



Rumors and Raw Intel

Japan PMI Comes In Much Weaker

The Japanese measure of manufacturing for March came in at 46.4 points, down from 52.9 in February. This could have been worse, but we have to keep in mind that the country had nearly two weeks of the month with normal manufacturing activity before the quake and tsunami hit on March 11th. A reading below 50

Economic Calendar	
Date	Release
Friday	Nonfarm and Private Payrolls
Friday	Unemployment Rate
Friday	ISM Index
Friday	Construction Spending
Friday	Auto and Truck Sales

is typically a measure of contraction in manufacturing - again not unexpected given the significant trauma to the Japan market. Other PMI's from around the world will be filtering in over the next 48 hours as well and most are expected to show strong measures for the month. We will keep an eye on the Japanese PMI for April to see if it is able to get back to expansion levels or if the broader four-weeks of full disruption will have a lasting impact on overall production - leaving in a contraction mode for a longer period.

In a separate note, it is important to take into consideration the latest recommendation by the UN International Atomic Energy Agency to expand the exclusion zone around the Fukushima plant from its current 12 mile radius to at least 25 miles. Unacceptable levels of radiation have been found at approximately 24 miles from the plant. Reactor number 2 is still expected to continue its meltdown with higher levels of radiation being released increasing on an hourly basis. Given how the radiation travels, it is "popping up" in some of the most unlikely places. It's a developing situation one that continues to create instability in global markets.

Domestic Economic Issues

- Walmart Sends Inflation Scare. Walmart CEO Bill Simon said that consumers face a serious inflation problem ahead. Having done a lot of work with Walmart over the years on a strategic level, this is an interesting comment. All of the statements done by the company publicly are carefully scrutinized and prepared. And Mr. Simon doesn't idly make public comments without there being some rational elements of "forecast" in them. Mr. Simon said that "inflation is going to be serious. We are seeing cost increases starting to come through at a pretty rapid rate", according to a USA Today editorial meeting. We'll let you read the entire interview in USA Today if you want to. But, this gives us a large corporate view of what is likely to come for the rest of the year. There are enough hints being given away by corporations to suggest that inflation at a consumer level across a wide range of products is likely on the way. Everything from clothing to plastics and food will see increases. The crisis in Japan will also add costs to anything with an electronic component. Knowing that the biggest retailer in the world (with arguably the strongest purchasing power and most sophisticated supply chain) is sending market signals that costs are spiking is likely a bad sign for the rest of



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the retail industry. There could have been other motivations for his message, but at this stage - we'll take them face value and send it out to our readers as a big "heads up". - Keith

- The never ending revision of GDP has gone through yet another permutation and this time the news is a bit better. If you have been keeping score at home the fourth quarter GDP was once stated as high as 3.4% but subsequent revisions took it down to 2.8%. Now the latest revision has it back to 3.1% and that is about two tenths of point better than had been expected. In the great scheme of things this doesn't matter all that much but it does suggest that there is more life in the export economy than had been expected but that in the fourth quarter those exports dropped a little and were replaced with additional activity in terms of inventory build and even some commercial construction.

The Pure Unadulterated Joy of Interpreting Job Data

The most important piece of data to come this month will be arriving tomorrow as the Labor Department lets us all know what is happening in the job market - at least in their interpretation. The fact is that there are few areas in the economy that provide a more complex set of statistics and interpretations than employment. What do we know at this point and what are the issues we will need to deal with for the rest of this year and into the next.

Just for the fun of it - let's start with what passes for good news these days. The latest data from ADP suggests that there have been some fairly impressive gains in the private sector. They have noted that there were some 200,000 jobs added by the private sector and the majority of these have been in small or medium sized business. This is more crucial than one would think as the small business sector has been very slow to get back in the swing of things since the recovery has ostensibly started to develop. The other piece of good news came earlier in the week when it was revealed that the number of new claims for unemployment is still declining. This would suggest that the big layoffs are coming to an end. The majority of the analysts are expecting to see some better news from the Labor Department data tomorrow as well. Most assume that the unemployment rate will remain under 9% but there are also those who assert that the improved labor market will soon have the perverse effect of making the jobless rate worse as people are lured back into the employment system by the prospect of better job opportunity.

