UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, August 12th

Headline, The Telegraph - **Victims of Greek Bailout Get Chance of Class Action.**

Monday, August 12th

“Aggrieved investors who lost tens of billions of euros in Greece’s bailout are being given the chance to bring class actions in American and Europe after a landmark deal between two US law firms.”

“Grant and Eisenhofer, one of the US’s top law firms, has struck an alliance with Boston-based Kyros Law to help investors pursue cases both within Greece and elsewhere.”

The lawsuit stems from the official Private Sector Involvement deal, which was aimed to cut Greece’s public debt by 110bn euros by selling Government debt to the public, but these investors took a 53.5% haircut in 2012 in the re-structuring of all Greek government debt.

- Headline, Globe and Mail - **After Decades of Loosening Mortgage Credit, Ottawa Tangled in a Mess of its Own Making.** “It’s getting hard to keep track of how many times the federal government has tried to lasso the galloping housing market.”

“The latest is a move by Canada Mortgage and Housing Corp., a federal Crown corporation, to limit the guarantees it offers banks on their mortgage-backed securities.”

By the end of July lenders (principally the banks) had used up almost 80% of this year’s available guarantee.

“But the episode highlights a troubling upshot of the real estate boom.”

“The Federal government had a major role in stoking the rapid expansion of mortgage credit in Canada. Now, as the long fueled rush into real estate appears to be stalling, taxpayers could be stuck with a large and unexpected bill.”

30% of Canadian mortgages were insured by the Federal government in 1988, but that number is now 75%, equaling $900 billion. This $900 billion exposure is 33% greater than the total Federal government debt of $676 billion.

Long Wave Analytics believes that the Canadian housing bubble is just at the beginning stage of bursting. The price, as a result of aggressive encouragement of home ownership by successive Canadian governments, will result in a huge cost to Canadian taxpayers.

- Headline, The Telegraph - **"European Banks Need to Sell £2.8 ($4.3 Trillion) in Assets."** This is required to meet Basel 111 regulations by 2018.

  According to the Bank of Scotland, a government owned entity and still in a precarious position, the majority of this amount will need to be cut from smaller European banks, which likely means another contraction in lending to small and medium size businesses.

  However, Europe's largest banks will have to reduce their assets by $860 billion and raise another $60 billion of capital to meet the new standards. The Royal Bank of Scotland contends that Barclays, UK, Credit Agricole, France and Germany's Deutsche Bank have the greatest requirement for fresh capital. Not surprisingly we are hearing that these three mega banks are in the deepest hole.

- Commenting in The Telegraph, Jeremy Warner, Assistant Editor, writes, "So you think Europe's debt crisis is finally over? Time to think again." **We whole-heartedly concur. Yes we know that the European politicians are trumpeting a return to growth, but that's what they have to do. And even if there is some slight uptick in growth, how can it be sustained?**

  According to the IMF structural unemployment is now at 10.1% versus the 7.4% pre-crisis. In Spain, the prime minister, Mario Rajoy, is trying to divert his citizens attention away from his own personal impropriety and the dismal economy, by teaming up with Argentina against Britain's sovereign interests. As Mr. Warner writes, "Desperation indeed, seeing that many of his dispossessed army of unemployed seem to be over here in Britain, enthusiastically manning the counters at Pret a Manger and most other London-based fast food chains."

  "Portugal, where imposed austerity programmes have backfired spectacularly, looks in even worse shape (than Spain). Nearly a quarter of sovereign debt has to be refinanced next year, with the government clinging to power only by the narrowest of majorities. Scarcely a week goes by without news of another ministerial resignation."

  And as for Greece, it is a basket case. Greek youth unemployment has reached a record 64.9% contributing to an overall jobless rate of 27.6% in May. The numbers are likely to increase as Athens fires 15,000 public sector workers by the end of September to comply with Troika demands.

  According to Ambrose Evans-Pritchard commenting in The Telegraph, "The IMF expects (Greek) public debt to spiral to 176% this year, and has warned EMU creditor states that they will have to provide substantial debt relief to put the country on a viable path." Mr. Evans-Pritchard quotes Professor Yanis Varoufakis from Athens University, "The manic attempt to keep Greece in the eurozone under conditions that are not sustainable is turning the country into a sort of Kosovo, an EU protectorate that produces little but surplus labour." And, "Nothing as devastating as this has ever been seen in my country before. The spirit of the Greek people has been broken. They've stopped demonstrating and are licking their wounds at home or leaving the country."

