

Dear Friends of IEWC, here is my account:

Industry News

Despite continued market volatility and a still very bearish market, the Wire Index managed to squeak out another relatively flat month, closing 5% higher than the value recorded in last month's newsletter. The Wire Index tracks the market value-weighted stock performance of six publicly traded wire and cable manufacturers and distributors. Click [here](#) for a list of these companies and historical data on the Wire Index.

Wire and cable assembly giant, Volex, stated its intention this month to sell its wire harness division to an internal management buyout group, Ionix Holdings Limited. Volex Group maintains separate divisions for its power supply cord, interconnect assembly and multi-drop harness products, and intends to sell the unprofitable wire harness division in order to focus on the other two profitable business units. The assets of the wire harness division were valued at £18.8 million in 2008. Volex Group has agreed to sell the division to Ionix Holdings for £1, followed by payments to Ionix Holdings as great as £850,000. The transaction is expected to be complete by the end of March. Click [here](#) to read full details of the proposed transaction.

China

Prior to the current recession, there was a popular idea that China and other large emerging economies were becoming decoupled from the United States. Where prior recessions in the US predictably dragged down the world's other major economies, the decoupled theory suggested that China was self-sufficient enough to sustain positive rates of growth in spite of a staggering US economy, even creating demands enough to support growth in many other world economies during a US downturn. It has now become clear that China is not yet independent enough to remain standing when the heaviest player in the global economy takes a fall.

With data released last month, the National Bureau of Statistics of China reported fourth quarter growth at only 6.8%. While the US and other more developed economies would be concerned about overheating with growth this fast, this reflects a relative recession for China, which typically reports growth well into the double-digits and officially targets an 8% annual rate. Although this 6.8% implies a still expanding Chinese economy, the data is rather deceiving for statistical reasons. While most industrialized countries report annual rates of quarterly GDP growth factoring in seasonal adjustments, the Chinese government produces only the single, unadjusted growth rate for the quarter, with very little supporting data. Given China's command and control government, and the lack of visibility into the underlying calculation, manipulation of the numbers also becomes suspect. Taking these factors into consideration, many large financial institutions have produced their own estimates of China's fourth quarter seasonally-adjusted annual growth rate, ranging from -1% to 4% – a significant slowdown reflective of a more "coupled" economy.

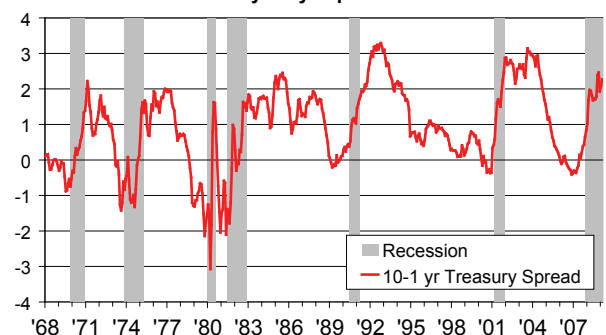
One thing that does give China higher hopes for the immediate future is the large stimulus plan that the Chinese government put into effect late last year. While this fiscal stimulus faces many of the same challenges as its American counterpart, its size relative to GDP is roughly three times as large as the US stimulus plan, and the Chinese government's lack of debt makes it much more affordable. China is not immune from the troubles in the US and the rest of the world, but it is heavy enough to create some pull of its own.

US Economy

As economic data roll in reflecting activity during December and January, the pain of the current recession is becoming more tangible. Recent employment data show 1.8 million jobs lost in the last three months, half of the jobs lost since the recession began in December 2007. Industrial Production declined 1.8% in January, topping off a full 10% decline since January 2008. The modest economic decline through August of last year proved teasingly insignificant compared to the fierce contraction of the past five months.

With all of the current pain, there are still some indications that the recovery is not too far around the corner. Retail sales climbed a full percentage point in January, and the ISM's PMI ticked up slightly to reflect a decelerating rate of contraction. The Conference Board's Leading Economic Index climbed for two months in a row ending January, the first consecutive increase since the beginning of the recession. Perhaps the most credible indication of pending recovery is the increased Treasury yield curve. The yield curve measures the different yields that the US Treasury has to pay on its various maturities of bills, notes and bonds when auctioned daily on the bond market. As the government pays different rates of interest for each bond maturity, the spread between the yields on short-term debt like the 1-year bill and long-term debt like the 10-year note becomes a measure of future interest rates expectations. If the yield curve has a positive slope where short-term rates are lower than long-term rates, this is considered normal and predicts economic growth in the near term, as an expanding economy increases the threat of inflation as well as a reactionary interest rate hike by the Fed. With

