

*Dear Friends of IEWC, here is my account:*

### US Bank Failures

I suspect that Treasury Secretary Hank Paulson and Federal Reserve Chairman Ben Bernanke have had a number of late nights this month. In order to keep up with the recent bank failures and market swings, both US agencies have made a number of impulsive moves to try and calm financial markets, many of which were implemented overnight between US market trading sessions. Despite the leaders' traditional hands-off approach to the markets, Bernanke described the current situation best when he told colleagues, "There are no atheists in foxholes and no ideologues in financial crises."

This past month got off to a bad start with the Federal takeover of Fannie Mae and Freddie Mac on Sept. 7th. Fannie and Freddie are Government Sponsored Enterprises (GSE) chartered by Congress with the purpose of supplying a steady flow of funds to the US mortgage market. Congress passed a law in July of this year intended to expand regulations and inject capital into the struggling GSEs, but this action was overshadowed by the complete government takeover accomplished early this month. Essentially, the Federal Government established a conservatorship which allowed the US Treasury to supply a large sum of loans to Fannie and Freddie as needed. As GSEs, these organizations carried an implicit backing by the Federal Government, and the government has now made good on its assumed role.

In what proved to be a rare showing of non-government intervention, the second major failing of the month came on Sept. 15th, when Lehman Brothers announced its intention to file for bankruptcy. The relatively small investment bank faced a number of debts associated with bad mortgage investments, and began to have trouble securing additional financing after its bonds were downgraded by various ratings agencies. Left with a pile of debts about \$129 billion greater than its assets, and no cost-effective method to raise capital, Lehman was forced into bankruptcy. On that same Monday, Merrill Lynch agreed to sell itself to Bank of America for \$50 billion, at a share price more than 60% below the September 2007 level.

The Federal Government's second moment of great market intervention came with the Federal Reserve's decision to lend up to \$85 billion to the American International Group (AIG), one of the world's largest insurance firms. Among other things, AIG spent some of its time in the last decade writing credit default swaps, a type of financial derivative used to insure against defaults. In the problem case, AIG wrote swaps to protect investors against default on the many mortgage-backed securities they were buying. As these securities went sour, AIG found itself with a rising number of obligations and a limited ability to raise additional capital after a credit-rating downgrade. Recognizing AIG's importance in the financial and insurance markets, the Federal Reserve, with the support of the US Treasury, effectively nationalized the company on Sept. 16th, intending to provide liquidity to the insurance giant while it sells off portions of its business in an orderly manner.

Following these bank failures, the Federal Government rolled out a lineup of additional programs designed to shore up financial markets. The Treasury announced a guaranty program for money market funds after some of these traditionally low-risk investments began to lose value. The Securities and Exchange Commission halted short selling on 799 financial company stocks in hopes of preventing precipitous stock declines like those that occurred earlier in the week. Banning short selling – the practice of borrowing existing shares, selling them, and buying replacement shares at a later date in hopes that share prices have since fallen – is about as useful as forcing the media to only print happy news, but I'm sure the SEC's intentions are good. The most potent and sweeping action of the week was the Treasury's plan to set up a government entity to repurchase up to \$700 billion of residential and commercial-related mortgages, the same troubled assets which are weighing down financial institutions' balance sheets around the world. After being submitted as legislation on the 20th, Congress will likely pass some form of the bill quickly before the legislative body takes its scheduled recess on the 26th to prepare for the November elections. Following this series of proposed government interventions late in the week, the stock market rallied more than 7 percent, ending the tumultuous week only 34 points below the prior week's closing. The Dow has since dropped back, closing at 11,016 on Monday the 22nd.

Witnessing the failure of financial institutions which market themselves with large, powerful animals and slogans like "The Strength to be There" (AIG) is unnerving. While some have been warning of this type of financial fallout for months, the magnitude of these bank failures has been greater than many analysts, including myself, ever expected. In this time of panic, we must keep our eyes on the fundamentals. For all that has happened this past month, business conditions remain relatively unchanged. The economy is soft, home prices are falling, banks are struggling to unload soured mortgage assets and lending standards are tight, but this list of challenges is no different that it was six months ago. These financial meltdowns impact the general economy primarily through their effects on lending practices. With great uncertainty and skepticism throughout, banks charge higher interest rates for loans to each other, and corporations face higher costs when issuing and insuring debt. Without adequate liquidity and access to loans, businesses and consumers have a more difficult time financing their regular operations and purchases, thus threatening economic growth. The reality of this impact, however, depends more on your immediate situation than any of the problems on Wall Street. For those consumers and businesses that behave responsibly and maintain good credit ratings, everything should be business as usual.

