

Dear Friends of IEWC, here is my account:

Industry News

May was a terrible month for financial markets, as investor fears put stocks in a tail spin. The Wire Index was not immune to these effects but ultimately fared pretty well considering that copper prices also fell. As I've written before, wire and cable industry stocks typically compound larger market movements, giving the Wire Index a beta of well above 1. Within the last month, however, industry stocks actually fell less than the market average, declining 7.9% from April's high compared to the S&P 500's 10.5% drop in the same period.

US Economy

A robust economic recovery continues in the US. The recovery is especially strong in the manufacturing sector, one of the industries that fared the worst in the downturn. New orders for durable goods increased at a 28% annualized rate in the first four months of this year, suggesting that the boom in manufacturing output (and hiring) will continue for the better part of this year. Retail sales and industrial production also continued their rebound in April, the most recent month for which data is available.

Meanwhile, markets were shaken by the persistent debt crisis in Europe and the uncertainty of expanded financial regulations on both sides of the Atlantic. There are certainly a few more reasons to be concerned this month than last, but the chances of a double-dip recession are still rather remote. There's no reason that the problems in Greece must spread to the United States. Perhaps the biggest risk is that businesses delay additional hiring and investment while waiting for the storm to blow over.

Copper Pricing

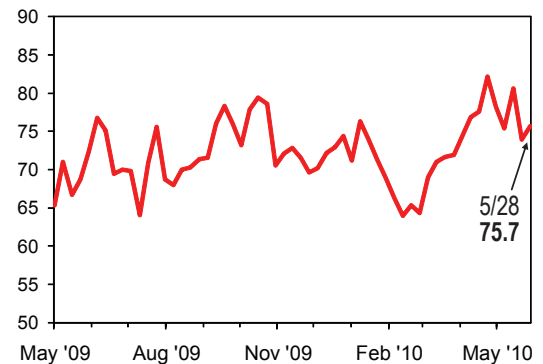
There are many ways to quantify the price of copper. The various measures, for what at first seems to be a simple data point, create a fair amount of confusion within the wire and cable industry. Different copper indices are used throughout the industry to affect product pricing, yet no index holds a clear advantage over the others. Take copper prices from this past Friday (5/28) for example. COMEX copper futures closed at \$3.10 USD/lb, LME futures closed at \$6,926 USD/tonne, SHFE futures closed at 55,720 RMB/tonne, while the Omega-Camden index held steady at \$3.40 USD/lb. Despite the global nature of today's economy, the index you might use depends more on where you live than anything else.

First, we should differentiate the futures prices from the Omega-Camden index; more on Camden pricing below. Futures contracts are financial instruments traded on a public exchange. In the case of copper, you can trade futures on the COMEX (short for Commodity Exchange and not specific to copper) division of the Chicago Mercantile Exchange (CME), on the London Metal Exchange (LME) or on the Shanghai Futures Exchange (SHFE). Futures contracts were originally created for farmers to hedge against fluctuations in crop prices. Copper futures are simply contracts to buy a couple dozen tons of copper at a specific price at a specific date in the future. Each index actually contains multiple prices for the commodity at any given time, one for each delivery month in the future. The CME and LME exchanges sell contracts for delivery as far as two years into the future. The price commonly quoted as the "current" price of copper is the one corresponding to the front month on the futures curve, set to expire shortly. The actual price on any given day for a lot of copper from the mine is called the spot price and typically mirrors the front month futures price.

To understand how these different futures indices interact, it's important to understand the concept of arbitrage, illustrated nicely by a recent proposal from one of my coworkers. He had come across an offer from The United States Mint to purchase a new series of Presidential or Native American \$1 coins. Trying to get the new coins into circulation, the mint offered to sell the new coins at cost and pay the shipping. Keenly aware of the rewards program on his credit card, my coworker figured that he could purchase the coins with his credit card, deposit the coins in his bank account, use the deposited funds to later pay off the card, and pocket the 3% rewards generated by the card. Best of all, by using the coins to pay off the credit card, the transaction required no up-front investment. Apart from the fact that immediately depositing the coins works against the spirit of the mint's direct ship program, the situation presented a possible arbitrage opportunity, i.e. a transaction generating risk-free profits. The only reason this arbitrage opportunity ultimately proved unprofitable falls to transportation costs. While the US Mint graciously offered to pay the shipping, it was still the responsibility of my coworker to receive a pallet of 5,000 metal coins and transport the coins to his bank. If the cost of his time and the equipment required to receive and deposit the coins was greater than the 3% rewards value on the \$5,000 purchase (as I suggested they were), then the arbitrage opportunity disappears. As far as I know, our warehouse hasn't received any coin shipments yet.

