

SMMA Quarterly Economic Report September 2008

Prepared by the Institute for Trend Research

The Macroeconomic Overview:

The US economy, as measured by the US Industrial Production Index, is showing signs of strain, but there appears to be just enough buoyancy in the overall economy for us to muddle through the rest of this year. Encouraging economic signs are coming from exports, energy, nondurable consumer goods new orders, machine new orders, high-tech industrials, health care, and other services. There is enough upside activity in these sectors that we do not expect an official recession (GDP) in 2008. We have not altered our projection that 2009 and 2010 will be characterized as broad-based recession years with actual decline in US Industrial Production and GDP.

The current combination of fast rising consumer loan delinquency rates, home prices that are still moving lower, tighter lending requirements, the lowest year-over-year growth for Retail Sales in 16 years, Lehman Brothers' bankruptcy, and rising inflationary pressures offer few avenues of escape for consumers and businesses. The economic signals aren't encouraging. Consumer confidence is at a level not seen since the early 1980s. The troubles in the banking industry continue to escalate. The government seizure of Freddie Mac and Fannie Mae is a clear signal of a systemic problem in the financial system that isn't yet close to being over. Lower energy prices of late and low interest rates are helpful, but even with the government's actions, we do not expect a quick turnaround for housing, the automotive industry, or consumer activity in general. There is a limit to how much government at several levels can accomplish given budget deficits and falling revenues.

Inflation remains a major roadblock to economic recovery. The Consumer Price Index for July 2008 was 5.6% higher than one year ago. The Producer Price Index (PPI) and the Intermediate Materials PPI inflation rates, over the last three months compared to the same period one year ago, are running at an upwardly mobile 8.9% and 14.6%, respectively. The dollar is strengthening, which will help to slow inflationary pressures from imports and is therefore somewhat helpful, but an ongoing strong dollar will likely diminish the rising trend in exports, which has propped up the US economy through these weak times. The fact that commodity prices are losing steam may be a welcome relief to some. It also proves the old adage that the US has "sneezed and other nations are catching a cold."

The Fed is perched on a razor thin precipice called stagflation. Inflation is rising, the economy continues to soften and unemployment is rising. Raising interest rates would likely stem inflation but could slow the economy even further – in the near term. It seems unlikely that the Federal Reserve will raise interest rates in the near term and therefore, inflation will continue to be a persistent headache in 2008 and 2009. Consumer discretionary spending will be squeezed further and the economy will end up in an even weaker cyclical position in 2009.

Management Objectives™

Look for new markets outside the hardest hit sectors and aggressively move into those that are not very cyclical or are counter-cyclical to the general economic business cycle as the economy continues to weaken through 2009 (medical products, oil/gas and renewable energy, aircraft, food production, military/government contracts). Gaining market share is essential in a recessionary environment. Be careful with long-term contracts that impact your expenses (material and labor). Prepare for economic conditions to get worse before they get better.

US Industrial Production

12MMA Trend: **Flat**

2009 Outlook: Decline in 2009

Estimated Annual Growth Rates:

2008: 0.6%
2009: - 2.9%

The US Industrial Production Index 12MMA (lower blue line) is likely to maintain an essentially flat trend through the remainder of this year. The internal rate-of-change signals offer no evidence that the diminishing year-over-year growth rate in the economy will reverse direction.

The 12MMA slipped off nearly four years of consecutive record highs in July and August but is still scraping along above year-earlier levels. Look for this trend to develop into a more overtly negative cycle in 2009. We had expected a brief bounce to occur in the second half of this year but the likelihood of that happening has diminished with the recent strengthening of the dollar and its potential negative impact on exports. The more ominous pressures stem from the persistent problems in the overall economy (housing, financials, automotive, inflation/oil) and evidence of a global slowdown taking hold in Europe, Japan, Canada, South America, Southeast Asia and China.

Key input for planning: Move to a “safe mode” to weather what we are projecting will be rough seas ahead in 2009-2010.

