

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



Monday, August 8th

Front Page Headline, Financial Times – “U.S. Stocks Fall After S&P Downgrade. Financials fall sharply and gold breaches \$1,700. ECB buys billions in European debt.”

MONDAY, AUGUST 8TH

- In a complaint filed in the New York State Supreme Court in Manhattan, the insurer AIG, still largely owned by taxpayers after \$182.3 billion (U.S.) of federal government bailouts, is suing Bank of America Corp. for \$10.5 billion (U.S.) of losses incurred from a “massive fraud” on mortgage investments. AIG complains it suffered the losses on \$28 billion (U.S.) of investments and accuses Bank of America and its Countrywide and Merrill Lynch units of misrepresenting the quality of mortgages placed in securities and sold to investors: “Defendants were engaged in a massive scheme to manipulate and deceive investors, like AIG, who had no alternative but to rely on the lies and omissions made.” Bank of America purchased Countrywide Financial for \$2.5 billion (U.S.) in July 2008 and acquired Merrill Lynch six months later. According to the Globe and Mail: “The Countrywide acquisition is almost universally considered a disaster (by analysts) due to the writing down of bad (mortgage) loans and the costs of litigation.”
- Following Standard & Poors’ (S&P) downgrade of the U.S. sovereign debt credit rating to ‘AA’ (High) from ‘AAA’ on Friday, in an interview with ABC’s “This Week,” the credit rating agency’s managing director, John Chambers stated: “If the fiscal position of the U.S. deteriorates further, or if political gridlock tightens even more, a further downgrade is possible. It will take stabilization and eventual decline of the federal debt as a share of the economy, as well as more consensus in Washington” for the U.S. to regain a top credit rating.
- Wells Fargo and Co. reaches a \$590 million (U.S.) agreement to settle claims with Wachovia investors wherein KPMG LLP, formerly Wachovia’s auditor, will pay an additional \$37 million (U.S.) to settle the suit, bringing the total settlement to \$627 million (U.S.).
- European bond dealers report the European Central Bank (ECB) intervened at the opening of the fixed income market buying Italian and Spanish bonds in a bid to stabilize financial markets. As a result, the yield on 10-year Italian bonds fell by 60 basis points to 5.49%, while the yield on 10-year Spanish bonds dropped by 79 basis points to 5.25%.

TUESDAY, AUGUST 9TH

- The Federal Statistics Office reports German exports declined by a seasonally adjusted 1.2% in June, following a 4.4% gain in May. Christian Schulz, an economist at Joh. Berenberg Gossler & Co, in London commented: “The German economy is rebalancing, meaning domestic demand is playing a bigger role.”
- Front Page Headline, Wall Street Journal – “U.S. Business Braces for Belt Tightening. Lower government spending could reverberate across many industries.”

Tough Customer

More than 80 companies get at least 20% of their revenue from a government source, according to Goldman Sachs. Here's a look at five:

Percent of sales to government in the latest fiscal year



**LOCKHEED
MARTIN** 

Military contractor gets 60% of its revenue from sales to the Defense Department alone, and 85% of its revenue from the U.S. government.



HUMANA

Insurer has a large business selling private Medicare coverage and drug-benefit plans, as well as contracts with the Defense Department.



 **MOTOROLA
SOLUTIONS**

Sells radios and networks for police, fire and other public safety. Government sales rose 4% to \$1.3 billion in the second quarter.



Martin Marietta Materials 

Half of sales by volume involve rock, sand or gravel for government-funded infrastructure projects.



DELL

Sales to the public sector, which includes education and health care, fell 1.8% to \$3.77 billion in the quarter ended in April.

