

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE
THAT WAS THE WEEK THAT WAS



Monday, July 12TH

Dagong Global Credit Rating, China's leading credit rating agency, downgrades the U.S. sovereign debt rating to 'AA' from 'AAA' and Britain and France to 'AA' Low from 'AAA'

MONDAY, JULY 12TH

- Cambridge Place Investment Management, a Boston-based investment fund, files a \$2.4 billion (U.S.) lawsuit in Massachusetts state court against 15 investment banks including Citigroup, Morgan Stanley, Goldman Sachs Group, Credit Suisse, Deutsche Bank, Merrill Lynch, UBS, Barclays, HSBC and RBS seeking reimbursement for losses related to sub-prime investment securities. The lawsuit alleges that “the Wall Street banks conducted inadequate due diligence” and sold securities backed by mortgages that were obtained from a “small group of now notorious sub-prime mortgage originators” who used faulty appraisals, accepted misleading data in loan applications and ignored their own underwriting standards
- In prepared remarks to the Fed's forum on restoring credit to small businesses, Federal Reserve Chairman Ben Bernanke urges banks and regulators to seek out ways to ensure that small businesses get the credit they need to create jobs. Mr. Bernanke stated: “The formation and growth of small businesses depends critically on access to credit. Unfortunately, those businesses report that credit conditions remain very difficult.”
- Several U.S. states, including California, Michigan and North Carolina, are preparing to make deep cuts to Medicaid commitments, as a federal funding stalemate for the poor remains unresolved – even as these same states face mandates to expand the Medicaid program under the new health care law
- Alcoa posts a profit of \$136 million (U.S.) in the second quarter compared to a loss of \$454 million (U.S.) in the same period a year ago, citing increased demand, higher foreign exchange revenues and lower energy costs
- At the National Governors Association annual meeting, the co-chairmen of President Obama's debt and deficit commission, Alan Simpson and Erskine Bowles warned current U.S. budgetary trends are “a cancer that will destroy the country from within” unless checked by tough action in Washington. The commission leaders elaborated: “At present, federal revenue is fully consumed by three programs: Social Security, Medicare and Medicaid. The rest of the federal government, including fighting two wars, homeland security, education, art, culture, veterans, you name it – the whole rest of the discretionary budget is being financed by China and other countries. We can't grow our way out of this. We could have decades of double-digit (economic) growth and not grow our way out of this enormous debt problem, (nor) can we tax our way out. The reality is we've got to do exactly what you all do every day as governors. We've got to cut spending, or increase revenues, or do some combination of that.”
- According to estimates by the Bank for International Settlements (BIS), banks worldwide owe nearly \$5 trillion (U.S.) to bondholders and other creditors, which will come due through 2012. About \$2.6 trillion (U.S.) of the liabilities are in Europe, of which American banks must refinance about \$1.3 trillion (U.S.).

TUESDAY, JULY 13TH

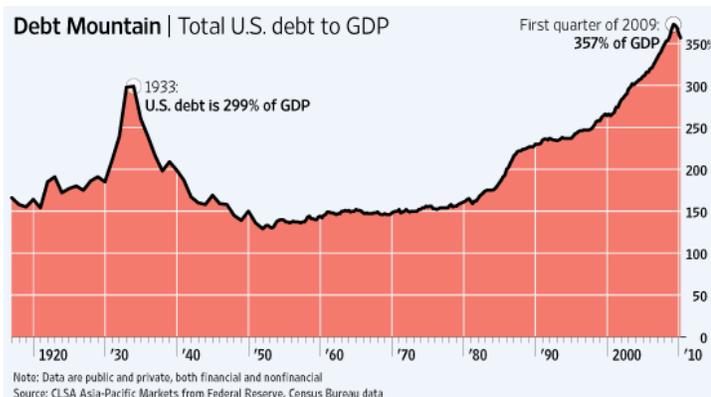
- Santa Clara, California-based Intel Corp., the world's largest chipmaker, reports a profit of \$2.89 billion (U.S.) in the second quarter, compared to a loss of \$398 million (U.S.) in the same period a year ago
- Moody's Investor Service downgrades Portugal's sovereign debt rating to 'A' (Low) from 'A' (High), citing rising debt levels and weak (economic) growth prospects; which may compel additional austerity measures in the country's 2011 budget. In a statement, Moody's warned it expects the government's "debt metrics to continue to deteriorate for at least another two to three years, with the debt-to-GDP and debt-to-revenues ratios eventually approaching 90% and 210%, respectively. Moody's also remains concerned about Portugal's medium term (economic) growth potential."
- The U.S. Treasury reports the federal government posted a deficit of \$68.42 billion (U.S.) in June, bringing the deficit to \$1 trillion (U.S.) for the first nine months of the current fiscal year and on a pace to reach \$1.33 trillion (U.S.) for the full fiscal year
- According to the Spanish newspaper El Economista, more than 400 of the 8,000 municipal councils across the country have stopped paying electricity, water and telephone bills. Spain's federation of regional governments warns: "Municipal councils are heading for slow asphyxiation," with many facing payroll terminations in August. In an interview with the UK Telegraph, Pedro Arahuetes, mayor of Segovia and chairman of the federation's finance committee, related that municipal councils have lost, not only 30% of tax revenues due to the property market and construction crash, but also, a further 20% in funding cuts by Madrid.
- The National Federation of Independent Business (NFIB) warns U.S. small businesses grew more pessimistic about their economic outlook in June, citing weak sales and political uncertainty. The NFIB's monthly survey of members revealed the small business optimism index declined by 3.2 points to a reading of 89. The NFIB survey concluded: "The performance of the economy is mediocre at best, given the extent of the decline over the past two years. Pent-up demand should be immense, but it is not triggering a rapid pickup in economic activity."

