

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



Monday, October 15th
The Commerce Department reports U.S. retail sales rose by a seasonally adjusted 1.1% in September, citing strong sales of automobiles, electronics and school supplies

Monday, October 15th

- Front Page Headline, Reuters News – **“Germany Softens Stance on Greece.** After visiting Greece last week, Chancellor Angela Merkel has adopted a more conciliatory approach towards Greece. Indeed, at a meeting of business leaders in Singapore yesterday, German Finance Minister Wolfgang Schaeuble stated: ‘Greece will not declare bankruptcy.’ At a news conference with Panama’s President Ricardo Martinelli, Ms. Merkel remarked: ‘I am in total agreement with Mr. Schaeuble and I am ruling out any steps – including a Greek insolvency or euro zone exit – which might unleash uncontrollable developments within the European Monetary Union.’ **At Longwave Analytics, we believe Ms. Merkel fears potential German bank losses on Greek debt.**
- The Federal Reserve Bank of New York reports its regional manufacturing index – also called the Empire State index – rose to a reading of minus 6.2 in October from a level of minus 10.4 in September, the lowest reading since April 2009. The index reflects manufacturing activity in New York State, northern New Jersey and southern Connecticut. Separately, the gauge measuring the six-month outlook by factory executives declined to a reading of 19.4 in October from a level of 27.2 in September.
- Front Page Headline, Reuters News – **“The Next Six Months Are Critical for Governments to Act: IMF / World Bank.** The Tokyo weekend meetings of the International Monetary Fund and the World Bank sounded a clear warning that global economic growth is slowing under the weight of substantial financial uncertainties. These uncertainties stem from how quickly European leaders will act to authorize a bond purchase plan by the European Central Bank (ECB) and whether the United States will overcome political divisions to avoid a ‘fiscal cliff’ of higher taxes and deep government spending cuts in January 2013. In a Reuters’ interview, IMF Deputy Managing Director Nemat Shafik stated: ‘It is our job to speak the inconvenient truths when they need to be spoken and put the numbers on the table and make objective recommendations in terms of what needs to be done. The challenge now is the politics of implementation. To prevent a deep downturn in the global economy represents the same challenge for Europe, the United States and emerging markets.’



German Chancellor Angela Merkel

Source: Reuters

- In its Autumn Business Outlook survey, the Bank of Canada states: “Canadian corporate leaders have tempered their expectations for business activity. Firms are generally more circumspect about near-term investment decisions and are focusing on minimizing costs, since little change is expected in the pace of sales growth over the next 12 months. The balance of opinion on investment remains positive but has declined, as many firms report shifting their focus towards more intensive use of existing capital over the near term. Hiring plans are also less widespread than indicated in the bank’s previous survey.”
- Front Page Headline, Reuters News – **“EU’s Nightmare Crisis Pushing Europe into Lasting Depression: Soros.** At a New York luncheon hosted by the National Association for Business Economics (NABE), fund manager George Soros warned: ‘There is a real danger that the nightmare euro (sovereign debt) crisis could destroy the European Union (EU), so Germany should either take steps to remedy the situation or exit the currency union altogether. The crisis is having a tremendous impact in the state of affairs and it is pushing the EU into a lasting depression, which is entirely self-inflicted ... The notion that government credits are riskless is the main false assumption underlying the euro zone. The sovereign debt problem could be corrected by introducing Eurobonds, but that has become politically unacceptable to Germany.’”
- Front Page Headline, Daily Telegraph U.K. – **“French Investors Flee Rocketing Tax Rates.** In an interview with Le Figaro, Laurence Parisot, President of the Mouvement des Entreprises de France (MEDEF) – the French employers’ federation – exclaimed: ‘The situation is very serious. Some business leaders are in a state of quasi-panic. The pace of bankruptcies has accelerated over the summer. We are witnessing a general loss of confidence by investors. Large foreign investors are shunning France altogether. It’s becoming really dramatic. Let’s be clear, Article 6 is not acceptable, even if modified. We will not be complicit in a disastrous economic mistake.’ The immediate bone of contention is Article 6 of the new tax law, which raises the top rate of capital gains tax from 34.5% to 62.2%. This compares with 21% in Spain, 26.4% in Germany and 28% in Britain. An alliance of private organizations in France has issued a protest entitled ‘State of Emergency for Business’, warning that confiscatory tax rates threaten lasting damage to the French economy.’”