- Standard and Poors (S&P) downgrades the credit ratings of thousands of U.S. debt issuers linked to the federal government, within the \$2.9 trillion (U.S.) municipal bond market, from 'AAA' to 'AA' (High); such as, school construction bonds in Irving, Texas; debt backed by a federal lease in Miami, Florida; and multi-family housing units in Oceanside, California.
- Canada Mortgage and Housing Corp. (CMHC) reports the nation's housing starts rose by 4.3% in July to a seasonally adjusted annual pace of 205,100, citing a significant increase in multi-residential construction
- The Office for National Statistics reports U.K. manufacturing output, excluding utilities and oil and gas extraction, fell by 0.4% in June, following an increase of 1.8% in May
- Federal Reserve Chairman Ben Bernanke announces the Federal Open Market Committee (FOMC) is "prepared to employ additional tools to bolster an economy hobbled by weak hiring anemic household spending." Furthermore, the FOMC pledged to maintain the Fed Funds rate at a record low at least through mid-2013, in order to revive an economic recovery that "is considerably slower than was anticipated." Also, the Fed will maintain its policy of reinvesting the proceeds of maturing securities in U.S. Treasuries. Separately, the Dow Jones Industrial Average (DJIA) had declined by over 200 points when Mr. Bernanke commenced his speech, but reversed course to close ahead by 400 points. Obviously, equity traders and investors had interpreted Mr. Bernanke's statement about the Fed Funds rate as additional bullish stimulus; when they should have realized the Fed was initiating that policy because it is worried that a meaningful economic recovery for the United States will require at least another two years of easy monetary policy.

WEDNESDAY, AUGUST 10TH

- Front Page Headline, Financial Times-Fed Moves To Tackle Struggling Economy. Short term interest rates held for two years. Door opened for more quantitative easing.
- Front Page Headline, Globe and Mail – "Dow Jones Plunges More Than 500 Points. Extends losses nearing the close on economic jitters."
- France's 'AAA' sovereign debt credit rating is affirmed by Standard and Poors (S&P), Moody's Investors Service and Fitch Ratings, with a stable outlook

- The Financial Times reports Commerzbank's 2nd. quarter earnings are all but eradicated by a 760 million euro (\$1.1 billion U.S.) write down on Greek bond holdings, as Germany's second largest bank by assets counts the cost of its large exposure to peripheral euro zone debt

THURSDAY AUGUST 11TH

- Front Page Headline, Financial Times - "Spain's Desperate Banks turn off Credit Tap – Move to hoard cash in an effort to avoid another bailout."
- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 7,000 to 395,000 in the week ended August 6th. while continuing claims fell by 60,000 to 3.69 million in the week ended July 30th. Those people who have exhausted their traditional benefits and are now receiving emergency or extended benefits from federal programs declined by 16,000 to 3.7 million in the week ended July 23rd.
- The Commerce Department reports the U.S. trade deficit widened by 4.4% to \$53.1 billion (U.S.) in June from \$50.8 billion (U.S.) in May, citing lower exports of capital equipment and industrial supplies
- Statistics Canada reports the nation's trade deficit widened to \$1.6 billion (CAD) in June from \$1 billion (CAD) in May, citing a decline in exports to the United States of 2.4% to \$26.5 billion (CAD)
- The Commerce Department reports U.S. consumer spending declined by 0.2% in June, following a rise of 0.1% in May, citing only a slight increase in disposable income of 0.1% and an increase in the pace of savings to \$620.6 billion (U.S.) from \$581.7 billion (U.S.) in May
- The Bank of Ireland reports a pre-tax loss of 556 million euros for the six months ended June 30th. compared to the profit of 116 million euros in the same period a year ago, citing higher funding costs and write downs of holdings in Irish sovereign debt securities
- According to the Financial Times/Economist Global Business Barometer, a survey of 1,500 corporate executives worldwide conducted during late July, reveals 33.8% of respondents expect business conditions in the global economy to worsen over the next six months, contrasting with 23.3% who expect business conditions to improve

