off one-third of U.S. oil producing capacity and causing a spike in energy prices.

However, the effect on the economy is rarely permanent. Economists predicted only a 0.5 percent drop in growth rate in the second half of the year, down from the 4 percent growth of previous forecasts. Typical of other natural disasters, the impact is also offset by government-led reconstruction and economic relief efforts. Emergency oil and gasoline stockpiles were released to absorb the supply shock; the Federal Reserve reduced long-term interest rates in anticipation of slower economic growth; governmental agencies began to help displaced workers. Contrary to popular belief while disasters influence individual and corporate consumption, the total amount of expenditure often rises, not falls.

What Should the Informed Investor Do?

The economic strain in the aftermath of a disaster is transitory. For example, the economic loss of the 9.11 attacks fell short by \$20 billion of the \$45 billion predicted. Moreover, U.S. financial markets are surprisingly resilient to historical calamities.

While disasters are a bane for individuals, national growth rates are hardly affected, thanks to federal intervention and rebuilding efforts. Hence, if the disaster does not trigger a change in prevailing market trends, there is no need to change investment strategies. For instance, the terrorist attacks merely compounded the numerous factors flagging the U.S. economy. And while the hurricanes were different in that they struck at a time when the economy was showing solid growth, crude oil prices had already doubled in the two years prior to Katrina.

Supervisor Prof. *Roman Magda*

Crises also have limited consequences because very often, investors realize that corporate earnings will bounce back. 95 percent of a stock's price depends on the profits of the firm beyond the next year. To put it more simply, stock prices recover from disasters. Despite the endogenous economic factors, market volatility is often ruled by emotions. Investors are human and tend to react irrationally to dire news. In the face of human tragedy, investors can hardly imagine that the affected people and economy will eventually recover. In such an emotionally charged environment, long-term investment strategies are difficult to execute. Thus an investor with a diversified portfolio of quality securities should not react to temporary setbacks, but should instead "stay the course," Market Strategists advised.

At some point, market rationality will prevail, even as periods of market irrationality are observed. Fund managers believed the spreads would return to their fair value over time. Few investors, however, have the risk tolerance and deep pockets to weather fluctuations in markets, especially through crises. Although markets become rational again, they can remain irrational longer than the investor can remain solvent.

Moreover, when a crisis does strike, many investors, despite prior planning to buy, succumb to the same fear of the market. Investing smartly now is the best course of action.

In the longer scheme, it is insensible to worry when the next catastrophe will strike. While investors are plagued by a fear of energy shortages, natural disasters and terror campaigns, there exists more alarming issues that could undermine market growth, such as the anti-globalization movement, ageing demographics, protectionist policies and intellectual property rights. Hence, while risks in the stock market are indeed very real, investors face them everyday.

The moral of the report? Treat the next disaster like a speed bump; it forces you to slow down but not to stop. Hindsight is the best investment tool, and one can always draw chart and conclusions afterwards, but for the everyday investor, it is crucial to get the timing right.