French President Francois Hollande and sentry

Source: EPA

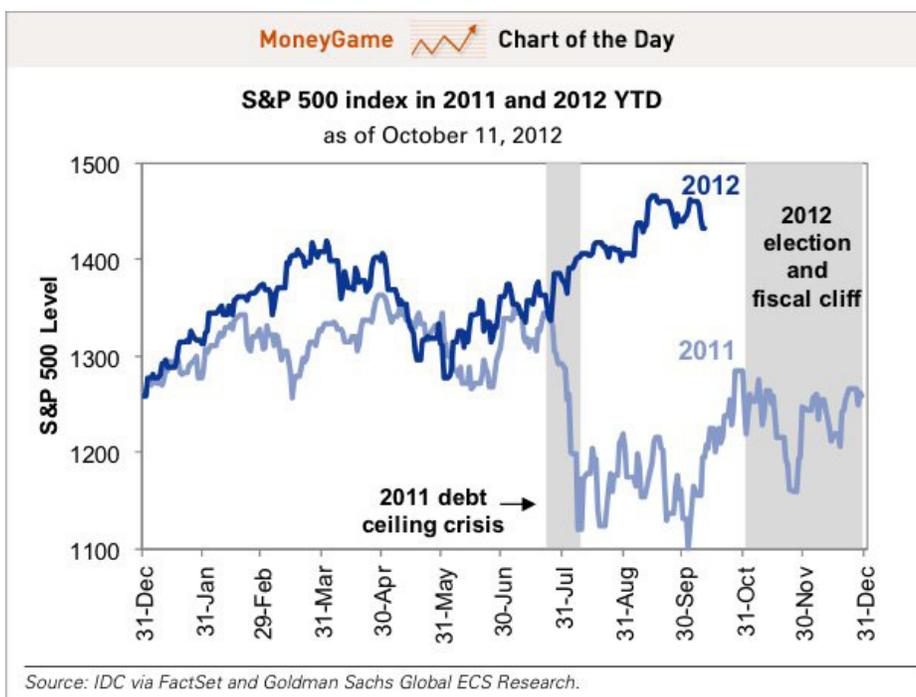
- Front Page Headline, Business Insider – **“Brinkmanship Will Send Stock Prices Right over the Fiscal Cliff.** Goldman Sachs’ equity strategy team, led by David Koskin, is convinced that the S&P 500 stock index will sink to 1,250 points by the year end from the current 1,440 point level, a decline of 13.2%. Koskin’s group thinks the fiscal cliff debate could unfold like last year’s statutory debt ceiling debate. ‘Budget forecasts in the spring of 2011 clearly indicated that the federal (statutory) debt ceiling would be reached by early August. All (during) spring and early summer, market participants assumed (that) Congress would raise the debt limit before the ceiling was reached. Although Congress ultimately voted to raise the debt limit, a default on U.S. Treasurys was only averted at the final hour. As the debate intensified, the S&P 500 plunged by 17% between July 25th. and August 8th. The convoluted resolution prompted Standard & Poor’s to strip the U.S. of its AAA sovereign (debt) credit rating. Some investors believe that last year’s debate was unique because many in the Congressional class of 2010 were elected under the ‘tea party’ banner on the promise to limit the size of the national debt. However, the dynamics are actually similar because both debates involve date-specific deadlines which encourage brinkmanship.”

Death of Equities?

Last week marked the biggest weekly outflow from stock funds in 2012



Source: Investment Company Institute



Source: IDC via FactSet and Goldman Sachs Global ECS Research.

Tuesday, October 16th

- Statistics Canada reports the nation's manufacturing sales rose by 1.5% in August from July, citing gains in automobiles and primary metals; as well as in the coal and petroleum sectors. In a research note to clients, Mazen Issa, a strategist at TD Securities commented: "We would fade the headline strength in manufacturing sales, since this number could be revised lower by Statscan. Moreover, set against the backdrop of weak foreign demand, the prospects for a robust rebound in manufacturing activity over the balance of the year are dim."
- The National Association of Homebuilders/Wells Fargo U.S. sentiment index rose to a reading of 41 in October, up from a level of 40 in September, the highest reading since June 2006
- Front Page Headline, Globe and Mail – **"World Faces Dangerous Economic Cocktail: OECD.** At a New Delhi conference, Angel Gurría, President of the Organization for Economic Co-operation and Development warned: 'Leading economic indicators for the 34-nation body point to weakening growth in the coming quarters for most major economies. The world has a problem of high unemployment, especially among youth; growing inequalities between rich and poor; and low economic growth – in some cases contracting growth. Some 50 million people are unemployed in OECD countries, which is 15 million more than in 2008. The gap between rich and poor is now at its widest in 30 years, with governments facing a loss of confidence in their ability to deal with boosting economic growth, tackling sovereign debt and stabilizing the financial sector.'
- Front Page Headline, Daily Telegraph U.K. – **"Germany Shocks EU with Fiscal Overlord Demand.** On a flight from Asia to Europe, German Finance Minister Wolfgang Schäuble informed German journalists: 'There must be a European Union (EU) currency commissioner with sweeping powers to strike down national budgets and to be feared around the world, implying a large step toward fiscal union and yet another EU treaty. When I put forward such proposals, you can take it as a given that Chancellor Merkel agrees.' One EU diplomat in Brussels reacted: 'If that is the demand, the Germans are not going to get it. Nobody in the council wants a new treaty right now. We've got the fiscal compact and quite enough fiscal discipline. Not even the Dutch want a commissioner telling them how to tax and spend.' **Wakeup call for Mr. Schäuble and Ms. Merkel: With your 'save the euro at any cost' agenda, will you have the support of the German electorate next September?**



