THE LONGWAVE ANALYST

BOLDER INVESTMENT PARTNERS

FORWARD WITHOUT FEAR

Ian Gordon Economic Forecaster & Interpreter of the KONDRATIEFF CYCLE

Those who cannot remember the past are condemned to repeat it. Santayana

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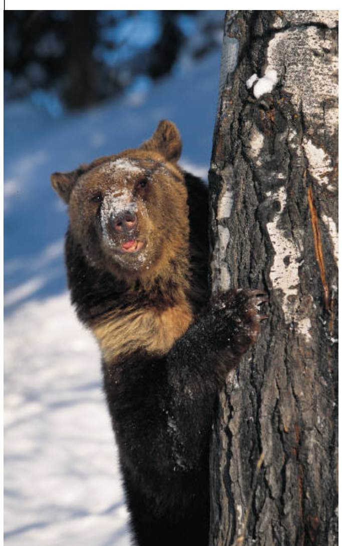
WINTER WARNING



"One ray of hope is that recessions in America have changed over the years. Thanks to a more flexible economy, smarter central bankers and lower inflation, recessions tend to be shorter and shallower." The Economist, Gloomy days in America, April 4th, 2008. I didn't know whether to laugh or cry when I read this. How can the writer not know that the economic downturn now facing the United States is a direct result of the moronic fiscal and monetary policies initiated by the Federal Reserve under the stewardship of Sir Alan Greenspan who, according to Ron Hubbard, chairman of the White House Council of Economic Advisors in 2003 "…Is the finest Chairman we've ever had." What a joke.

This man couldn't see a bubble even if it blew up in his face. This man strongly advised against the supervision of the derivatives market, which were the reason for Bear Stearns collapse.

The $600 trillion notional value of these derivatives is the Achilles heel which threatens the collapse of the world banking system. But of course Central Bankers are now "much smarter" than their predecessors; so, not to worry!

Obviously Henry Paulson, Treasury Secretary, thinks that at least the Federal Reserve led by Ben Bernanke is smarter, because he wants the Federal Reserve to assume stewardship over the entire financial system in the United States.

One must not forget that Mr. Paulson was, prior to his appointment as Treasury Secretary, head of Goldman Sachs. And Goldman Sachs has part ownership in the Federal Reserve. Wouldn't Mr. Paulson like to see the powers of the Federal Reserve expanded beyond the banking system into the investment banking sector of the economy?

Mr. Bernanke has already, in effect, expanded Federal Reserve control into investment banks by offering them similar lending facilities that had until now been offered only to the Federal Reserve member banks.

These banks are taking full advantage of the Fed's generosity. The emergency lending programme was initiated by the Fed on March 17th. In the three weeks following, the rate of borrowing grew from $13.8 billion a day in the first week to $38.1 billion per day in the third week. The Federal Reserve accepts pretty crappy paper as collateral in exchange for the loans, which undermines its Treasury bond holdings. But no matter, the Federal Reserve has the power of the printing press to make good its position.

There has been a rumour circulating for a couple of years or so that the Canadian Dollar and the Mexican Peso are to be amalgamated with the US dollar. Say it ain't so. Can you imagine our money (the Canadian Dollar) being controlled by a Central Bank that just loves to print money, its motto being 'the more the merrier.'

Maybe the new Governor of the Bank of Canada, a protégé of Goldman Sachs, will prepare the way for our subservience to America.

And we've seen the bullying American attitude to the so-called free trade agreement between the US, Canada and Mexico. Remember the softwood lumber disputes where the American government imposed tariffs on Canadian lumber to appease the American lumber producers.

Anyway, look at the pickle that the European Central Bank finds itself in at this time. A singular monetary policy spread across the continent is not effective. A tough interest rate policy is not what Spain, Italy, and shortly, Ireland need. Their collective economies are beginning to hurt.

It is unlikely that the Euro will survive a staggered economic collapse among its members.

