

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



Monday, September 26th

The Commerce Department reports U.S. new home sales declined by 2.3% to an annual pace of 295,000 units in August – a six-month low – citing continuing high unemployment and an ample supply of foreclosures on existing homes

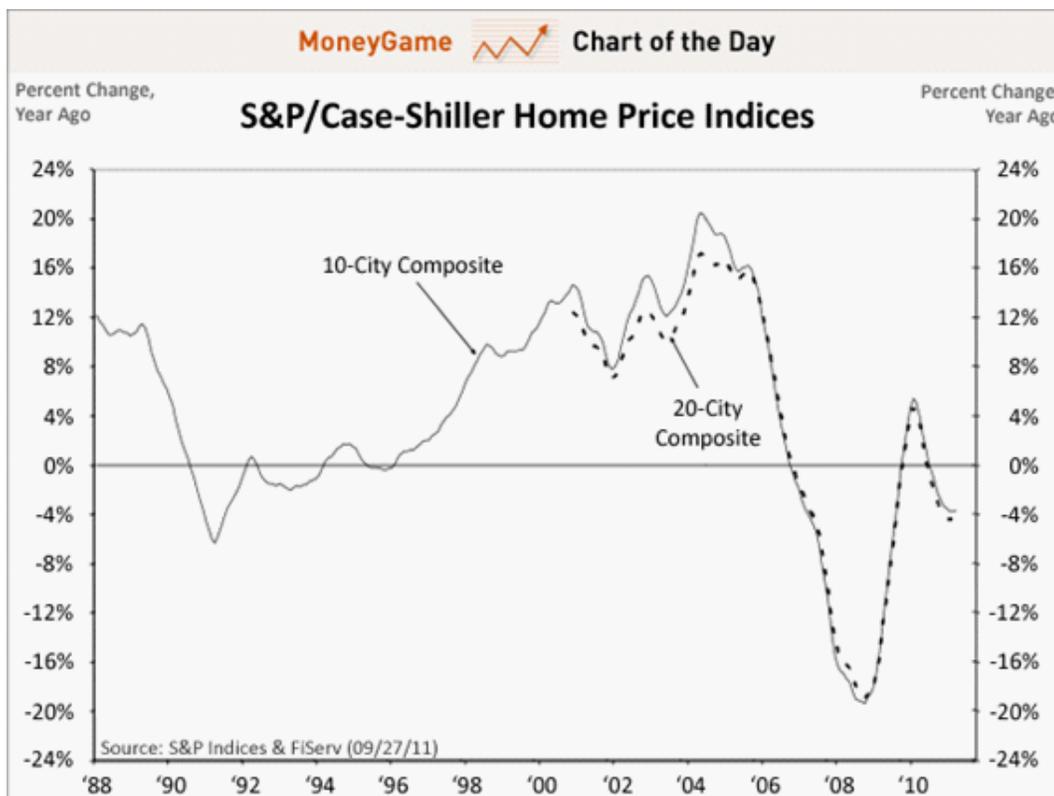
MONDAY, SEPTEMBER 26TH

- According to a recent U.S. corporate earnings outlook by Morgan Stanley, analyst Adam Parker warns: “We have heard investors suggest \$80 (U.S.) in earnings per share (EPS) was a fair bear case for 2012. We decided to look at history as a guide in assessing the bear case (for) EPS. The 2001 recession saw a 13% revenue decline and a 57% EPS drawdown. The 2008 recession saw a 14% revenue decline and a 51% EPS drawdown, peak-to-trough. For 2012, bottom-up estimates (excluding financials) embed a 5% revenue INCREASE and just over 10% year-over-year EPS growth. If prior recessions prove relevant to next year’s economy, \$54 (U.S.) to \$68 (U.S.) EPS in 2012 would be a more likely range than the \$112 (U.S.) that the bottom-up consensus estimates currently embed.” According to the Business Insider, “If one attaches a 15 times price earnings (PE) multiple to the low end of that range – which some would argue is a generous valuation – you’d arrive at an 810 level for the S&P 500 index. That represents a 32% plunge in the index from today’s intra-day high level of 1,194 points.”
- Front Page Headline, Wall Street Journal – “Putin Return Complicates U.S. Policy. Russian President Dmitry Medvedev’s weekend announcement that he will step down in March 2012, paves the way for Vladimir Putin’s reascension to Russia’s highest office. Mr. Putin declared his candidacy for the presidency at a pro-Kremlin party congress in Moscow on Saturday.” See also, The Week That Was, Tuesday, September 20th.
- In a vote of 79 to 12, The U.S. Senate passes two stop-gap spending measures which fund the government through November 18th. and provide \$2.5 billion (U.S.) in disaster relief funds, thereby, averting a government shutdown if the bills are approved by the House
- Front Page Headline, Bloomberg News – “Debt Agreement at Risk as Lawmakers Target Cuts. Senator Lindsay Graham (R.-SC) announces he will introduce legislation to protect the U.S. Defense Department from automatic budget cuts that would take effect should the Congressional ‘super committee’ fail to reach an agreement on \$1.5 trillion (U.S.) of spending cuts by November 25th.” See Winter Warning, September 28th. – The Demise of the American Dream – Summation.
- Front Page Headline, Globe and Mail – “Watchdog Warns Banks about Easy Credit. Julie Dickson, Superintendent of the Office of the Superintendent for Financial Institutions (OSFI) warns Canadian banks not to increase risk tolerance in search for more business, as the regulator commences stress testing the banking sector’s exposure to various forms of consumer debt. The test will examine mortgage business, focusing particularly on home equity lines of credit.”
- Front Page Headline, U.K. Daily Telegraph – “Sergei Magnitsky’s Mother Demands Russian Murder Investigation. In a complaint lodged with prosecutors, Natalia Magnitskaya, alleges her son was illegally arrested, tortured and ultimately murdered