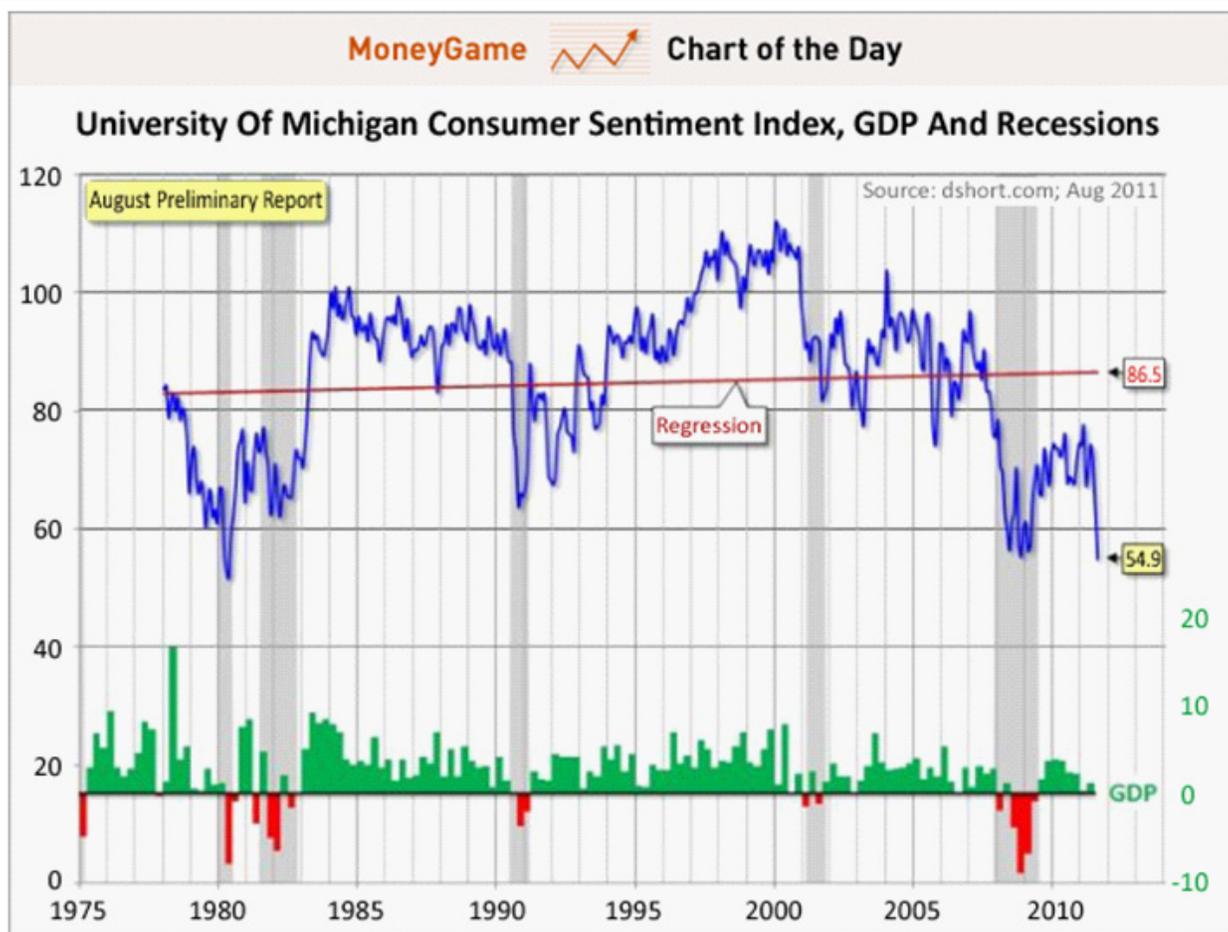


Source: Financial Times

- China's defense ministry announces the nation's first aircraft carrier, the Varyag, is ready to begin sea trials. In an address on Chinese television, Rear Admiral Yin Zhuo stated it could be four years before pilots are fully trained for carrier operations
- The Statistics Bureau reports Australia's unemployment rate rose to 5.1% in July from 4.9% in June
- Greece's Statistical Authority reports the country's unemployment rate rose to 16.6% in June – a record high – from 15.8% in May, as ADEDY (the country's main civil service union) vows to file lawsuits against the Socialist government over a 50 billion euro privatization program. Ilias Ilipoulos, general secretary of the union, remarked: "For us, this (privatization) is an act of national treason and those who attempt it will face the consequences. We will use all the means at our disposal to hopefully overturn the government, but mainly to file lawsuits against those who sign these agreements."
- According to the Washington Post, in an attempt to stem its financial hemorrhaging, the United States Postal Service (USPS) is seeking to reduce its work force by 20% – or 120,000 workers – via layoffs currently prohibited by union contracts. USPS also wants to withdraw its employees from the government health and retirement plans.

