

THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

ECONOMIC WINTER



Profits and Prophecies

On October 3rd, 2004, the Vancouver Courier, a relatively small but serious newspaper published a story about my work and my thoughts of the future, which were to say the least, dire. I think that it is time to resurrect this piece, because I consider that my predictions referenced in that newspaper are about to come true.

Profits and Prophecies

Ian Gordon doesn't look like a prophet of doom. A vice-president of Canaccord Capital, one of the major brokerage companies in Canada, the affable 62-year-old is more at home in a sober jacket and tie rather than gypsy head scarf. With his conservative dress and military bearing, a product of his years as a young man serving as an officer in the British army, he could almost be mistaken for a school principal.

Gordon leads a busy, but relatively quiet life as an investment advisor specializing in Vancouver's speculative junior gold mining sector. He commutes to his downtown Vancouver office several times a week from White Rock. Some days he works from home. Occasionally, he makes business trips abroad and, on weekends, he likes nothing better than relaxing on his back deck.

Despite appearances, this unassuming man is making an extraordinary prediction contrary to current optimism: a financial earthquake is about to rupture the U.S. economy and the reverberations will be felt across the globe, including here in Vancouver.

It could start with a failure in the banking system in China, or the collapse of a major company like Ford could be the catalyst, but

as the dominoes fall around the world, Gordon envisages a global depression akin to that of the 1930s, except this time it could be worse. Not everyone will suffer. "Those that have money will always have money," he says with quiet gravitas from his highrise office on Granville Street.

But he does believe there will be widespread, long-lasting hardship.

Gordon's long-term view is in stark contrast to the generally positive view on the global economy heard daily. Even the most pessimistic commentators would draw back from predicting the same dire economic Armageddon. His view could also be seen as self-serving given his ties to the gold industry. But Gordon, confident in his history, remains undaunted by his critics, and advises his clients to prepare for the worst.

Gordon's bleak prediction comes from his studies of a little-known statistician in 1920s Russia named Nickolai Kondratieff. A member of the Institute of Agricultural Economics, Kondratieff wrote a series of papers arguing that capitalist economies expand and contract in a long wave of about 60 years, first rising up to a peak about half way through the cycle before falling back down.

Often credited by his followers with predicting the Wall Street Crash of 1929, Kondratieff died young in a Siberian gulag during Stalin's purges, but his ideas were resurrected by Harvard professor Joseph Schumpeter in the 1930s. Economic prognosticators have subsequently taken up the torch.

Gordon describes the Kondratieff Wave Cycle as taking four stages: Spring (“the upswing starts”), Summer (“boom and inflation”), Fall (“speculative boom and euphoria leads to a stock market crash”) and Winter (“deflationary depression”).

Gordon is convinced Winter, characterized by business failures, mass unemployment, widespread fear and a deflationary drop in overall prices as debt is “cleansed” from the economy, began with the peak in the DOW Jones in January 2000 and could drag on until 2020. He says that if this current downturn in the Kondratieff Wave is true to form, it will also end with a war-possibly the death throes of the U.S. as it loses its grip on global economic hegemony.

These predictions seem wild in comparison with the conventional thinking that the fallout from the dot-com debacle is truly over and the world is enjoying an economic recovery. Major North American stock markets are well above the lows they plummeted to in October 2002 and latest statistics show that the Canadian and B.C. economies are growing, unemployment is falling and confidence is high.

“I don’t think there is any crisis emerging or some sort of huge meltdown. In fact, currently this year we are seeing one of the first synchronized recoveries of global economies since 1995,” says Toronto-based economist Carl Gomez of the Royal Bank of Canada. Gomez admits that U.S. debts and deficits could become a problem if its economy stops growing, but says the debt is at “manageable” levels. The local economy is faring well, too. “As far as the labour market goes things look pretty impressive for the Canadian economy.”

Even Vancouver’s real estate market, sometimes a worrying area, looks fine to him. “House prices didn’t go anywhere from 1995 to 1998 and the fact that they are starting to rise now is just making up for lost ground,” says Gomez, dismissing out of hand any suggestion of a “housing bubble.”