Tuesday, August 13th

- Headline, The Globe and Mail - **"Fairfax Leads Move to Buy Blackberry."** Fairfax Holdings a Canadian investment company led by Prem Watsa is looking to form a conglomerate to buy the troubled Canadian smartphone company. Fairfax owns 10% of Blackberry and Mr. Watsa was on the Blackberry board until his resignation yesterday to avoid criticism that he was in a conflict of interest.

- Headline, The Telegraph - **"BP Sues US Environment Agency Over Government Contracts Ban."**

  "BP has launched a legal challenge to the ban on winning new work for the US government, claiming it faces a "substantial threat of irreparable harm unless the restriction is lifted."

The April 2010 disaster killed 11 men. Source: EPA

The US Environmental Protection Agency (EPA) placed the ban on BP in November last year after the company pleaded guilty to criminal charges related to the Gulf of Mexico disaster, which killed 11 men and spewed millions of barrels of oil, which resulted in the worst offshore spill in US history.

BP thought that the EPA ban would be temporary, but in February the EPA issued a “mandatory debarment” against BP Exploration and Production’s Houston headquarters.

BP has now sued the EPA, demanding that the ban be lifted alleging that “the suspension is unlawful, arbitrary, capricious, and an abuse of EPA’s discretion” and contends it “faces a substantial threat of irreparable harm if the injunction is not granted.”

BP is one of the largest fuel suppliers to the US government, primarily the military, with contracts worth more than $1.34 billion.

BP also has more than 700 oil and gas exploration blocks in the Gulf of Mexico, which are not affected by the ban.

“The move against EPA adds yet another strand to the ever-growing web of litigation in which BP is embroiled over the Gulf disaster.”

“The company is still on trial over civil penalties and could face fines of more than $17bn under the Clean Water Act—compared with $3.5bn it has budgeted—if it is found grossly negligent, a charge it denies.”

“It is also battling to stem payouts under the compensation settlement it struck last year with businesses who say they lost money in the spill. BP says many of the payouts are for ‘fictitious’ losses.”

“The cost has risen from an original $7.8bn estimate to $9.6bn and is this quarter expected to use up the remaining $300m BP has set aside, pushing the total bill for the disaster above $42.4bn.”

- Global Research Article - The Bi-polar World of Rich Bankers. Wall Street 'Take-Off' 2012-2013, by Professor James Petras.

  "On July 16, 2013, Goldman Sachs, the fifth largest US bank by assets announced its second quarter profits doubled the previous year to $1.93 billion. J. P. Morgan, the largest bank made $6.1 billion in the second quarter up 32% over the year before and expects to make $25 billion in profits in 2013. Wells Fargo, the fourth largest bank, reaped $5.27 billion, up 20%. Citigroup's profits topped $4.18 billion, up 42% over the previous year,

  The ruling elite, the financial CEOs pay is soaring; John Stumpf of Wells Fargo received $19.3 million in 2012; Jamie Dimon of J. P. Morgan Chase pocketed $18.7 million and Lloyd Blankfein of Goldman Sachs took $13.3 million.

  The Bush-Obama Wall Street bailout has resulted in the deepening financialization of the US economy: Finance has displaced the technology industry as the profitable sector of the US economy. While the US economy stagnates and the European Union wallows in recession and with over 50 million unemployed, US financial corporations in the Standard and Poor 500 index earned aggregate profits of $49 billion in the second quarter of 2013, while the tech sector reported $41.5 billion. For 2013, Wall Street is projected to earn $198.5 billion in profits, while tech companies are expected to earn $183 billion. Within the financial sector, the most 'speculative sectors', i.e. investment banks and brokerage houses, are dominant and dynamic growing 40% in 2013. Over 20% of the S and P corporate profits are concentrated in the financial sector.

  The financial crash of 2008 - 2009 and the Obama bailout, reinforced the dominance of Wall Street over the US economy. The result is the parasitic financial sector is extracting enormous rents and profits from the economy and depriving the productive industries of capital and earnings. The recovery and boom of corporate profits since the crisis turns out to be concentrated in the same financial sector which provoked the crash a few years back."

- The US Department of Justice has moved to block the proposed merger between US Airways and American Airlines citing that the proposed merger would violate anti-trust laws and would lead to less competition and higher prices for consumers.

  AMR, American Airlines parent company, filed for bankruptcy protection in 2011 and a protracted legal battle at this time would likely place American Airlines back into bankruptcy.