On Friday the US reported its steepest job losses in 5 years. Non-farm payrolls fell by 80,000 in March. This is the third consecutive month that the labour market has contracted. The Labor department also revised upwards the number of job losses in January and February. This brought the total job losses for the first three months of the year to 232,000 and pushed the unemployment rate to 5.1%. This reinforces the notion that the US is already in recession. First-time claims for unemployment benefits rose above 400,000 during the past week for the first time since 2005.

Like many of the official economic numbers compiled by the US government, the unemployment numbers have a fudge factor, which in this case is called the Net Birth/Death model. "The BLS (Bureau of Labor Statistics) Net Birth/Death jobs unreasonably increased to 142K in March; last March it was 128K. This is plain ridiculous. An examination of these fictitious jobs shows the BLS unfathomably manufactured 28K in construction and 6K in financial activities." The King Report, April 7th, 2008.

Mr. Bernanke reporting to Congress on April 2nd "noted that the credit markets are still under duress and that Bear Sterns told the Fed that it would seek Chapter 11 bankruptcy, so the Fed intervened to prevent a meltdown. 'The adverse effects would not have been confined to the financial system but would have been felt broadly in the real economy through its effects on asset values and credit availability…With financial conditions fragile, the sudden failure of Bear Sterns would have led to a chaotic unwinding of positions in those markets and could have severely shaken confidence.'" The King Report, April 3rd, 2008

So, as we said in an earlier report, it's the derivatives. No bank with a piece of this $600 trillion on its books can be allowed to fail. Otherwise the whole house of cards collapses, bringing down the entire banking system with it. Will the Fed keep them all from failing? That is the $600 trillion question?

In today's (Monday April 7th, 2008) Financial Times, Alan Greenspan asserts that "The Fed is blameless on the property bubble."

"Doubtless each individual housing bubble has its own idiosyncratic characteristics and some point to Federal Reserve monetary policy complicity in the US bubble. But the US bubble was close to median world experience and the evidence that monetary policy added to the bubble is statistically very fragile." At least he admits to the bubble.

Now listen to this, because Mr. Greenspan shifts the whole responsibility for the bubble on the investment community. "The core of the subprime problem lies with the misjudgments of the investment community. Subprime securitization exploded because subprime mortgage backed securities were seemingly under priced (high yielding at original issuance. Subprime delinquencies and foreclosures were modest at the time, creating the illusion of great profit opportunities. Investors of all stripes pressed securitisers for more MBSs (Mortgage-backed securities). Securitisers, in turn pressed lenders for mortgage paper with little concern about its quality. Even with full authority to intervene, it is not credible that regulators would have been able to prevent the subprime debacle." Alan Greenspan.

But without your massive monetary and fiscal stimulus, Mr. Greenspan, there could not have been a housing bubble and without a housing bubble there could not have been a subprime securitization meltdown. Mr. Greenspan, you are fully responsible, not only for the housing bubble, but the stock market bubble and the credit bubble and this will be your legacy. And please, Financial Times, (my favourite newspaper), no more published excuses from the ex-Chairman.

The headline in the Financial Times of Monday April 7th, 2008 reads "IMF head calls for global help with crisis."

"I really think that the need for public intervention is becoming more evident" Dominque Strauss-Kahn, who is the Managing Director of the IMF (International Monetary Fund) told the Financial Times. "Government intervention-whether in the securities market, the housing market or the banking sector- would act as a 'third line of defence' supporting monetary and fiscal policy, he said." Financial Times. Oh goody, we can now have an international 'plunge protection team,' and our free market system can be socialized.

"Mr. Strauss-Kahn, a former French finance minister, rubbished the notion that the credit crisis was largely a US problem. 'The crisis is global,' he said. 'The so-called decoupling theory is totally misleading.' Developing countries such as China and India would be affected." Of course they would, because the credit crisis has to have a major negative economic impact in the developed world, which then negatively impacts the developing world.

Richard Russell, the veteran Dow Theory advocate, has changed course again with regards to the stock market. He's bullish.

"Question—Russell, please answer this, at the January 2008 lows, stock values never came close to what we expect at a primary bear market bottom. What do you make of that?"

