

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

# THAT WAS THE WEEK THAT WAS



## Monday, February 1ST

U.S. President Barack Obama proposes a \$3.8 trillion (U.S.) budget for the fiscal year ending September 30, 2011 which includes a \$100 billion (U.S.) of job creation stimulus spending, higher taxes for the wealthy and a deficit of \$1.3 trillion (U.S.).

## MONDAY, FEBRUARY 1ST

The budget forecasts a deficit of \$1.6 trillion (U.S.) for fiscal 2010 with deficits remaining above \$700 billion (U.S.) for the rest of the decade.

- The U.S. Institute for Supply Management Index increased to a reading of 58.4 in January from 54.9 in December, reflecting a reduction in inventory draw downs and some improvement in global trade. The ISM diffusion index tracks the breadth of growth in manufacturing firms from a survey of purchasing managers.
- Exxon Mobil Corp. posts a net income of \$6.05 billion (U.S.) in the 4th. quarter, compared with a net profit of \$7.82 billion (U.S.) in the same period of 2008, citing a loss in its refining operations, increased revenue on higher oil prices and greater production from new capital projects.
- In an interview with Le Matin Dimanche, Switzerland's justice minister, Eveline Widmer-Schlumpf, warns that the Union Bank of Switzerland (UBS) could collapse if sensitive talks fail with the United States, concerning a high-profile tax investigation. "The actions of UBS in the United States are very problematic, not only because they are punishable, but also, because they threaten all of the bank's activities. The Swiss economy and the job market would suffer on a major scale if UBS fails, as a result of its license being revoked in the United States."
- Neil Barofsky, the special inspector-general overseeing the U.S. government's financial rescue initiatives, such as the Troubled Asset Relief Program (TARP), is to probe allegations of insider trading among American bank executives and their associates during the autumn of 2008, when the U.S. government and banks were frequently exchanging information. Separately, in a sobering 224-page report, Mr. Barofsky argues that failed financial reform could put the United States on course for another bubble and economic crash. He warns that all the "money, moral hazard and government credibility" will be wasted, if the U.S. sinks into an even deeper crisis in the next decade. Mr. Barofsky writes: "It is hard to see how any of the fundamental problems in the (financial) system have been addressed to date." There is just no end to the spending or the socialism, which is why we deemed Mr. Obama to be a one-term President six months ago. (See Winter Warning, July 20, 2009 – The Scourge of Unemployment).
- The Commerce Department reports U.S. personal income rose 0.4% and consumer spending rose 0.2% in December; while the personal savings rate increased by 4.8% from 4.5% reported in November. Separately, construction spending fell by 1.2% in December to a seasonally adjusted annual rate of \$902.5 billion (U.S.).

- John Lipsky, the first director of the International Monetary Fund announces that the IMF is in “ongoing contact” with Greek authorities following a “scoping mission” to assess financial assistance possibilities: “The IMF stands ready to support Greece in any way we can. It is a matter for the Greek authorities to decide, in collaboration with the European Union, but we are here to help if we are wanted.”
- The Miami Herald reports the Securities and Exchange Commission (SEC) has ordered the City of Miami, Florida, to submit its financial records to an SEC inquiry regarding a series of bond issues marketed and money transfers effected, earlier this decade. In a broad investigation, which could impact Miami’s public projects for years, the SEC is probing the city’s major bond issues between 2006 and 2009; as well as questionable financial transfers made to balance its budget.