It is people like my coworker that keep the different futures prices for copper on par with each other. At any given time, if the opportunity exists

Wire Index



BY THE
NUMBERS
(US)

**Industrial
Production**
(Mar to Apr change)

+0.8%

**April
Unemployment**

9.9%

Retail Sales
(Mar to Apr change)

+0.5%

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

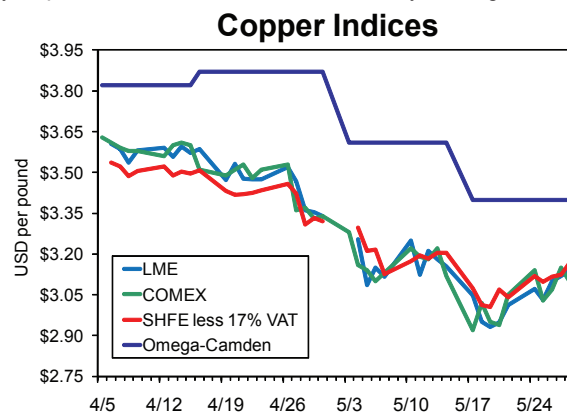
+2.9%

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

+2.2%

to buy a contract for future delivery of copper on one index and lock in a higher selling price for the copper with a contract on another index with the same expiration date, someone will seize it. In doing so, the increased demand for the cheaper contract drives up its price, and the increased supply of the more expensive contract drives down its price. Eventually this causes the prices to converge and eliminates additional arbitrage opportunities. Presumably, the same convergence would take place if my coworker carried out his scheme. After receiving a couple pallets of coins, the local bank may suggest that they will no longer accept the coins or only deposit them at a discount, effectively ending the arbitrage.

Examining the differences between the quoted futures contracts, most of the discrepancy is boiled away when converted to a common currency and unit of measure. Keeping the recent COMEX price as a baseline at \$3.10 US dollars per pound, the LME contract falls close by at \$3.14/lb when converted from metric tonnes to pounds. These prices often don't fall dead on with each other, but they're close enough to prevent any recurring arbitrage. Just like the costs associated with receiving and transporting the coins, there are real costs in receiving and reselling the copper on another index. Converting the Shanghai futures into a \$/lb figure, it still comes in higher than the other indices. This difference is explained by China's 17% value added tax. Remove the adder for this tax and the Shanghai copper value approaches par with the others at \$3.17/lb. As displayed in the graph to the right, the three futures prices closed within a tight range from each other every day for the past two months.



The Omega-Camden index, commonly known as just "Camden," is significantly different from the futures indices. The Camden copper price is not determined by any sort of public exchange but is simply a list price published by a private company, the International Wire Group. International Wire publishes Camden pricing twice a month, with changes effective on the 1st and 16th of each month. While futures contracts specify the purchase or sale of raw copper cathode directly from the mine, Camden pricing is generally considered to include additional costs for transportation and drawing the copper down to rod. As shown in the graph, depending on the volatility of the futures markets, this usually gives Camden a spread of 20 to 50 cents above the price of cathode in the futures markets. There's really no magic to this spread – International Wire makes some attempt to predict copper futures prices over the next 15 days and determines a price that will maintain a healthy margin for them above the market price. The wide and continued use of the Camden price index in the wire and cable industry appears to stem from the previous market position of Camden Wire in Camden, New York, now part of the International Wire Group. While International Wire remains a leader in the manufacture of bare wire products, Camden Wire once held a more dominant position supplying copper stranding to the many wire insulators around North America. Because so many wire and cable manufacturers purchased copper conductor from Camden Wire using the Camden price index, these wire insulators then built their own price structures on the same index; thus, providing a simple facility to pass along copper cost fluctuations from the rod and strand manufacturers to the end-users. Even though Camden Wire has since lost some of its market share, the traditional use of their copper index continues among many North American wire manufacturers, distributors and end-users.

Understanding the general equilibrium of the available copper indices, the choice of which index to use when setting up special agreements and pricing contracts proves immaterial. The fact that the Omega-Camden index only moves twice a month may provide some extra stability to a pricing agreement, but this price stickiness and International Wire's autonomy in fixing the Camden index also risks that the index could fall significantly out of line with the market for a period of time. The attention paid to each futures index is mostly regional. As one might guess, the US-based COMEX index is most popular around North America, the London-based LME copper index is common across Europe and the many regions of the world with British and European influence, while the Shanghai Futures Exchange price is watched more closely in China and other parts of Asia Pacific.

As always, the *Hot Wire*® is free. Email me to receive the newsletter directly each month.

Sincerely,

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



Disclaimer: IEWC provided this newsletter and the information herein for your convenience only and does not guarantee the accuracy or completeness of the information. IEWC assumes no responsibility for the use of, or reliance on, the information provided herein and disclaims all liability for any and all damages arising out of the use of, or reliance on, this information.

Customer Driven • Solution Focused ... we've got you covered!®