"Answer—I've thought about this situation, just as I thought about this same situation at the October 2002 lows. My answer is the following—neither October 2002 nor January 2008 represented a major or primary bear market bottom. Both, I believe, were important secondary or cyclical correction-bottoms within a **continuing primary bull market.** I see no other explanation. Remember, one of the most important Dow Theory concepts is that bear markets end with stocks at great values. Stocks were not great values in the classic sense at October 2002 or January 2008."

"Question—Wait, Russell, whoa—are you telling me that we've been in a primary bull market ever since the early 1980s, and that we're still in the same primary bull market?"

"Answer—That's correct. That's what I'm saying. Somewhere ahead we're finally going to enter a true primary bear market, maybe one of the greatest and most tragic in history. That future bear market will end with something we haven't seen since the 1980 to 1982 period, and I'm talking about **great values** in stocks. And when I say great values I'm talking about blue-chip stocks selling in single-digit price/earning ratios while at the same time providing dividend yields of 6-7-8%, the kind of yields we last saw at the lows of the early 1980s."

Since this is my letter, I'm going to tell you that I think Richard Russell, much as I respect his market savvy, is wrong, wrong, wrong. The primary winter bear market in stocks began in early 2000.

By October 2002 the S&P 500 Index had lost about 50% of its value from its peak in early 2000. Over the same period, the Nasdaq lost 78%; the Dow Jones Industrials, which comprises only 30 major companies, lost only 29%.

But this was just too much for the Federal Reserve. Interest rates were cut from 6% to 1%, and the banks were flooded with money. The principal beneficiary of this excessive stimulus was the real estate market, and we all know what is happening to that Fed-induced bubble. But the stock market also benefited. This allowed the Dow Jones Industrials to make a new high in October 2007; the S&P, essentially double-topped, making a slightly higher high last October as compared to the high it made in March 2000; But the poor Nasdaq only recovered 55% of its losses from its March 2000 peak.

Mr. Russell's argument is based on Dow Theory, which states that lows and highs must be confirmed by both the Dow Jones Industrial Average and the Dow Jones Transportation Average; otherwise, the trend remains in place.

He states that the DJIA made a new low this March. This is true, on a closing basis, but not true on an absolute price basis. Meanwhile the Transportation failed to make a new price low in March, on either basis, thus failing to confirm the new Industrial Average low.

If we turn to last year to see the closing price high of the two averages, we note that the Transportation Index made its high in May, whereas the Industrial Average didn't make its high until October. That's a long time for the confirmation.

My bet says that the Industrial high made last October is the high, which will not be surpassed for many years. I mean, maybe 25 years or so; just like the high that was made in October 1929 (the previous Kondratieff autumn stock bull market peak) was not regained until 1955.

At the stock market bottom and this might well be 90% below the peak in prices, which would be similar to the 1929-1932 bear market, values might well be extraordinary.

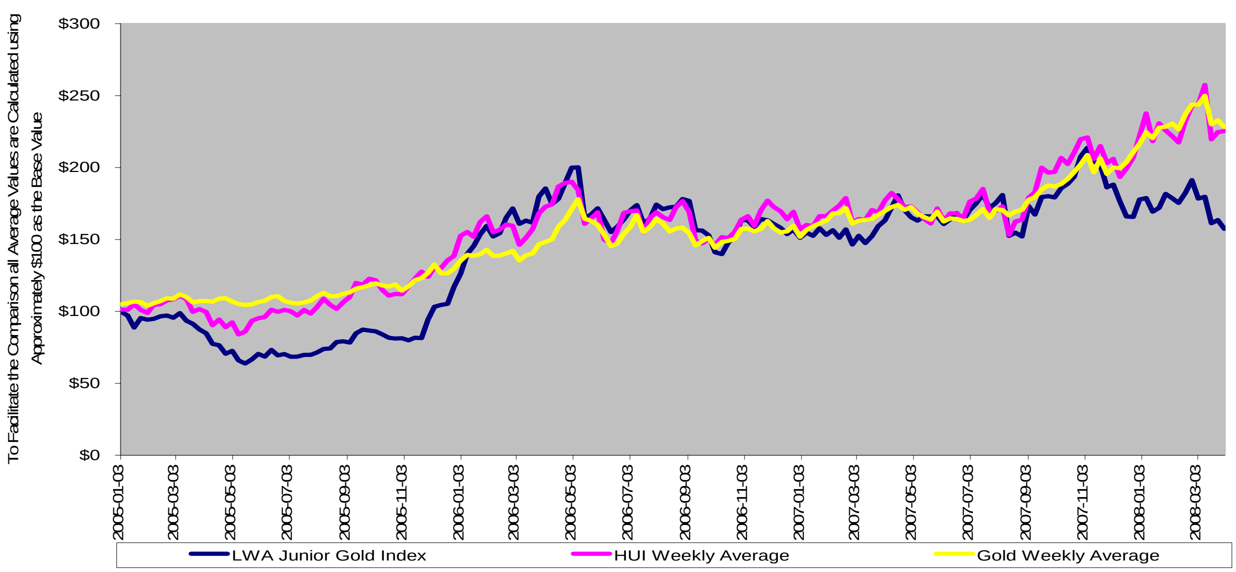
Dow Jones Industrial Average –Weekly Chart. Chart Courtesy of Reuters