This good news is somewhat balanced by the not so good news that public sector employment is starting to fall off. This has been expected by analysts and will continue to be an issue for the duration of the year. States and local governments are knee deep in their fiscal crisis and they have run out of the federal's stimulus cash that had allowed them to avoid the layoffs they are engaged in now. The estimate is that public sector layoffs will accelerate through the year and may add as many as 350,000 to 500,000 people to the list of unemployed before there is a hint of fiscal recovery.

The really fun part of looking at the employment picture is the fact that so many fundamental factors have changed as far as employment in the US is concerned. These changes have altered the way that people look for jobs, the expectations they have, the way that employers hire, the function of the education system and the way that communities conduct economic development. There are also huge implications for the way that statistics are gathered.

These are just a few of the major issues in employment as compared to even a decade ago. Let's start with mobility. The US was once a nation proud of the fact that its labor force was highly mobile and could thus move to where the job growth was. This ensured that there would be fewer places facing labor shortages at the same time that other locations were glutted with those looking for work. Those days are gone and now the US has one of the least mobile societies. What happened?



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Almost thirty years ago the US had a period of double digit unemployment similar to today. Three decades ago the guy who lost his job could find another one in some new territory and come back to the family and declare "Hey honey - I got a job making widgets in Arizona". Mom packed up the kids and off they went to Arizona. That was when 80% of households were dominated by a primary wage earner and that was usually the male. Today 70% of all traditional households are dual wage earner homes and only about 30% of those are dominated by males. The percentage of men in that position took a big hit in this last recession as the sectors that lost the majority of jobs were those that have been traditionally male dominated (construction, manufacturing and finance).

This has an impact on the mobility issue. Now that guy comes home and announces that he has a job in Nebraska making wind turbines and his wife wishes him good luck. She has a better job than he does, better benefits than he does and has no interest in hauling the kids to a new school and home. Thus the move is not often made.

There are other complications stemming from the fact that 30 years ago the majority of people looking for that new job were renters and setting up in a new community was a lot simpler than it is now. The homeowner who is underwater or simply doesn't want to sell the house at a loss is not going to jump to that new position as readily - especially if there is a pay cut involved.

There is yet another new wrinkle as far as job mobility. In a conversation with a recruiter trying to get people for jobs in South Dakota he mentioned that a major issue was the complexity of child custody. People would be willing to move but if they did they lost access to their kids and thus they had to reject the offer.

These are all factors that will combine to create a situation the US has not faced in the past. There will be parts of the US that will have chronic issues of unemployment for years to come as people will not be able to relocate for job opportunities and will be essentially locked in place. At the same time there will be job shortages in the regions that are growing as they will not be able to pull effectively from the pool of people seeking work. This means there may well be instances of wage inflation in select parts of the country as well as in select industries.

STRATEGIC BUSINESS IMPACT - The impact on business will be varied and it will all come down to what area of the country a business is in. The fast growing sections will not have the choices that one would expect when the rate of unemployment is as high as it is - much will depend on the local employee base. The fact is that the economy may well be experiencing some wage inflation at the same time that there is very high joblessness and that is an awkward situation at best.

Global Economic Issues

- China Shuts Down 10% of Dairy Capacity. In an effort to improve dairy product safety, 20% of China's dairy industry has lost its license. The Chinese Government is taking a strong step in trying to ensure that the dairy industry in the country can meet some of the tougher international standards being set out by the US and others. As a result of this move, 20% of the countries dairy farms will no longer be able to operate - effectively removing the 10% of capacity that this segment currently produces. Analysts believe that the move will certainly help the large companies produce more - and give them a greater share of the market as a result. This may not have a large impact on the US dairy industry - but it is an interesting development to watch. There is one interesting piece of this however, it also includes and affects the infant formula portion of the Chinese market. Powdered US formulas could see a boost from this development - and for a country





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with such a huge population, it could be a nice boost for that segment of the food production industry.

