Global Industrial Outlook: Kind of Sluggish

Brian Langenberg

We anticipate no substantive improvement in manufacturing activity. Not in the U.S. or internationally. If anything, headwinds may have become slightly more pronounced because a U.S.—Iran "deal" that everybody hates except a) the Iranian government and b) the Obama administration will result in the release of Iranian oil supply back onto the global market. Oil had rallied from about $50 to $60 over the past month (I like round numbers), but has since round-tripped. Expect further, deeper capital spending cuts in the U.S. oil sector to continue affecting demand for large capital equipment.

China's stock market sell-off could be dangerous—but probably isn't. The bad news is off about 25%, and the institutional investment world is preparing to hyperventilate while throwing up charts comparing its stock markets to 1929. Except this is *not* 1929. The world remains in a global mode of austerity and caution—not ebullience. Monetary policy is loose and supportive of markets, whereas 1929 saw tightening. Further, the just-passed Trans Pacific Act (TPA) is the complete opposite of Smoot-Hawley trade protectionism.

Still, the rest of the world is hardly doing great. Greece is threatening to refuse to pay its debts unless Europe (READ: Germany) allows them to not pay their debts. If Greece leaves, it's Greece's problem. If Spain did that, it would be Europe's problem. If you are a Spanish politician watching what is going on in Greece, and you are not particularly stupid, you won't try to emulate. Meanwhile, global industrial activity is stagnant at best.

May manufacturing activity:

China	49.4
South Korea	46.1
Brazil	46.5
India	47.8

Bright spots remain global aerospace and automotive production—each benefitting from overall global economic growth and lower fuel prices.

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

U.S. remains the safe, modest growth bet. Weakness abounds in commodity related sectors—oil, coal and farm equipment—but fundamentals remain positive for non-residential construction, consumer durables (auto, housing) boosted by gradually improving employment. And of course that huge Boeing backlog is comforting to the whole aerospace supply chain, albeit Boeing is not fully comforted by the ability of its supply chain to deliver.

Europe. I do not care about Greece. I do care about Germany, France, the Nordics (collectively) and Central/Eastern Europe. The weaker Euro benefits exports, while lower commodity prices and slowing China growth are headwinds. Life will go on. Modest growth will continue.

Middle East. Not sure what the Iranian "deal" will do. My sense is nothing as Saudi Arabia can still print money at $50/barrel or lower. Right now they are investing to keep their mature fields working. Incremental growth in defense spending is likely.

Latin America. Mexico continues to grow, and capital investment in the auto and aerospace sectors remains strong. Brazil, Argentina, much of the region seems set to remain in the tank along with lower commodity prices.

China. Directly speaking, not a big market for heavy capital equipment shipments out of the U.S.; weak euro, strong dollar exacerbate the situation. Long-term I hope their government's increased belligerence and the recent hack of U.S. government systems is waking up even the densest pockets of U.S. isolationism of either political party if not their constituents. Asia gets it. Japan is being pushed by the rest of the region to build its armed forces and Japan is changing its constitution to allow overseas war fighting.

Oil & Gas. Assuming Iranian oil comes back into the global market, prices will be further pressured. We continue to see negative comps for the next 2-4 quarters before stabilizing at lower spending levels.

Mining. Whole coal sector trading like it's about to go under and JOY global results did not carve out much of a silver lining; bad news for CAT, JOY and others.

Power generation. U.S. power generation remains weak, Band-Aid sales (wind turbines) continue strong. Those of you who supply GE on the gas turbine side should be concerned with the EU's challenge of the Alstom-GE hook up because a) the deal could fall through entirely and b) the longer it drags, the longer commercial uncertainty can be used against GE in the marketplace. GE has stated they offered concessions. Stay tuned.

Transportation infrastructure. More stability through 2016-2017, with perhaps modest growth. I remain convinced that lower oil prices will lessen

the growth profile for oil shipped by rail.

Machinery. Agriculture remains weak, as do cranes. Continue to see modest demand growth as lower energy related demand is offset by non-residential and residential construction.

Consumer (auto, appliances). Auto benefitting from old cars, improving employment and capital investment in Mexico. Residential construction growth should help appliances. Magically, not only is GE having a hard time closing on Alstom (power gen) but the U.S. DOJ is challenging the sale of GE Appliances to Electrolux!

Aerospace / Defense. Global commercial aircraft demand is rock solid driven by economic growth, low fuel prices and strong capital markets. Cargo is also picking up. Defense spending has troughed in the U.S. and international growth strikes us as likely though with little benefit to the U.S. industrial base.

Focus Company: Boeing (BA)

Pretty sure you already know they make airplanes, but we will spend a bit of time detailing the platforms, breadth, and growth opportunities, along with that *huge* backlog which ended 1Q15 at $495 billion, i.e. — $435B commercial, $60B military.

Unfilled orders (as of June) were 5,689 aircraft. A look by major platform:

737 MAX	2,831
737-800	1,181
747	31
767	39
777	563
787	803

Boeing's 12-month stock performance.

The foreseeable future growth engines are 787 and 737. Boeing's No. 1 priority over the next 2–3 years is to ensure supply chain performance so they can capture margin on the huge backlog.

Longer-term current and potential suppliers to Boeing must focus on three things:

1. Long-term program decisions
2. Potential insourcing
3. Execution

The last is obvious; Boeing wants and needs to execute on their backlog and it is broadly believed the commercial aerospace supply chain is stretched to the limit. Meeting and exceeding their expectations would be a minimum hurdle for future programs, as existing suppliers already know.

We will be interested — and so should you — in how Boeing approaches vertical integration in the coming years. When current CEO Jim McNerney, who is retiring, came in, he did what all GE executives do — drive the company with financial metrics and seek to minimize capital investment and outsource as much as possible to capture higher returns on capital. When the 787 was in development, as much R&D work as possible was pushed down to suppliers. Unfortunately the move proved "penny-wise, pound-foolish" and delays and problems drove an incremental reversal toward Boeing taking more ownership. With McNerney retiring and Dennis Muilenberg, a 30-year veteran and engineer, taking over, we anticipate a greater emphasis on "owning" the development and supply chain.

The key for component and systems manufacturers is that demand is strong and opportunities to position yourself for future programs exists, but the bar is high! **PTE**

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