Monday October 18th, 2010

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, October 18TH

The Federal Reserve reports U.S. industrial production declined by 0.2% in September compared to August, while capacity utilization declined slightly to 74.7% in September from 74.8% in August

MONDAY, OCTOBER 18TH

- South Korea's central bank announces to a parliamentary committee that it is considering gold purchases, in order to diversify its $290 billion (U.S.) of foreign exchange reserves, which are 63% weighted in U.S. dollars. Owning just 14 tonnes of gold, South Korea is one of the smallest holders of gold among the world's larger economies. According to the World Gold Council, the global average is 10%; with Germany, France and the United States each holding over 50% of their foreign exchange reserves in gold. South Korea's central bank governor, Kim Choong-soo, commented: "We need to give careful consideration to the matter of increasing gold volumes in the foreign reserves."
  Wake-up call for Mr. Choong-soo: Why not follow India's lead with an initial purchase of the remaining gold holdings earmarked for sale by the International Monetary Fund (IMF)? Then, add to your holdings on significant gold price corrections; as they present buying opportunities.

- The Royal Bank of Canada acquires London-based fund manager BlueBay Asset Management for $1.54 billion (CAD). BlueBay was founded in 2001 and had assets of $40 billion (U.S.) as at September 30th. RBC Wealth Management general manager George Lewis commented: "This acquisition will further RBC's strategy to leverage our position as a top 10 global wealth manager."

- Statistics Canada reports foreign investment in Canadian securities doubled in August to $11.09 billion (CAD) from $5.51 billion (CAD) in July, citing attractive yields on some corporate issues

TUESDAY, OCTOBER 19TH

- Alderman Ed Burke, Chairman of the Finance Committee for the City of Chicago, during the first day of hearings on Mayor Daley's proposed $6.15 billion (U.S.) budget, declared: "At the present time, the City pension funds are actually selling assets to meet (current) obligations. It's similar to watching the house burn down without being able to turn on the fire hydrant." Gene Saffold, the City's Chief Financial Officer, commented: "Stabilizing employee pensions long-term would require greater employee contributions, higher taxes, major changes to the pension systems or a combination of those steps. Without relief, the City would have to double its property taxes for the next 40 years to cover its pension obligations." According to a recent report by Joshua Rauh, an associate professor at Northwestern University's Kellogg School of Management: "To cover the (City's) outstanding liabilities, each Chicago household would have to pay approximately $42,000 (U.S.) – the highest amount among all American cities."

- The People's Bank of China raises its one-year lending rate to 5.56% from 5.31% and its deposit rate to 5.50% from 5.25%, ahead of September inflation data due for release on Thursday

- Bank of America Corp. reports a loss of $7.65 billion (U.S.) in the 3rd. quarter, citing a $10.4 billion (U.S.) goodwill impairment charge resulting from new legislation which limits fees that B of A can collect when merchants process its Global debit cards

- The Commerce Department reports U.S. housing starts rose by 0.3% in September to a 610,000 annual rate from an upwardly revised 608,000 in August

- Bank of Canada Governor Mark Carney keeps the bank rate steady at 1% citing: “The economic outlook for Canada has changed to a more modest growth profile, reflecting a more gradual (economic) recovery and a more subdued profile for household spending.” Expect the Bank of Canada to retain its reactive profile as a lagging, rather than a leading, indicator for the Canadian economy.

- Goldman Sachs Group posts a net profit of $1.74 billion (U.S.) in the 3rd. quarter, compared to a profit of $3.03 billion (U.S.) in the same period a year ago

- The European Central Bank (ECB) reports the euro zone’s current account deficit widened to a seasonally adjusted $7.5 billion pounds in August, compared with a deficit of 4.1 billion pounds in July

WEDNESDAY, OCTOBER 20TH

- In the House of Commons, George Osborne, U.K. Chancellor of the Exchequer, announces record austerity measures in the British budget, eliminating almost 500,000 public sector jobs and imposing a tax on banks to extract the “maximum sustainable” revenue. Mr. Osborne plans to virtually eliminate a 156 billion pound ($245 billion U.S.) budget deficit with average cuts in government departments of 19%. Mr. Osborne stated: “It’s a day of rebuilding, when we set out a 4-year plan to put our public services and welfare state on a sustainable footing.”