- The Brazilian economy appears to be cooling a bit and that is probably good news for those who have been concerned about the high interest rates that have marked the country over the past couple of years. The new government under Rousseff is just as determined as that of Lula to keep inflation from crushing the life out of Brazil and the central bank continues to maintain some of the highest rates in the world. There is now some evidence that unemployment rates are going up slightly - perhaps enough to convince the central bankers that these rates can at least remain where they are - as opposed to rising again. The country has not actually tried to slow the pace down in the way that China has but there has been aggressive use of monetary policy to accomplish that task.

Commodity Prices on Very Fast Track

The focus of the last few weeks has been on the impact of high oil prices and that makes sense. What is not getting quite the attention it deserves is the fact that food commodities are skyrocketing at a pace that puts oil to shame. This is not the kind of impact that strikes people as directly as the hike in oil but it will ultimately drive the inflation threat later this year. And the news gets worse and worse.

The latest salvo comes from the US Department of Agriculture. The estimate they gave a few weeks ago has proven to be a little optimistic and now they are asserting that the amount of corn and soybeans in storage is far less than they had originally thought.

It is now obvious that levels will fall to critical levels before the harvest comes in to replenish and at the moment there is no expectation that the coming harvest will be particularly good.

The hope had been that record high prices would be enough to push back demand but that hasn't been the case. The price of corn has risen by 52% and soybeans are up by 34%. Wheat prices have been up over 80% at times and the price for cotton has at times surged as high as 156% above what it was a year ago. In most years that price hike would have been more than enough to cause a reduction in demand but not this time. There are factors that have kept demand high vary but three stand out at this point.

The first is that 25% of the US corn crop is going to ethanol and with per barrel oil prices up, the demand for ethanol has returned. It doesn't hurt that all the subsidies that have been promoting more ethanol use are still in place. As long as the US subsidizes ethanol and blocks the import of the material from Brazil, the prices will be high and the demand for corn will be significant. The second factor in keeping demand high is that countries like China and India are importing far more corn and other grains for use as feed for livestock. The demand for meat is rising very fast in Asian states that have created a nearly insatiable demand for those feed grains. The final factor is weather related as last year was brutal as far as many harvests were concerned. There has simply been insufficient supply coming in for even normal levels of demand so when there is any sort of interruption in the supply system the shortages become acute and very quickly.

Under normal circumstances these numbers would provoke farmers to go into overdrive for this year's planting but there are already indications that the price of fuel is going to be an inhibitor and may result in less activity than would be expected. There is also a concern that this will be a late and cold spring and that harvests will be adversely affected. The bottom line is that most indicators are suggesting a year much like 2008 - high prices for commodities and high food inflation couple with major shortages in many parts of the world. The storage deficit is severe - 15% less in storage than last year and that takes supplies down to critical levels.

STRATEGIC BUSINESS IMPACT - The impact will be obvious in many respects and subtle in others. Just as in 2008 there will be higher prices that will push inflation at the



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"real" rate and there will be widespread shortages of food in many parts of the world. The more subtle changes will be the ones to watch. If the past is any pattern, there will be a reaction on the part of farmers as they switch from crops that are not proving as profitable towards those that are in shortage today. That often leads to a glut in the crops that are in demand today and a shortage for those crops that farmers are switching from.

There will also be an impact on the support industries for agriculture. It is expected that everything from farm machinery to transportation will be affected by the high prices as farmers reap their reward. The consumer will see higher food costs and that will at some point impact everything from restaurants to institutions serving food (hospitals, retirement homes, schools and the like). This is where the "real" inflation numbers become the core inflation numbers that worry the central bank.

This will be a good season to pay close attention to those farm reports - especially as the key corn and soybean states start to assess where they think crop yields will be in a few months.