Why are the junior gold stocks performing so abysmally? I've asked myself the same question. I now have an answer.

As many of you will know, I have been an advocate of investing in the junior precious metal companies, principally gold companies, since 2000. I like the leverage. For the most part that has stood us in good stead, but lately they've been a bust. Why? Because they're seen as a high risk investment.

Note the following chart that tracks gold, the HUI (large gold cap stocks) and the LWA junior gold stocks index. They tracked each other consistently from 2003 until October of last year, when the junior gold's turned turtle. Last October was when the market finally came to recognize risk and it didn't like it.

Junior Gold Stocks Lagging



See Appendix A for a list of the Stocks Included in the LWA Junior Gold Index

Will these companies regain investor confidence? I firmly believe they will, particularly those with gold or silver in the ground. This will happen when the debt catastrophe manifests itself in the form of a massive banking problem. At that time the rush to gold will turn into a stampede and gold shares of every persuasion will become the primary investment asset of choice. Be patient, the time of reckoning is nigh.

With regards to debt, a friend suggested to me that rather than contract it would expand. In the short term that is true, because the Fed, in desperation, attempts to bail out the banks by lending them even more money. This is a fatal mistake, because in the ensuing economic contraction the value of the assets against which the banks lent out money drops. This is already occurring in real estate. It will happen to all assets. This puts a great strain on the banks, the creditors, and likewise their debtors. Eventually, both creditor and debtor are forced into bankruptcy. This effectively reduces debt and it also forces a contraction in the money supply and this is deflationary.

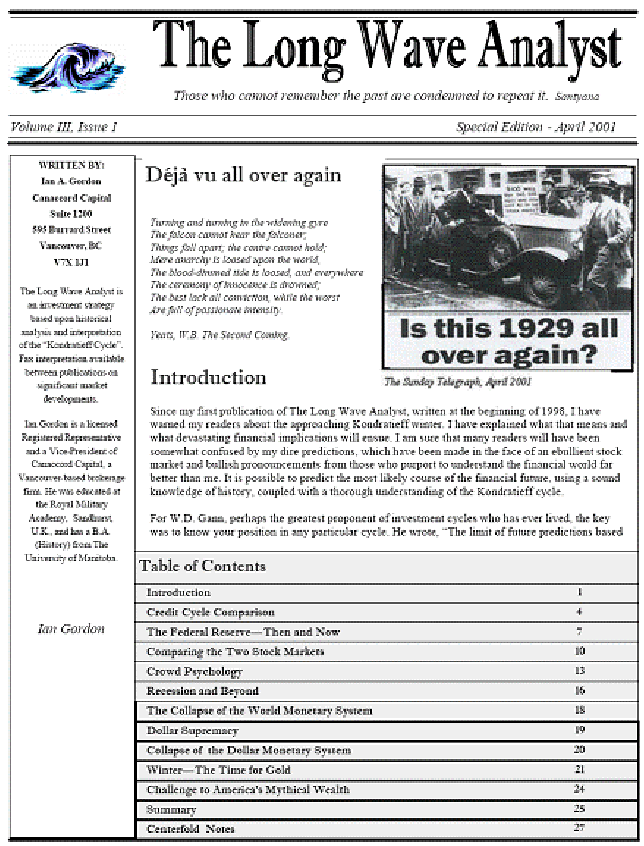
In the United States between 1929 and 1933, 10,000 banks failed and there were 85,000 business bankruptcies.

