

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



Monday, August 15th

The Toronto-Dominion Bank agrees to acquire the Canadian credit card portfolio – which operates under the name of MBNA – from Bank of America for \$8.6 billion (CAD)

MONDAY, AUGUST 15TH

- In an open letter penned collectively by the finance ministers of Australia, Britain, Canada, Singapore and South Africa, it is argued that global political resolve is the most needed cure for the ongoing economic crisis: “The United States plays an especially important role in restoring confidence. Credible fiscal commitments are in America’s own (best) interests and the world’s. It will also reduce the chances of a disruptive transition as we move towards a new global economy, with major emerging economies playing an increasing role, both in global consumption and savings flows ... Credible fiscal plans and stronger banks must be matched by more progress on global rebalancing. In any co-ordinated global effort, all countries must make their contribution ... Progress on an international framework to support rebalancing has to move from discussion to action at this autumn’s meetings of G20 leaders and finance ministers.” At Longwave Analytics, we note that the newly appointed Congressional ‘super committee’ will not be forthcoming with its debt reduction recommendations until after the U.S. Thanksgiving holiday of November 17th. Moreover, since the 2012 American presidential election campaign is already unfolding in Iowa and will soon spread to the primaries across the U.S., the likelihood of political gridlock in Washington abating anytime soon is non-existent.
- The Cabinet Office reports Japan’s real gross domestic product (GDP) contracted at an annualized rate of 1.3% in the 2nd. quarter, citing consumer spending and factory production continuing to suffer in the aftermath of the March earthquake and tsunami

- Google Inc., the biggest maker of smartphone software, agrees to buy Motorola Mobility Holdings for \$12.5 billion (U.S.), gaining mobile patents and expansion in the hardware business

TUESDAY, AUGUST 16TH

- Front Page Headline, Washington Post -Perry Warns of Fed Treason. Candidate says Bernanke would be ‘treasonous’ if the Fed printed more money prior to the 2012 election
- Fitch Ratings affirms its ‘AAA’ sovereign debt credit rating for the United States with a stable outlook citing: “The affirmation of the U.S. ‘AAA’ sovereign rating reflects the fact that the key pillars of America’s exceptional creditworthiness remains intact: its pivotal role in the global financial system and the flexible, diversified and wealthy economy that provides its revenue base. We will review our fiscal projections at the end of November and medium-term economic outlook by the end of the year. However, the outlook for the rating also depends on the economy and the ability of the political process in Washington to reduce the public debt.”
- Statistics Canada reports the nation’s manufacturing sales declined by 1.5% in June. Jimmy Jean, an analyst with Desjardins Capital Markets commented: “(This report) sets us up for another monthly GDP disappointment and heightens the risks of a 2nd. quarter GDP coming in negative. The handoff to the 3rd. quarter will also be very weak.”

- The Federal Reserve reports U.S. industrial production rose by 0.9% in July, following a revised gain of 0.4% in June
- The Commerce Department reports U.S. housing starts declined by 1.5% to a 604,000 annual rate in July, following a 10.8% gain in June. Building permits, a proxy for future construction, also declined to a 597,000 annual pace from 617,000 in June. Patrick Newport, and economist at IHS Global Insight in Lexington, Massachusetts, commented: "The (U.S.) housing market is still very depressed. Demand for new homes is extremely weak and the foreclosure pipeline is still high. It's because of the weak economy, weak job growth and falling home prices."
- In a joint announcement to a Paris news conference, French President Nicolas Sarkozy and German Chancellor Angela Merkel propose the establishment of a European Union (EU) economic council, a balanced budget amendment to the EU constitution and a tax on financial transactions to be tabled in September. President Sarkozy stated: "We want to express our absolute will to defend the euro and assume Germany's and France's particular responsibilities in Europe and to have on all of these subjects a complete unity of views." Chancellor Merkel continued: "Germany and France feel absolutely obliged to strengthen the euro as our common currency and develop it further. It is entirely clear that for this to happen, we need a stronger interplay of financial and economic policy in the euro zone."