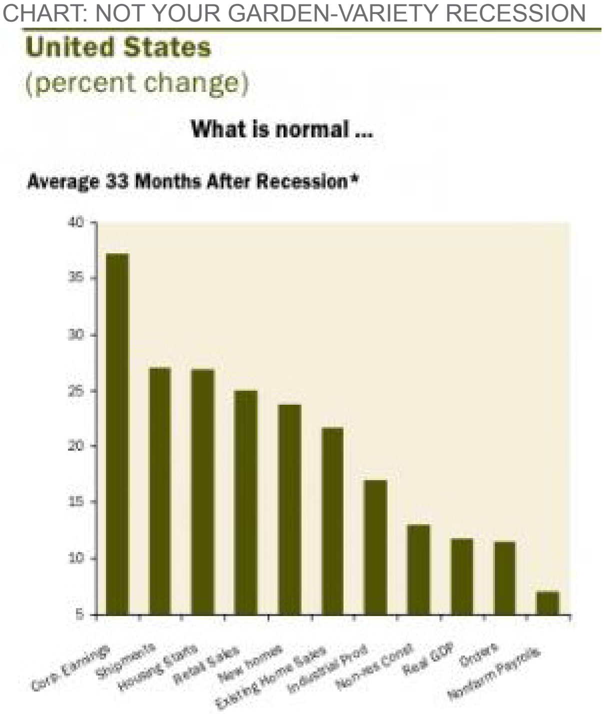
- Commensurate with the release of its regional economic outlook, the International Monetary Fund (IMF) warns Eastern European governments: “Now that the region is finally recovering (economically), it would be a good time to start with fiscal consolidation and in the next few years get (fiscal) deficits back to more sustainable levels.” During the credit crisis, the IMF provided more than $70 billion (U.S.) of loans to Hungary, Latvia, Ukraine, Romania and Serbia; together with $30 billion (U.S.) of loans from the European Central Bank (ECB) and the World Bank.

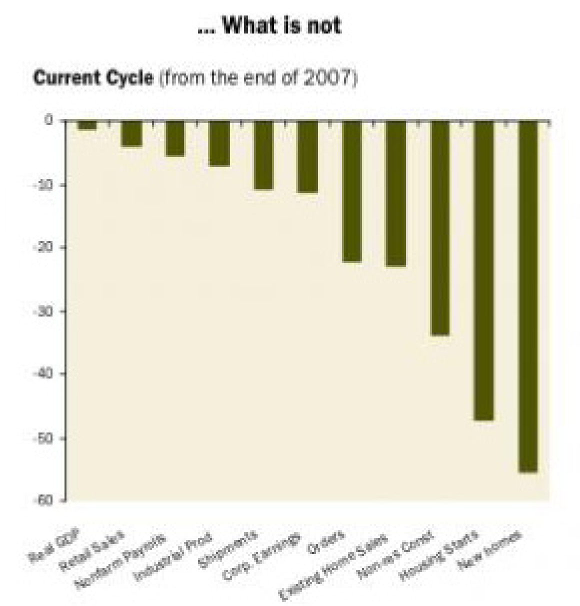
- Saskatchewan Premier Brad Wall announces his government will not condone BHP Billiton’s bid for Potash Corp. citing: “I don’t see how this takeover (offer) provides a net benefit to Canada. We are not going to bet the future of this Province, the future of this important industry and jobs for Saskatchewan people, on jobs that may not materialize.”