Wednesday, August 14th

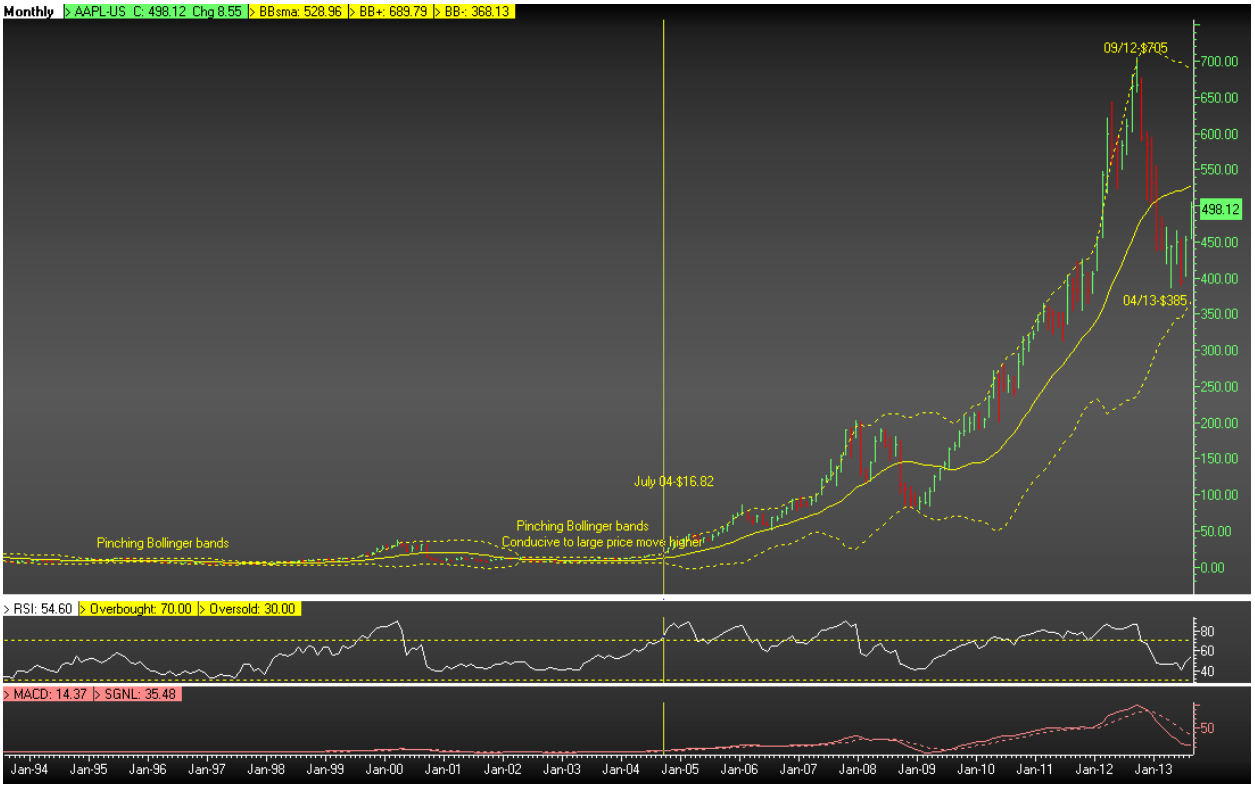
- Headline, Globe and Mail - **Icahn's big bet lifts Apple's stock.** Activist discloses investment, said to more than $1 billion worth of shares, and pushes CEO for larger buyback.

  "Activist Carl Icahn has thrown his weight behind dissatisfied Apple Inc. investors, taking up a large stake in the world's most valuable company."

  Mr. Icahn's involvement in Apple, which he disclosed via Twitter, lifted the company's stock and almost instantly created more than $12 billion (U.S.) in shareholder value."