Bruno Wall, president of Wall Financial Corporation, agrees. “The fundamentals seem pretty solid for the real estate market,” he says. “To me the biggest risk to the market is a significant increase in interest rates. I think one or two hundred points isn’t going to do it, but if there’s something more significant than that, that would clearly have an impact on homeowners and investors in real estate, as it always does.”

Not surprisingly, Gordon—a fixture on the gold investment circuit (an industry sales drive meeting twice a year at Canada Place), a regular on radio talk shows on CKNW and Financial Sense web radio and a frequent presence on websites about gold investing—is used to what he considers the short-term approach of the skeptics. “They tend to be guided by the here and now and probably don’t have a good grasp of history,” he says.

A passion for history drew Gordon to Kondratieff. He graduated with a BA in history in 1972, five years after emigrating from Britain to Winnipeg to marry his Canadian wife. Bored by his job in human resources, he was segueing into a new career in investments when he started subscribing in 1980 to a monthly financial newsletter called Donald J. Hoppe Analysis (later changed to The Kondratieff Wave Analyst) written by feisty U.S. economist Donald J. Hoppe.

“He was my mentor,” says Gordon, remembering how he looked forward eagerly to the 12-page newsletter every month. Even though Gordon says that Hoppe “got it wrong” when he predicted a Thirties-style depression in the mid-1980s, Gordon’s respect remains undiminished. “Every newsletter contained just a host of different historical facts,” says Gordon, who never met or talked to Hoppe.

As Gordon moved up Canada’s investment industry food chain from Dominion Securities Ames in Thunder Bay to leading investment house Nesbitt Burns in Toronto in 1988, and then to James Capel, where he was national sales manager in 1994, he continued to be a keen student of the Kondratieff Long Wave. “I read anything I could devote to the subject,” he says, including Hoppe’s newsletter until it ceased publication in July 1993.

At the beginning of 1998, Gordon joined Canaccord Capital as an advisor to private and institutional investors just a couple of years after he and his business partners founded Woodstone Capital, a boutique Vancouver-based brokerage firm.

His previous role managing a new company had left him with a pressing problem. “I had no clients,” he says. “How was I going to attract people to Ian Gordon? One way I thought was to start writing a newsletter, so I called it the Long Wave Analyst. Really it was a sort of copy of The Kondratieff Wave Analyst.”

Gordon found a ready audience for his dire predictions as the dot-com mania climaxed. Among his admirers was Robert Prechter, an influential wave theorist who devoted a whole chapter to the Kondratieff Wave cycle in his best-selling book *Conquer The Crash*, published in 2002. Like Gordon, Prechter suggests in the book that we are heading into the biggest stock market crash “possibly since that of 1720-1784.” Prechter, who learned about Gordon after somebody had sent him a copy of the Long Wave Newsletter, described him as “an astute historian and student of the subject.”

This was not faint praise, but as Prechter himself points out, most economists lump the Kondratieff Wave theory in the same bracket as soothsaying or astrology.

“It could be that there are fundamental forces at work,” says UBC professor of economics, Hugh Neary. “But there is no theory that I know of that explains that.”

“I think it’s important to distinguish between the mysticism of his [Gordon’s] approach and the real weaknesses in the U.S. economy that he describes,” says Michael Lebowitz, professor emeritus at Simon Fraser University, in an e-mail. “You don’t have to believe in the phases of the moon to recognize the vulnerability of the U.S. economy with its budget and trade deficits, which even the IMF complained about.”

Mysticism or not, when Gordon looks down from his office at the bustling downtown and the adjacent high-rise project that threatens to obscure his view, he sees real reasons why disaster is looming.

“People are really too complacent,” he says.

He winces as he mentally computes the debt mountain that has accumulated from years of historically low interest rates, particularly in the U.S. In his conversation, lectures and in writings on his website (www.longwavegroup.com), he talks about how the debt is “horrific,” “a bubble- ready to burst into smithereens,” “a financial disaster” that will “destroy the middle class.”

“I can picture this crane being dismantled,” he says, pointing to the giant mechanical arm opposite his window, “and a safety fence being put around that hole in the ground.”

His imagination is grounded in historical precedent. The unfinished skeleton of the chateau-styled Hotel Vancouver, only a couple of blocks away from Gordon’s office, brooded over the downtown for half a decade during the Great Depression when the stagnant economy halted its construction.

