

SMMA Quarterly Economic Report December 2008

Prepared by the Institute for Trend Research

The Macroeconomic Overview:

The US Industrial Production Index is running below the year-earlier level (Phase D, recession) and contracting at an accelerating rate. More troubles lie ahead for the US economy. Look for the downturn to encompass all of 2009 and last into 2010. As yet, there are no leading indicator signs telling us when the recovery will begin in the overall economy, however, we think an upturn will likely begin appearing as we move through the latter stages of 2009 and begin taking shape in a clearer pattern by the time we reach early 2010.

Rising exports of US manufactured machinery and equipment to offshore buyers taking advantage of the bargain prices offered by the weaker dollar had helped keep this sector of the economy growing into the third quarter of 2008. A stronger dollar has reduced the price advantage and now, with the global economies slipping into recession, there is likely to be a weakening in machinery new orders trend. Look for the recession to become broad-based.

The Federal Reserve has lowered interest rates for the eighth time in 17 months. While the Stock Market responded favorably to the December 16th Fed Funds .75 basis point rate cut (to .25%), the economy has not seen the effect of the generous stimulus. Granted, interest rate cuts generally take about six to nine months to filter out into the economy.

The consumer has retreated out of the mall and into the home. Retail Sales for the past 12 months has dropped below the year-ago level. The negativity is more severe than what we saw in the early part of this decade. In fact, the Retail Sales seasonal "rise" since March is the weakest in 61 years. Rising unemployment will be with us into 2010 and perhaps beyond. The housing and automotive industries are likely to stay depressed through 2009 and other industries are expected to follow their lead.

Housing continues its catastrophic decline with the November data mimicking declines not seen since 1936. Housing Starts are at their lowest level in decades and a whopping 33.1% below the year-ago disastrous level of 2007 (12MMT). We are not yet at the bottom, although we expect the rates-of-change will be improving in the next one to two quarter. Sooner, if the Feds force mortgages down to recording setting lows (4.5%) for first time home buyers, as has been bandied about. But it may very well be mid 2010 before the data trends improve. After a decline of such severity, even the recovery phase could be painfully slow and modest.

Government budgets are increasingly constrained by the economic realities declining tax revenues from businesses and individuals during an economic crisis when they "need" to offer assistance. Expect government discretionary spending to come under increased scrutiny and to be rolled back at the state and local levels. Look for Washington to record larger and larger deficits for the next two to three years, including "bailouts" to States.

Management Objectives™

Cash in king and will remain so through 2009. However, do not give up on a relentless commitment to improving efficiencies, products and services. Clearly delineate your competitive advantages. Lead with optimism. Avoid capital expenditures. Have a plan for dealing with shifting economic conditions.

US Industrial Production

Trend: **Decline**

Outlook: Decline in 2009

Estimated Annual Growth Rates:

2009: - 4.1%
2010: - 2.0%

US Industrial Production Index is giving clear warning signals for the US economy as we head into 2009. There are no signs of a near term trend reversal.

Production on an annual basis moved below the year-ago level and is now 0.9% below the same period last year. Production in the high tech sector of our economy is still in Phase C, slowing in its ascent but not yet in recession. Given the strength of the dollar and the global nature of the recession, expect the high tech to continue to bend toward its own recession.

Key input for planning: Continue work force reductions and cut costs wherever possible.