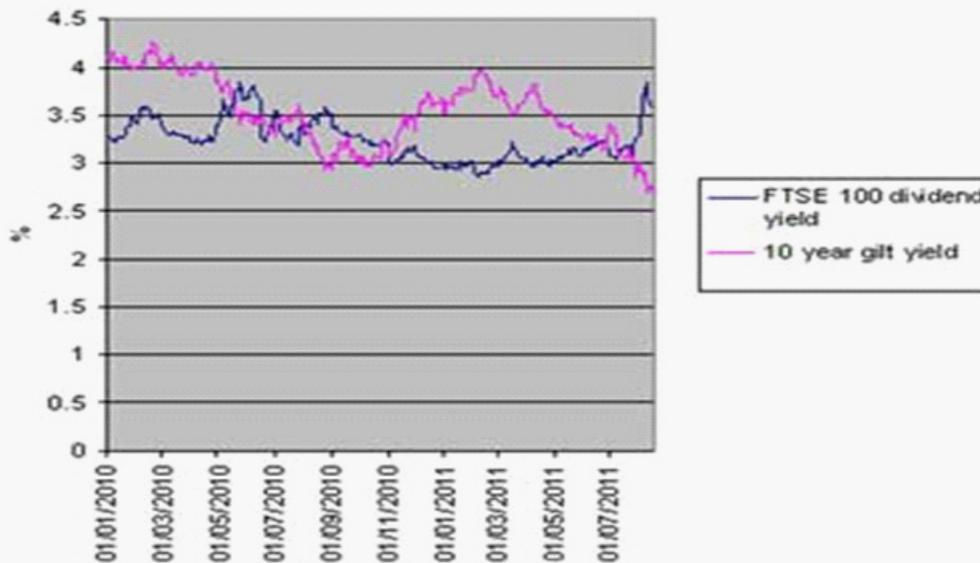
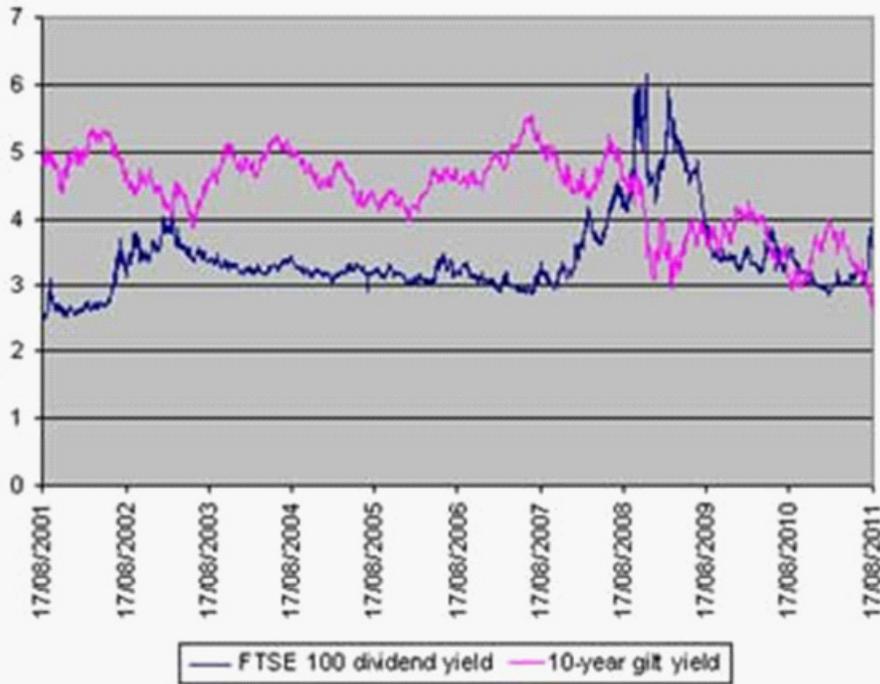
WEDNESDAY, AUGUST 17TH