- Releasing its quarterly economic forecast, the Bank of Canada states it anticipates an annualized GDP growth of 1.6% for the 3rd. quarter, downwardly revised from 2.8% it forecast last July. Indeed, central bank governor Mark Carney chose to revise his economic growth forecasts for the next two years: 2.3% for 2011 and 3.3% for 2012; compared to July’s forecasts of 2.9% for 2011 and 2.2% for 2012. Clearly, Mr. Carney doesn’t expect any meaningful growth in the Canadian economy until sometime in 2012. As long as Mr. Carney maintains a firm gaze in the rear view mirror, we would expect more downward GDP forecast revisions in the coming calendar quarters.

- The U.S. Federal Reserve reports that its most recent “beige book” survey of economic conditions in the central bank’s 12 districts reveals that economic activity “continued to rise, albeit at a modest pace.” Retailers told the Boston Fed that consumers are focused on “getting a good deal,” and the Cleveland Fed reported that consumers “remain price sensitive and focused on buying necessities.” The beige book also noted that many companies felt the economy was still too weak to add permanent jobs. The San Francisco Fed allowed that in most sectors, businesses “expect that ongoing productivity gains and cost efficiencies will largely offset the need for staffing increases over the near term.”

CHART: NOT YOUR GARDEN-VARIETY RECESSION





*covers eight recession cycles going back to 1950 (does not include the truncated 1980 recession)
Source: Haver Analytics, Gluskin Sheff

THURSDAY, OCTOBER 21ST

- In the wake of its $6 billion (U.S.) acquisition of Affiliated Computer Services Inc., Xerox Corp. announces additional cost cutting plans, including the elimination of 2,500 jobs

- The Labor Department announces U.S. initial claims for state unemployment benefits declined by 23,000 to 452,000 in the week ended October 15th. from an upwardly revised 475,000, previously reported as 462,000. Continuing claims declined by 9,000 to 4.44 million in the week ended October 9th. However, the continuing claims figure does not include the number of Americans receiving emergency and extended benefits under federal programs, which increased by 279,000 to 5.07 million in the week ended October 2nd.

- In a report by the TD Bank, chief economist Craig Alexander warns: "Canadian personal indebtedness has become excessive. The relentless rise in household debt in Canada, both in absolute terms and relative to personal disposable income, is a growing cause for concern. Household debt as a share of personal disposable income has tripled since the 1980s, to146% from 50%, with debt accumulating accelerating at an alarming rate, especially since 2007." The TD estimates that the appropriate level should be in the 138% to 140% range.

- Nokia Corp. announces 1,800 job layoffs, mostly affecting production in its Symbian Smartphone organization and its services organization

- The Office for National Statistics reports U.K. retail sales, including fuel, declined by 0.2% in September, following a downwardly revised drop of 0.7% in August. Andrew Goodwin, senior economics advisor to the Ernst & Young ITEM Club commented: "Consumers' spending power continues to be squeezed by high inflation and weak earnings growth, while unemployment is likely to creep upwards as yesterday's public spending cuts begin to bite."

- China's National Bureau of Statistics reports the country's gross domestic product (GDP) rose by 9.6% in the 3rd. quarter, an appreciable contraction from the 11.9% growth rate registered in the 1st. quarter of the year

FRIDAY, OCTOBER 22ND

- Statistics Canada reports the country's retail sales rose by 0.5% to $36.1 billion (CAD) in August, following flat sales in July and June, citing increased sales at food and beverage stores, motor vehicle and parts dealers and furniture and home furnishing stores

- Canada's Finance Department reports the federal government posted a deficit of $5.8 billion (CAD) in August compared with a deficit of $5.3 billion (CAD) in August, 2009. So far this fiscal year, which began April 1st., the federal deficit totals $13.5 billion (CAD), down from the $23.7 billion (CAD) during the same 5-month period in 2009.

- Statistics Canada reports the country's consumer price index rose by 0.2 in September, pushing the annual inflation rate to 1.9%, while the core rate (ex-food and energy declined slightly to 1.5%

- In a report released on Thursday, parliamentary budget officer Kevin Page notes the rising trend in recent years of provincial and territorial governments to set specific fiscal targets, by introducing legislation committed to eliminating deficits. Mr. Page argues that on their own, such laws aren't always enough to persuade governments to tighten their fiscal belts: "At the same time, there were significant differences across jurisdictions in governments' abilities to meet their rules and improve their finances. This suggests that fiscal rules on their own cannot be relied upon to improve a government's finances and that other factors are also needed such as: clear policy goals; political will;

public support; and a strong budget framework and reporting practices."