US Leading Indicator

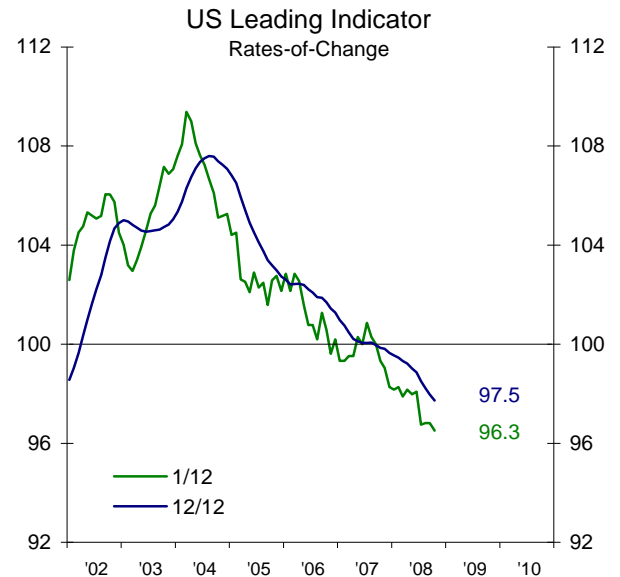
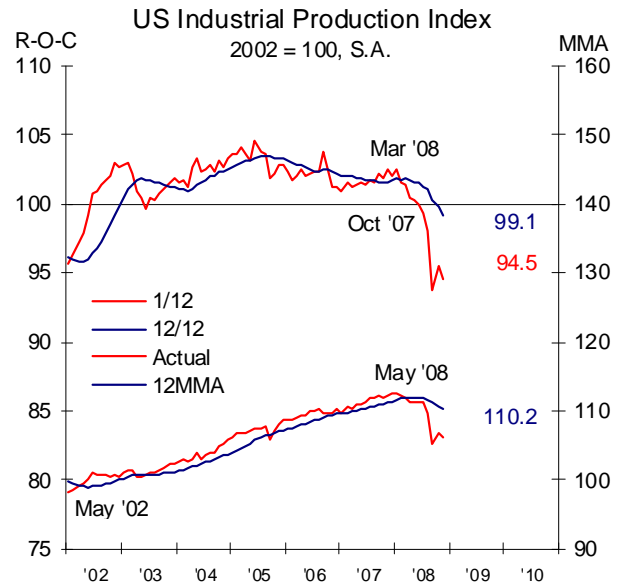
The US Leading Indicator trend through November is negative. Given that we don't have a low to date in this leading indicator, we should expect at least another nine months of decline in the Retail Sales 12/12. That in turn means that the outlook for Retail Sales is a fairly dismal retail selling environment going through the middle of 2009 or longer.

The US Leading Indicator 1/12 has a negative heading, as does the 12/12. The 1/12 stands at 96.3. The 12/12 is at 97.5, its lowest reading in over 25 years.

The actual monthly Index for November came in at 99.0, down from 99.4 last month. This is a steeper-than-normal November drop. Along with the negative rate-of-change trends, the steepness of the November decline reflects the overriding negative cyclical nature of the trend.

Another leading indicator signal that foreshadows similar difficulties ahead for the US economy is the *Purchasing Managers Index* (not shown). The actual Index (36.2) is the lowest it has been since 1982, indicating that a deep contraction, similar to the 1980s recession, is probable. All aspects of the Index are negative or reflecting cyclical weakness.

Both of these leading indicators are signaling trouble for the general economy going into the third quarter of 2009 (median timing to the US Industrial Production 12/12 low).



North America Light Vehicle Production

12MMA Trend: **Decline**

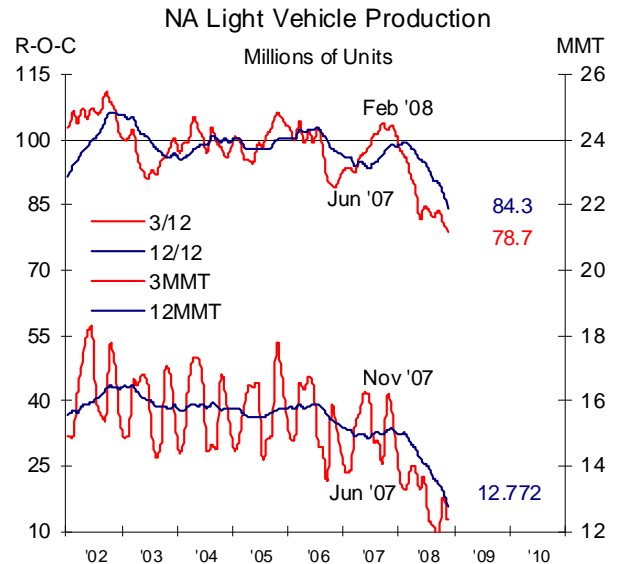
2009 Outlook: Decline through 2009

Estimated Annual Growth Rates:

2009: -1
2010: -10.5%

There are no indications that the recession in North America Light Vehicle Production is going to end anytime soon.

