

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



### Monday, August 9TH

The Federal Home Loan Mortgage Corp. (Freddie Mac) is seeking \$1.8 billion (U.S.) in additional aid from the U.S. Treasury Department after reporting a net loss of \$4 billion (U.S.) in the second quarter, its fourth consecutive quarterly loss.

### MONDAY, AUGUST 9TH

Last week, its rival cousin, the Federal National Mortgage Corp. (Fannie Mae) reported a \$1.2 billion (U.S.) loss in the second quarter, announcing it would seek \$1.5 billion (U.S.) in additional Treasury aid. Both companies were seized by the Federal Government in 2008 and have been sustained by a promise of unlimited Treasury support; which now totals \$148.3 billion since April, 2009. U.S. Treasury Secretary Tim Geithner is planning, by January, 2011, to present “a comprehensive reform proposal” for the two mortgage giants; who together own or guarantee more than half of the \$11 trillion (U.S.) domestic residential mortgage market.

This represents another staggering American litany of woeful debt mismanagement, which can neither end soon, nor end well

- The American Society of Civil Engineers (ASCE) reports 4,095 of America’s 85,000 dams are in need of repair, including 1,826 that could cause loss of life if they failed. ASCE warns the nation’s infrastructure, everything from highways to sewer systems, is in need of a \$2.2 trillion (U.S.) upgrade; while the country’s ports and transportation systems are becoming far less productive than those of many emerging nations. Ignoring America’s decaying infrastructure can only serve to exacerbate the country’s downward slide into an economic quagmire of negative GDP growth and uncompetitiveness

- In the 2009 annual report of the U.S. Social Security program released last week, the trustees disclosed that 2.74 million Americans filed for benefits last year – an historical record. Despite the full retirement age rising from 65 to 66, there was a marked increase in the number of people receiving reduced benefits because they filed early. The trustees also reported that pension and disability payments will exceed revenue in 2010 and 2011; returning to a surplus in 2012 through 2014. For every year after 2015, the trustees project that Social Security will be paying out more than it receives in tax collections, as 78 million ‘baby boomers’ begin retiring.

### TUESDAY, AUGUST 10TH

- As indicated last week, the U.S. House of Representatives votes to transfer an additional \$26 billion (U.S.) of federal monies to cash-strapped U.S. states, in order to forestall layoffs of about 320,000 teachers, police officers and firefighters; as well as increased payments to the Medicaid health insurance plan, directed for the poor. The cost for this \$26 billion (U.S.) stimulus package will be supposedly, met by closing tax loopholes for U.S. companies operating abroad.
- Chinese customs authorities report the country’s trade surplus widened to \$28.7 billion (U.S.), an 18-month high, from \$20.02 billion (U.S.), as exports increased to record levels