Peering down on Dunsmuir Street below, he speculates that many of the businesses will be boarded up and half as many cars will be moving along the street in the not-so-distant future. Gordon, astonishingly, envisages oil prices dropping dramatically as consumption halves. “When you throw 25 per cent of the workforce out of work as they did in the last Depression, people aren’t driving SUVs,” he says.

Deflation of money, the opposite of inflation, will mean that the prices of goods, costs of services and wages will fall, but debt will rise in real terms becoming more onerous. Jobs in debt-laden companies will be “in jeopardy,” and equities and RRSPs will plummet. Workers will be laid off in steel, forestry and commodities industries as world demand slows. Many will default on their mortgage payments, homes will be repossessed and the real estate “bubble” will burst.

This vision echoes the Depression experience when a mansion in the affluent Shaughnessy Heights area (then dubbed “Poverty Hill”), appraised in 1920 for \$75,000, sold in 1939 for \$7,500. Vancouver in the Depression was known as the “hobo capital of Canada,” and Gordon envisages encampments of homeless people springing up in Stanley Park, the B.C. border being shut to Canada’s migrating workers and rising taxes as the tax base shrinks.

Although Gordon hesitates to pinpoint a specific date, he reckons we could even hit rock bottom in a couple of years, meaning the 2010 Olympics will be “somewhat muted.”

The social repercussions will be worse south of the border, he believes, than in Vancouver because citizens in the U.S. are armed. “I think things like the Patriot Act are just the initial way to really control a dangerous population,” he says.

Gordon speaks quietly, firmly, choosing his words deliberately. Occasionally, he stops to lean back in his chair and reflect on the sun-drenched city below, allowing his words to sink in.

“I don’t like talking about it. It does bother me. I get really worried about it,” he says in almost a whisper. “I hope to God I’m wrong, I really do. The only thing is I can’t see how I am wrong because of the debt.”

Gordon’s fears haven’t stopped him enjoying life. During an interview he picks up a model off his desk of his smart new Lexus (paid for in full), and jokes darkly, “I shouldn’t be driving [it] in a Depression.”

He laughs at the irony that he took out a mortgage to buy a “big house” in White Rock last March before the Kondratieff Winter had begun to really kick in.

These would hardly seem the actions of someone who believes that real estate and automobiles are going to plummet in price, but Gordon, now in his ‘60s, says he felt at his age he could not put off these kind of decisions. He had been feeling cramped in his former apartment and last year he remarried. “I knew I was paying too much,” he says, “But I needed to change my lifestyle.”

He also feels he has protected himself by putting all his other assets in gold and gold shares. And he predicts that gold, which has climbed from around \$250 US an ounce in 2001 to around \$418 US at the time of this story, will soar in value as in the Great Depression. (Others, including Robert Prechter, have argued that deflation will be accompanied by a fall in the value of gold).

As with other “gold bugs,” Gordon might simply be stirring up fears. Gold loves chaos, fear and panic, and the gold community is a breeding ground for doom-mongering and conspiracy theories. Gordon also sells stock for a living in speculative mining companies, shares of which are risky and volatile. But Gordon, with his belief that gold is safer than houses, doesn’t see any conflict of interest. He sees it as walking his talk. “I’ve always had a fascination and belief in gold, because I trust it. But if I thought that selling real estate would make my clients lots of money that’s what I would sell them.”

Mark Twain once quipped, “Prophecy is a good line of business, but it is full of risks.” Certainly, Kondratieff Long Wave analysis can seem like an unreliable compass to the future.

Lebowitz questions Gordon’s reading of the Long Wave. “If you really believe in Kondratieff waves, you would have to be predicting that we’ve finished with the slump of the fourth wave and now have entered the boom phase of the next wave.” Another who thinks we are about to start a new upswing, rather than a downswing, is Gordon’s mentor Donald Hoppe.

When Gordon was interviewed for this article, he believed Hoppe was dead. In fact, Hoppe stopped writing his newsletter in 1993 because, at 70 years old, he felt he was too busy working. Speaking on the phone from his home in Chicago, Hoppe-still much alive-scoffed at the idea of another Great Depression taking place.

“Expecting a repetition of the Great Depression would be equivalent to expecting World War II again. History doesn’t work that way. The conditions of the Great Depression are just not present today,” he says.

