

# MUNICIPAL BOND MARKET NOTE

## JANNEY FIXED INCOME STRATEGY

June 3, 2013



The U.S. is still one of the foremost leaders in industrial output.

## A 21st Century U.S. Manufacturing Renaissance

### The Onshoring and Reshoring of Jobs in the U.S. Will Strengthen the Municipal Landscape

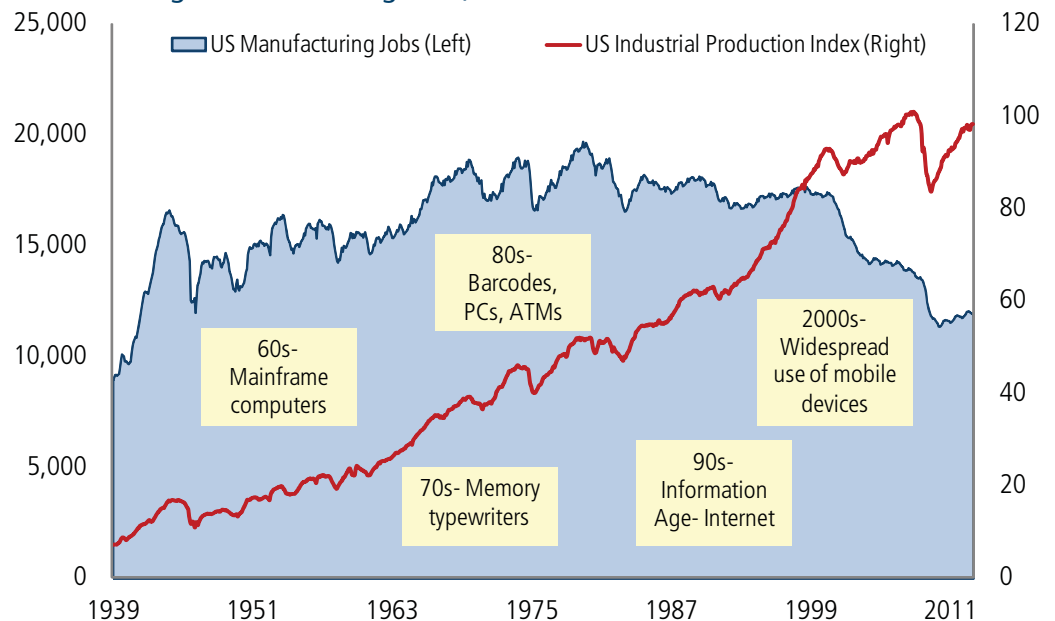
- Companies are in the early stages of onshoring and reshoring jobs in the U.S.
- There has been a build-up of anecdotal evidence about companies onshoring and reshoring, which is likely to lead to improvements in the U.S. manufacturing sector, even if the macroeconomic numbers do not yet incorporate that evidence.
- This positive employment trend will add to the already strong manufacturing output of the U.S. and help reinforce state and local government credit quality.
- Although U.S. manufacturing employment peaked in 1979, different forms of technology have subsequently made many of those jobs obsolete.
- We do not expect the number of US manufacturing jobs to return to record levels, but this rebirth is stimulating governments, allowing companies to better meet customer expectations, and offers investors a clear sign that the U.S. is not in decline.
- Companies such as Deere (DE), Ford (F), Nike (NKE) and Hanesbrands (HBI) have moved or are moving or placing operations in U.S. states such as: Iowa, Ohio, New Mexico, and Virginia.
- We also believe investors, analysts and observers should consider state and local government exposure to manufacturing jobs as a positive.

## U.S. MANUFACTURING LEADERSHIP

### Clearing Up the Misperception

Most believe the United States manufacturing sector has been deteriorating since the 1970s. This is a notion that has been seared into the minds of many through music, television, movies, literature

### Manufacturing Jobs are Coming Back, but Will Not Return to Past Record Levels



Source: Bloomberg & Janney Fixed Income Strategy. Manufacturing jobs in thousands. Production index, 2007=100.

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Reshoring is the return to the U.S. of manufacturing jobs formerly offshored and onshoring is the addition of manufacturing jobs in the US.

Renaissance (or rebirth) is a fitting designation, because corporations are in the beginning stages of a significant change in their manufacturing process.

This Renaissance will add to the already strong manufacturing output of the U.S. and help strengthen the credit quality of state and local governments across the country.

tinues to be one of the foremost leaders in manufacturing as measured by output. This misperception exists because the number of manufacturing jobs, but not the U.S. manufacturing sector's output, has declined. Manufacturing employment peaked in June of 1979, at a little over 19 million jobs.

Recently, U.S. Manufacturing as measured by output has reached its highest point, while U.S. manufacturing employment fell to its lowest - an inverse relationship that exists mostly as a result of technological innovation. The decline (by 40% since 1979) in manufacturing employment does not mean manufacturing is not an important part of the nation's economy. Quite the opposite is the case. In fact, there are still many local governments that are more dependent upon manufacturing than any other sector. Traditionally, this might have raised red flags or given analysts pause when assessing a credit for fear that those jobs, and underlying tax revenues, were at risk. It is our opinion that this is not necessarily the case and that there is a renewal in U.S. manufacturing building.