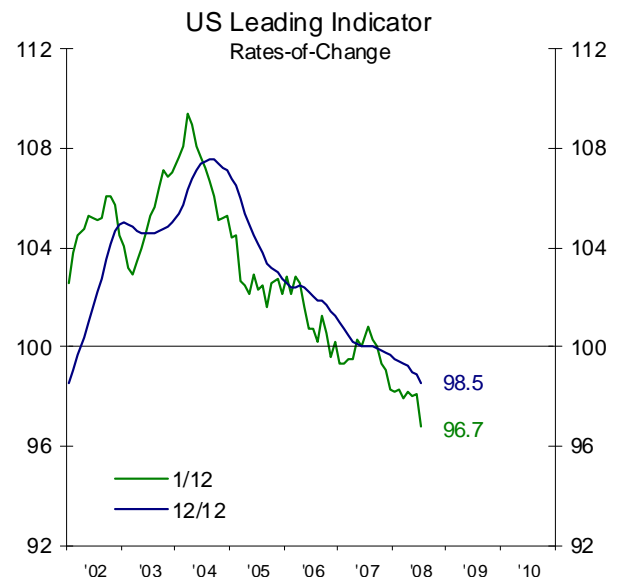
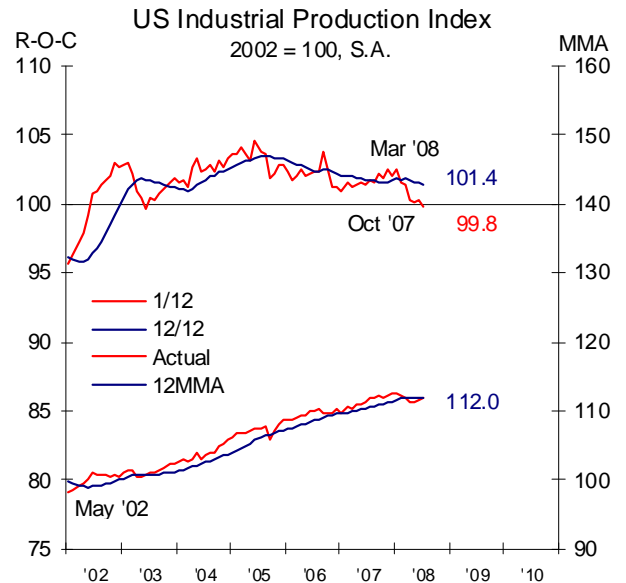
US Leading Indicator

The US Leading Indicator trend, put out by the Conference Board, continues to reflect that “sinking feeling” permeating the overall US economy. As a leading indicator signal for Industrial Production, we see no upside momentum heading our way.

The monthly Index declined to 101.2 (not shown) and is now at its lowest level in 44 months. The corresponding rates-of-change moved lower (1/12 of 96.7 and a 12/12 of 98.5), which means more economic decline is on the horizon.

The US Leading Indicator is shaded toward consumer conditions/activity, which includes the extensive damage done in the housing and credit markets.

Another leading indicator signal for the US economy is the Institute for Supply Management’s *Purchasing Managers Index*. The August number slipped below 50 (49.9) for the fifth time in the last eight months. A reading below 50 represents a contraction in US manufacturing. Recent results are an ominous signal for where the overall economy will be heading in 2009.



North America Light Vehicle Production

12MMA Trend: **Decline**

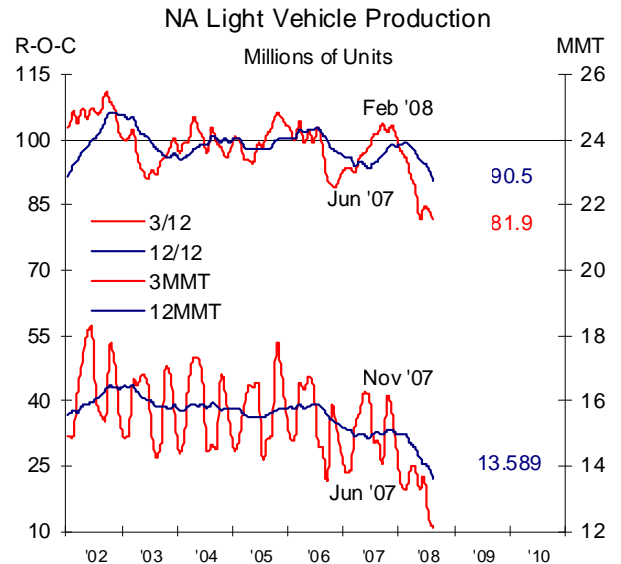
2009 Outlook: Decline through 2009

Estimated Annual Growth Rates:

2008: -14.7%

2009: -10.5 %

The North America Light Vehicle Production 12MMT is cascading downward, with the August 12MMT reaching a 14½-year low of 13.589 million units. The recessionary trend for production is beginning to resemble the collapse in the housing market where an accumulation of factors added up to devastating, long-term results. We are forecasting the 12MMT will fall to 11.5 million units by the end of 2009. The shift into recovery for this industry will not be measured in months but in years.



The seasonal drop in the 3MMT (lower red line) since May is reminiscent of 1990 and 1981, two unpleasant years by most people’s definition. Think back to what you would have done differently if you could do it all over again. Use that as a starting point for your planning for the rest of 2008 and for 2009.

