CAPITOL ANALYSTS NETWORK, INC.

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WASHINGTON OUTLOOK

War Risks: On to Iraq?

Before military action is possible, the U.S. must first exhaust diplomatic solutions. There's perhaps a 40 percent chance that Hussein will agree to and then honor the intrusive, go anywhere, at anytime, U.N. inspection regime just adopted that prevents war. While many possibilities exist, the most likely is that the U.S. and its allies will overthrow Saddam Hussein next spring or summer, using a force over 200,000 to do so.

An invasion would succeed. Iraq has fewer people than Afghanistan, and its armed forces are less than one-third as potent as they were during the 1991 Gulf War. Meanwhile, technological advances make the U.S. stronger than in 1991. The U.S. still needs time to replace the 21,000 missiles and smart bombs, and to repair overtaxed air carriers and aircraft, all used during the Afghani campaign. Meanwhile, the Administration recently signed lengthy contracts with commercial ship owners to begin transporting heavy military equipment to the area.

If an invasion is launched, it will have multi-lateral support, especially from Russia and France. Iraq's two major creditors will switch sides once it becomes clear a new government will be formed which they can't afford to alienate. Other creditors also would make similar calculations and back the U.S. when it's safer to do so. After any invasion, Iraq would turn from an enemy into a regional ally. The U.S. would likely base troops there indefinitely with the new government's support, devaluing the Saudi's military significance and pressuring Iran and Syria into stop backing terrorists. Iraqi oil fields are under producing. With sanctions lifted, they would be modernized, boosting output at OPEC's expense. Iraq would use the new oil revenue and reduced defense expenditures to rebuild.

Are There Any Stock Plunge-Fighting Tax Breaks On the Horizon?

The Administration is conducting an internal debate over the scope of its economic stimulus and tax reform program that will be announced no later than early February. Expect an investor friendly proposal to pass next summer; lower capital gains tax rates and holding periods, larger individual capital loss write-offs, dividend exclusions, faster depreciation, and more generous IRA and 401 (k) rules are under consideration. The estate tax will be permanently repealed, except perhaps for the very largest of estates.

Sweeping reforms also are being studied, including substituting a business transfer tax for the corporate income tax and substituting a value added tax for the individual income tax.

CAN's Legislative Overview of the Lame Duck Session and the Coming 108th Congress

Industry fundamentals and investment fashions matter, but policy changes do, too. CAN uses an industry risk weighting system to communicate where federal legislative or regulatory actions are likely to help or hurt investors. In CAN's rating system, positive risk weights are bullish and negative risk weights are bearish, on a scale that runs from +10 to -10. Here are our current findings.

Telecommunications (DSL equipment providers): +7

The FCC has initiated a rule making process that will accelerate broadband deployment. Formal FCC action is anticipated between December and March. Their review is expected to especially help DSL providers. House passage of the Tauzin-Dingell bill last March, which offers incentives to regional Bell companies to roll out DSL to the public, will buttress the FCC. The GOP Senate takeover also will help. The new Commerce Committee Chairman, John McCain (R-AZ) is sympathetic, and he replaces Ernest Hollings (D-SC) who opposes the RBOCs. The idea here is to buy companies that sell picks and shovels to gold prospectors. RBOCs should benefit, too.

Mining: +7

Interior Secretary Norton has ended the war on miners on federal land. Highly profitable leases will once again be let.

Pharmacy Benefit Managers: +7

The Bush Administration rolled out its revised seniors pharmaceutical discount card program in late August, and it became final on November 4. If it survives a likely court challenge, PBMs are expected to get 10 million seniors as new customers. If they lose in court, the Administration will rely on the Congressional GOP to pass remedial legislation.

Defense: +7

The public's militant mood toward terrorist threats means that the Administration should get almost everything it asks for on defense this year. There is a 60 percent chance of a war with Iraq this year.

Property Casualty Companies and Terrorism Insurance: +7

The Administration will push hard in the lame duck session to have Congress pass a compromise reached with Senate Democrats. It has a 50 percent chance of passage in the next week. Otherwise, the next Congress will take it up. For three years, the industry would receive for free 90 percent federal terrorism reinsurance coverage above a thresh hold.

Sallie Mae: +6

There will be a concerted effort to raise federal student loan limits in 2003 as part of reauthorization of the Higher Education Act. It's also possible that the direct lending program, whereby the federal government lends to students directly, is curtailed.

Agribusiness: +6

As a result of the recently passed farm bill, Congress will bankroll prosperity in the rural economy by providing record subsidies to crop farmers for the next six years. Also, the next Round of WTO talks will help American agribusiness, especially biotech. Ethanol producers may have to wait until the next Congress to benefit from a mandatory increase in ethanol usage as part of a coming energy bill.

Trade: +6

The U.S. will sign free trade agreements with Chile and Singapore soon and send them to Congress for ratification, utilizing the President's recently granted trade promotion authority.

Credit Card Issuers and Auto Lenders: +5

House and Senate negotiators have reached a compromise that amends the bankruptcy code. It would help credit card issuers that market to above average income families and also auto finance companies. Speaker Hastert (R-IL) must decide whether to send the agreement to the House floor over the objections of the pro-life community or start over next year. The bill narrows the bankruptcy rights of abortion clinic protestors who are sued for that reason.

Paper and Wood Products: +5

Eventually a revised U.S.-Canadian trade agreement will be reached that restricts Canadian imports. Canada is unhappy about the sanctions imposed by Bush.

Managed Care: +5

Only 15 percent of seniors are enrolled in managed care. Medicare overhaul legislation under development at the White House would create a large incentive for them to join. The GOP Congress is unlikely to pass a patient bill of rights bill that hurts much.

Highway Builders: +4

Congress will approve legislation boosting spending on America's highways, probably by year end.

Tobacco: +4

The Justice Department lacks the financial resources to fully prosecute the Clinton case, which was viewed as weak anyway. If the Department offers a good enough settlement deal, the companies will take it.

Brokerage: +4

Don't expect Congress to create private accounts as part of Social Security reform next year. However, changes in capital gains and 401 (k) laws may spur trading and M & A activity.

Rural Hospitals: +3

Congress likely will boost Medicare payment rates in the next Congress.

Asbestos Impaired Manufacturers: +2

The GOP would like to move a bill that would reduce industry exposure and aid speedy delivery of compensation to the truly ill. Until Senate Democrats demonstrate their willingness to negotiate, however, investors should be cautious.

Pharmaceuticals: 0

The Bush discount card plan will hurt somewhat. However, Medicare overhaul legislation will help by expanding total seniors' consumption.

Fannie Mae/Freddie Mac: -3

The Administration has considerable latitude, if it wants to use it, to curb the companies' growth rates. It can, for example, block further GSE debt issuances or forbid entry into new product lines. Eventually new restrictions are expected.

Life Insurers : -6

Accelerating the phase-out of the estate tax and making this change permanent will damage the incentive to purchase whole life and universal life policies.

Retail Pharmacies: -7

The Administration will push hard to implement its private sector based plan to offer uninsured seniors discount cards for pharmaceuticals. Retail pharmacies will be forced to give up generous margins on sales to seniors.

Tax Haven Headquartered Corporations: -7

Bermuda headquartered Ingersoll-Rand, Cooper Industries, and Nabors Industries, among others, are targets of aggressive loophole closing tax reformers. Both GOP tax Committee Chairmen, Congressman Bill Thomas (R-CA) and Senator Charles Grassley (R-IA) want action; they will move against flagrant corporate expatriates.

Airlines and Tourism: -8

If the U.S. defangs Iraq by force, and there is a 60 percent chance of this happening, these industries will suffer.

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