German Finance Minister Wolfgang Schäuble

Source: Reuters News

Wednesday, October 17th

- The Commerce Department reports U.S. housing starts increased by 15% to an annualized pace of 872,000 in September, the fastest since July 2008. Building permits also registered a hefty gain of 11.6% to an 894,000 annualized rate.
- The National Bureau of Statistics reports China's gross domestic product (GDP) grew by 7.4% in the 3rd. quarter on a year-over-year basis, following a 7.6% growth rate in the 2nd. quarter, citing weaker export demand, slowing domestic investment and lower household spending. Israeli central banker Stanley Fischer commented: "A significant decline in China's GDP growth rate – impressive as it is even after the decline – still has a dramatic impact on global growth which, to put it mildly, is anemic."
- According to the latest Re/Max Commercial Investor Report, demand for commercial properties remained buoyant in major Canadian markets during the first half of the year, citing an increase in commercial sales and dollar volume in Greater Vancouver, Calgary, Regina, Edmonton, Winnipeg, London, Greater Toronto, Ottawa and Halifax-Dartmouth.



Downtown Vancouver, British Columbia

Source: Brent Lewin / Bloomberg News

Thursday, October 18th

- The Philadelphia Federal Reserve reports its U.S. business activity index – which covers the mid-Atlantic region rose to a reading of 5.7 in October following a level of minus 1.9 in September. In a note to clients,

Peter Boockvar, a portfolio manager at Miller Tabak in New York commented: "We must see more manufacturing surveys over the next few weeks to gauge any new trend different than the rather lackluster activity witnessed in manufacturing over the past four months."

- Front Page Headline, Globe and Mail – **"Violence Erupts In Athens Demonstrations.** Thousands of Greeks take to the streets of Athens in a demonstration marred by violence, with protestors demanding Greece's government cancel plans to appease international creditors with more spending cuts and tax increases. Many demonstrators waved banners imploring the government to 'Stop the Measures Driving Us into Poverty.' Upwards of 40,000 people participated in the demonstration, which was linked to a 24-hour general strike that brought much of Greece to an economic standstill. Minor clashes erupted as hooded youths hurled gasoline bombs and rocks at police, who responded by firing tear gas and stun grenades at the protestors."



Greek riot police attempt to avoid gasoline bombs hurled by protestors in Athens.

Source: AP

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 46,000 to a seasonally adjusted 388,000 in the week ended October 13th. while continuing claims fell by 29,000 to 3.252 million in the week ended October 6th.
- Front Page Headline, Financial Times – **"Fiscal Cliff Overshadows White House Race.** Business tensions over the looming 'fiscal cliff' prompts a group of top Wall Street executives – including Jamie Dimon of JP Morgan, Lloyd Blankfein of Goldman Sachs and Michael Corbat of Citigroup – to send a letter to the U.S. Congress and President Obama, urging them to reach an agreement: 'At a time when U.S. gross domestic

product (GDP) growth is less than 2%, and with nearly 25 million Americans either out of work or underemployed, the still-fragile U.S. economy cannot sustain – and the American people do not deserve – the impact of more (political) gridlock in Washington.” **See also, Economic Winter, The Looming American Fiscal Cliff Crisis – June 15, 2012.**

Friday, October 19th

- The National Association of Realtors reports U.S. existing home sales fell by 1.7% to a 4.75 million annual pace in September, citing a declining inventory of homes for sale, as the median price of an existing home rose by 11.3% on a year-over-year basis
- Front Page Headline, New York Times – **“Moody’s Warns of Weakness in German Banking Sector.** In a new report, which reaffirmed the negative outlook it has assigned to German banks since 2008, Moody’s Investors Service warns: ‘Intense competition and low interest rates are causing margin pressure that will likely further erode already weak bank revenues and profits. The combination of low profits and high leverage will make it difficult for many German banks to cope with major (unforeseen) losses. The long-standing structural weaknesses of the banking industry have not changed.’”
- Front Page Headline, New York Times – **“Germany Refuses ESM Aid to Banks.** At a news conference following a summit meeting of European leaders, German Chancellor Angela Merkel makes it clear that Germany stands among the EU countries unwilling to allow any bailout money to flow directly from the newly formed European Stability Mechanism to troubled European banks any time soon. Ms. Merkel denied that one of her goals at the meeting had been to block the prospect of any new German-financed bailouts before the general elections next September.” **Difficult to believe, Madam Chancellor; very difficult to believe.**

CLOSING LEVELS FOR FRIDAY, OCTOBER 19TH

WEEKLY CHANGE

CLOSING LEVELS FOR FRIDAY, OCTOBER 19TH		WEEKLY CHANGE
Dow Jones Industrial Average	13,343.51	+ 14.66 points
Spot Gold Bullion (December)	\$1,724.00 (U.S.)	– \$35.70 per oz.
S&P / TSX Composite	12,415.98	+ 213.94 points
10 - Year U.S. Treasury Yield	1.76%	+ 10 basis points
Canadian Dollar	100.68 cents (U.S.)	– 1.43 cents
U.S. Dollar Index Future (Spot Price)	79.626 cents	– 0.055 cent
WTI Crude Oil (November)	\$90.44 (U.S.)	– \$1.42 per barrel

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