UBC’s Hugh Neary says that modern governments and policy makers are sophisticated enough to deal with pressing economic issues. He suggests that crises and bubbles will continue to come and go and they will be painful for the people involved, but they will be localized and contained.

“Even if there is this Kondratieff downward force politicians can respond, and there are policies that they can use to counteract it. The question is if they are clever enough and have the political will,” says Neary.

“We’re not condemned to hell, unless we agree to go there.”

The “dismal science” is littered with failed prognostications. James Dale Davidson and Lord William Rees-Mogg, former editor of the Times of London, predicted a depression in the 1990s in *The Great Reckoning* in 1991. The book sold well, but they got it wrong.

Says Hoppe: “It was a big fat book with all the charts and numbers. It was a marvellous piece of work and it was predicting the imminent collapse of the whole Western economy and of course it didn’t happen and the reason it didn’t happen is because the Fed [the U.S. Federal Reserve Bank] didn’t let it happen.”

Gordon, surprised that Hoppe is alive, nevertheless maintains that we are in a downturn that could last years.

Like a weatherman making a long range forecast he has had to adjust his outlook. After initially suggesting the Winter cycle should run until about 2010, he changed that to 2020, saying he realized that the economic unraveling would take longer than he initially expected.

There is a fierce battle being waged against powerful economic forces. And Gordon argues that the weapon of choice-more debt-will only increase the pain in the day of reckoning.

Time will tell if he’s right.

If Ian Gordon’s Predictions Come True...

Profits and Prophecies

By Robert Alstead-Contributing writer

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Of course academia will continue to scoff at my predictions, just as they did when the Courier writer, Robert Alstead, contacted them for their comments regarding my long wave economic predictions. Hugh Leary an economics professor at the University of British Columbia, according to Alstead, says: “Even if there is this downward Kondratieff force, politicians can respond, and there are policies they can use to counteract it.” My mentor Donald Hoppe, now deceased, responded at that time, “Expecting a repetition of the Great Depression would be equivalent to expecting World war 11 again. History doesn’t work that way. The conditions of the Great Depression are just not present today.” Well, maybe ‘history doesn’t work that way’, but cycles do.

The following are some quotations that I have taken from Mr. Hoppe's writings. Certainly, as you can see he was very bearish at that time, why he changed his opinion when he was contacted by the reporter in 2004 is beyond me. Governments cannot control economic cycles, these cycles, like all cycles, function according to natural law.

"And only an understanding of the long wave can provide the insights necessary to realize that this credit expansion must and will end in a financial and economic collapse that will take years to overcome, and lead to changes in the American standards of living and the U. S. position in the world that almost no one comprehends today." January 1987, P. 2

Well of course, we agree with this statement. That it hasn't happened yet, and have no doubt that it will happen, is entirely attributable to fiat paper money, which has been used to delay the inevitable. Never forget this quotation from Ludwig von Mises: "The wavelike movement affecting the economic system and the recurrence of periods of depression is the unavoidable outcome of attempts repeated again and again, to lower the market rate of interest by means of credit expansion. The alternative is only whether the crisis should come sooner as a voluntary abandonment of further credit expansion or later, as a total catastrophe of the currency involved." Well, there has been no abandonment of the credit expansion, on the contrary, central banks are printing money at a record pace and all fiat money is 'debt' (credit) money. The collapse is going to be a catastrophe far greater than the last Great Depression.

"New Wave, Old Idea. In every great credit bubble the delusion arises that the business cycle has been abolished and that a prosperity built on the quicksand of fiat credit can continue indefinitely." March 1989, P. 31

As I have constantly attempted to emphasize, economic and financial cycles, like all cycles, are governed by natural law and function according to that law. Because economic and financial cycles are driven by money, they can be temporarily controlled by money. Ultimately like all cycles, they revert to their normal path. This means that we are facing an economic winter depression; likely far worse than the depression of the 1930s, a failure of the world monetary system, a stock bear market of unparalleled ferocity and a collapse in real estate prices.