Key input for planning: It is time to lead your company into greener pastures.

Industrial Machinery Production

12MMA Trend: **Decline**

2009 Outlook: Decline through 2009

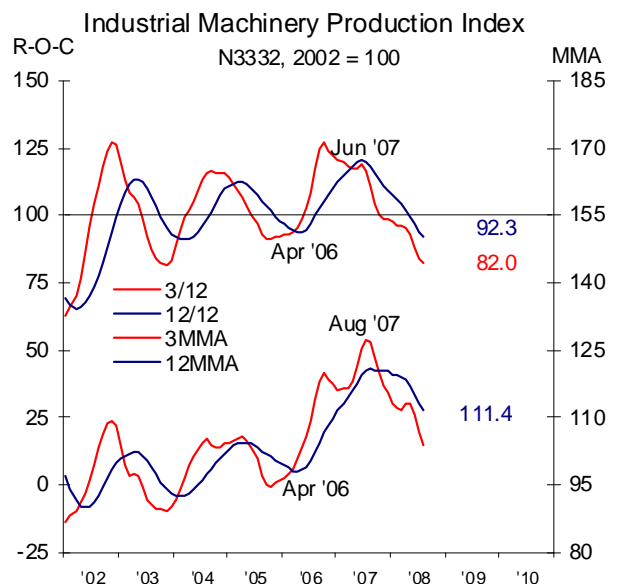
Estimated Annual Growth Rates:

2008: - 6.4%

2009: - 8.6%

The Industrial Machinery Production 12MMA and 3MMA are below year ago levels by 7.7% and 18.0%, respectively. More decline is expected.

Our forecast calls for a period of stability/mildly slower rate of decline over the next four quarters, no recovery trend is in sight. Industrial Machinery New Orders is showing virtually the same results as this index, at 5.6% below year-ago levels (12MMT basis).



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

Metalworking Machinery New Orders

12MMT Trend: **Positive**

2009 Outlook: Deteriorating conditions in 2009

Estimated Annual Growth Rates:

2008: 9.5%

2009: - 7.5%

The 12MMT has hit a 49-year record high of \$30.6 billion and is 8.0% above last year. 2008 is tracking with the forecast of moderate growth. Look for the data trend rise to continue into early 2009.

The 3/12 rate-of-change is declining and about to downward pass the 12/12, a signal that the 12MMT rate of growth will weaken by the end of the year. Expect growth to slow and then disappear in 2009, finishing the year about 7.5% below 2008 (12MMT).

Key Input for Planning: The inflation-adjusted growth rate is 5.9% (12MMT basis). Industry participants will be busy through the end of this year. Fill the pipeline for 2009. Conditions are expected to deteriorate.

Mining (w/o Oil & Gas)

12MMA Trend: **Leveling off**

2009 Outlook: Essentially flat

Estimated Annual Growth Rates:

2008: - 3.6%

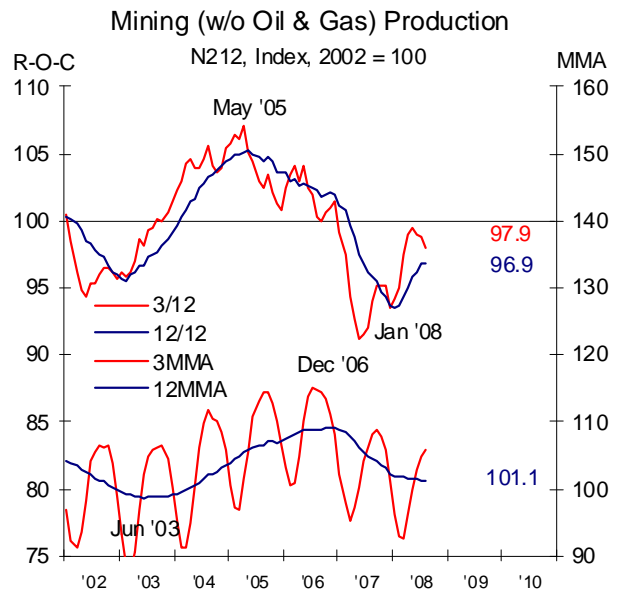
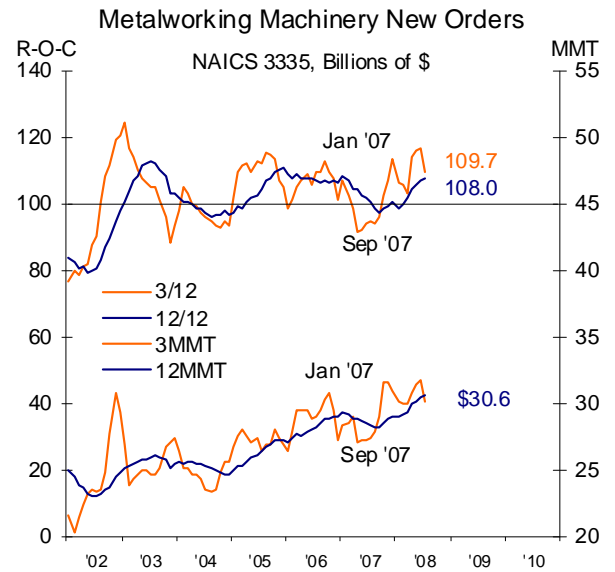
2009: - 0.9%