WEDNESDAY, JULY 14TH

- The Commerce Department reports U.S. retail sales declined by 0.5% in June, following a drop of 1.1% in May, reflecting consumer concern about high unemployment and the outlook for the economy
- According to a recent Bloomberg National Poll, 70% of Americans believe the U.S. economy is mired in an economic downturn and the nation is divided over concerns regarding the continuing high unemployment rate and the burgeoning federal deficit. Of those polled, 70% replied that reducing unemployment is the priority, while 50% responded that the federal deficit "is dangerously out of control."
- The Province of Nova Scotia launches a \$750 million (U.S.) issue of 5-year, 2.375% notes priced at a discount to yield 2.476%, representing a yield spread of 60 basis points over comparable U.S. Treasuries
- At a Jobs for America summit, business groups including the U.S. Chamber of Commerce, the Business Roundtable and the National Federation of Independent Business, issue an open letter to President Barack Obama beseeching the administration to cut (corporate) taxes, act on pledges to expand export markets and streamline government rules
- In its annual review of the Irish economy, the International Monetary Fund (IMF) cites the Irish government's need to initiate additional spending cuts and/or tax increases, if it is to attain its goal of reducing its budget deficit to 3% of gross domestic product (GDP) by 2014
- Prosecutors in Dusseldorf, Germany, possibly aided by stolen bank data purchased by the government, raided 13 offices of Credit Suisse AG as Berlin searched for evidence that bank employees may have assisted customers in evading taxes
- The Commerce Department reports the U.S. trade deficit increased to \$42.3 billion (U.S.) in May, compared with \$39 billion (U.S.) in April, citing a rising level of imports from China
- The U.K. Office for National Statistics (ONS) reveals the full scale of Britain's national indebtedness as 4 trillion pounds, about 4 times higher than previously acknowledged

- Geoff Dicks, a U.K. economist with the Office for Budget Responsibility (OBR), warns that millions of British workers will suffer effective pay cuts and a decline in their standard of living in the next four years, as pay increases fail to keep pace with the rate of inflation
- According to minutes of their policy meeting on June 22-23, the Federal Reserve Open Market Committee (FOMC) reduced its forecast for 2010 U.S. GDP growth to a range of 3% to 3.5% from a prior projection of 3.2% to 3.7%. Moreover, the FOMC minutes stated the Fed “would need to consider whether further policy stimulus might become appropriate if the (U.S. economic) outlook were to worsen appreciably” and the economy might not regain its “longer-run path” until 2016. But Ben, for the record you said: “We are not going to monetize the debt.”

- The New York Empire State manufacturing index declined to a reading of 5.08 in July from a level of 19.57 in June
- The Federal Reserve Bank of Philadelphia’s economic index declined to a reading of 5.1 in July from a level of 8 in June, citing manufacturing may moderate as companies are less inclined to rebuild inventories as the economic recovery shows signs of stalling
- The Commerce Department reports U.S. industrial production rose by 0.1% in June, citing higher temperatures across the nation led to increased utility usage
- Every Canadian province, excepting Newfoundland and Labrador, has filed an intervenor application with the Supreme Court of Canada, seeking to participate in the two-day hearing next April, where the federal government will attempt to secure a ruling that it has the authority to create a single securities regulator for Canada. Deemed unconstitutional by the Provinces of Quebec, Alberta and Manitoba, each province plans to voice their strong objections to a national agency to be named the Canadian Securities Regulatory Authority.