in a Moscow prison in November 2009. Demanding that a fully-fledged murder investigation be opened into a case that continues to damage Russia's relations with the West, Mrs. Magnitskaya stated: "During the almost two years since my son's death, I have learned and reviewed information proving that a crime was committed against my son, and that his death came about as a result of premeditated violent actions." Naturally, while we sympathize with Mrs. Magnitskaya, we are loathe to expect any investigation being launched by the incoming President Vladimir Putin on the ides of March. Beware!

TUESDAY, SEPTEMBER 27TH

- The Conference Board's index of U.S. consumer confidence increased slightly to a reading of 45.4 in September, following a revised level of 45.2 in August, the lowest reading since April 2009
- Front Page Headline, Washington Post – "Bipartisanship Is Dead – At Least Until 2013. Recent political battles over the statutory debt limit and disaster relief funding reveal not only, do the two parties not agree on much of anything, but also, both parties are waiting until the 2012 election for a sign from voters. See also, Winter Warning, September 28, 2011 –The Demise of the American Dream – Summation.
- In a Financial Post article entitled Banks Face Pension Funding Shortfalls, reporter Barry Critchley warns: "They are viewed as bastions of stability in the global financial world and are touted for the way they weathered the global financial crisis, Nonetheless, Canada's big six chartered banks face a looming problem: all have potential pension funding issues. Three of them posted a deficit in 2010 for their main plans, the latest fiscal year for which information is available. When the other pension funds / benefit plans run by the banks for their employees are included, the situation is much worse: all had overall pension fund deficits in 2010. More importantly, the funding status trend for the banks' main pension funds is negative."
- Front Page Headline, U.K. Daily Telegraph – "German Turmoil over EU Bailouts. Germany's top judge has issued a blunt warning that no further fiscal powers may be surrendered to Europe without a new constitution and a popular referendum, vastly complicating plans to boost the EU's rescue fund.
- According to the Business Insider, the S&P / Case Shiller home price composite index of 20 U.S. cities declined by 4.1% on a year-over-year basis in July, as the housing double dip continues unabated, given the ample supply of foreclosures and the continuing high unemployment rate.



- Front Page Headline, Agence France Presse – “Russian Finance Minister Ousted in Dispute. Russian Finance Minister Alexei Kudrin not in tune with Putin’s return to the Kremlin next March. No surprise here.
- U.S. Postal Service workers rally across America hoping to draw attention to Democratic backed legislation – supported by their labor unions – which they believe would best fix the U.S. Postal Services (USPS) financial problems. At a downtown Washington rally, several dozen workers angrily targeted Representative Darrell Issa (R-Cal.), Chairman of the House Oversight and Government Reform Committee, who is co-sponsoring a bill that would establish a financial control board which would overhaul USPS finances and possibly force layoffs. See also, Winter Warning, September 28, 2011 – The Demise of the American Dream – The Impending Implosion of the U.S. Postal Service.

