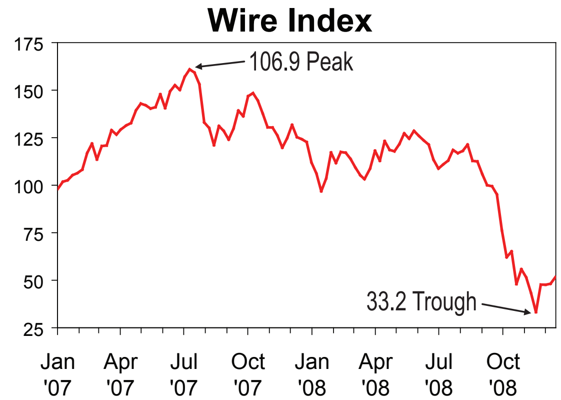
HOT WIRE™

News and Economic Outlook for the Wire and Cable Industry

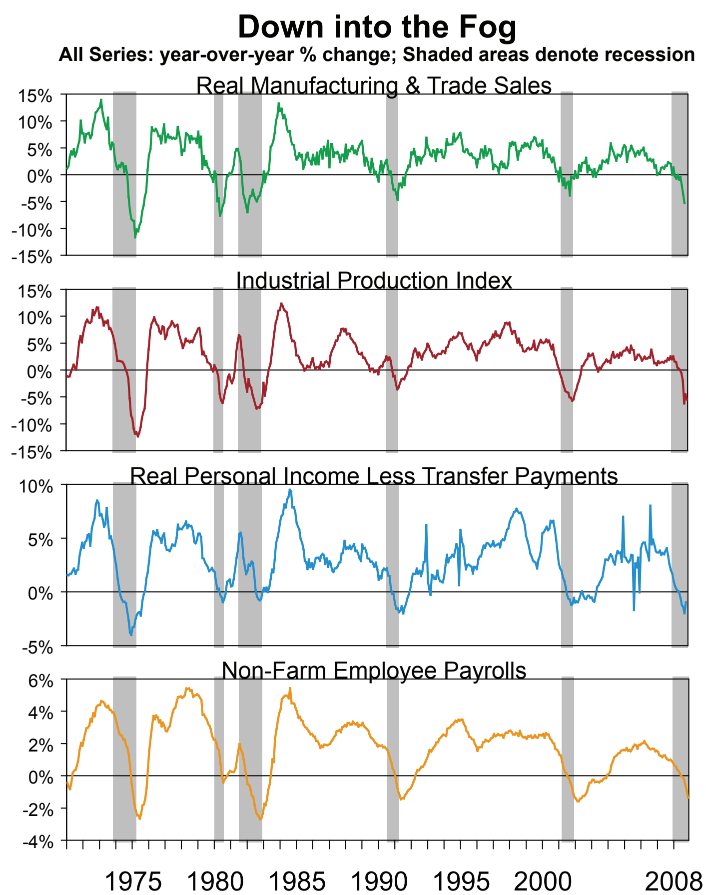
INDUSTRIAL ELECTRIC WIRE & CABLE™

Dear Friends of IEWC, here is my account:



Industry News The Wire Index ended its freefall this month, closing up from the previous month for the first time since May. This does not necessarily signal a turnaround, but more likely marks the point where investors can no longer justify beating down the value of these stocks. If the Wire Index has already seen its trough for the current cycle – which I believe is likely – then the total decline from its peak in July of 2007 can go on record as -79%. The current bottom for the weekly-calculated index was on November 21st, when the Index measured a mere 33.2. Compare this to the S&P 500's current peak-to-trough decline of just over -50%.

US Economy Early this year, in the February edition of the *Hot Wire*™, I analyzed the four series of data below and argued that, while some of the indicators showed moderate weakness at the time, the US economy would still likely avoid recession this year. Unfortunately, I was wrong. The National Bureau of Economic Research (NBER), the private organization with the traditional responsibility for determining business cycle dates, examined these same sets of data and declared at the beginning of this month that the economy is, in fact, in a recession that began in December of 2007. As the graph clearly demonstrates, the slight declines in sales, production, income and employment that I observed in February have now accelerated to reflect the severity of the current recession. Ultimately, the string of bank failures this fall and the ensuing panic which still grips many businesses, investors and consumers turned what looked like a mild economic softening into an all-out contraction.



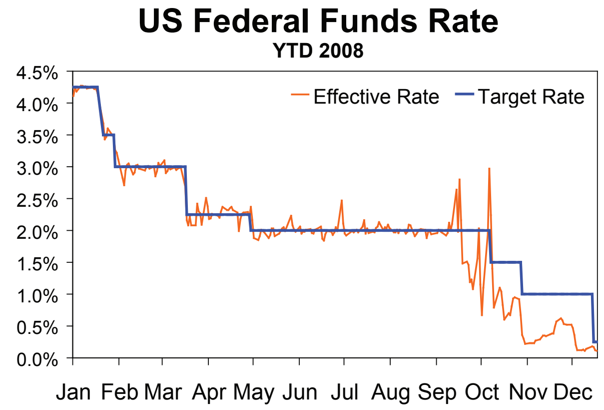
Zero Interest Rate Policy Throughout the current crisis, The Federal Reserve Board has been very active in US markets, rapidly expanding their balance sheet to accommodate the financing and purchase of several private sector assets, all in an effort to provide maximum liquidity to the markets. If all of these previous efforts were like selling arms to their allies, the Fed officially declared war on the 16th of this month, formally enacting a zero interest rate policy, targeting a Fed Funds rate between 0.25% and 0%.

