Global Industrial Outlook: Oil Slick, Currency Headwinds Worsen

By Brian Langenberg, CFA

End market conditions for the power transmission industry continue to worsen. With the Euro down 13% year to date and U.S. oil production surging we are seeing increasing headwinds, if not storm clouds, for the sector.

***These three factors are challenging to growth*:**

- Oil
- Currency
- War

Oil. The general consensus remains for a (25%) reduction in 2015 capital spending by global oil companies, but those forecasts implicitly assume at least some recovery in oil price from curtailed exploration activity. Unfortunately, cuts in natural gas fracturing—even 4-6% in a week—do not boost oil price.

Currency. The Japanese Yen is already a challenge in the Middle East for U.S. construction equipment manufacturers. Now Europe is about to benefit with the Euro down 13% year to date; expect the Old World to gain an incremental advantage in exporting capital equipment. Not just cranes and excavators—start to think about the advantage to Airbus which sells in dollars and manufactures largely in Euros.

War. The war between ISIS, coupled with lack of U.S. leadership, is a threat to the development and sustainment of oil supplies directly in Iraq and Libya in the near-term. In Europe, Putin continues to rattle his saber with no obvious U.S. confrontation. Conversely, the strong dollar/weak Euro impact of oil/conflict diplomacy will likely end up helping European competitiveness.

OUTLOOK

Here is our outlook for key geographic regions and end markets:

U.S. remains best growth spot. Non-residential construction, consumer durables (auto, housing) and gradually improving employment will offset weaker commodity based demand. Conversely exports will likely start taking a hit.

Europe. Taking a marginal hit (Nordics, resource related parts of German economy) from conflict in Eastern Europe. Conversely the weak Euro should prove a boon for Germany, France and others.

Middle East. Oil & Gas activity should remain strong—even with production cuts—because mature fields require more capital and the region is seeking to capture more of the value stream. Increased Japanese construction equipment competition is a negative for U.S. manufacturers.

Latin America. Mexico is doing well; the rest of the region is seeing the usual political unrest you see when commodity-driven economies are whacked by low-commodity prices. Expect no near-term improvement.

Oil & Gas. One month ago WTI (West Texas Intermediate) was at a "depressed" $52; now we are looking at $45—so expect more capital spending cuts.

Mining. *Still* awful. Aftermarket is now stabilized despite cash burn at coal companies, but low oil price further impacts coal, as does low steel price (Chinese glut) exacerbated by the strong dollar.

Power generation. U.S. power generation remains weak owing to efficiency gains throughout the economy and lack of regulatory support for new construction. Globally, the industry looks good—including coal and gas.

Transportation infrastructure. More pothole filling; no major infrastructure upgrade anytime soon. While I've heard rumblings of a multi-year highway bill, reality suggests other factors, e.g.—'16 Presidential election, ObamaCare disruptions, etc.—would make for a

"status quo" or "status quo with certainty" outcome vs. a big infrastructure rebuild. I would love to be wrong. I doubt I will be wrong.

Machinery: Nobody is feeling the love outside replacement demand for U.S. trucks along with modest incremental demand from non-residential and residential construction markets (cement mixers).

Consumer (auto, appliances). Old cars = continued U.S. strength. Auto related end markets will remain solid. Auto investment in Latin America, particularly Mexico, continues to increase. U.S. residential recovery is on-track and will further support construction equipment demand. Weak Euro could start to impact exports.

Aerospace/Defense. Strong commercial build rates, coupled with two significant wars and depleted U.S. inventories, will continue to support a continued recovery in aftermarket activity. Long-term we expect a U.S. defense recapitalization — but not before 2017 authorization, given the current Administration. Foreign policy matters — and messes — are out there to be cleaned up. As an offset, the stronger dollar hurts Boeing and advantages Airbus as they both sell in dollars but, as mentioned, Airbus manufacturers primarily in Euros.

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Brian K. Langenberg, CFA, has been recognized as a member of the Institutional Investor All-America Research Team, a *Wall Street Journal* All-Star, and *Forbes/Starmine* (#1 earnings estimator for industrials). Langenberg speaks and meets regularly with CEOs and senior executives of companies with over $1 trillion in global revenue. His team publishes the *Quarterly Earnings Monitor/Survey* — gathering intelligence and global insight to support decision-making. You can reach him at *Brian@Langenberg-llc.com* or his website at *www.Langenberg-LLC.com*.

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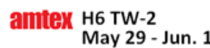

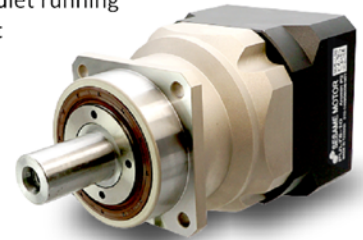

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