Geopolitical Risk Assessment

- **Developments Between North and South Korea.** Amid a world of breaking news, North and South Korean events have been stoked again. South Korean activists have again used a new technique to **send (reportedly) 200,000 leaflets into North Korea calling on the citizens in the country to overthrow the government of Kim Jong IL.** The leaflets, sent over by helium balloons, show news of the Middle East uprisings and the successful overthrow recently of dictatorships. North Korea has threatened to shell the areas used as launch sites for the balloons. This comes just a day after South Korea made two moves. First, it removed a ban on private enterprises from giving aid to the North Koreans which are facing massive starvation across the country. Second, the South began a new set of military drills around a disputed island region which has infuriated the North. North Korean officials released a statement today telling the South to "choose dialogue or war" - banter that South Korea took without giving much credence.
- North Korea is one of the countries that still needs to be on a watch list. As we have mentioned a number of times, **the starving portion of the population is so poor and defeated** that it will not likely be able to mount any sort of uprising as we have seen in the Middle East. But, the military could get to a state in which it starts to challenge leadership. **Many military soldiers have families that are starving and the soldiers themselves are eating a weak variety of porridge on most days - not enough to keep them from disease and ultimately a form of malnourishment.** With food stores in dismal shape after a year of poor harvests throughout the region, the situation in North Korea is both silent and deadly. Little news is emerging about the plight of the people in North Korea - but the Kim Jong IL regime still wants to saber rattle from time to time to make the world pay attention. With South Korea lifting private aid restrictions, **we are assuming that the food situation in North Korea is getting dire for a majority of the population.** South Korea was using this tactic (banning its aid to the North) as a major political tool in fighting against the Kim Government (trying to create instability and ultimately an overthrow from the inside). Obviously, they have intelligence to show that it isn't going to break Kim - **leaving a humanitarian crisis on their border if they don't ease up and jump in with aid.**



- **Oil Jumps on, well, nothing really.** This is not meant to be so tongue-in-cheek, but the oil markets are not making a lot of sense presently. Look at the facts: oil **supplies** in the US jumped in the most recent report issued yesterday. Stockpiles of oil are growing. Elsewhere just two days ago, Libya rebels were advancing and there were talks of allowing the rebels to sell oil - and the price on the global exchanges fell. Then, this morning, news of renewed strength in pro-Gaddafi forces starting to once again take ground from rebels and indecision on behalf of the coalition supporting rebel troops led to the current \$2 spike we currently see. Oh, and we can't forget the "wasn't as bad as it could have been but certainly wasn't as good as it could have been" labor report. Frankly, it really didn't move the needle at all but the fact that there wasn't any job loss led to speculation that oil demand would rise. **This is nonsense in trading activity and the daily swings are becoming noise.** Lastly, there is the "end of the month" technical trading frenzy that comes as funds are forced to reinvest money that was taken out of the market earlier in the month. Here's what is important to take away from all of this as a business operator:
 1. **Brent is over \$117 a barrel.** Analysts had said that anything over \$110 for a sustained period of time would set back European economic recovery and lead to another possible recession. We've been there for some time.
 2. **West Texas Intermediate even rose above \$106 in early trading Thursday.** Here again, increases in fuel prices are leading consumers to change spending habits - a real threat to the economic recovery.
 3. **Jet prices are still among some of the biggest concerns for analysts** - the impact to the airline industry is profound and really being understated at present. Specifically - watch the European airlines closely. Jet fuel prices were the most impacted by the Libyan situation and prices in Europe are higher than in most regions. Japan was also a huge net exporter of jet fuel (4-6% of global supply) - with this disruption to the jet fuel supply chain, there will be some significant spikes in price across different markets. Again, recapping information we have shared with you in the past, the additional cost of jet fuel to US airlines will be measured in the billions this year. Qantas was among the latest to issue a warning on earnings and to announce a planned reduction in staff and flights to cut costs in the wake of the global oil price spike and several disruptions in global markets.

There are a lot of analysts starting to finally take note of the impact that oil prices are starting to have on the global economy. We've been pounding on it for months now and remain concerned that the rise in fuel prices over the summer could be significant enough to really change some consumer and business spending. We'll have to wait and see how high the speculation market can send it.

- **Corn Supplies at Lowest Levels in 15 Years.** Farmers will plant the second highest volume of corn on record - and it won't matter. **Global demand for corn is increasing at a rate that the global farming community can't keep up with.** And, given the President's speech this week on the need to reduce reliance on foreign oil sources, this is likely to get worse. More emphasis will be placed on ethanol production (and granted it can come from many sources), but corn demand will increase to go into fuel production. The price of corn has doubled just since last summer, going from \$3.50 a bushel to more than \$7 in recent trading.

Working this through a complete analysis, there are some trouble spots ahead. First, according to a piece from the Associated Press, ingredient prices are approximately 10% of food costs. However, with both transportation costs (because of fuel) and increased prices for the raw material (in this case corn) rising,



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there is a significant chance that food prices in general will increase as a result beyond levels they are currently at.

