



Finding A Home For Global Manufacturing:

Read much of the mainstream press; listen to most economists on talk radio and TV and you will become persuaded that the vast increase in global trade is good for the U.S. economy and our working people. What are the real facts, however? Behind this barrage of pro-trade propaganda is some disquieting facts. Facts that reveal quite clearly global trade is really about screwing the American economy in general and the U.S. worker in particular. Global trade is allowing the world to dump its products onto America and buying little from us in return. Our half a trillion dollar trade deficit did not spring up like magic.

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This is not the first time American industry has come under siege. We should have learned our lesson thirty years ago. That is when Japan embarked on creating a massive industrial enterprise with electronics and automobiles its core products. While we gobbled up that nation's exports, Japan placed even more barriers against American imports with the refusal to purchase even one grain of rice from America plus many other agricultural products in short supply on that Island nation. Japan went on an unprecedented economic spree. Many of us thought industrial and economic power would shift from the States to the "Land of the Rising Sun." What happened? Reality caught up to Japan and the "miracle" bubble burst. Japanese banks, which had funded the growth at the urging of the Japanese

government, just kept lending without any real security. The chickens came home to roost and those banks became bankrupt almost overnight. Huge portfolios of property which banks had secured through mortgage finance, became worthless. A grand example was the famous Pebble Beach golf complex in Monterey, California. A Japanese outfit wildly overpaid \$700 million for the property in the mid-eighties, only to lose it a couple of years later when a Japanese bank foreclosed for non-payment. The bank sold it back to an American, Marvin Davis, for \$300 million. Since 1990, Japan has been in a recession and only its exports (mainly to America) has kept it alive. Now, the shoe is on the other foot and American real estate companies are purchasing all sorts of Japanese property at fire sale prices. In the end, who won? America. Who lost? Japan.

Enter the 21st century, and China. Unlike Japan which essentially is a western style democracy, China remains politically a Socialist state. That is why I believe a day of reckoning rapidly is approaching from a political as well as an economic standpoint. Forget Bush's "axis of evil." The two rogue nations are not North Korea and Iran; they are China and Russia. China has no intention of playing the game that Europe and America are expecting. Barriers make it almost impossible for America to sell goods to China of any real quantity. China never will be interested in reciprocity. When it relates to its economy, the Chinese do not recognize the rule of law nor intellectual property.



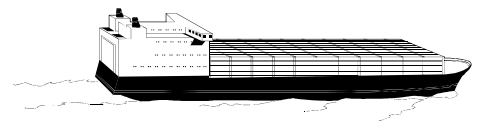
Announcements

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Happy New Year!

Let's put the issues of China's cultural and political differences to one side. The major reason why China will implode is not any fancy economic theories but the realities of moving merchandise from Asia to America. The demand for "mega" ships to handle this one way trade means there are fewer ports available to accommodate cargo from China. Already, the ports of Los Angeles and Long Beach are bursting at the seams as the gateways for Asia-originated freight. Because the Panama Canal is almost 100 years old, the visionaries who designed and built it (an all-American project) never dreamed cargo ships would start to exceed 100,000 tons deadweight.



Finding A Home For Global Manufacturing:-cont-

If the status quo prevails, shipping companies never will be able to build these super sized vessels fast enough to keep up with demand. If current trade patterns are maintained for the next five years, available tonnage will have to double just to keep up with growth. There is no way (let's forget Europe and just talk America) our gateway ports could handle these volumes without significant delays leading to sales and marketing chaos for shippers.

The fact that almost nothing moves back to Asia (see our item on the backhaul later in the Newsletter), places severe mechanical and economic strains upon equipment including vessels and their containers. Up until Japan and China burst upon the world trading scene, the transport business generally was an orderly business. Today, most venerable American and British shipping companies either have shut down or have been acquired by Asian interests. The only western shipping company that remains viable is Maersk Shipping of Denmark. I believe America has the flexibility and the human and financial resources to wait out the inevitable implosion of China—in the same way as we watched Japan implode fifteen years ago. Who really cares about this implosion? China is a rogue nation in my estimation; neither a friend nor an ally of America but one wholly interested in its own welfare. Industry is very mobile today. It is very easy to shut up shop in one part of the world and manufacture full scale in another within just a few months. Watch for the rise of manufacturing once again in America. What we can't handle, let's start looking at our neighbors to the South—in Central and South America. At the end of the day, this part of the world presents enormous, and far greater opportunities for America. Also, they are predominantly Christian nations and fit far more easily into our Judeo-Christian heritage. Let's see how things play out. My money is on America!



Aircraft From China Are Full Of Cargo, But What About The Backhaul?

The air cargo agreement signed last summer between the U.S. and China has led to a big ramp up in number of flights into and out of the largest trading nation in Asia. FedEx, UPS, Polar Air and Northwest Airlines all were awarded additional flights, and wasted little time in adding to their schedules. No doubt about it; China has become the most dynamic cargo market on the planet. Leave out China plus the South Pacific market and international air freight volume would show almost no growth. Yet, with all the hoopla and hyperbole about the China market, little has been said of exactly what kind and how much air freight is entering China. Or to use the transport term; the backhaul into China.

Airlines are reporting that with the end of 2004, about \$60 billion worth of goods will have left China on their aircraft bound for the U.S. These same airlines are silent, however, on the volume of goods entering China ex-U.S. As the American trade deficit with China is by far the largest of any nation, it is a safe bet to assume that we export much less to China than we import. This is certainly true for high value industrial goods which are the backbone of air cargo. Pricing and availability of lift also provide a strong hint of the

imbalance between outbound and inbound cargo. While freight from China often is backlogged with late deliveries, I can call almost any airline serving the China market to book its next flight out—and at a favorable rate.

