

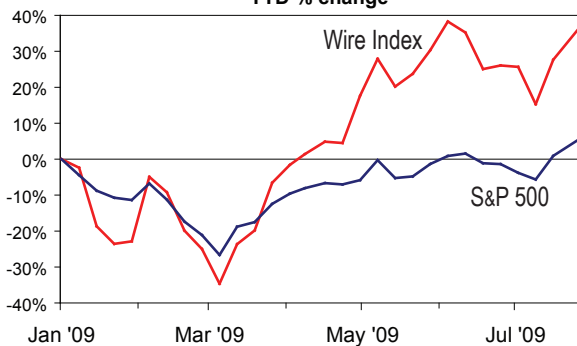
Dear Friends of IEWC, here is my account:

### Industry News

The US stock market compiled a significant rally in the past three weeks leading to a 14% increase in the Wire Index over this time last month. As shown in the graph below, the S&P 500 index turned into slightly positive territory for the year in the last two months. In contrast, the Wire Index is up more than 30% since the beginning of this year after falling from January to March. Over the past couple of years, the Wire Index has generally moved in a magnitude much greater than that of the market as a whole. I understand this to be a function largely of fluctuations in copper as the wire and cable industry players have proved financially sensitive to price movements for the red metal. As we saw with the collapse in commodity prices last year, falling metal prices destroyed inventory values and led to sizeable accounting write-downs for many. When copper rises, inventory values appreciate and investors read an increase in demand, boosting the industry's balance sheets and stock values.

### Wire Index vs. S&P 500

YTD % change



In modern portfolio theory, the relationship between an asset's returns and that of the broader market is described by a single variable called beta ( $\beta$ ). A beta of 0 indicates an asset that has no correlation with the markets while a positive beta indicates a positive correlation with the market. As you might expect, a negative beta implies a negative correlation with the market meaning that the asset moves in the opposite direction of broad market indices like the S&P 500. Beyond measuring the direction of an asset's correlation, a beta also describes the magnitude of the relationship, with a beta greater than 1 or less than -1 signaling volatility greater than the market, and a beta between -1 and 1 implying less volatility than the market. The larger the beta, the more risky the asset and the higher the potential returns.

From looking at weekly returns for the Wire Index versus the S&P 500 since the beginning of 2008, I calculated a beta of 1.9. A beta of this value indicates that the asset, in this case a weighted portfolio of Wire Index stocks, will increase or fall with the market but at a rate almost twice that of the S&P 500. You can see this relationship clearly in the year-to-date returns displayed in the above graph, as the Wire Index fell further than the market on the way down and has now climbed significantly higher than the market after the turn. This makes for some risky (and lucrative) investments in the wire and cable industry.

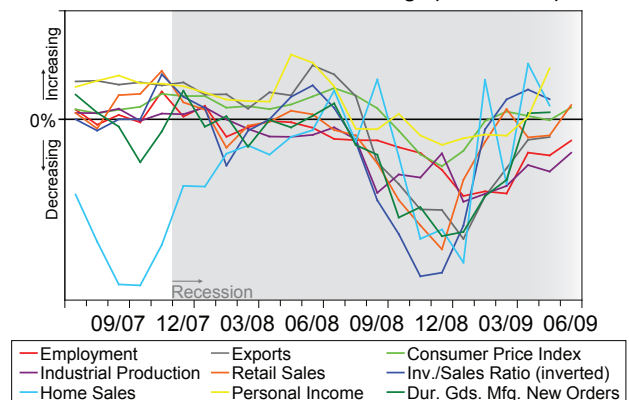
The Wire Index tracks the market value-weighted stock performance of six publicly traded wire and cable manufacturers and distributors. Click on the graph above for a list of these companies and historical data on the Wire Index.

### US Economy

The business cycle is alive and well. As shown in the graph below, a wide range of indicators on the US economy continue to improve and are starting to point back towards growth. The scale used in the graph is varied somewhat to allow multiple series to appear on one plot, but the trends in each statistic are similar. With the exception of housing, most indicators of the economy remained fairly stagnant through the first eight months of the official recession. This mild trend led many analysts – including this one – to argue that the economy was not heading into recession. With the fallout on Wall Street in September '08, however, panic put the brakes on economic activity and led to a steep decline in industrial production, home sales, retail sales, new orders and exports. With fewer shipments going out the door, manufacturer and trade inventories climbed relative to sales, further slowing the flow of orders up the supply chain. Employment, income and prices contracted in the subsequent months following their typical lag. In the first few months of this summer, all of these measures of the economy have started to move in the right direction. Although exports, employment and industrial production still remain below the 0% line and were thus still in decline during the previous three months, their pace of contraction has slowed – a prerequisite for turning positive. Perhaps most important, the Inventory/Sales ratio (inverted on the graph) has started to fall steadily, paving the way for a sustainable uptick in manufacturing activity. Not until manufacturer stocks fall back to leaner levels will consumption of component products like wire and cable make a significant comeback.