The 3MMT (lower red line) reflects the mildest onset of seasonal rise in 23 years. The 3/12 is still falling below the 12/12, indicating more cyclical decline ahead for production. The 12MMT (lower blue line) has declined now for 30 months, second only to the 39-month decline of the Great Depression.



Key input for planning: Look for aftermarket opportunities because that market is expected to realize only a mild Phase D period later in 2009.

Industrial Machinery Production

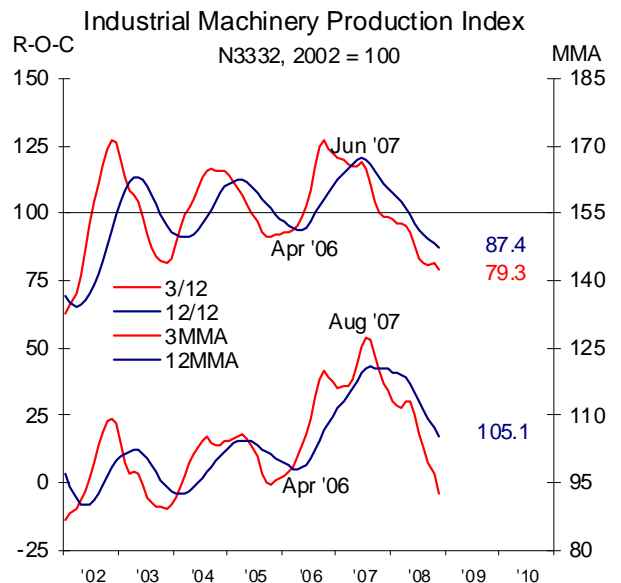
12MMA Trend: **Decline**

2009 Outlook: Decline through late 2010

Estimated Annual Growth Rates:

2009: - 9.9%
2010: - 8.9%

Industrial Machinery Production is 12.6% below last year (12MMA basis) and down 20.7% in the past three months from the same period last year. The credit crunch and global challenges are creating significant downward pressure on new orders and significantly slowing production dramatically.



The 3/12 rate-of-change continues to decline well below the 12/12. Look for activity to move into a broad (deep) trough late in 2009 and into 2010. Rates-of-change above 100 are not expected before 2011.

Key Input for Planning: Be careful you are not financing the debts of your customers through aging accounts receivable.

Metalworking Machinery New Orders

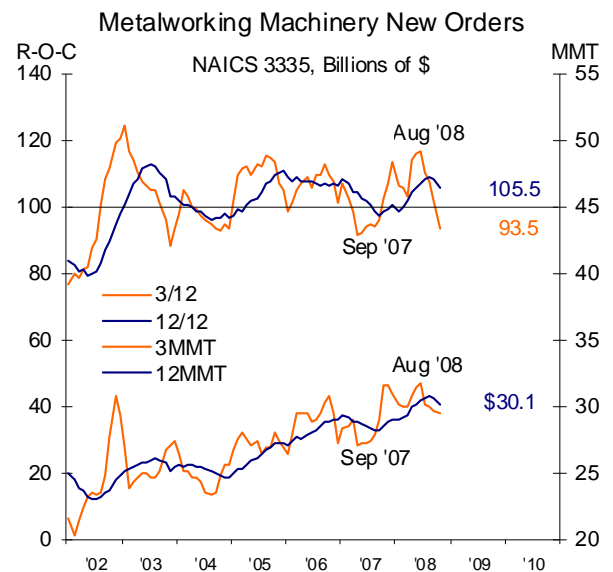
12MMT Trend: **Declining**

Outlook: Decline into 2010

Estimated Annual Growth Rates:

2009: 3.6%
2010: -10.4%

The party is winding down for those in the metalworking industry, as New Orders declined precipitously over the last three months. The falling 3/12 rate-of-change suggests the decline in New Orders will not only continue but the drop will become steeper as we head into 2009.



New Orders for October were down 15.1% from the same time in 2007. The data trend (12MMT) fell for the second consecutive month and stands at \$30.1 billion as the woes of the financial industry permeated the market. On the export side, New Orders did not decline in October on a year-over-year basis, making that the strongest aspect of industry activity.