It is as well at this point to remind ourselves of what the great 'Austrian School' economist Ludwig von Mises wrote-"There is no means of avoiding the final collapse of a boom brought about by credit expansion. The question is only whether the crisis should come sooner as a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved."

"There has never been any attempt to abandon the credit expansion. Indeed any crisis was simply an excuse to open the monetary spigots." Gordon, Ian. The Long Wave Analyst Special Edition, August-November 2007. Page 2.

So we've reached the point of no return. There can be no return to credit expansion. Those days are over. Now we face the dark-side of this totally irresponsible credit bubble; that is, we now must live through its collapse, and suffer the consequences.

In 2001 The Long Wave Analyst Special Edition asked the question, "Is this 1929 all over again." This week's edition of Canadian Business poses the same question. Yes it is 1929 all over again and the simple reason for this is the debt.



The Long Wave Analyst

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The Long Wave Analyst is an investment strategy based upon historical analysis and interpretation of the "Kondratieff Cycle". Fax interpretation available between publications on significant market developments.

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Ian Gordon

Déjà vu all over again

Turning and turning in the widening gyre
The falcon cannot hear the falconer;
Things fall apart; the centre cannot hold;
Mere anarchy is loosed upon the world,
The blood-dimmed tide is loosed, and everywhere
The ceremony of innocence is drowned;
The best lack all conviction, while the worst
Are full of passionate intensity.

Yeats, W.B. The Second Coming.

Is this 1929 all over again?

The Sunday Telegraph, April 2001

Introduction

Since my first publication of The Long Wave Analyst, written at the beginning of 1998, I have warned my readers about the approaching Kondratieff winter. I have explained what that means and what devastating financial implications will ensue. I am sure that many readers will have been somewhat confused by my dire predictions, which have been made in the face of an ebullient stock market and bullish pronouncements from those who purport to understand the financial world far better than me. It is possible to predict the most likely course of the financial future, using a sound knowledge of history, coupled with a thorough understanding of the Kondratieff cycle.

For W.D. Gann, perhaps the greatest proponent of investment cycles who has ever lived, the key was to know your position in any particular cycle. He wrote, "The limit of future predictions based

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APPENDIX A

LWA Junior Gold Index Stocks

1. Dynasty Metals & Mining Inc. (DMM:V)
2. Emgold Mining Cp. (EMR:V)
3. Madison Minerals Inc. (MMR:V)
4. New Guinea Gold Cp. (NGG:V)
5. Pelangio Mines Inc. (PLG:T)
6. Royal Standard Minerals Inc. (RSM:V)
7. Trade Winds Ventures Inc. (TWD:V)
8. Currie Rose Resources Inc. (CUI:V)
9. Goldex Resources Cp. (GDX:V)
10. Ross River Minerals (RRM:V)
11. Samex Mining Cp. (SXG.V)
12. Staccato Gold Resources Ltd. (CAT:V)
13. Pinnacle Mines Ltd. (PNL:V)
14. Redstar Gold Cp. (RGC:V)
15. VG Gold Inc. (VG:V)
16. Everton Resources Inc. (EVR:V)
17. Tinka Resources Ltd. (TK:V)
18. Dynasty Gold Cp. (DYG:V)
19. Temex Resources Cp. (TME:V)
20. Atna Resources Ltd. (ATN:T)
21. Grayd Resources Cp. (GYD:V)
22. Northern Star Mining Cp. (NSM:V)
23. American Bonanza Gold Mining Cp. (BZA:T)
24. Goldrea Resources Cp. (GOR:V)
25. Freegold Ventures Ltd. (ITF:T)

*** A price weighted index is calculated by summing up the prices of each of the stocks in the index and then dividing by the total number of stocks within that index**

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