Descent in the 12MMA is the predominant trend characteristic of this industry through August (lower blue line). Look for this general trend to be maintained through the remainder of this year and to a lesser extent for 2009. The trend is expected to deteriorate further in 2010.

The 12/12 rate-of-change is in Phase A, which normally means the 12MMA data trend is advancing toward an actual recovery. We don't think this will develop into much more than a leveling off in the 12MMA recession trend. We are looking for the 12/12 to crest below 100 during 2009.

Nonmetallic Minerals Mining Production is in tough shape (-13.3%) and dragging the broader Mining Production (excluding oil and gas) trend downward.

Key Input for Planning: Reduce overhead further. Use cash for opportunistic acquisitions.



Ship Production

12MMA Trend: **Flat**

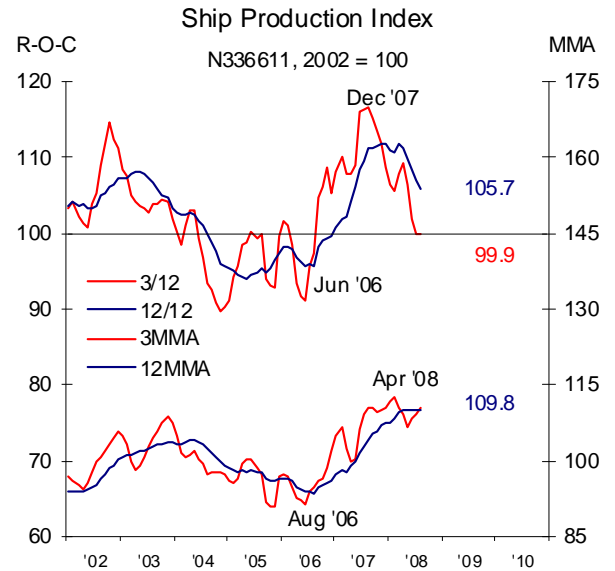
2009 Outlook: Decline in '09

Estimated Annual Growth Rates:

2008: 0.5%

2009: - 2.7%

Ship Production normally lags the economy, as measured by US Industrial Production. The 12MMA peaked in April 2008 and is in a mild decline. The industry is following unusually close behind the US Industrial Production 12MMA data trend in this period of difficulty. 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 well-defined deteriorating rate-of-change trends. The 3/12 (99.9) tells us that production over the last three months is in a steeper-than-normal decline. Any sign that this trend will reverse direction is dimmed by the fact that the 3/12 is running well below the 12/12. It should be noted that 2007 was running record highs during the same period.

Key Input for Planning: Reduce overhead costs quickly. Look to divert resources to new markets.

Canada

12MMA Trend: **Negative**

2009 Outlook: Decline in '09

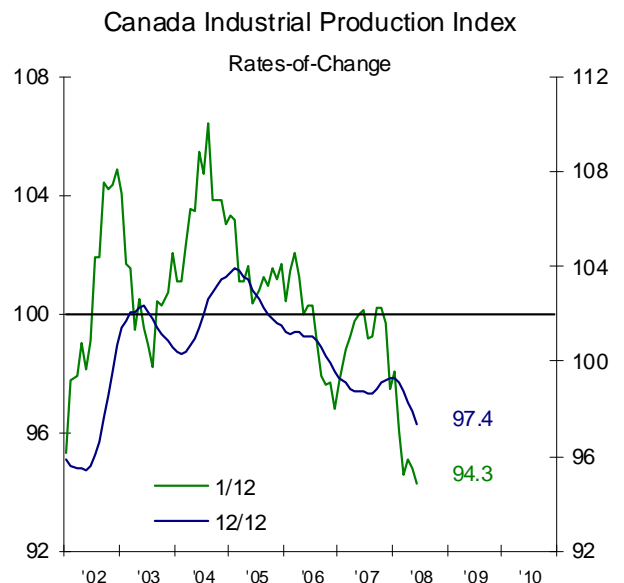
Estimated Annual Growth Rates:

2008: - 4.7%

2009: - 3.3%

The Canadian Industrial Production Index declined for the 9th consecutive month (12MMA basis) and is sitting 2.6% below the year earlier.