### Heading in the Right Direction

All series: 3mo annualized % change (varied scale)



### The Recovery

Even the most dismal forecasters will now admit that the world economy is making strides to pull out of the recession in the next couple quarters. The main point of interest now falls on the strength of the pending recovery. If the recent World Economic Outlook report from the IMF represents a

BY THE  
NUMBERS  
(US)

**Industrial  
Production**  
(May to June change)

**-1.4%**

**June  
Unemployment**

**9.5%**

**Retail Sales**  
(May to June change)

**+0.8%**

**Mfg.'s New Orders  
for Durable Goods**  
(Apr to May change)

**+1.8%**

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

**-1.4%**

basic consensus view, then the mainstream clearly expects a very slow recovery. The IMF report forecasts a 2.5% growth rate for the world economy during 2010, compared to the pre-recession 5.1% growth recorded in 2007. The study projects US growth at a mere 0.8%, most of Europe near zero or in decline, and Japan and Canada leading the advanced economies with a sluggish 1.6% and 1.7% forecast, respectively. Even China's 2010 8.5% growth forecast puts growth only a point higher than their 2009 projection of 7.5% – a relative recession for the emerging economy. If these predictions come true, next year's recovery will feel much more like an extended idle than a noticeable acceleration. The rationale for such meager forecasts stem from the idea that the debt-fueled American consumer that drove economic growth in the previous expansion has now lost its line of credit and will no longer serve as the economic engine it used to be. Without a large block of consumers to take its place, the argument goes, global trade will languish and overall economic activity will be slower for an extended period of time.

Opposite the mainstream prediction of a sluggish recovery, history suggests that the economy is capable of making a sizeable recovery in a short amount of time. Looking at the record of past recessions in the US in the table to the right, a 6-9 month recovery in GDP is typical. With the US economy already about \$275 billion smaller than it was before the recession began in December 2007, even a three quarter recovery next year would require annualized growth rates above 3% – robust growth by US standards. As painful as any recession is, economic decline has the benefit of what is usually called creative destruction. Creative destruction involves the failing of businesses and employment relationships which ultimately makes room for greater innovation and more efficient allocation of resources in the future. It is the many opportunities created by this destructive process which pave the way for the V-shaped recovery that follows most recessions.

Recession Period	Pre-Recession Real* GDP	Recession End	Full GDP Recovery	Recovery Length
'55 - '54	\$2.1 trillion	Q2 1954	Q4 1954	2 quarters
'57 - '58	\$2.3 trillion	Q2 1958	Q4 1958	2 quarters
'60 - '61	\$2.5 trillion	Q1 1961	Q2 1961	1 quarter
'69 - '70	\$3.8 trillion	Q4 1970	Q1 1971	1 quarter
'73 - '75	\$4.3 trillion	Q1 1975	Q3 1975	2 quarters
'80	\$5.2 trillion	Q3 1980	Q1 1981	2 quarters
'81 - '82	\$5.3 trillion	Q4 1982	Q2 1983	2 quarters
'90 - '91	\$7.1 trillion	Q1 1991	Q4 1991	2 quarters
'01	\$9.9 trillion	Q4 2001	Q4 2001	0 quarters
'07 - '09	\$11.6 trillion			

\*Real, inflation adjusted GDP measured in fixed 2000 dollars


In the coming economic recovery, I believe the actual pace of growth will be more robust than the consensus predicts yet more prolonged than the typical rebound. With the severe economic contraction of the last 12 months, the economy has little direction to go but up. Core industries like housing and automotive are producing well below long-term, sustainable levels, leading to an imminent rebound in these sectors. And the creative destruction of the recession is feeding the next decade's greatest advances. Think the transition to higher fuel-efficiency and more renewable energy sources, the upending of the traditional newspaper industry, or the rise of the middle-class in China and India. Surely, the American consumer will not be the economic force that it used to be, and the transition to a new economic balance will take more than a few months; but we have every reason to believe that the next economic driver will soon take its place. The only trouble is that we don't yet know just what that new engine will be.

**Copper** Copper prices continue to post month-over-month increases, reminiscent of the climb in 2005 before the first spike above \$4.00/lb. While I believe another jump like that is unlikely in the current economic situation, the market's continued acceptance of such high prices gives weight to the idea that the recent collapse to sub-\$2.00 copper was more an exception than a return to previous norms. Comex copper futures closed at \$2.54/lb on the 27th of this month, the highest closing price since October of last year. Higher costs for copper and other inputs continue to make their way back into material costs for wire and cable products, reversing many of the price decreases that made their way through the industry this past winter.

**Oil/Gas/Polymers** Oil prices continue to make a home in the \$60 levels, staying relatively close to that range for the last two months. Futures prices for polypropylene and polyethylene compounds as traded on the LME have followed a similar pattern, holding fairly steady in recent weeks but still well above the low prices reached at the end of last year. Nymex crude oil futures closed at \$68.38/bbl on the 27th. Natural gas closed at \$3.06/mmBtu on the same day, still very near the commodity's lowest prices of the recession.

Eager to hear commentary on a particular issue from an industry perspective? Send me your ideas.

Sincerely,



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