Key Input for Planning: Be prepared to give up some margin to fill the pipeline. Also, go hunting for sales in new territories.

Mining Production (w/o Oil & Gas)

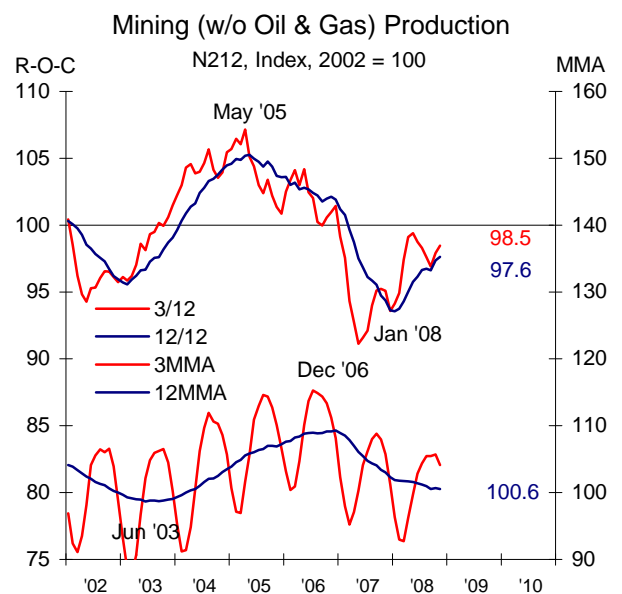
12MMA Trend: **Leveling off**

2009 Outlook: Flat to mild decline

Estimated Annual Growth Rates:

2009: - 0.9%
2010: - 7.5%

A healthy boost in October in the actual data (Nov declined again) helped to make the rate-of-descent in the 3MMA and the 12MMA milder than normal. The rate-of-change trends also moved higher.



Look for this general trend to deteriorate through 2009, with more noticeable decline in 2010. The positive rates-of-change trends that the 12MMA will likely move more horizontally through the first half of 2009, with a more noticeable 12MMA decline beyond that point. We are hearing of a significant slowdown in mining activity within the last six to eight weeks, something not yet evident in the data.

Key Input for Planning: A diversified industry/market portfolio will likely provide pockets of “relief” in the current economic environment.

Ship Production

12MMA Trend: **Decline**

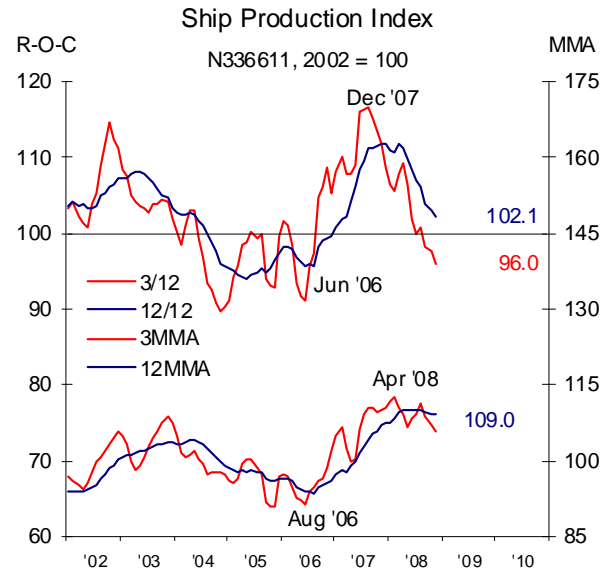
2009 Outlook: Negative in 2009

Estimated Annual Growth Rates:

2008: - 2.7%

2009: - 5.7%

October and November saw a slight increase in the actual index even though the 3MMA slipped lower. However, given the expanding recessionary trend in global markets it will take more than a mild bounce to turn this ship around. Our forecast has been revised downward reflecting the softening in the global economies and the industry's earlier-than-normal weakness.



The upper portion of the chart shows the noticeable decline in the rates-of-change. The 3/12 (96.0) tells us that production over the last three months is in a steeper-than-normal decline. Any hope that this market will reverse direction soon is thwarted by the fact that the 3/12 is well below the 12/12. It should be noted that 2007 was running at a record high during the same period.