Second, the number of total farmed acres in the US doesn't move that much from year to year. Therefore, when the number of acres of corn goes up, there is a tradeoff. One of the losers this year could be soybeans. According to reports, farmers have dropped their volume of soybean plantings by nearly 1%. That will be significant for the rest of the global markets (huge consumers of soybean products) if those countries are unable to get suitable crops again this year. The forecast of another poor production year in Asia coupled with more food production going into ethanol would be a disaster for global food prices. This is a scenario that we don't want to discuss in detail yet - let's give Mother Nature an opportunity to turn the tide and provide some good growing seasons for the producer part of the globe.

Even if your company is not directly affected by the price of corn, it is important to understand how it fundamentally plays into consumer discretionary spending, alternative fuel production, and generally the farming economy (therefore purchases of heavy farm equipment and supplies, etc.). That would be the silver lining in the report - the farming community is going to prosper for the near term (minus higher diesel prices for those that don't manage it well).

Supply Chain - Business Threats and Opportunities

- Mental Anguish in Japan and the Supply Chain. For those of us that were directly impacted or had family or friends affected by Katrina, we understand what the Japanese population is going through. The difference is that the situation in Japan continues to unfold. Mental health officials are saying that the psychological toll on citizens in Japan is starting to have an effect on their behavior and physical health. Clinical anxiety and depression is starting to pop up in a significant way from Tokyo northward. Consider the stress on a family in Tokyo who continue to get significant aftershocks (making them worry "what if this is the next big one"), are concerned about the Fukushima Daiichi plant and the potential for a major radioactive disaster in the making there, water supplies being tainted from time to time with radioactive iodine levels at dangerous levels, etc. The "worries" could go on forever.

Officials in the country suggest that a majority of the population have been unable to sleep much because of the disaster. Anxiety over the nuclear power plant and rolling black outs, supplies of basic materials running out, and a host of worries are leading to significant insomnia across the country. After three weeks of this continuously, it takes a physical toll on the body. As we contemplate our business interactions with associates in the country, we typically fail to realize what they are personally dealing with and that their "normal" business mindset is affected at present. One notion that also needs to be watched is the ability for many business people to think strategically. They are living in a day-to-day, hour-to-hour environment at present, and the ability to think forward and plan ahead is going to be limited for some time.

For the supply chain manager, this is important to understand because production delays from higher rates of absenteeism and drops in productivity, product quality, and a host of other challenges could emerge even for those plants in the southern part of the nation that were less directly impacted. We often get so wrapped up in the nuts and bolts of running a manufacturing company that we forget to stop and think about the debilitating mental conditions that can impact a region. Japan has a host of problems, but it will have to grapple with a nation that is going to suffer through some near term mental depression impacts from this disaster. And professionals say that this first wave of major depression cases are just now likely to start appearing - about the time some conditions start to get "back to normal".



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Earning your spot as the third largest economy in the world and one of the primary producers of certain products around the world, the stability and health of your workforce becomes a global concern.

Environment – Business Threats and Opportunities

- Xinjiang Province in China has Foot and Mouth. The stability of the pork population in China is of great concern at present because of the global food shortage risk. Pigs in one of the provinces that are still far from the primary breeding provinces in central and southwest China are alarming enough to warrant watching. Foot and mouth disease is easily spread between animals and is usually responsible for thousands of head of swine or beef to be culled when an outbreak happens. The same region had an outbreak in February – nearly 4,000 pigs were culled as a result. The most recent outbreak has thus far been limited to just about 100 hogs thus far – culling estimates to prevent spread of disease have not been released. Several years ago in 2008, hundreds of thousands of pigs and other cattle were culled as a result of a major outbreak of various diseases in the country. This was near the end of the global food shortage, but it had a significant impact on world food prices as a result. The more China has to import in food stocks to support its population, the more global food prices rise. The country has already had to boost its import of wheat and corn for both human consumption and feeder stocks this year as a result of massive drought and flooding across much of Asia. We'll keep an eye on the situation in the country and the potential spread of this disease in the pork population.