- The Labor Department reports U.S. worker productivity declined at a 0.9% annual rate in the second quarter
- U.S. Defense Secretary Robert Gates announces the Pentagon will eliminate thousands of jobs, including a substantial number of its private contractors, as well as a major military command based in Norfolk, Virginia.
- The U.S. Federal Reserve Open Market Committee (FOMC) keeps its Fed Funds rate at its target range of 0.00% to 0.25%, citing the likelihood of maintaining that range “for an extended period.” The FOMC also decided to begin reinvesting more than \$150 billion (U.S.) in annual proceeds from maturing mortgage-backed and agency securities into long-term U.S. Treasuries, while maintaining the size of the Fed’s balance sheet at a constant \$2.3 trillion (U.S.). In a statement the FOMC concluded: “the pace of (U.S.) recovery in income and employment has slowed in recent months and is likely to be more modest” than previously anticipated.  
At Long Wave Analytics, we maintain our view that this remodeled version of a quantitative easing policy only serves to monetize the U.S. debt further. Undoubtedly, Fed Chairman Bernanke, Treasury Secretary Geithner and President Obama will continue to disappoint global investors by stubbornly clinging to the belief that the American deficit and national debt problems can be solved through the issuance of more debt. Caveat emptor.
- The Commerce department reports the U.S. trade deficit widened by a record \$7.9 billion (U.S.) in June to \$49.9 billion (U.S.), citing a rise in imports and a decline in exports
- At a London press conference, Bank of England Governor Mervyn King warns: “The overall (economic) outlook is weaker as (GDP) growth may peak at a 3% annual pace in 2012, instead of the 3.6% rate forecast in May; as planned (government) budget cuts and the persistence of tight credit conditions” remain risks to economic growth
- China’s Statistics Bureau reports the country’s industrial production rose by 13.4% in July from the same period a year ago; while the inflation rate increased to 3.3%, the fastest growth rate in almost 2 years
- Statistics Canada reports the nation’s trade deficit widened to \$1.13 billion (CAD) in June from \$695 million (CAD) in May; citing an overall decline in exports led by a 7.1% decline in sales of industrial goods and materials, as well as a 24% drop in exports of gold and other precious metals
- The U.S. Treasury Department reports the federal government posted a \$165.04 billion (U.S.) deficit for July, or \$1.98 trillion (U.S.) on an annualized basis. Now 10 months into fiscal 2010, the federal government has accumulated a deficit of \$1.169 trillion (U.S.). For all of fiscal 2009, the U.S. government posted a deficit of \$1.42 trillion (U.S.) and is on track to at least match that amount in the current fiscal year.

### WEDNESDAY, AUGUST 11TH

- The Canada Pension Plan (CPP) posts a 1.3% investment loss in its fiscal 1st. quarter ended June 30th. citing lower global stock market prices. In a statement, David Denison, Chief Executive Officer of the CPP investment board reported: “This was a challenging quarter for public equity markets around the world, many of which experienced double-digit declines. This was also a quarter where the CPP Fund benefited from diversification into private equity, real estate, infrastructure and private debt holdings.”  
Wake-up call for Mr. Denison: Look to see your portfolio losses swiftly multiply if you continue to have 54% of the CPP portfolio invested in public equities for the remainder of 2010 and beyond. If the CPP’s mandate is to ‘preserve and grow’ while purporting to be a global investor; how is it the investment board doesn’t see the macro picture? The stock market is not the place to be invested during the Kondratieff winter, despite what Rob Carrick of the Globe and Mail editorializes – starting today with the Dow Jones Industrial Average losing 265 points and the TSX Composite losing 256 points.

### THURSDAY, AUGUST 12TH

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 2,000 to 484,000 in the week ended August 7th., while continuing claims declined by 118,000 to 4.452 million in the week ended July 31st.
- Realty Trac reports 325,229 U.S. properties received either a notice of default, auction or, bank repossession during July, a 4% increase from June. Noting lenders seized 92,858 properties in July – a 9% increase from June, Rick Sharga, senior vice president of marketing at Realty Trac commented: “The (foreclosure) numbers are exploding due to unemployment and economic displacement. We will see them get a lot worse unless we see some job creation.”
- European Union (EU) industrial production declined by 0.1% in June, amid expectations of a 0.6% increase

- In a new report, Douglas Porter, Bank of Montreal (BMO) deputy chief economist, suggests that most industrialized nations should continue stimulus programs to support their economies because they haven't been really tried. "That's especially true in the United States, where whatever money Washington has devoted to supporting the economy, has been undercut by fiscal belt-tightening at the state level."

Wake-up call for Mr. Porter: Even the most recent \$26 billion (U.S.) federal support package for the States will prove insufficient to balance all State budgets. If you haven't noticed, the U.S. federal government has already posted a \$1.169 trillion (U.S.) deficit 10 months into its current fiscal year; while carrying an accumulated national debt of \$13.38 trillion (U.S.). We suggest you apply for Christine Romer's recently vacated White House position – that of Chairman, Council of Economic Advisors – because you would fit right in with the Obama administration's economic mindset.

