

CONNECTICUT NEWS JUNKIE

OP-ED | All Eyes On England

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With a huge percentage of Connecticut's economy dependent upon the defense and aerospace industries, all eyes turned toward England over the past week.

The international air show at Farnborough, England, concluded July 20. In 2012, \$712 billion in new orders were announced at this biannual event. How that will compare with new orders announced this year will be an important indicator of the health of these key industries — as well as the resulting economic benefits to flow to the Nutmeg State? The final numbers are still being tallied.

Last year, more than 3,000 companies in Connecticut won nearly \$10.2 billion in defense contracts. What that is less than in other recent years, it is still sharply higher than the \$6.2 billion recorded in 2002.

About 100,000 people in the state are employed in the defense and aerospace industries with combined payroll of about \$7 billion.

As a result, in addition to the numerous defense and aerospace companies that will be showcasing their products and abilities in Farnborough, even the Connecticut Department of Economic and Community Development will be on hand to help push new orders to our borders.

The market for new commercial aircraft is traditionally highly cyclical. As airlines become profitable, orders for airplanes surges. Conversely, when airlines are flying fewer passengers and deficits arise, orders for planes slumps.

As well, the market for defense systems has its own cycle — more spending during war and far less when perceived risks are diminished. U.S. defense spending today represents roughly 4 percent of Gross Domestic Product — compared to 8.9 percent during the Vietnam War, 11.7 percent during the Korean War, and a huge 34.5 percent during World War II.

Despite continued political unrest in the Middle East, overall the wars America has been fighting are slowly winding down. Great news for humanity, of course, but it seems to me there will be a negative impact on the defense industry in Connecticut. An overall poor business climate in our state, of course, does not help attract new companies in any industry and I believe it restricts potential expansion of companies already located here.

Nevertheless, there are individual companies within the defense industry that are worthy of investor consideration.

In recent years, government regulators have tended to turn “thumbs down” to substantial industry consolidation. Cash flow developed by these companies, therefore, tended to result in increased dividends, reduction in debt and even stock buy-back programs. Careful research can identify interesting investment opportunities with companies showing these characteristics.

There is a new area, as well, that I believe is on the precipice of major expansion: drones.

The international market for airborne intelligence, surveillance and reconnaissance was \$17.5 billion in 2011, according to a report issued by Visiongain. The same report noted that the worldwide market for unmanned aerial vehicles totaled \$3 billion in 2011. The continual news accounts of these vehicles, drones, operating in both military and civilian situations, clearly suggests to me that this market is going to expand dramatically in coming months and years.

A few months from now, in October, Connecticut will play host to its own mini-version of Farnborough. Aerospace Components Manufacturers (ACM), a consortium of Connecticut-based firms supplying the major aircraft and engine companies, will conduct a trade show in Windsor. While most of the ACM member firms are privately held, their success does give an indication of where we stand in the defense industry cycle as well as the overall direction of the publicly traded behemoths.

One industry analyst suggested that one of the few ways for the large defense companies to grow will be to capture market share from others. At Farnborough, Connecticut companies were trying to do just that. And, in Windsor in October, ACM member companies will be trying to capture business that might otherwise go to overseas firms.

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