- Fitch Ratings downgrades the State of New Jersey's general obligation bonds and the Garden State Preservation Trust's open space revenue bonds from 'AA' to 'AA' (Low) with a negative outlook, citing: "the mounting budgetary pressure presented by significant and growing funding needs for the State's unfunded pension and employee benefit liabilities; particularly in the context of a weak economic recovery, a high debt burden, limited financial flexibility and persistent structural imbalance."
- Front Page Headline, Wall Street Journal – Venezuela to Nationalize Gold Industry. President Hugo Chavez attempts to boost Venezuela's international reserves.
- The Labor Department reports the U.S. producer price index (PPI) rose by 0.2% in July, following a 0.4% decline in June, citing higher prices for tobacco, trucks and pharmaceuticals

- The Office for National Statistics reports the number of U.K. workers claiming unemployment benefits rose by 37,100 in July, the largest increase since May 2009

THURSDAY, AUGUST 18TH

- The Philadelphia Federal Reserve Bank's factory index declines to a reading of minus 30.7 in August – the lowest reading since March 2009 – from a positive level of 3.2 in July. Readings below zero indicate a contraction in production at the region's factories.
- Front Page Headline, Bloomberg News – "U.S. Stocks Tumble on Global Economic Growth Concerns." Speculation that European banks lack enough capital.
- The National Association of Realtors reports U.S. existing home sales declined by 3.5% in July to an annual pace of 4.67 million, citing fewer buyers entering the housing market
- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 9,000 to 408,000 in the week ended August 13th. while continuing claims rose by 7,000 to 3.7 million in the week ended August 6th. People who have exhausted their traditional benefits and are now receiving extended or emergency benefits declined by 43,700 to 3.66 million in the week ended July 30th. David Semmens, an economist at Standard Chartered Bank in New York commented: "People continue to get laid off. The uncertainty in the economic outlook is continuing to give hiring managers sleepless nights and is keeping businesses from expanding. We have an incredibly long way to go to get a healthy labor market."
- U.S. President Barack Obama, joined by the leaders of Britain, France, Germany and Canada, calls upon Syrian President Bashar al-Assad to leave office, citing: "The time has come for the Syrian people to determine their future."
- The Labor Department reports the U.S. consumer price index (CPI) rose by 0.5% in July, following an increase of 0.2% in June while the core index –excluding food and energy – rose by 0.2%
- Front Page Headline, Globe and Mail – "U.S. & EU Dangerously Close to Recession: Morgan Stanley." Bank criticizes policymakers and predicts ECB will cut interest rates.



- In an op-ed article in the U.K. Daily Telegraph entitled *The Coming Depression in Pictures*, business reporter Jeremy Warner opines: “The graphic below tracks the yield on the FTSE 100 against the yield on 10-year gilts – the so-called ‘yield gap.’ The traditional relationship, which has ruled with only a few aberrations since the late 1950s, is that government bonds yield more than equities. This relationship is underpinned by the idea that over time equities will always deliver a better return than bonds. They are also judged to be better hedge against inflation. But with the advent of the financial crisis, the relationship has begun to show severe signs of strain.

Sometime in mid-2011, the relationship unambiguously reversed (see second graphic below). When shares are cheap relative to bonds, there’s usually a good reason for it. In a recession, corporate bonds suffer, dividends are cut and corporate insolvencies rise. Therefore, equities decline (in price). By contrast, bonds become the default savings security of choice.

Money that would be normally spent or invested in productive assets gets instead, squirrelled away in cash and its nearest equivalent, government bonds. A vicious circle develops, wherein more cash saving means less demand, (which) equals less spending and employment, (which) equals more cash sav

ing. It's what John Maynard Keynes dubbed 'the paradox of thrift' – it's obviously, good for people to save, but it's very bad for demand. Bond yields are driven down to a level which reflects a deflationary environment, where prices fall rather than inflate. Not good."