In normal practice, the Fed keeps its heavy hand on the economy through Open Market Operations, its primary tool used to shape the money supply. In using this tool, the Fed buys and sells government bonds with banks in order to affect the interest rate that domestic banks charge each other for cash loans. By purchasing bonds, the Fed increases the bank's reserves, allowing that bank to loan out a fraction of those funds, effectively increasing the supply of money in the economy. When making much-publicized adjustments to the Fed Funds rate, the Reserve Board is really announcing its intention to purchase or sell more bonds in order to expand or curb the money supply. A growing money supply, *ceteris paribus*, creates lower interest rates, and vice-versa. Because this monetary policy tool is an imperfect way to affect interest rates, however, the effective Fed Funds interest rate usually only hovers near the "target" rate that the board formally announces. As shown in the chart on the opposite page, the Fed's recent announcement was mostly a formality, as Fed policy pushed actual inter-bank loan rates below 0.5% for most of the last fifty days. By holding interest rates at these historic lows, the Federal Reserve is flooding the system with excess liquidity in hopes of easing the fears that have many hoarding cash. If liquidity is easy to come by and banks are flush with excess reserves, there is more incentive to reopen the lines of credit that keep businesses in business.

The Fed is even preparing itself with its next major weapon, what is generally referred to as quantitative easing. With interest rates already as low as they can go, the Fed is now in the process of flooding banks with reserves in excess of what is required to encourage 0% inter-bank

BY THE NUMBERS (US)	Industrial Production (Oct to Nov change)	November Unemployment	Retail Sales (Oct to Nov change)	Mfg.'s New Orders for Durable Goods (Sept to Oct change)	November CPI Inflation (over prev. 12 months)
	-0.6%	6.7%	-2.0%	-6.9%	+1.1%

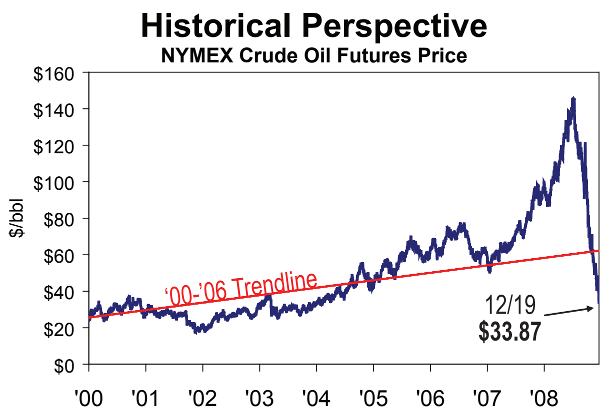
loans. The Fed will do this by expanding its purchases to include mortgage-backed securities and debt from various government-sponsored agencies. Here again, the goal is the same – create enough liquidity to keep the gears of the economy turning. All of these actions will ensure that the current recession does not include a repeat of the Great Depression. The Fed Chairman, Ben Bernanke, is one of the foremost scholars on the economy of the 1930's and is now applying a lifetime of study to real life decisions as the head of the central bank. I believe the Chairman's real challenge will be reigning in all the excess money when the economy picks up again, a necessity to avoid another lending-fueled inflationary bubble that got us to where we are today.



Oil/Gas/Polymers Throughout the past few months of trauma, high emotion and overall decline, many historic events have transpired, not the least of which is the cliff-like decline in the price of a barrel of crude oil. Crude oil prices, as determined on the Nymex futures exchange, reached a much-noted peak of $147/bbl in July of this year. Since then, prices have collapsed by more than 75%, attracting much less attention on the way down than they did on the way up.

This dramatic decline has many significant effects on our economy, most notably the cost of energy. Average gasoline prices in the US have fallen from well over $4.00/gallon to less than $1.70. As a whole, this creates a much needed fiscal stimulus for American consumers. Diesel prices have come down with similar speed, lowering the cost of shipping and transportation for everything from highway trucking to ocean freight and increasing the fiscal sense of long-distance trade. Although these price changes can be quite disruptive to the oil firms and the shipping companies who have to ride the downward trend in the cost of their product, these price changes are consistent with what the market does best – allocating resources. At a time when demand for energy and transportation is declining, the market senses the excess supply and lowers prices, boosting demand just when it is needed most.

Polymer costs realized a similar decline in the previous five months. Futures for Polypropylene and Linear Low Density Polyethylene as traded on the London Metal Exchange are down more than 50% from their summer highs. This is, of course, a direct result of the decline in oil and natural gas prices, feeder stock for the production of these plastics. Just like the delay in bringing exchange copper prices to the market for finished wire and cable products, insulation and jacketing compound costs face a similar time lag from changes in the cost of raw materials – possibly longer considering the additional stages of production.



The question now is whether the long-term price for oil lies closer to $30 or $120. OPEC, the infamous oil cartel, seems to lean towards the higher end, pledging to cut production by 9 percent next month in order to offset the commodity's steady decline. As oil accelerated past $120/bbl, I predicted that such elevated prices would not hold, though I did not foresee such a significant decline south of $50. If the more moderate upward trend established between 2000 and 2006 is any indicator, then the run-up during the past two years was indeed excessive, but so then is the downward correction of the past five months. See this comparison in the graph to the left.

Nymex crude oil closed at $33.87/bbl on the 19th of this month, with natural gas futures posting similar declines to close at 5.33/mmBtu.

2009 It's almost here. As most anyone will tell you, the next year holds a significant amount of uncertainty. The global economy is under a stress that is remarkably unprecedented in modern history. All things considered, I believe the turnaround will occur sometime in this next year, but that still makes me an optimist. With a steep recession fueled mostly by fear and hysteria, a return to rational decision-making may lend itself to a relatively speedy recovery. Only time will tell for sure. Stay tuned.

Wishing you the very best this holiday season!

Sincerely,

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