## TUESDAY, FEBRUARY 2ND

- The U.S. National Association of Realtors’ pending home sales index, based upon sales contracts signed for existing homes, rose by 1% in December, as buyers returned to the market after the federal tax credit was reinstated. The extended and expanded federal tax credit gives \$8,000 (U.S.) to qualified first-time buyers and \$6,500 (U.S.) to qualified repeat buyers, who must sign a contract by April 30th. and close by June 30th. in order to receive the subsidy.
- Ford Motor’s U.S. vehicle sales rose by 24.6%, while Nissan Motor posted a 16% increase in vehicle sales in January
- Bridgewater Paper, a subsidiary of Montreal-based Abitibi Bowater, has filed for administration (a form of bankruptcy protection) in the United Kingdom. The parent pulp, paper and lumber producer, currently operating under a court-supervised restructuring itself, has 50 plants in Canada, the United States, the United Kingdom and South Korea.
- Atlanta-based shipping giant United Parcel Service (UPS) posts a profit of \$757 million (U.S.) in the 4th. quarter and triple the profit in the same period a year ago, citing a strong holiday season and solid international business
- U.S. President Barack Obama unveils a \$30 billion (U.S.) small business lending program, as the White House attempts to make congressional passage of its jobs initiatives a test of the Republican commitment to bolstering the weak economy
- Fitch Ratings downgrades China Citic Bank Corp and China Merchants Bank Co., two mid-sized Chinese banks, to ‘D’ from ‘C/D’ citing “weaknesses of internal and/or external origin.” Banks with ‘C’ ratings are deemed “adequate,” but with “one or more troublesome aspects.” The Fitch statement noted Citic used to be one of China’s best capitalized banks, but its position slipped as it ramped up lending. Fitch also highlighted that China Merchants Bank “established a retail franchise, solid loan loss reserve coverage and more diversified revenues than its peers,” but that’s not enough to counterbalance the deterioration in its capital position.
- The Labour Ministry reports Spain’s jobless claims rose by 3.1% to four million in January from December and had increased by 22% from December, 2008. According to data recently released by Spain’s National Statistics Institute, the country’s unemployment rate rose to 19.3% in December, representing the European Union’s second highest unemployment rate behind that of Latvia. (See Winter Warning, January 11, 2010 – The Pain in Spain Is Likely to Remain).
- The Commerce Department reports the percentage of Americans who owned their own homes at the end of 2009 has declined to 67.3%, the lowest percentage since the 2nd. quarter of the year 2000
- After three years of plunging U.S. real estate values, new research suggests that when a home’s value falls below 75% of the amount owed on the mortgage, the owner begins to seriously contemplate walking away and allowing the property to go into default. By the 3rd. quarter of 2009, an estimated 4.5 million American homeowners had reached this critical threshold and which is now projected to climb to a peak of 5.1 million by June, 2010 – amounting to 10% of all Americans who have mortgages. Sam Khater, a senior economist with First American CoreLogic, the firm which conducted the research, confided “People’s emotional attachment to their property is evaporating into the air.”
- According to credit rating agency Moody’s, bad debts at Britain’s banks will not peak for another year, in a warning that the U.K.’s (perceived) emergence from the economic downturn is a “false dawn for credit.” Moody’s senior vice-president Robert Thomas says “banks remain fragile because there are reasons to remain concerned about bank asset quality and earnings in 2010 and 2011. Lenders are likely to push more companies into a wind-up since they grow less willing to continue forbearance measures, such as extending repayment periods, or relaxing covenant rules.”

- At a town hall meeting in Nashua, New Hampshire, U.S. President Barack Obama confides that “We should all be able to agree that we’ve got to do something about our long-term (government) deficits. These deficits won’t just burden our kids and our grandkids decades from now. They could damage our markets now, they could drive up our interest rates now (and) they could jeopardize our (economic) recovery right now.”
- The U.S. Federal Housing Administration (FHA) reports 9.1% of FHA borrowers have missed at least three mortgage payments as of December, 2009, foreshadowing a deluge of foreclosures which could exhaust the agency’s cash reserves. If the default and foreclosure rates continue to mount, the federal government would automatically use taxpayer money to cover the losses. This would represent a first for the FHA, which has always used the fees it charges borrowers to cover any losses.
- In an editorial regarding President Obama’s budget proposal for fiscal 2011, the New York Times states: “Unless miraculous growth, or miraculous political compromises, creates some unforeseen change over the next decade, there is virtually no room for new domestic initiatives for Mr. Obama or his successors. Beyond that lies the possibility that the United States could begin to suffer the same disease that has afflicted Japan over the past decade. As debt grew more rapidly than income, that country’s influence around the world eroded.”
- The Institute for Fiscal Studies (IFS) warns that Britain is facing the longest period of spending cuts since records began in 1948, if the government is to repair the damage to public finances inflicted by the banking crisis. The IFS forecasts that departmental spending should be cut for at least five consecutive years, as the government struggles to curb public borrowing.