"...All prolonged credit expansions ultimately collapse when it becomes inescapably obvious that the whole credit system has become rotten with bad debt, although it is remarkable how long almost everyone will ignore or refuse to recognize even glaring examples of deterioration in major areas of the credit system. But while a credit inflation boom is in progress, it develops a powerful constituency of supporters. Almost no one wants to see it end, particularly those in the Wall Street establishment, building their paper empires and reeling in their pyramiding of paper profits. That is why every effort is made through the main stream financial press and electronic media (the propaganda organs of the establishment) to minimize the risks of the expanding debt bubble and to encourage even more expansion." June 1989, P. 63

Apparently, total worldwide debt amounts to \$225 trillion (U.S.) and that is about 315% of global GDP. Now if that isn't a debt bubble of humungous proportions, I don't know what is. It's mind boggling and all due to the fact that all world currencies are fiat paper. Major central banks are trying to keep it all afloat by issuing copious amounts of paper money. They are desperate, because they know that if it all unravels the world will be thrown into an economic depression far worse than anything yet experienced. It is not a question of 'if' but of 'when' and in all likelihood 'when' is this year. Why 2014? Because that is 100 years from the anniversary of the 1st World War, when the gold standard monetary system collapsed as the combatants resorted to the issuance of paper money to pay for the war. You should not forget that the purpose of a long wave winter is to cleanse the economy of debt. Central banks have resisted that debt cleansing process by issuing huge amounts of new debt. If you think that it is in man's power to override cycles, then you are going to be sadly and frighteningly disillusioned.

“One of the prerequisites of a long wave crash and depression is an almost unanimous belief that such events have become, ‘impossible’. As I have said many times before this credit bubble and speculation mania will not end until it has bagged just about everybody. At the final peak of this long wave boom, the last of the stock market bears will have been crushed, wave and cycle theories, in the eyes of the public, will be totally discredited and the few remaining skeptics and ‘Prophets of Doom’ among newsletter writers will be laughed at or ignored, while the words of the super-bullish forecasters will make headlines”. July 1989, P. 73-74

Remember this was written 25 years ago. At that time the DJIA was 2,530 and overall debt in the U.S. was miniscule in comparison with what it is today. At this time, there are very few stock market bears left and those of us who write about long wave cycles have very few followers. I haven’t been invited to speak on the Canadian Business News Network TV channel in several years, whereas previously I appeared on the channel on a fairly regular basis. On that channel, certainly, all they want to talk to are money managers, who by the nature of their business are always bullish. As Mr. Hoppe noted all those years ago this supports the notion that we are at the peak of the central bank induced long wave boom and what lies ahead is a catastrophic downturn.

“Sometimes the thought occurs to me that since I started writing these letters some seven years ago, I have been working to solve a single vital problem. That problem is the ultimate fate of both the U. S. credit dollar and the world financial system that has been built upon the dollar during the past 35 years. If the U.S. dollar is destroyed, the world’s existing financial, economic and political arrangements are almost certain to suffer a similar fate. Those who speak of \$5,000 gold and \$200 silver almost never follow their predictions with an equally specific analysis of how such prices would relate to the overall economic and financial system in the U. S. and in the entire western world.” Nov, 1982 P. 205

We have seen the bankruptcy of some major U.S. and British banking institutions and the bailout of most of the others, the bankruptcy of two of the three largest U.S. car manufacturers and the failure of AIG, Fannie Mae and Freddie Mac. This is only the first wave and what lies directly in front of us is probably the destruction of the world economy and financial system.

I have suffered from a similar conjecture. If the U.S. dollar is destroyed as I believe it will be, that has to mean that the economy ceases to function and the implications of that are frightening. Indeed, how do stock markets operate when currencies have no value? A \$5,000 (U.S.) gold price and a \$200 (U.S.) price for silver, which in my opinion are likely, certainly the gold price, portend an economic and financial collapse of historic proportions. It is something that not one of us will want to experience.

It is difficult to write anything positive about a long wave winter cycle. It has always been the season of economic depression brought about by a credit collapse. It is the season in which debt is wrung out of the economy and that process wreaks havoc on creditor and debtor alike. In the ensuing financial maelstrom gold becomes the money of choice.

You are making a big mistake if you trust in the power of our economic and financial leaders to forestall an economic winter. It is the miserable season, which completes the long wave cycle. It is not in man’s power to overcome the natural sequence of the cycle.

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