- In a report entitled The Dollars and Sense of Solving Poverty, The National Council of Welfare concludes: “The government should make a \$1 billion (CAD) investment in order to eradicate the root causes of poverty in Canada, or face billions more in ongoing expenses ... Poverty costs Canadian taxpayers more than \$24 billion (CAD) a year, but a large investment now would reduce poverty costs to taxpayers in the ensuing years.”
- Front Page Headline, National Post – “British Columbia Could Lose RCMP if November Deadline Not Met. With negotiations over the policing contract in B.C. stalled, the Canadian Government has given the Province an ultimatum: sign a 20-year deal by November or we’ll withdraw RCMP services from the Province
- Front Page Headline, Business Insider – “Poll Disaster for President Obama. A pair of polls released by Quinnipiac University show Obama in a statistical tie with Texas Governor Rick Perry and former Massachusetts Governor Mitt Romney in Ohio, with the President holding a slight lead over Perry in Pennsylvania. More strikingly, a majority of voters in both states do not believe Obama deserves another term – with majorities also disapproving of the President’s job performance. Quote from the July 9, 2009 Winter Warning, The Scourge of Unemployment – ‘We lack confidence in the socialist Obama administration, suffice to say, we perceive the incumbent to be a one-term President.’

WEDNESDAY, SEPTEMBER 28TH

- The Commerce Department reports while demand for U.S. durable goods declined by 0.1% in August, orders for American capital goods – such as computers and communications gear (excluding military hardware and aircraft) , rose by 1.1%
- A new report by the National League of Cities outlines how the economic downturn has shrunk U.S. city budgets: forcing them to issue layoff notices, roll back infrastructure projects and make cuts to public services. Municipalities have lost revenue due to reduced property tax collections from a depressed housing market and state and federal aid has also declined.

