THE LONGWAVE ANALYST

BOLDER INVESTMENT PARTNERS

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

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THAT WAS THE WEEK THAT WAS

Monday 24th November

In a pre-budget report, U.K Chancellor of the Exchequer Alistair Darling announced a cut in the Valued Added Tax (VAT) from 17.5% to 15%. Mr. Darling also announced that Government borrowing will total 78 billion pounds this year and next year will reach a staggering 118 billion pounds. Indeed, Government borrowing will total 400 billion pounds over the next 5 years.

Royal Bank of Canada takes $645 million (CAD) in write downs and balance of revenue drops 15% in the fiscal 4th.quarter.

October U.S. new home sales decline by 3.1%, while home prices fall by 11.3%.

New bailout for CitiGroup reached with U.S. Government: key provisions -

- The U.S. Treasury will inject $20 billion of capital
- The U.S. Government will guarantee a $306 billion pool of Citibank's troubled assets, including mortgage-backed securities. CitiGroup must absorb the first $29 billion in losses and 10% of anything beyond that. The U.S. Treasury will absorb the next $5 billion in losses, followed by the FDIC absorbing the next $10 billion in losses. Any losses in these assets beyond that level would be absorbed by the Federal Reserve Board. The guarantees will be for 10 years for residential assets and five years for nonresidential assets.
- Citibank will issue $7 billion of preferred stock carrying an 8% dividend, as payment for the guarantee.
- Citibank will issue warrants to the U.S. Treasury and the Federal Deposit Insurance Corporation (FDIC) for 254 million common shares at a strike price of $10.61.
- The U.S. Government must approve all executive compensation, including bonuses.
- Effective with the payment of the next dividend on common stock, Citibank agreed not to pay out more than 1 cent per share for three years.

Perhaps, the run on Citibank has been temporarily averted by this bailout, but with approximately, $1.2 trillion in off balance sheet assets, it won't be long before CitiGroup returns with the begging bowl. In the meantime, maybe it will be the U.S. Treasury which faces the run.

In the commentary section of the Financial Times of this date, Richard Duncan, the author of The Dollar Crisis: Causes, Consequences and Cures, urges a return to a dollar linked to gold. "The events of September 2008 – the nationalization of Fannie Mae, Freddie Mac and AIG; the disappearance of the investment banking industry in the U.S. and the Bush administration's $700 billion bailout to save what is left of Anglo-American capitalism-demonstrate that the 37-year experiment with fiat money and floating exchange rates has failed catastrophically."

"When Richard Nixon destroyed the Breton Woods International Monetary System in 1971 by closing the 'gold window' at the Treasury, he severed the last link between dollars and gold. What followed was a spiraling proliferation of increasingly spurious credit instruments denominated in a debased currency. The most glaring and lethal example of this madness has been the exponential growth of the unregulated derivatives market, which has ballooned in size to $600,000 billion ($600 trillion), the equivalent of almost $100,000 per person on earth." Financial Times, Monday, November 24, 2008.

Tuesday 25th November

The U.S. Treasury announced it will allocate $20 billion of TARP funds to the Federal Reserve, to back a lending facility for the consumer asset backed securities market, established by the Federal Reserve Bank of New York who will lend up to $200 billion on a non-recourse basis to holders of newly issued AAA-rated asset-backed securities for a term of at least one year.

According to the Federal Deposit Insurance Corporation, the number of problem banks in the U.S. grew from 117 to 171 during the third quarter. This is an increase of 50%. With more than 8,000 banks operating in the U.S., it will be interesting to see how far into the future problem banks will exceed 1,000 and then 2,000, then 3,000 etc. but you get the picture.

The FDIC is planning to raise additional capital (Where from we ask?) to increase reserves that have already been depleted by the 22 bank failures so far, including Washington Mutual, which is the largest bank failure in U.S. history.

The proposed marriage between BHP and Rio Tinto is off. The value of BHP's bid for Rio has already fallen from $180 billion when announced in November, 2007 to just 62 billion last week. Marus Kloopers BHP chief executive said "it is just not the time to be taking on the level of debt that exists on the Rio Tinto balance sheet". Financial Times, 26th. November, 2008.

BHP already carries a significant debt burden of $40 billion, attributable to its all cash purchase of Alcan, the Canadian aluminum producer. Everyone is beginning to realize that debt is an anathema in a deflationary world, for example, ask the executives of Canadian mining companies Teck Cominco and Nova Gold, how they feel about it.

The Federal Reserve adds $800 billion to the economy, of which $600 billion will be used to purchase mortgage bonds that have either been issued or guaranteed by government-sponsored housing enterprises such as Fannie Mae, Freddie Mac, Ginnie Mae and the Federal Loan Bank. A total of $200 billion will be lent to holders of AAA rated securities backed by student loans, credit card loans and small business loans. These AAA rated securities are toxic.

The Caisse de Depot, a giant Canadian Pension Fund manager, has recently been forced to sell $10 billion (CAD) of equity and fixed income securities, in order to raise cash because it has over $30 billion (CAD) of funds currently tied up in unmarketable non-bank asset backed commercial paper.

Wednesday 27th November

CitiGroup says gold could rise above $2,000 next year as world unravels. Daily Telegraph, www.telegraph.co.uk- Ambrose Pritchard-Evans
"The bank said the damage caused by the financial excesses of the last quarter century was forcing the world's authorities to take steps that had never been tried before".

"This gamble was likely to end in one of two extreme ways: with either a resurgence of inflation, or a downward spiral into depression, civil disorder and possibly wars. Both outcomes will cause a rush for gold." Ibid. We're betting on the latter.

U.S. new home sales fall by 5.3% in October.

Thursday 28th November

The Japanese Government reported that factory output had fallen by 3.1% in October vs. September. This is the worst month over month performance since the Great Depression. The outlook for subsequent months is even bleaker. According to Bloomberg, Japanese businesses expect to reduce their output by 6.4% in November. It's bad everywhere.

As the Bank of China cut its 1-year administered interest rate by 108 basis points to 5.58%, Zhang Ping, Chairman of the Cabinet's National Development and Reform Commission warned "This crisis is spreading all over the world and its impact on China's economy is deepening … Excessive production halts and closing of enterprises will cause massive unemployment, which will lead to instability." The Globe and Mail, Friday, November 28, 2008.

Panasonic warns that net profit will decline by 90% this year.

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Friday 28th November

British taxpayers increase their holdings in Royal Bank of Scotland to 58% through a British Government injection of 20 billion pounds ($38 billion CAD) additional capital into the troubled bank. This, after the bank's shareholders nixed a rights offering and who can blame them?

The DJIA rallied every day this week closing at 8,829.04; Thursday, of course, the market was closed for American Thanksgiving. That's impressive, but it looks a lot like 1929. The Dow's price peak of 381.17 on September 3, 1929 and the initial bear market bottom on November 14, 1929 at 198.69 was a drop of a little less than 48%. Similarly, the DJIA made a price peak on October 11, 2007 at 14,198 points and the initial bear market bottomed last Friday, November 20, 2008 at 7,499 points, which is slightly less than a 48% fall in prices.

From the November 14, 1929 price bottom, stocks rallied until April 17, 1930 reaching 294.07 points; equivalent to a little better than a 50% recovery. Will the DJIA imitate the rally of November, 1929 to April, 1930? We think that it's likely. If it does, it will afford shareholders their last chance to bail out of stocks (except all gold stocks), before the deluge.

The price of gold closed the week $17 higher than the previous weekly close. The HUI (Gold Bugs Index) closed at 247.40, up 34.55 points over the previous week's closing price.

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