- In a Bloomberg News op-ed, Boston University economics professor Laurence Kotlikoff writes: "Let's get real. The U.S. is bankrupt. Neither spending more, nor taxing less, will help the country pay its bills. What it can and must do is radically simplify its tax, health-care, retirement and financial systems, each of which is a complete mess. But this is the good news. It means they can each be redesigned to achieve their legitimate purposes at much lower cost and in the process, revitalize the economy. Herb Stein, Chairman of the Council of Economic Advisors under U.S. President Richard Nixon, coined an oft-repeated phrase: Something that can't go on, will stop. True enough. Uncle Sam's Ponzi scheme will stop. But it will stop too late. And it will stop in a very nasty manner. The first possibility is massive benefit cuts visited on the baby boomers in retirement. The second is astronomical tax increases that leave the young with little incentive to work and save. And the third is the government simply printing vast quantities of money to cover its bills. Most likely, we will see a combination of all three responses with dramatic increases in poverty (levels), taxes, interest rates and consumer prices. This is an awful downhill road to follow, but it's the one (that) we are on."

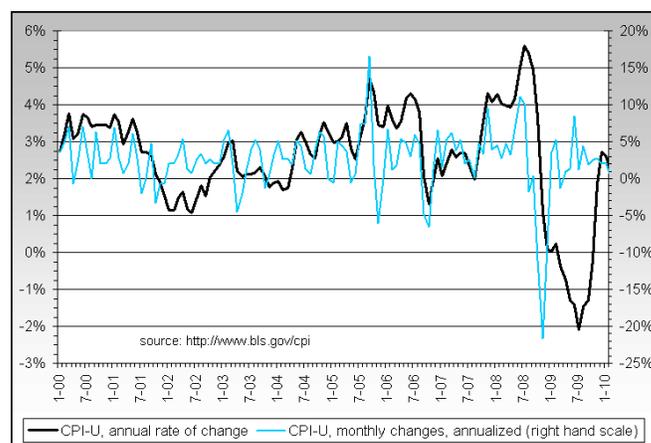
At Long Wave Analytics, while we do not dispute the main thrust of Professor Kotlikoff's forecast; we can foresee an American economic 'civil war' erupting early in 2011 between fiscal liberals and conservatives, battling over tax reform, fiscal deficits, the national debt, Medicare, Medicaid and Social Security. Warring over these entitlement programs will consume a great deal of time and effort; likely ending in a set of old-fashioned American compromises. In a period of continuing high unemployment, however, there also remains a real risk of social unrest unfolding at some point

- Sprott Inc. posts a net profit of \$7.7 million (CAD) in the 2nd. quarter, up from \$5.6 million (CAD) in the same period a year ago. Chief Executive Officer Eric Sprott cited: "Our best performers were (investment) funds with significant gold exposure, such as the Sprott Physical Gold Trust, the Sprott Gold Bullion Fund and the Sprott Gold and Precious Minerals Fund.
- Greece's statistics agency reports the country's gross domestic product (GDP) declined by 1.5% while the unemployment rate rose slightly to 12% in the second quarter citing: "a decline in (domestic) investment and a significant reduction in public consumption."
- New data from the bipartisan Joint Committee on Taxation reveals that U.S. households earning in excess of \$1 million (U.S.) a year, would reap nearly \$31 billion (U.S.) in tax breaks under the Republican plan in 2011, for an average tax cut per household of about \$100,000 (U.S.)

#### FRIDAY, AUGUST 13TH

- The Commerce Department reports U.S. retail sales rose by 0.4% in July led by increased auto sales
- The Bureau of Labor Statistics (BLS) reports the U.S. consumer price index rose by 0.3% on a seasonally adjusted basis in July, following a 0.1 % decline in June. The core rate (ex-food and energy) rose by 0.1% in July and by 0.2% in June.

U.S. Consumer Price Index



CLOSING LEVELS FOR FRIDAY AUGUST 13th.		WEEKLY CHANGE
Dow Jones Industrial Average	10, 303.20	– 350.40 points
Spot Gold Bullion (December)	\$1,217.40	+ \$12.10 per ounce
S&P/TSX Composite	11,528.30	– 271.70 points

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