What we make and what China needs are hardly similar. China has become a huge importer of commodities, not finished goods. Oil for its rapidly growing transportation network, coal for its powerplants; all kinds of raw materials for its manufacturing operations. China even is the largest importer of humble sawdust, used in the making of stuffed toys of which China is the largest producer.

Let's hope the airlines serving China do not repeat a mistake often made in air cargo's past. The belief that markets can grow forever. China is a huge market, and will continue to expand. But airlines have to strike a better balance between inbound cargo into the U.S. and the backhaul to make this market genuinely profitable. It will take selling on both sides of the Pacific to convince U.S. shippers to move more of their freight by air and to persuade China's importers of both consumer and business products to book more of their merchandise by air instead of ocean.

Cost Can Add Up With Supply Chain Disruptions:

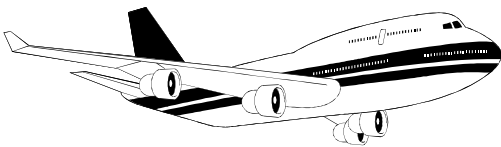
Open any shipping publication and inevitably there is an article on how new supply chain "strategies" are creating a brave new world in transportation. How electronic wizardry is making old-fashioned forwarding obsolete. How cargo moves more smoothly, efficiently and at less cost with the 3PLs. With all this propaganda gushing forth from the 3PLs and other organizations busily interposing themselves between forwarder and customer, one would think everyone is happy in supply chainland. Well, you would be wrong.

A recent survey taken of traffic managers and purchasing agents showed not blissful contentment with their 3PL vendors but acute discomfort. Fully 50 per cent of shippers' time is spent trying to resolve supply chain disruptions and

mistakes. And these errors don't come cheap. Supply chain disruptions often cost shippers six and seven figures when cargo doesn't arrive on time, in damaged condition or more rarely, never showing up at all. When traffic managers actually attack these problems with their suppliers, they don't rely on hi-tech to resolve them, but base their actions on habit and gut instinct. They also contact their forwarder rather than any intermediary because one who was surveyed stated, "we get straight answers from our forwarders." Talking to the 3PLs and talking to shippers reveal two different worlds. One is the world of myth; the other of reality. If these hi-tech 3PLs are so good, why are their clients spending half their valuable time trying to correct the 3PLs' mistakes? Could it be that the emperor wears no clothes?

Passenger Aircraft Increasing International Flights In 2005:

We've all been reading those scare stories about tight cargo capacity in 2005. Listen to some of the pundits, consultants and other "experts: and one would believe shippers and forwarders will be lucky, due to supposed lack of lift, that their freight will be delivered on time. Out of this fog of misconceptions shines some truthful rays of light. U.S. passenger carriers are boosting significantly their international flights while cutting back on domestic schedules. This means greatly increased lift for cargo. About 75 per cent of all international freight still is carried across oceans in the bellies of passenger aircraft. Belly freight also is consistently cheaper than being put aboard all-cargo aircraft. During the past few weeks, four of the biggest U.S. airlines; American, Continental, Delta and United have announced plans to move deeper into the international market.



To be candid, the shift from domestic to international flights by the "legacy" carriers amounts to an act of desperation. Lower cost competitors and the Internet have turned the domestic market into a toxic wasteland. Internationally, competition is not nearly as ruthless. Passengers still pay a hefty sum to travel overseas, particularly to Asia. Here is a rare case where the combination carriers' traditional emphasis on passengers translates into opportunities for cargo. Of course, increasing the number of international flights and shrinking domestic service will not solve the airlines' problems. Of the \$75 billion generated by the legacy carriers last year, only about \$17 billion or less than 25 per cent emanated from international operations. U.S. carriers may be boosting international flights for all the wrong reasons, but who's complaining? More lift means greater assurance of on-time deliveries and less pressure on rates.

Pendulum Swinging Back To Service:

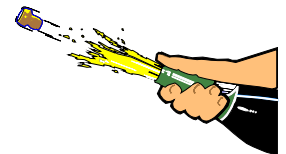
The French have a saying, "the only permanent thing in life is change." A basic change may be coming to our industry in 2005. The pendulum slowly is swinging back to service as an important component in air cargo. Sure, forwarders and airlines always have paid lip service to the importance of service. But when negotiations in those once smoke filled rooms got down to brass tacks—it was price, price and more price. The lower the price, the better chance for the deal. So, what if forwarders cut off our noses to spite out faces. So, we accepted prices that would give us no more than one or two per cent yields. Because of brutal competition, shippers had the upper hand, seemingly forever, and could dictate rates. But the year 2004 revealed a slight change in emphasis; which I expect to accelerate this year. Price, of course, almost always will be the dominant factor when the shipper awards business to the forwarder. But service no longer will be the forgotten stepchild. Why this change in emphasis? I believe there are two principal reasons; one outside the control of shippers but the other a new sense of realism by the air cargo customer.

The factor beyond the shipper's control is America's love affair with imports. Merchandise, particularly from that great world factory, China, is flooding our nation. Almost everything we touch, feel, wear or hear is coming from abroad—particularly China. Airlines serving the Asian market are backlogged with cargo with little relief in sight. When its tough to move freight, price becomes secondary. It is the forwarder moving customer cargo when promised despite crowded lift, onerous security restrictions and ground obstacles who will get the business—not the one offering the lowest rate.

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The other reason, less tangible, is the changing attitude of the shipper. No, he has not become a philanthropist. Rather, thoughtful shippers are starting to realize that a higher level of service will be translated into greater satisfaction among their own customers. It is finally sinking in that you can't get Nordstrom service at Wal-Mart prices.

Happy New
Year



Our most sincere wishes for a Happy & Prosperous New Year!!!



Sincerely,

Julian A. Keeling