### The Top Metro Area Most Dependent Upon Manufacturing

Metro Area	State	Manufacturing Employment (%)	Manufacturing Employment (#)	Nonfarm Employment (#)
Elhart-Goshen	IN	45%	50,900	112,600
Columbus	IN	38%	18,600	49,100
Dalton	GA	33%	20,700	62,900
Sheboygan	WI	32%	18,200	56,200
Holland-Grand Haven	MI	29%	33,000	112,300
Oshkosh-Neenah	WI	27%	24,700	92,000
Hickory-Lenoir-Morgantown	NC	26%	36,800	142,500
Racine	WI	25%	18,500	72,600
Kokomo	WI	24%	10,100	41,700
Pascagoula	MS	24%	13,200	55,500
Morristown	TN	23%	10,500	44,700
Fond du Lac	WI	23%	10,200	44,700
Rockford	IL	22%	32,400	146,800
Wausau	WI	22%	14,200	65,100
Decatur	AL	22%	11,700	53,800

Source: Bureau of Labor Statistics via Governing magazine and Janney FIS.

There has probably never been a better time to be a local government with the attributes manufacturers are looking for. That is because the U.S. is probably in the second, or maybe the third year of a new employment trend. This trend is being recognized by some, but not many. And though there is only a small amount of evidence to support our claim, we believe that the U.S. is currently in the beginning stages of a significant change in the U.S. manufacturing sector. That change is because U.S. companies have been rethinking their recent history of offshoring manufacturing operations. This belief conversion is the foundation of what we are referring to as a 21st Century U.S. Manufacturing Renaissance.

Trends of reshoring (the return to the U.S. of manufacturing jobs formerly offshored) and onshoring (the addition of manufacturing jobs in the US) are starting to develop. Please keep in mind that while we do not expect the number of US manufacturing jobs to return to the levels which peaked in 1979, we believe this rebirth is stimulating select local government tax revenues, allowing companies to better meet customer expectations, and is offering investors a clear sign that the U.S. is not in decline. This Renaissance will add to the already strong manufacturing output of the U.S. and help strengthen the credit quality of state and local governments across the country.

### A U.S. Manufacturing Renaissance

We believe that the U.S. is in the initial stage of a manufacturing Renaissance. There has been a build up of anecdotal evidence about companies onshoring and reshoring, which is likely to lead to improvements in the U.S. manufacturing sector, even if the macroeconomic numbers don't yet incorporate that evidence. Currently the numbers are small. And one must really dig for them. But, you

“Ideally, you’d have every plant you own on a barge to move with currencies and changes in the economy,” said Jack Welch in 1998 when he was the CEO of General Electric- from the Economist, January 2013.

Jeff Immelt, GE’s current CEO refers to outsourcing as “yesterday’s model.” GE is locating production and engineers to Kentucky and Michigan- also from the Economist, January 2013.

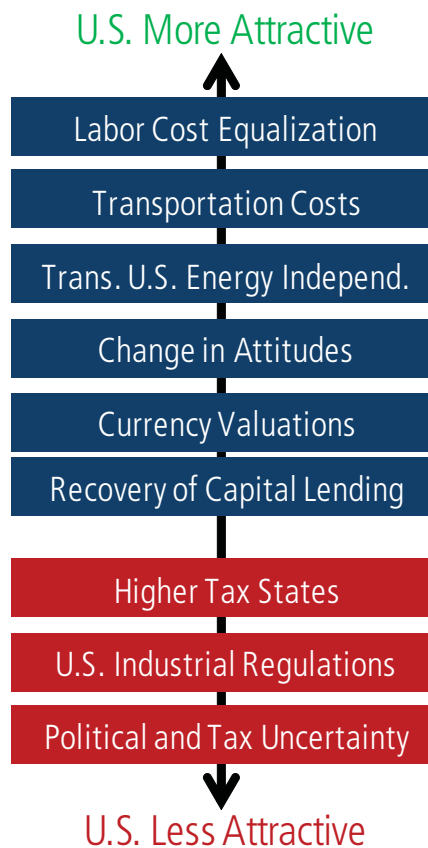
“The idea that manufacturing is old-fashioned is, itself old-fashioned,” Antoine van Agtmael- investment manager who coined the term, “emerging markets.” From the WSJ, April 20, 2013.

can be sure that on a regular basis over the last few years we have read and observed instances where U.S. companies reported decisions to reshore or onshore new or existing manufacturing capabilities within the US.

## Why are Companies Staying in the U.S. and/or Bringing Positions Back?

For many years U.S. businesses, especially U.S. manufacturers, have been sending or offshoring jobs (mainly those which require a lower level of skills) overseas or just over the U.S. borders. The logic behind such a strategy was to reduce costs, plain and simple. Corporate planners historically believed they would save on manufacturing costs using this strategy. And in some cases costs might have been lowered. After a while the exercise practically became the expected procedure in many industries. The reversal of this thinking is being influenced by several factors. Now, there are many

### Range of U.S. Attractiveness



Source: Janney FIS.