FRIDAY, JULY 16TH

- Reuters/University of Michigan reports its U.S. consumer sentiment index declines to a reading of 66.5 in July from a level of 76 in June, citing consumer concerns about unemployment and a struggling economy
- The Treasury Department reports net foreign buying of U.S. securities declined to \$35.4 billion (U.S.) in May, compared to \$81.5 billion (U.S.) in April, citing foreign investors were sellers of stocks, while foreign central banks reduced their holdings of Treasury Bills
- The Labor Department reports the U.S. consumer price index (CPI) declined by 0.1% in June, following a drop of 0.2% in May
- American International Group (AIG) agrees to pay \$725 million (U.S.) to a group of Ohio pension funds, in order to settle a securities lawsuit alleging that the company engaged in insurance bid-rigging and inflated its stock price and insurance reserves
- Citigroup Inc. reports a profit of \$2.7 billion (U.S.) in the second quarter, a decline of 37% from a year ago when it avoided a loss with a \$6.7 billion (U.S.) gain on the sale of its Smith Barney brokerage arm

THURSDAY, JULY 15TH

- The Labor department reports initial claims for state unemployment benefits declined by 31,000 to 429,000 in the week ending July 12th., while continuing claims increased from 4.434 million to 4.681 million in the week ending July 3rd.
- Goldman Sachs Group agrees to pay \$550 million (U.S.) and alter its business practices, in order to settle Security & Exchange Commission claims that it misled investors in the marketing of collateralized debt obligations (CDOs) linked to subprime mortgages
- The Canadian Real Estate Association reports housing sales declined by 8.2% compared to May, citing reduced activity in Toronto and Calgary
- The Commerce Department reports the U.S. producer price index (PPI) fell by 0.5% in June, compared to a decline of 0.3% in May

- The Canadian Securities Administrators (CSA), a regulatory arm of provincial securities commissions, issues a draft of new rules which will require credit rating agencies to be registered with securities regulators, bringing the industry under their control for the first time. Canadian credit rating agencies must adopt new conflict of interest policies pledging, neither to rate products they have helped to structure, nor allow staff to determine ratings if they have been involved in negotiating the fees. The CSA also stated that rating agencies would be subject to compliance reviews by regulators, including enforcement actions for violations. With the experience of the non-bank asset backed commercial paper (ABCP) fiasco of 2007 – 2008 a vivid memory in the Canadian investor psyche, not only are these new regulations long overdue, but also, hopefully, they will have some teeth.
- Capital Economics forecaster Roger Bootle warns U.K. house prices will likely decline by 5% this year and by 10% in each of the years 2011 and 2012, as a result of government spending cuts, tax increases and rising unemployment
- In a Washington Post op-ed, reporter Howard Schneider warns: “A massive wave of borrowing will start cresting this year when the U.S. and European governments sell an estimated \$4 trillion (U.S.) of new bond (and note issues). The surge will course (its way) through the world financial system for several years; as countries, corporations and banks borrow record amounts of money to repair the damage from the financial crisis and repay loans from the (economic) boom which preceded it. One crucial concern about the nascent economic recovery is whether markets can smoothly absorb this new debt, or whether it will force less-creditworthy governments into a Greek-style (financial) crisis, push weaker banks and corporations into default, and possibly trigger another (economic) downturn. The United States as a classic safe-haven investment, has benefited from the current caution in the market, as investors plow money into U.S. Treasury securities, keeping interest rates at historical low levels.” At Long Wave Analytics, we have been beating heavily upon this drum for years. U.S. President Obama is still of a spending mindset and with the mid-term elections around the corner, political gridlock looms. We expect an economic civil war to erupt in America during the first quarter of 2011, which could lead to an unsettling period of domestic social unrest.

Combined government borrowing by the United States, United Kingdom, Japan and the 16 euro-zone countries in the second half of this year:

\$4.36 trillion



Greece, Portugal, Italy and Ireland, considered the weakest euro-zone countries, will be borrowing about \$360 billion.

SOURCES: Standard & Poor's, U.S. Treasury Department, International Monetary Fund

U.S. deficit and financing needs in coming years:



U.S. nonfinancial corporate borrowers estimated bond refinancing, 2011-2014:



Bank bonds maturing, 2010-2013:

\$5 trillion



During the Kondratieff economic winter, the investment strategy of owning gold bullion, or shares in gold producing companies and high quality juniors with gold in the ground assets, and treasury bills (cash) isn't everything – it's the only thing!

Ian A. Gordon, The Long Wave Analyst www.longwavegroup.com

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