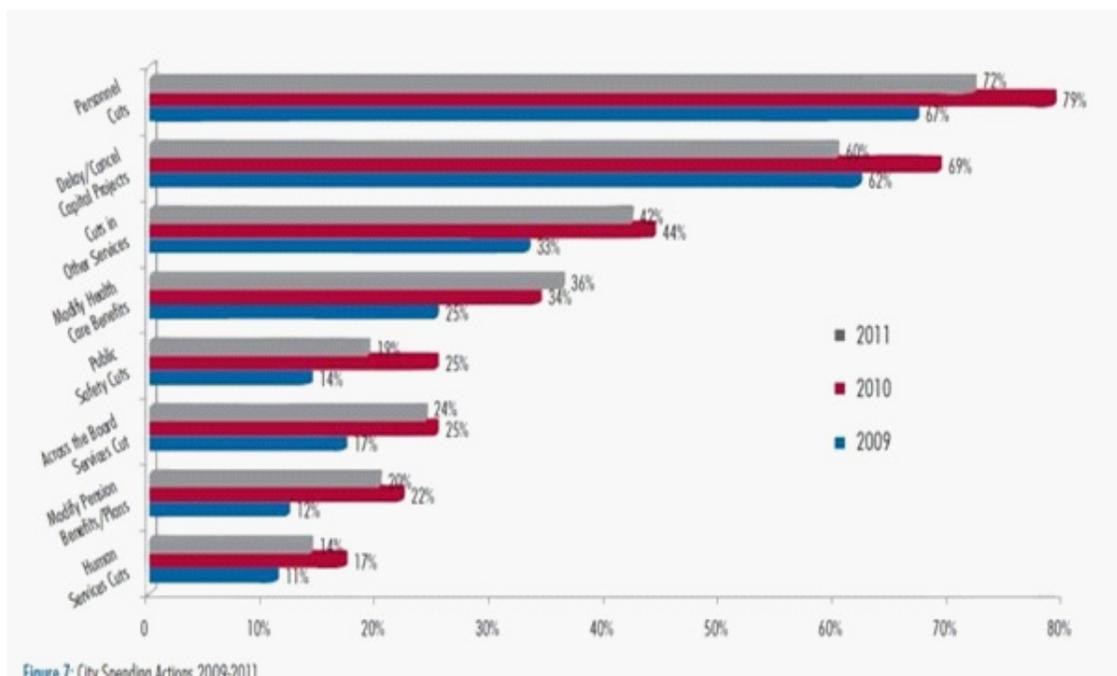


Figure 7: City Spending Actions 2009-2011

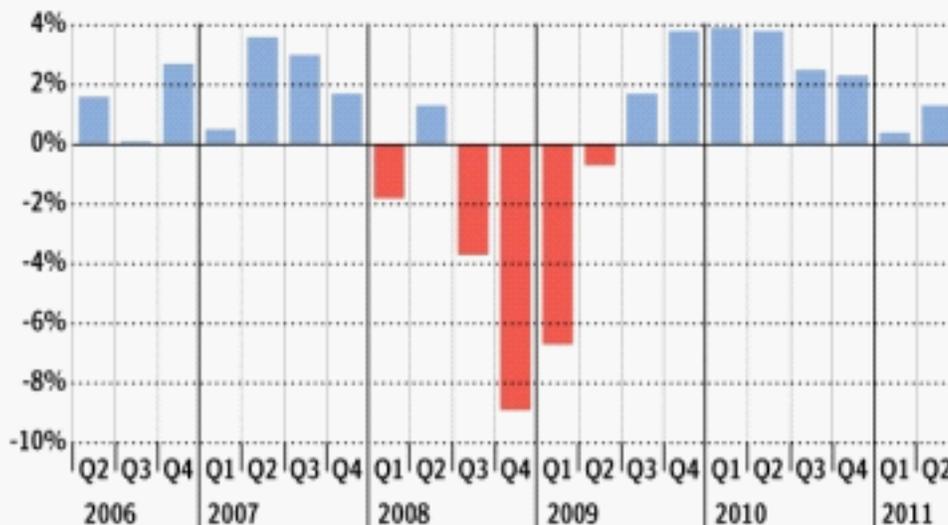
THURSDAY, SEPTEMBER 29TH

- Fitch ratings downgrades New Zealand’s sovereign debt credit rating to ‘A’ from ‘A’ (high) with a stable outlook, citing the nation’s high level of external debt and its persistent current account deficit
- The Labor Department reports U.S. claims for state unemployment benefits declined by 37,000 to 391,000 in the week ended September 24th. due to seasonal adjustment difficulties, while continuing claims fell by about 20,000 in the week ended September 17th. Those people who have exhausted their traditional benefits and are now receiving emergency of extended benefits from federal programs increased by 75,550 to 3.58 million in the week ended September 10th.
- The National Association of Realtors reports U.S. pending home sales declined by 1.2% in August, following a 1.3% drop in July, citing continuing high unemployment and an acceleration in the residential foreclosure process
- The Commerce Department reports the U.S. gross domestic product (GDP) grew at a revised annual rate of 1.3% in the 2nd. quarter, previously reported as 1%, aided by increased exports and spending in the services sector
- Enbridge Energy Inc. and Enterprise Products Partners LP announce joint-venture plans to construct a Wrangler oil pipeline from Alberta linking Cushing, Oklahoma to refineries on the Texas Gulf Coast to compete against Trans Canada Inc.’s proposed Keystone XL line
- Standard & Poor’s upgrades General Motors credit rating to ‘BB’ (High), citing two years of solid financial performance and the benefits of its new 4-year labor agreement with the United Auto Workers
- Front Page Headline, Financial Times – “German Parliament Approves EFSF Boost. The German Bundestag votes – by an overwhelming majority – in favour of measures to bolster the size of the European Financial Stability Facility (EFSF) – the euro zone’s bailout fund – currently at 440 billion euros.
- Stephen Elop, Nokia’s President and Chief Executive Officer announces 3,500 job layoffs and the closure of its manufacturing plant at Cluj, Romania, citing: “We must take painful, yet necessary, steps to align our work force and operations with our path ahead. With these changes we will emerge as a more dynamic, nimble and efficient challenger.”