US Treasury Yield Curve
10yr - 1yr Spread



BY THE
NUMBERS
(US)

**Industrial
Production**
(Dec to Jan change)

-1.8%

**January
Unemployment**

7.6%

Retail Sales
(Dec to Jan change)

+1.1%

**Mfg.'s New Orders
for Durable Goods**
(Nov to Dec change)

-3.0%

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

0.0%

expectations of rising inflation and higher interest rates, bond traders purchasing long-term debt demand a higher return on investment, pushing up Treasury yields. Conversely, expectations of a recessionary period with lower interest rates and possible deflation cause bond traders to bid down the yields on long-term notes, creating a negatively sloped yield curve. A negative yield spread has successfully forecasted every post-war recession 6-24 months in advance, issuing only one false alarm in 1966. Similarly, as is evident in the graph above, the return of a sharply positive yield curve correctly signaled the near end of each recession. The yield curve successfully forecasted the current recession with an inversion in 2006 and early 2007 when most (including me) were still very optimistic, and may now be correctly predicting the bottom at a time when many are as pessimistic as ever.

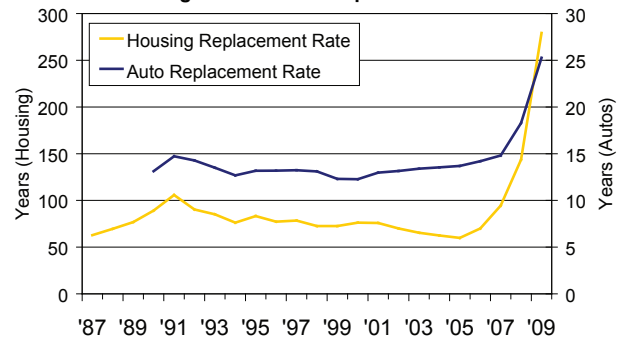
US Housing & Autos

The markets for homes and cars are at the center of the current recession (and the wire and cable industry). Housing sales and starts declined steadily from the 2005 peak and proved to be a major source of the current crisis via improper lending and securitization practices. Unit auto sales stagnated for most of the last decade and declined substantially throughout last year, exacerbating the downturn and gaining much media attention as automakers went looking for a bailout. As the recession worsened this past fall, housing and auto statistics went from bad to worse. Although these markets now seem to be perpetually withering, it is important to understand that these fractional sales figures cannot last forever. The faster sales decline, the greater the pent-up demand and the sooner the turnaround.

Comparing the number of existing housing units in the US with the rate at which builders put up new homes, history suggests that the average replacement rate is about 70 years. This is calculated by simply dividing the existing stock of homes by the annual rate of housing starts, yielding the number of years required to replace the existing stock at the current build rate. Given the amount of houses that go up each year without replacing an existing home to accommodate a rising homeowner population, surely many homes age more than 70 years before they are replaced, but this calculation still provides a historical context for what a sustainable relationship between housing stock and housing starts looks like. As shown in the graph to the right, the replacement rate for homes climbed to an average of 144 years in 2008 as housing starts fell off, and shot up to 279 years with the even slower rate of starts reported for January of this year. Clearly, the current pace of home construction is unsustainably low. As painful as this trend is for the many people regularly employed in home construction, it shows that the market is doing what is necessary to work off the market's current excess inventory, and that more normal conditions will inevitably return in the near future.

How Old is Yours?

Housing & Auto Stock Replacement Rates



The story for the US auto market is similar. Extrapolating the Department of Transportation's vehicle registration records through 2006, there are about 240 million cars and light trucks on the road today. Divide this number by the industry's underperforming annual unit sales of 13.1 million in 2008, and the auto replacement rate is 18 years. Using the feeble sales recorded last month, this replacement rate jumps to more than 25 years. Admittedly, I was able to drive a 17-year-old car to its death soon after college, but even that was pushing it. Unless Americans are making a permanent shift to own many fewer cars, we can expect auto sales to turnaround soon.

Copper

Comex future prices continue to hold on near the \$1.50/lb level, closing at \$1.41 on the 20th of this month, despite steadily rising inventories.

As copper prices fell swiftly this past fall, it became realistic to wonder if copper would return to the more stable, sub-\$1.00 price levels that dominated before the run-up began in 2004. While future copper prices are impossible to predict with any regularity, the current climate leads me to believe that there is little reason to hold out for a further, significant decline in copper prices. Generally, investors have already priced in Armageddon. The Dow is down to almost half of its 2007 peak, and the financial collapse of last fall caused as much negative investor hysteria as one could imagine. Considering that copper managed to stay well above \$1.00 during all of this, it seems unlikely that prices will remain at these lower levels once a more normal growth outlook takes hold.

Sincerely,

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