- The Office for National Statistics reports U.K. retail sales rose by 0.2% in July citing: "Household goods stores, clothing and footwear shops and non-store retailing (including the Internet and mail orders) all suffered lower sales."
- Chicago-based Sears Holdings reports a second quarter loss of \$146 million (U.S.) compared with a loss of \$39 million (U.S.) in the same period a year ago. Accordingly, Sears has announced another 250 job cuts, two months after it announced 700 layoffs.
- Front Page Headline, Daily Telegraph – "Bond Markets Signal 'Japanese' Slump for U.S. and Europe. Global credit markets brace for deflation and perhaps depression. See also, Winter Warning, Aug. 17/11 – Hope Springs Eternal in the Human Breast.

FRIDAY, AUGUST 19TH

- Front Page Headline, New York Times – "U.S. Probes S&P over Mortgage Securities" Justice Dept. investigating if S&P improperly rated mortgage securities prior to 2008.
- The Los Angeles Times reports the City of Los Angeles has fired Standard and Poors (S&P) because the City has "really lost faith in S&P's judgment," according City Controller Wendy Greuel. In point of fact, it would appear that S&P was fired because it downgraded one of Los Angeles' investment pools to 'AA' from 'AAA'. Clearly, Mayor Antonio Villaraigoso and City Council have their heads well buried in the sand. At Longwave Analytics, we wonder after Moody's Investors Service and Fitch Ratings follow S&P's lead, to whom will Mayor Villaraigoso be selling the City's next bond issue at a competitive yield, without a credit rating?
- The Office for National Statistics reports the U.K posted a deficit of 20 million pounds (\$33 million U.S.) in July – excluding government support for banks – which was smaller than forecasts, citing higher tax revenue on corporate profits and a new bank levy

- Statistics Canada reports the nation's annual inflation rate (CPI) declined to 2.7% from 3.1% in June, citing lower prices for gasoline; while the core rate (ex food and energy) rose by 1.6% from 1.3% in the same period
- Front Page Headline, Globe and Mail – "World Stocks Plunge on Recession Fears. European banking shares hit a new 30-month low."
- The Bank of America announces 3,500 job layoffs, effective within the current quarter, citing continuing challenges presented by its \$1 trillion (U.S.) problem loan portfolio and a slowing domestic economy
- At a special session of the House of Commons, Bank of Canada Governor Mark Carney and Finance Minister Jim Flaherty testify: "While volatility in markets and a stream of discouraging economic news point to slower-than-anticipated (GDP) growth, globally and in Canada, it does not (portend) a new downturn." Governor Carney continued: "Although the (Canadian) economy may have contracted in the second quarter and faces headwinds from abroad which are blowing harder, (economic) growth is picking up again, and I do not see either the United States or Europe sliding back into recession."

In the Summation remarks of our August 17th. Winter Warning – Hope Springs Eternal in the Human Breast, we stated: "As is evidenced by the recent sharp decline in the Dow Jones Industrial Average (DJIA) and in stock markets around the globe, we are witnessing a rapidly slowing economy in the United States, a moribund economic situation developing in the Euro zone and continued economic stagnation in Japan; as the Longwave winter cycle intensifies and is fuelled by the world being awash in debt. It is now 80 years (four 20-year cycles identified by the late W.D. Gann) since the tragic year of 1931 when the world's economic system crashed. History is on the verge of repeating itself."

As the current economic downturn accelerates, we now expect that reality will hit Finance Minister Flaherty and Governor Carney like 'a ton of bricks.' At that time, we must hope that when their heads stop spinning, their faces are still to the front!

CLOSING LEVELS FOR FRIDAY, AUGUST 19TH.		WEEKLY CHANGE
Dow Jones Industrial Average	10,817.65	– 451.37 points
Spot Gold Bullion (December)	\$1,852.20 (U.S.)	+ \$109.60 per oz.
S&P / TSX Composite	12,007.47	– 534.73 points
10-Year U.S. Treasury Yield	2.06%	– 19 basis points
Canadian Dollar	101.15 cents (U.S.)	+ 0.21 cent
U.S. Dollar Index Future (Spot Price)	73.989 cents	– 0.577 cent
WTI Crude Oil (September)	\$82.26 (U.S.)	– \$ 3.12 per barrel

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