BY THE  
NUMBERS  
(US)

**Conference Board  
Leading Index**  
(July to Aug change)

**-0.5%**

**July  
Unemployment**

**6.1%**

**Retail Sales**  
(July to Aug change)

**-0.3%**

**Mfg.'s New Orders  
for Durable Goods**  
(June to July change)

**+1.3%**

**August  
CPI Inflation**  
(over prev. 12 months)

**+5.4%**

Those who find it opportune to say so have touted the recent financial crisis as proof that market capitalism is failing. While the financial crisis has certainly pointed out some needed improvements in financial regulation, the causes of the crisis are rooted in government failure – not market failure. The Federal Government works diligently to create ever rising rates of homeownership; creating and guaranteeing mortgages through the GSEs Fannie Mae, Freddie Mac and Ginnie Mae; insuring mortgages with The Federal Housing Administration; and creating attractive deductions and first-time homebuyer credits in the tax code. All of these actions in effect subsidize homeownership, increasing demand for homes and creating an unnaturally high rate of homeownership. Although not as directly, Greenspan's decision to hold the Fed Funds Rate below 1% for much of '03 and '04 also encouraged increases in homeownership. When the government provides paths to homeownership that the market wouldn't otherwise provide, we should only expect to eventually uncover problems of "excess" in the mortgage and housing industries.

**2008 Hot Wire Business Survey**

My sincere thanks to those of you who took the time to respond to last month's *Hot Wire* Business Survey. I received a total of 40 responses, with a diverse sampling of wire and cable manufacturers, sub-assemblers and original equipment manufacturers. Although many of your survey answers may have presented a more pessimistic outlook following this recent week of turmoil, I figure that it is a good exercise in long-term thinking to contemplate the business outlook that you all presented just a few weeks ago.

As the charts to the right show, self-reported 2008 business activity is mixed. Just less than half of the respondents indicated that their businesses are flat or down for the year, while the same number of respondents answered that their business activity was up more than 5%. Hiring activity in the industry seems slow, as only 28% of the respondents cited a 2008 expansion in company headcount. Capacity expansion appears moderately healthier with just over half of all respondents noting an acquisition, facility expansion or significant capital investment during 2008. The industry outlook for 2009 is cautiously optimistic, but individual business predictions were decidedly more confident, with a quarter of respondents calling for 10%+ growth next year. For the last question of the survey, responses were split evenly between feeling that the general economy is and is not in recession. As vague as this question was, I believe the 50/50 split is telling of a stagnant economy which continues to ride the fence between growth and contraction.

**Commodities**

Nymex Copper prices fell steadily throughout the past 30 days, dropping as low as \$3.07 before climbing to close at \$3.27/lb on the 22nd of September. These lower prices reflect concern over shrinking global demand as the financial crisis worsened and stocks fell around the world. As the dust settles and the economic outlook becomes slightly clearer in the coming months, I expect that copper will rebound closer to the \$3.50 level before the end of the year.

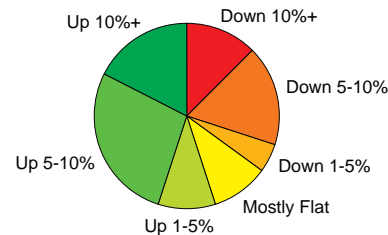
In what would have made headlines in any other month, crude oil futures posted steep declines, at one point falling more than 35% from its record high this summer. Despite damaging hurricanes in the Gulf, broader economic concerns eliminated support for \$100+ oil, allowing Nymex futures to plummet to \$91.15 before the recent rebound. In what appears to be a day of hysteric trading, oil has since jumped a record \$25.45 during trading and closed at \$120.92/bbl on the 22nd. In the current market environment, I don't read much into this volatility, but can only assume that oil's extreme dive and climb is a delayed mimicking of the stock market's similar maneuver last week. Clearly, all markets are exhibiting a great deal of volatility in the near term.

Look for my 2008 Presidential Election coverage in next month's issue.

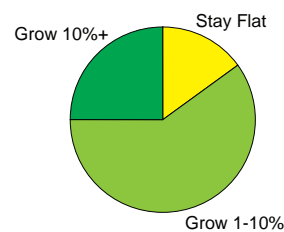
I welcome your thoughts on my reports! Feel free to call or email if you have questions or comments about something I've written in the *Hot Wire*.

**2008 Hot Wire Business Survey Results**

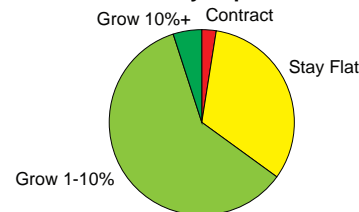
**2008 Company Activity**



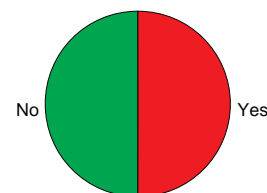
**2009 Company Expectations**



**2009 Industry Expectations**



**Economy in Recession**



Sincerely,

*Brian Hirt*

Brian Hirt  
M.A. Economics  
IEWC Business Analyst  
BHirt@iewc.com  
262-957-1118



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