In an interview this week, Mr. Page called the government's deficit reduction plan "weak," because it doesn't adequately explain how departments will restrain their spending growth or how the Conservatives will finance such major initiatives as their crime bills, which are expected to strain the capacity of the nation's prisons. "The government's update falls well below the bar with regard to analysis. It underwhelms." Mr. Page argues since the risks to the global economy are considerable, the Bank of Canada has little room to exert any influence through an easy monetary policy, such as lowering interest rates and Canada faces an host of tough fiscal decisions stemming from the country's aging population. Mr. Page believes the government needs to make a stronger commitment to eliminate the federal deficit: "The question is whether there is political will to act in a transparent way. We need debate and action."

At Long Wave Analytics, we have respected the work done by Mr. Page as parliamentary budget officer; an admiration, however, not always shared by the very politicians who hired him for this post, including Finance Minister Jim Flaherty. We would encourage Mr. Page not to compromise his principles, but continue to come forward with the courage of his convictions, for the education and information of his fellow Canadians. Well done Kevin!

- Also, this week in the Financial Times, guest writer Mark Williams pens an article entitled: "Few Silver Linings When Gold Bubble Bursts." Mr. Williams teaches finance at Boston University School of Management and is author of Uncontrolled Risk: The Lessons of Lehman Brothers and How Systemic Risk Can Still Bring Down the World Financial System.

While we confess that we have not read Mr. Williams' book, we definitely take issue with four selective main points which Mr. Williams touts in his article and we would like to refute / respond in point form:

1) "Beware of bubbles. And now it's gold. Over the last four years, gold has staged a spectacular price rise and won many new investors. Everyone from hedge funds to individuals has jumped in, seeing gold is a way to improve portfolio diversification. Today, portfolios often allocate 5% or more to gold. A decade ago, such an allocation in sound investment circles would have been heresy."

Mr. Williams is correct in the sense that heresy means "an opinion contrary to what is normally accepted or maintained." However, it just happened to be the CORRECT opinion of Ian Gordon, President of Long Wave Analytics, at a time when gold was trading at $250 U.S. a troy ounce a decade ago. That's right 10 years ago, not four years ago! We invite Mr. Williams to view the gold chart from a decade ago to witness one of the most classic double bottoms of any precious metal ever recorded. (See below)

The Gold Bullion Double Bottom – $250 U.S. per ounce August /99 to April /01 (Source The Privateer)

2) "Gold is acting, as it should, as a hedge."
WRONG! Gold is a currency, namely MONEY. Investors are buying gold because they no longer have confidence in fiat (paper) money, especially U.S. dollars, the world's reserve currency, of the world's largest debtor nation.

3) "This bubble will likely be pricked only when economic outlooks improve and unemployment figures in countries like the U.S. drop below 8%."
WRONG! Only the expunction of accumulated debt will restore the U.S. economy to health and that is going to require many, many years.

4) "When this bubble goes bust and gold prices plummet, it will be a sign that the Global economy has snapped back from economic chaos to prosperity. This will signal job growth, stable currencies and a stop to U.S. Federal Reserve quantitative easing."
WRONG! Economies are not going to "snap back" to prosperity. To witness any recovery in the U.S. housing market, the unemployment rate and the debt and deficit levels is going to be a very long-term process.

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CLOSING LEVELS FOR FRIDAY, OCTOBER 22ND.		WEEKLY CHANGE
Dow Jones Industrial Average	11,132.56	+ 69.78 points
Spot Gold Bullion (December)	$1,325.10 (U.S.)	– $43.90 per ounce
S&P / TSX Composite	12,601.18	– 7.92 points

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