U.S. GROWTH REVISED UP

U.S. GDP

QUARTER-OVER-QUARTER PERCENTAGE CHANGE, SEASONALLY ADJUSTED ANNUALIZED RATE



SOURCE: BLOOMBERG NEWS

ANDREW BARR / NATIONAL POST

FRIDAY, SEPTEMBER 30TH

- The Thomson Reuters / University of Michigan final index of consumer sentiment rose to a reading of 59.4 in September following a level of 55.7 in August
- The Commerce Department reports U.S. consumer spending rose by 0.2% in August – following a gain of 0.7% in July – as personal income declined by 0.1% . Separately, the Institute for Supply Management-Chicago Inc. (ISM) reports its business barometer rose to a reading of 60.4 in September from 58.5 in August.
- Statistics Canada reports the nation's gross domestic product (GDP) expanded by 0.3% annual basis in July.
- Parliamentary Budget Officer, Kevin Page warns: "Our overall analysis suggests that the fiscal structure at the federal, provincial and territorial level is not sustainable over the long term. The Parliamentary Budget Office estimates that permanent and immediate fiscal actions, either through increased taxes, or reduced program spending – or some combination of both – would be required to ensure the net debt-to-GDP ratio does not ultimately rise above its current level. Even if the economy recovers over the next few years, the additional spending on health care and elderly benefits is expected to erode public finances, taking governments from surpluses over the medium term to sizeable deficits over the long term."
- The Department of Finance reports Canada's budget deficit totaled \$1.6 billion (CAD) in July, down from \$2.2 billion (CAD) in June, but up from the \$473 million (CAD) recorded in July 2010. Government revenues were \$200 million (CAD) lower in July on a year-over-year basis. The Finance Department stated: "Lower revenues in July reflected a 12.8% drop in corporate tax payments, as well as a 13.9% decline in excise taxes and duties. Revenue from the goods and services tax fell by 13.4% from July 2010. Meanwhile, program expenses in July rose by \$800 million (CAD) and public debt charges rose by \$100 million (CAD) to \$2.78 billion (CAD)."
- Front Page Headline, Wall Street Journal – "House is Gone, but Debt Lives on. American banks increasingly go to court and obtain 'deficiency judgments' against former homeowners when foreclosure sales of houses don't bring enough to cover the full amount of the mortgage."
- Front Page Headline, Wall Street Journal – "Stocks Slump as 3rd. Quarter Ends. Share prices declined into the close as the Dow Jones Industrial Average (DJIA) fell by 240.60 points, closing the quarter at 10,913.38. The session also capped the Dow's 5th. consecutive monthly drop, the longest since the six months ending in February 2009."
- In a new report, the U.S. Securities and Exchange Commission (SEC) suggests: "the ratings industry remains plagued by lax controls. Our examiners have identified concerns at each of the 10 rating firms, including the three biggest: Standard & Poors (S&P), Moody's Investors Service and Fitch Ratings – a unit of Fimalac SA of France. Each of these firms have made changes to improve their operations since the financial crisis, however, despite these changes, we have identified apparent failures at every firm examined ... None of the specific problems highlighted in our report were deemed a material regulatory deficiency, but they could be in the future."
- Front Page Headline, Wall Street Journal – "Texas Bank is Closed; U.S. 2011 Failures at 74. Texas regulators close the First International Bank of Plano, bringing the nationwide tally of bank failures to 74 for the year. The Federal Deposit Insurance Corp. (FDIC) announced the bank was closed by the State's Department of Banking. The American First National Bank of Houston agreed to take over the failed bank and its seven branches, acquire all of the bank's deposits and purchase substantially all of its assets. The FDIC estimates that the cost of the failure to the Deposit Insurance Fund will reach \$53.8 million (U.S.)."
- Front Page Headline – "World Is Heading for Great Stagnation" – Goldman Sachs. "We believe there is a 40% chance of the current (economic) situation developing into a period of stagnation among developed countries. Stagnations typically mean long periods of sluggish (GDP) growth, low inflation, rising unemployment, stagnant house prices and lower returns on equities. Trends in Europe and the U.S. are so far still following (economic) growth paths that would be typical of stagnation. Looking at 150 years of macroeconomic history, we found that the probability of (economic) stagnation is much higher following financial crises. Given those risks, whether America and Europe manage to avoid a 'Great Stagnation' by a pick-up in (economic) recovery, is likely to depend upon policy being able to restore confidence and putting in place reforms that can decisively jolt (economic) growth."

At Longwave Analytics, looking at the same period of macro-economic history, we believe that Goldman Sachs is much too optimistic in its economic outlook. Rather than envisioning the global economy to meander sideways, in the current economic winter cycle we foresee severe declines in gross domestic product into a state of depression; fuelled by mountainous burdens of ever-expanding sovereign debt which will never be repaid. We also foresee a staggering number of pension promises and entitlement guarantees which will never be honoured. We anticipate a period of deflation ensuing, which will culminate in an unprecedented number of bankruptcies on the government, corporate and personal level.

CLOSING LEVELS FOR FRIDAY, SEPTEMBER 30TH.		WEEKLY CHANGE
Dow Jones Industrial Average	10,913.38	+ 141.90 points
Spot Gold Bullion (December)	\$1,622.30 (U.S.)	– \$17.50 per oz.
S&P / TSX Composite	11,623.84	+ 160.97 points
10-Year U.S. Treasury Yield	1.92%	+ 9 basis points
Canadian Dollar	95.40 cents (U.S.)	– 1.74 cent
U.S. Dollar Index Future (Spot Price)	78.796 cents	+ 0.495 cent
WTI Crude Oil (November)	\$79.20 (U.S.)	– \$ 0.65 per barrel

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