### WEDNESDAY, FEBRUARY 3RD

- New Zealand reports its unemployment rate rose to 7.3% in the 4th. quarter from 6.5% in the 3rd. quarter, marking the highest level in 10 years
- Cisco Systems Inc., the leading maker of network equipment, reports a net profit of \$1.9 billion (U.S.) in its fiscal second quarter ended January 23rd., citing results were “remarkably well-balanced” between products and geographies
- The U.S. Treasury expects to hit the government’s debt ceiling of \$12.4 trillion (U.S.) by the end of February. Last week the U.S. Senate approved legislation to increase the statutory debt limit by \$1.9 trillion (U.S.) to \$14.3 trillion (U.S.) while the House of Representatives is expected to vote on the increase next week.
- Steven Hess, senior credit officer at Moody’s Investors Service warns the U.S. deficits projected in the federal budget outlook by the Obama administration, do not stabilize debt levels in relation to gross domestic product (GDP): “Unless further measures are taken to reduce the budget deficit further, or the economy rebounds more vigorously than expected, the federal financial picture as presented in the projections for the next decade will at some point put pressure on the ‘AAA’ government bond rating.”
- Estimates from the National Employment Report from Automatic Data Processing (ADP), indicates that 22,000 private sector jobs were lost in January, the fewest number since February, 2008

- Invoking sweeping new European Union Treaty powers in order to impose a radical jolt to the Greek economy, the European Commission (EC) has ordered Greece to slash public spending and provide details of its austerity plan within “one month.” Joaquin Almunia, the European Union’s economic commissioner, noted tough measures were “extremely urgent” to prevent a further flight from Greek debt. “The huge imbalances from which the Greek economy is suffering is not sustainable in the long run.” Mr. Almunia stated concerns have spread beyond Greece to other euro zone countries where public finances are spinning out of control, mainly Spain and Portugal: “In these countries we have seen a constant loss of competitiveness ever since they joined the euro zone and their external financing needs are quite big.”

### THURSDAY, FEBRUARY 4TH

- The Bank of England’s Monetary Policy Committee maintains its key lending rate at 0.5% and suspends its 200 billion pound (\$319 billion U.S.) quantitative easing program of British gilt (bond) purchases, noting while it expects a “gradual recovery in the level of (economic) activity,” the Bank stands ready to resume the purchases, if necessary
- Toyota Motor Corp. posts a net profit of 153.2 billion yen (\$1.68 billion U.S.) in the last three months of 2009, predicting a net profit for its fiscal year ending March 31, 2010, despite a massive auto recall in the current quarter
- The Commerce Department reports U.S. factory orders increased by 1% in December, following a 1% gain also in November

- Japanese electronics maker Sony Corp. posts a net profit of 79.2 billion yen (\$861 million U.S.) in the October – December quarter, citing stronger sales levels and benefits resulting from corporate restructuring measures
- Spain's borrowing costs rise at a sale of 3-year notes and Portugal reduces the size of a treasury bill auction, both due to sharply lower investor demand, induced by worries whether these two European Union members will be able to fund their fiscal deficits
- The European Central Bank (ECB) keeps its key lending rate at 1% and at a press conference in Frankfurt central bank president Jean-Claude Trichet stated: "We expect and we are confident that the Greek government will take all the decisions that will permit it to reach the goal" of cutting its deficit below the European Union's limit. Mr. Trichet said euro members drew down their benefits in advance when they joined the European Monetary Union (EMU) and enjoyed "very easy financing" for their current account deficits. They cannot expect "ex post" help if they get into trouble later. These are the rules of the club.
- In a Financial Times editorial, reporter Edmund Conway warns: "Should markets pass the same (debt) verdict on Britain as on Greece, the results would be almost identical and just as disastrous. I have pointed out before that countries, like individuals, occasionally, reach the point where they have borrowed so much that their debt simply becomes impossible to whittle away. Greece, the markets seem to think, has now passed that point and an IMF bailout would only layer new debt on top of the old. In the end, the only solution is to find some way to slash spending and raise taxes without a) sparking riots or revolution and b) critically damaging the economy."
- The Labor Department reports U.S. initial claims for state unemployment benefits rose by 8,000 to a seasonally adjusted 480,000 in the week ended January 30th. while continuing claims remained unchanged at 4.6 million in the week ended January 23rd.
- U.K. energy giant Royal Dutch Shell announces another 1,000 job layoffs and plans to sell six oil refineries, citing widening refinery losses and an uncertain energy outlook. Shell also reports a profit of \$9.8 billion (U.S.) for 2009, compared to profit of \$31.4 billion (U.S.) in 2008.
- GMAC Financial Services, now owned by the U.S. government, reports a net loss of \$5 billion (U.S.) in the 4th. quarter, compared to a net profit of \$7.5 billion (U.S.) in the same period of 2008
- New York Attorney General Andrew Cuomo's office files civil fraud charges against the Bank of America, its former Chief Executive Officer Ken Lewis and its former Chief Financial Officer Joe Price, citing the bank for failing to properly disclose corporate losses and bonuses paid to employees at Merrill Lynch, when it acquired the Wall Street investment bank in the fall of 2008. Mr. Cuomo deems the Bank of America's actions "egregious and reprehensible" in deceiving, not only shareholders, but also, the federal government.
- Warren Buffett's Berkshire Hathaway Inc. launches an \$8 billion (U.S.) six-tranche debt offering of senior, secured fixed and floating-rate notes within a 5-year maturity range, in order to help finance its takeover of Burlington Northern Santa Fe Corp. In the process, Standard & Poors downgraded the conglomerate's debt rating from 'AAA' to 'AA' (High).