Currently we are seeing several individual instances of this trend across many corporate sectors and in various states and municipalities. There is original equipment manufacturing (OEM) company activity in the mid-west U.S. where Deere (DE) upgraded plants in Waterloo, Iowa and Ford (F) moved medium duty truck manufacturing to Ohio from Mexico. And in the soft-line retail sector we have recently seen companies like Nike (NKE), Hanesbrands (HBI) and Gildan Activewear (GIL) make moves to keep or expand operations in the U.S. There is currently no identifiable trend pointing toward a specific geographic area of the US; however, it does not appear, at least from our preliminary observations, that this activity is not very prevalent in the middle Atlantic or northeastern states.

## Is Exposure to Manufacturing a Strength or Weakness for Local Governments?

Many investors have viewed larger manufacturing employment bases as exposures to be wary of when reviewing credit profiles. This has become an outdated view in our opinion. We believe that manufacturing bases of employment are signs that a local government possesses attributes that are attractive to corporations, and they could be candidates for expansion. While it always remains

reasons why the U.S. is becoming a more attractive option.

One of the most important reasons companies cite is that labor costs are starting to equalize. Labor costs are rising in areas such as China, Mexico and India. And although it is an option for companies to outsource, many are resisting this practice for several reasons. It is not only hard costs that companies are citing. Other costs are becoming important pieces of the decision matrix- overall transportation and energy costs are important too. Changes in corporate attitudes are also crucial. In many cases companies are deciding that they wish to be closer to their U.S. customers and research and development operations, many of which are located in the U.S.

## Who is Onshoring and Reshoring & Where is it Happening?

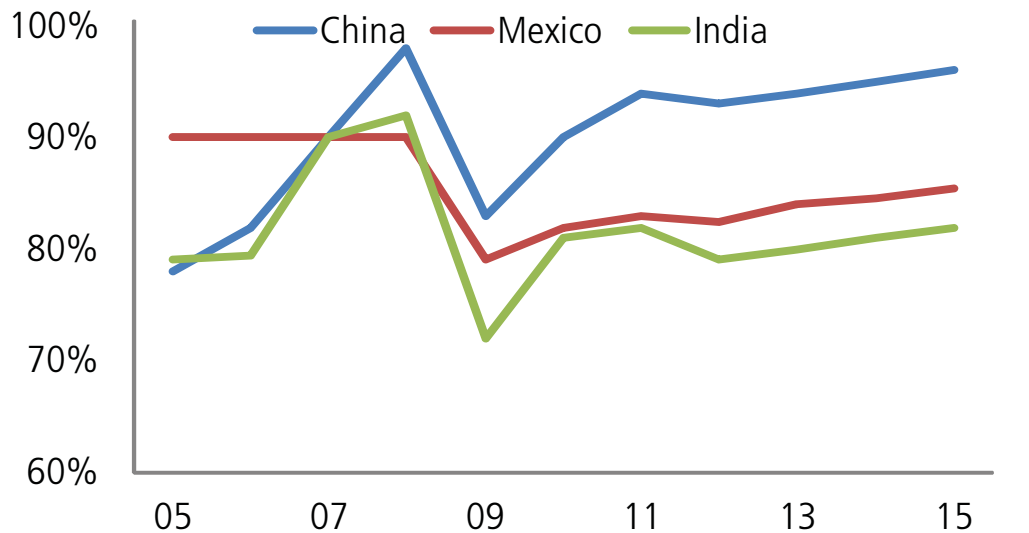
“A decade ago, nine out of 10 companies would tell you they were thinking about building their next plant in China. Today it’s more like three out of 10 and maybe five out of that 10, say they want to build in the U.S.” Antoine van Agtmael, 2013.

A critic writes, “reshoring will not happen,” quote from Tim Leunig, economic historian at the London School of Economic- Financial Times October 2011.

While a Boston Consulting Group survey from 2012 reports that 37% of companies with sales of over \$1 billion are planning on or actively considering reshoring production in some way.

possible that a company could relocate, we think that the current reshoring and onshoring trends are poised to continue and will expand the fastest where the most specialized and highly educated workers can be found and costs kept the lowest.

## Manufacturing - Outsourcing Cost Index is Forecast to Rise



Source: AlixPartners and Janney FIS.

## Other Reading and Sources

- Zweig, Jason; “Here Comes the Next Hot Emerging Market: the U.S.,” Wall Street Journal; April 20, 2013.
- Maciag, Mike; “The Metro Economies Most Dependent Upon Manufacturing,” Governing; April 5, 2013.
- Here, there and everywhere- Special Report Outsourcing and Offshoring,” Economist, January 19, 2013, p 49.
- “Welcome Home,” Economist, January 19, 2013, p. 11.
- Immelt, Jeffrey R.; “The CEO of General Electric on Sparking an American Manufacturing Renewal;” Harvard Business Review; March 2012.

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