

Dear Friends of IEWC, here is my account:

Industry News

The Wire Index posted another flat month, closing at 71.3 on the 22nd of this month. The index still remains virtually unchanged since May of 2009. Click on the graph to the right for more information and historical data on the Wire Index.

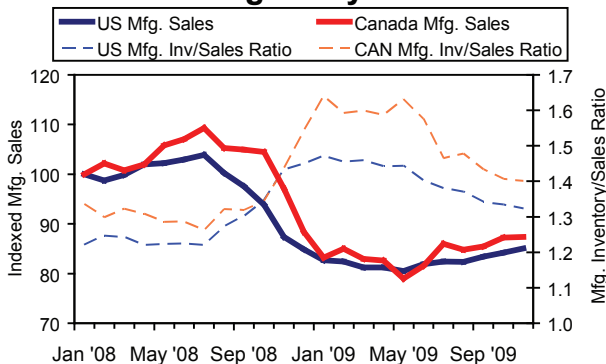
After a year nearly void of merger and acquisition activity among wire and cable manufacturers, 2010 brought moves from two of the world's largest manufacturers. On January 20th, Southwire signed an agreement to purchase the brand and two manufacturing facilities of American Insulated Wire Corporation (AIW). The acquisition is an industry consolidation with the potential to strengthen Southwire's position, as the product lines of AIW should add to Southwire's existing market share. Though there were limited details announced around the acquisition, the purchase also seems to be one that allows Leviton, AIW's parent company, to divest itself from wire and cable manufacturing and focus on its dominant core business of producing various switches, receptacles, outlets and other electrical components. Read the press release from Southwire [here](#).

In a more global play, General Cable announced its expansion in South Africa on the 19th of this month with the purchase of a 90% stake in Phoenix Power Cables of Durban, South Africa. Already one of the continent's leading cable manufacturers, the sale significantly increases General Cable's presence in South Africa, which according to General Cable's press release, accounts for 25% of the wire and cable consumption on the continent. Read the General Cable press release [here](#).

Canadian Economy

As shown in the graph below, the trend in Canadian manufacturing over the past 24 months was similar to that of the US. The actual size of the Canadian manufacturing economy is only about 10% that of the US, but the countries share the largest trading relationship in the world, closely linking the performance of their economies. The curve of declining shipments, indexed to January 2008, shows a Canadian manufacturing sector with a decline that trailed the US and was ultimately sharper and more severe in the contraction.

A Neighborly Affair



As this ratio climbs, production slows as manufacturers work off of existing inventories to satisfy demand. After bottoming out in May of 2009, however, the recovery in Canadian manufacturing has exceeded the relative increase in the US during the same period. The more extreme fluctuations of the Canadian manufacturing economy are largely attributed to the country's sizeable natural resources sector. The manufacture of petroleum and coal products fell sharply when the commodities boom ended at the end of 2008, worsening the manufacturing sector's overall decline. Following the commodities trend back up over the past eight months, the same energy sector is strengthening the numbers for Canada's manufacturing recovery. With inventory levels in both countries approaching the pre-recession norms, look for the tandem increase in manufacturing sales to continue throughout this year.

Inflation

With government debt ballooning and central banks still pouring money into the economy, there is a growing fear of inflation. Inflation "hawks," as they are affectionately called, warn constantly about the economic force and grow especially loud in times like these. As I wrote in last [June's Hot Wire®](#), inflation is a common and discrete tool that governments use to shrink a mounting debt burden. By decreasing the value of a country's currency over time, incomes and tax revenues increase in nominal terms while outstanding debts stay constant. This gives governments the extra funds they need to pay down loans while simultaneously shrinking the size of the debt relative to the inflated economy. Runaway inflation, though a boon for debtors, works as a tax on savings. As any good hawk would tell you, by diminishing the buying power of savings over time with inflation, governments create an implicit tax on savings accounts to pay off its debt, even before residents file a return.