The rate-of-change trends are overtly negative. The 3/12 is running well below 100 and below the 12/12, presenting two negative ITR Checking Points that indicate more problems lie ahead.



One bright spot in the economy as measured by Manufacturing Sales is a 47% year-over-year increase in Petroleum and Coal Products. This is not enough to make up for the decline in automobile and machinery production. Additionally, weaker energy prices will soon erode the advantage in this sector.

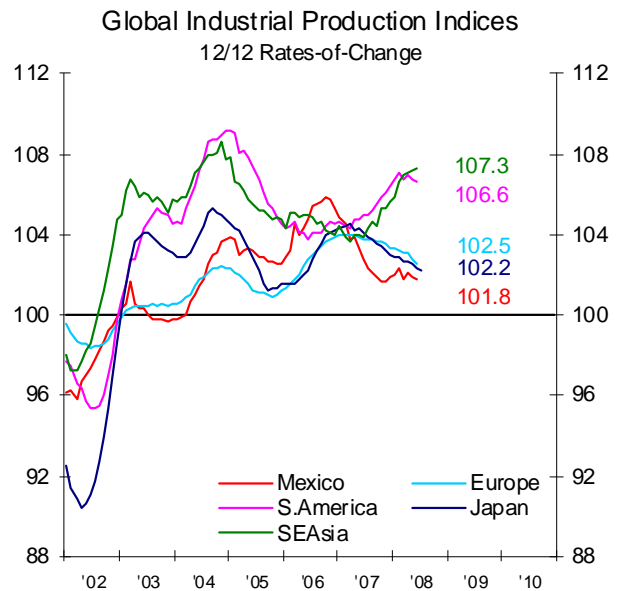
Key Input for Planning: Be prepared for ongoing difficulties in 2009, coinciding with the US economy.

The Global Economy:

Europe: The overall rate of growth slowed for the 14th consecutive month. Both the 3/12 and 12/12 moved lower, continuing a mild but longer-than-normal declining trend. The cyclical trend for Production is getting weaker.

There are no signs that this trend will reverse direction anytime soon. Exogenous factors in the European economies are not encouraging. Inflation reached a 16-year high in July and unemployment is rising.

Southeast Asia: Growth in the Industrial Production sectors of this region are beginning to showing early, mild signs of weakening. Inflation is rising, currencies are weaker, business confidence is falling and central banks are hesitant to raise interest rates to ward off rising prices while economic conditions are slowly weakening.



Annual average growth rates for production in S. Korea (9.4%) and Thailand (11.0%) are holding up well. However, growth in Taiwan (5.1%) is less than half what it was in January 2008 (12.3%). Singapore's growth rate (2.3%) is less than one fourth the pace in February 2008 (10.0%). Likewise, growth rates in Indonesia (3.3%) and Malaysia (1.2%) have declined from 7.5% and 6.6%, respectively (Feb 2008). Exports are declining to developed nations and even to China.

Japan: The pace of growth in industrial production is 2.2% above last year but it has been slowing since March 2007 (12MMA). The 12MMA is expected to continue this mild decline as is signaled by the declining 12/12 rate-of-change. The outlook for the remainder of 2008 is for the year to finish approximately 0.4% above 2007. We anticipate a more overtly negative cycle in Japanese Industrial Production will begin in early 2009.

South America: The Industrial Production 12MMA for South America is at a record high, 6.6% above the year earlier, but growth is slowing as reflected in the declining rate-of-change. Seasonal rise is the weakest in four years and below the normal range, reflecting mounting cyclical problems.

Commodities are pumping up the Industrial Production results in Brazil, the region's largest economy. We are projecting that production (12MMA) will rise through at least the next several quarters. Increasing food and energy demands in China and India are providing a stimulative environment for growth in the Brazilian economy; however, that doesn't make the economy business cycle proof.

Mexico: Mexico's 12MMA is in mild decline from its record setting June high and is currently 1.8% above 2007. We anticipate that the 12MMA will be flat to mildly declining through the remainder of 2008. In 2009, the 12MMA's movement will start off as a plateau with an increasing negative bias as the year progresses. There is too much dependence on the strength and stability of the US economy for Mexico not to experience additional problems ahead.