FRIDAY, AUGUST 12TH

- The Hellenic Statistics Authority (ELSTAT) reports Greece's gross domestic product (GDP) contracted at a 6.9% annual rate in the 2nd. quarter compared with a decline of 8.1% in the 1st. quarter citing: "The reduction in domestic demand (final consumption spending and gross fixed capital formation) contributed to the contraction, which was partially offset by the improved trade balance." As austerity measures take a toll on consumer spending, the Greek economy remains in a depressed state for a third year.
- Industrial production in the 17 countries which comprise the euro zone declined by 0.7% in June. Ben May, an economist at Capital Economics commented: "This figure means euro zone industrial output rose by 0.3% in the 2nd. quarter, the weakest expansion since late 2009. We expect the underlying pace of economic growth to slow further during the next two quarters."
- Front Page headline, New York Times – "As Dizzying Week Ends on Wall Street, Dangers Linger. Many think the Wall Street roller coaster ride is likely to continue."



- The Thomson Reuters / University of Michigan preliminary index of U.S. consumer sentiment declined to a reading of 54.9 in August from a level of 63.7 in July, reflecting a negative conviction in the domestic economic outlook not seen since May 1980
- The European Securities and Markets Authority – a body that co-ordinates the European Union’s market policies – announces that: “short sales of securities will be curtailed in France, Belgium, Italy and Spain, effective immediately (temporary short sale bans are already in effect in Turkey and Greece). Today, some authorities have decided to impose or extend existing short-selling bans in their respective countries. They have done so, either to restrict the benefits that can be achieved from spreading false rumours, or to achieve a regulatory level playing field, given the close linkage between some European Union (EU) markets.” HORSE FEATHERS! At Longwave Analytics, we neither condone, nor support short sale bans – temporary or otherwise – because we believe they serve no positive purpose; rather they unduly interrupt and restrict the natural flow of funds and capital in the free enterprise marketplace.
- Regulators close the First National Bank of Olathe, Kansas, making it America’s 64th. bank failure this year. First National had \$538 million (U.S.) in assets and \$524 million (U.S.) in total deposits. It was the first bank closed in the State of Kansas this year. The Federal Deposit Insurance Corp. (FDIC) said First National’s six branches would reopen tomorrow as part of Enterprise Bank and Trust, of Clayton, Missouri.
- According to the U.K. Telegraph, the U.S. Securities and Exchange Commission (SEC) is examining the models used by Standard and Poors (S&P) in its calculations used in its decision to downgrade the U.S. sovereign debt credit rating from ‘AAA’ to ‘AA’ (High). As reported in the Privateer, “the U.S. Treasury is projecting average annual increases in U.S. ‘discretionary spending’ of \$2.01 trillion (U.S.) every year for the next 10 years. S&P is projecting average annual figures of \$2.21 trillion over the same period.” At Longwave Analytics, we believe this represents a ridiculous waste of time by the SEC. The fact is that America’s national debt will likely approximate \$16.5 trillion (U.S.) by end of 2012. Whether or not America is \$22 trillion (U.S.) in debt by the year 2020 is rather immaterial, because \$16.5 trillion (U.S.) can never be repaid.

- Under pressure to meet the European Central Bank (ECB)-imposed target of balancing the budget by 2013, Italian Prime Minister Silvio Berlusconi introduces a harsh package of tax increases and spending cuts for Italy's fragile economy. Adopted by emergency decree following cabinet approval, the package imposes austerity measures of 20 billion euros in 2012 and a further 25.5 billion euros in 2013. The package must be approved by parliament within 60 days. Prime Minister Berlusconi lamented: "We are personally, very pained to have to adopt these measures."

CLOSING LEVELS FOR FRIDAY, AUGUST 12TH.

WEEKLY CHANGE

Dow Jones Industrial Average	11,269.02	– 175.58 points
Spot Gold Bullion (December)	\$1,742.60 (U.S.)	+ \$90.80 per oz.
S&P / TSX Composite	12,542.20	+ 380.00 points
10-Year U.S. Treasury Yield	2.25%	– 31basis points
Canadian Dollar	100.94 cents (U.S.)	– 0.99 cent
U.S. Dollar Index Future (Spot Price)	74.566 cents	+ 0.042 cent
WTI Crude Oil (September)	\$85.38 (U.S.)	– \$1.50 per barrel

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