FRIDAY, FEBRUARY 5TH

- The Labor Department reports U.S. non-farm payrolls declined by 20,000 in January, compared with a revised decline of 150,000 in December previously reported as a decline of 85,000. Meanwhile, the U.S. unemployment rate fell to 9.7% in January from 10% in December.



- JP Morgan Chase & Co. Chief Executive Officer Jamie Dimon, was paid \$27.8 million (U.S.) in 2007 in cash, stock and options and \$1 million (U.S.) in salary but no bonus in 2008. Now, according to a recent regulatory filing, Mr. Dimon has been awarded a bonus of about \$17 million (U.S.) for 2009, consisting of \$8.5 million (U.S.) in restricted company stock and 563,562 stock options.  
And worth every penny, naturally!

- British Airways Plc, the U.K.'s largest airline, reports a net loss of 37 million pounds (\$58 million U.S.) in the fiscal 3rd. quarter ended December 31, 2009, compared to a net loss of 51 million pounds in the same quarter of 2008, citing significant cost and capacity reductions reflecting lower demand for air travel
- Meanwhile, Goldman Sachs Chief Executive Officer, Lloyd Blankfein, will receive a \$9 million (U.S.) all-stock bonus for 2009, in addition to his salary of \$600,000 (U.S.). Mr. Blankfein was awarded 58,381 company shares at today's closing price of \$154.61 (U.S.) per share. The stock will vest over 3 years and cannot be sold for 5 years. Goldman Sachs executives must hold 90% of all company equity awards until Warren Buffet's Berkshire Hathaway divests of its investment in the bank, then retain 75% of their holdings until retirement.
- Statistics Canada reports 43,000 jobs were created in the country's economy in January while the unemployment rate declined slightly to 8.3% from a revised rate of 8.4% in December, previously reported as 8.5%
- Portugal risks a political crisis as its finance minister, Fernando Teixeira dos Santos, appeals to opposition parties not to defeat the minority Socialist government over a regional finance bill that would undermine the country's international credibility. In a televised address, Mr. Santos said opposition proposals to allow the Portuguese islands of Madeira and the Azores to increase their debt levels would have "grave consequences for Portugal's public accounts" and send "the worst possible message" to financial markets. Subsequently, rumours circulated that Portuguese Prime Minister Jose Socrates was on the verge of tendering his resignation, after failing to secure enough votes in parliament to institute austerity measures.
- Speaking at a conference in Florida, Toronto-Dominion Bank Chief Executive Officer Ed Clark remarked that he had met with Canadian Prime Minister Stephen Harper last week for a pre-budget consultation quipping, "He doesn't listen but you get to chat with him". Mr. Clark suggested to the Prime Minister that the government should focus on reducing the federal deficit and leave administered interest rates alone. Moreover, Mr. Clark related that the Canadian Council of Chief Executives had met two weeks ago and a majority of them were saying to the government "raise my taxes" and eliminate the deficit.
- The Congressional Budget Office (CBO) reports that for the first time in 25 years, U.S. Social Security is receiving less tax revenue than it is spending on benefits. CBO financial information reveals that Social Security could record a \$28 billion (U.S.) deficit this fiscal year which ends September 30th.

Based on our Technical work, we believe Gold made an important bottom today and we should see some fairly significant price movements to the upside.

Ian A. Gordon, The Long Wave Analyst

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