Key Input for Planning: Plan on negative years in 2009 and 2010.

Canada

12MMA Trend: **Negative**

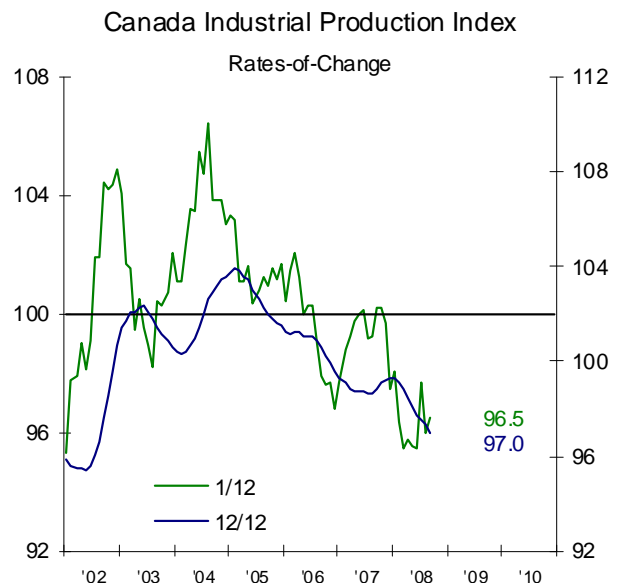
2009 Outlook: Decline into 2010

Estimated Annual Growth Rates:

2009: - 4.0%

2010: - 3.3%

Canada Industrial Production is well into a recessionary trend. Despite some minor improvement in the monthly data and quarterly numbers, the annual trend is still heading lower and will continue generally downward well into 2010.



Canada's leading indicator trend is also negative, a further indication that the recent modest improvement in the 3MMA trend is unlikely to hold.

Key Input for Planning: Canada's economy will continue to struggle as commodity prices fall and demand for exports, especially to the US, deteriorate through 2009. Improve efficiencies and conserve cash.

The Global Economy:

Europe: The EU27 12MMA is contracting and is currently 0.5% above last year. Look for the trend to be negative through 2009.

The October Euro Zone Manufacturing PMI dropped to 41.1, its lowest recorded level since the start of the series in 1997. Add in services and the PMI dropped to 39.7, well below 50, the benchmark indicating an expanding economy. Contributing to the bleak outlook is the five point drop in New Orders in the last month.

Southeast Asia: Manufacturing for all eight economies continues to be at a record high (12MMA) but the growth is slowing. We expect a full-blown recession in 2009. Exports are off dramatically. Investments are shrinking. Commodities have fallen 30% to 50% this year.

China is feeling the stress of global pressures. Actual production is up from the year before but the lowest comparison is the weakest in 3½ years. Exports dropped precipitously in November. Two of the last three months have posted the mildest gains since 1996. Housing prices are falling and Retail Sales are sluggish.

Japan: Contractions in the world economy are resulting in a collapse of Japan's export markets, which in turn is pulling Industrial Production down faster than we expected. The Production 12MMA is a slim 0.1% above one year ago. Significant production cuts were spread among electronic firms, auto companies, and machinery makers. Production is expected to contract in 2009 by 4.0% versus 2008.

South America: The Industrial Production 12MMA for South America is at a record high and it is 6.4% above a year earlier. However, these commodity-dependent economies will feel the impact of the current deflationary spiral in commodities. Seasonal rise is the weakest in more than four years.

Industrial Production in Brazil, the region's largest economy, is still on the rise and, at 5.9% above last year (12MMA basis), is well above most economies. A combination of negative seasonal and cyclical pressures will begin to slow 12MMA growth and lead to contraction in 2009. Brazil's *real* has lost nearly 30% of its value against the dollar in the last three months, marking the biggest decline of all major world currencies.

Mexico: Demand for Mexican exports is declining at an accelerated pace. The US economy is heading into its steepest and longest recession in several decades. All internal and external indications for Mexico's economy are pointing towards further decline. Production fell in September to 1.8% below last year's level. Manufacturing and mining were the major contributors to the drop. Seasonal decline was worse than normal and at a level not seen in over 20 years.