Besides its negative effect on thrifty households, inflation can be especially damaging for businesses. Much of the downside for business can be summed up in what economists call "menu costs." In its simplest form, menu costs are what restaurants have to pay to reprint their menus. The reluctance of restaurateurs to have new menus printed every time the cost of potatoes rises 3% is what tends to make prices sticky. When

Wire Index



BY THE
NUMBERS
(US)

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

+0.6%

**December
Unemployment**

10.0%

Retail Sales
(Nov to Dec change)

-0.2%

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

-0.7%

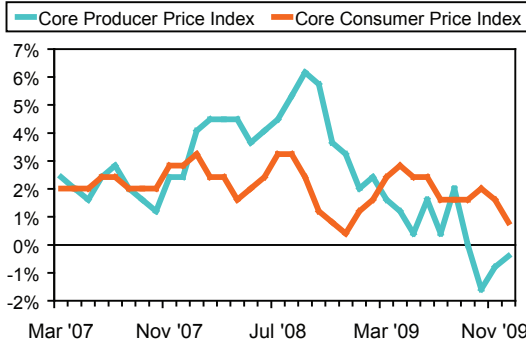
**December
CPI Inflation**
(over prev. 12 months)

+2.7%

the restaurant finally does decide to pay the printer and raise the price of French fries, the owner spends money that otherwise could have contributed to her net income. In a more complex form, think about the menu costs borne by the wire and cable industry. How much time do buyers and sellers of wire and cable spend updating price lists, maintaining index-based pricing schemes and negotiating new pricing agreements? If metals prices were inherently stable, these employees could be put to more productive uses in the company, increasing overall efficiency. (Of course no more than a decade ago, commodity costs were much more stable.) Besides menu costs, inflation also limits the ability of companies to forecast future cash flows, especially as it relates to international trade and the sensitivity to changes in currency exchange rates. On any micro level, the adverse effects of runaway inflation can appear modest, but the aggregate effect on the economy is quite costly.

US Inflation

3-month Average Annualized Rate



On some levels, the risk of inflation today appears small, despite growing government debts. As shown in the graph to the left, core price indices in the US reflect mostly steady prices. These “core” indices measure inflation apart from the volatile food and energy sectors. The three-month trend for the producer price index, which measures the prices paid for finished manufactured goods, has even turned negative. With demand only beginning to recover and much of the labor force still unemployed, wages and costs are flat, forcing sellers to compete for buyers on price. The US Federal Reserve seems to find comfort in this trend, as the pattern has kept the Reserve Board from even signaling a raise in interest rates any time soon. On the other hand, commodity and equity values are skyrocketing again. Though not yet reflected in the prices of most consumer goods, these rising prices are in themselves a form of inflation. As the Fed keeps the money spigot open, general monetary

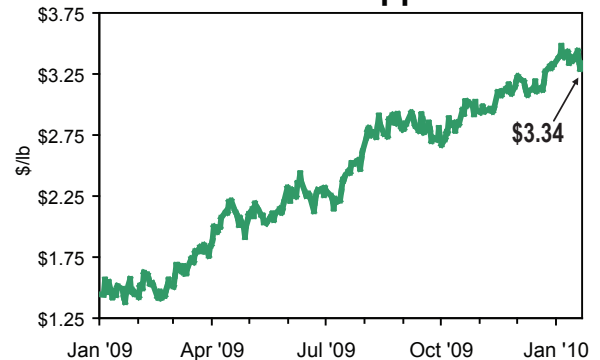
theory suggests that the funds need to find a home somewhere. Currently, investors seem to be putting the money towards assets like copper, oil, gold and stocks. This trend is not terribly different from that of 2002-2004, when the Fed kept interest rates below 2% and the US experienced an incredible inflationary bubble in housing and commodities in the years that followed.

At this point, it is difficult to tell exactly where the inflation trend is headed. If the Federal Reserve begins raising interest rates soon to moderate asset prices and the recovery, I don't think it's too late to keep prices in check and avoid another bubble. If rates remain this low for most of this year, however, I fear that we could see another inflationary asset bubble – even if “core” price indices hold steady.

Copper

Comex copper futures broke the \$3.30 mark heading into the New Year, reaching 15-month highs. With the continued upward trend, prices are now well within the \$3.00 - \$4.00 band that effectively contained copper prices from March 2007 through September of 2008 before the bottom fell out on asset prices. Given the quick return to these price levels in the economic recovery, investors have created a convincing argument that prices will again hold to the \$3.00 - \$4.00 range for an extended period of time. Alternatively, if this is simply the beginning of another asset bubble driven by loose money, then I would expect copper prices to continue upwards well past \$4.00/lb.

Comex Copper



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Sincerely,

Brian Hirt

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



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