  "'The market pays attention when he takes positions', says Jeff Fidacaro, senior technology analyst at Monness Crespi Hardt in New York. 'When he identifies value he becomes very aggressive trying to realize that value.'" (see chart on following page)

AAPL - Monthly chart



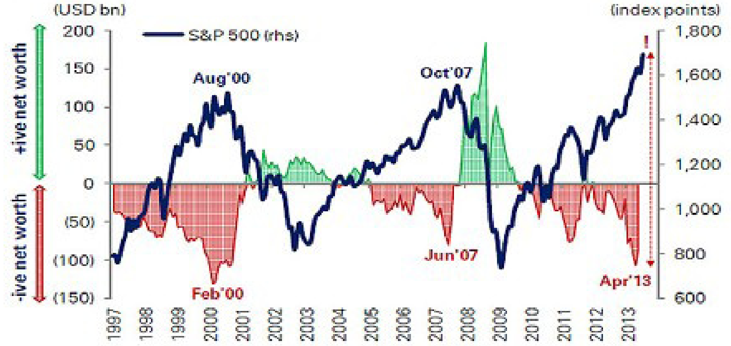
Source: Thomson Reuters

- The Telegraph, **"Investors Euphoric as US Margin Debt Reaches 'Danger' Levels.** Fund Managers Around the World are Gripped by Euphoria, Convinced that America is in Full Recovery and Europe Has Overcome its Debt Crisis." By Ambrose Evans-Pritchard.

"Bank of America's monthly survey of investors showed a dramatic rise in confidence in August, with a net 72pc expecting growth to accelerate over the next year. It is the highest reading since 2009."

Almost everybody expects bond yields to rise as deflation fears evaporate, with just 3% still worried about the risk of an economic relapse. Managers have slashed their bond allocation to a 28-month low.

Figure 1: Investors' credit balance* (lhs) vs. the S&P500



*Credit balance = Free Credit Cash Accounts + Credit Balances in Margin Accounts – Margin Debt.
Source: NYSE, Deutsche Bank

“The Survey is watched by veterans as a ‘contrarian indicator’, tracking herd mentality at key moments. Michael Hartnett, the bank’s investment strategist, advised clients to take the opposite trade and buy US Treasury bonds.”

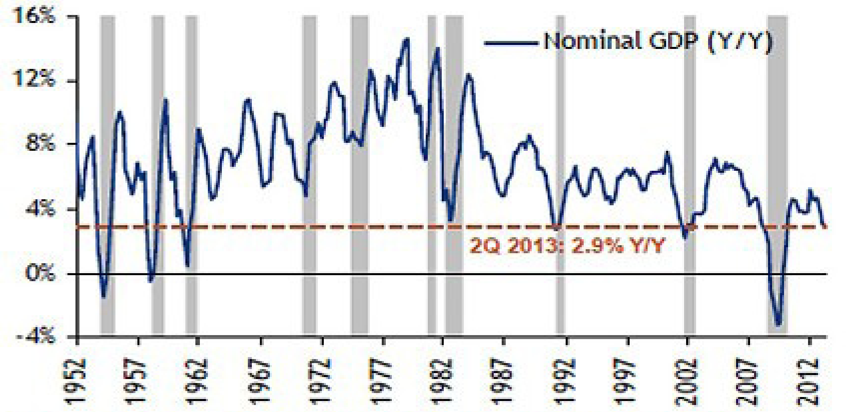
“The exuberant mood comes as margin debt on Wall Street hovers near $377bn, just below its all-time high and well above the peaks before the dotcom crash and the Lehman crisis.”

“‘Investors have rarely been more levered than today,’ said Deutsche Bank, warning that the spike in margin debt is a ‘red flag’ and should be watched closely.”

“The bank described this form of debt as ‘a tool used by stock speculators to borrow money from brokerages to buy more stock than they could otherwise afford on their own. If the stock rises, they end up making more money. If the stock crashes the opposite materializes. This kind of speculation is highly alarming.’”

“The bank warned that forced sales of stock can set off panic and a rush for the exits, snowballing into a crash, as happened in 1929. It said that the equity rally may have further legs but it cited ‘astonishing similarities’ between the latest patterns and events preceding prior market crises.”

Chart 1: Nominal GDP growth over the past year was slowest ever recorded outside of a recession



Note: shaded areas denote NBER recessions. Source: BofA Merrill Lynch Global Research, BEA

“Andrew Lapthorne from Society Generale said the rush to leverage is a classic sign of a credit cycle near exhaustion. ‘Profits have been along at stall speed just as in 2006 and 2007, and just like then people are resorting to leverage to squeeze out the last dime,’ he said.”

“Mr. Lapthorne said a new twist is that US profits have begun to stall as well, with cash flow growth falling from double digit rates to zero”

“He said the rise in margin debt is matched by a leveraged excess across the system, with debt-driven buy-backs of corporate shares running at a $400bn annual rate. Leveraged buy-outs are back in vogue. Junk bond yields are near record lows.”

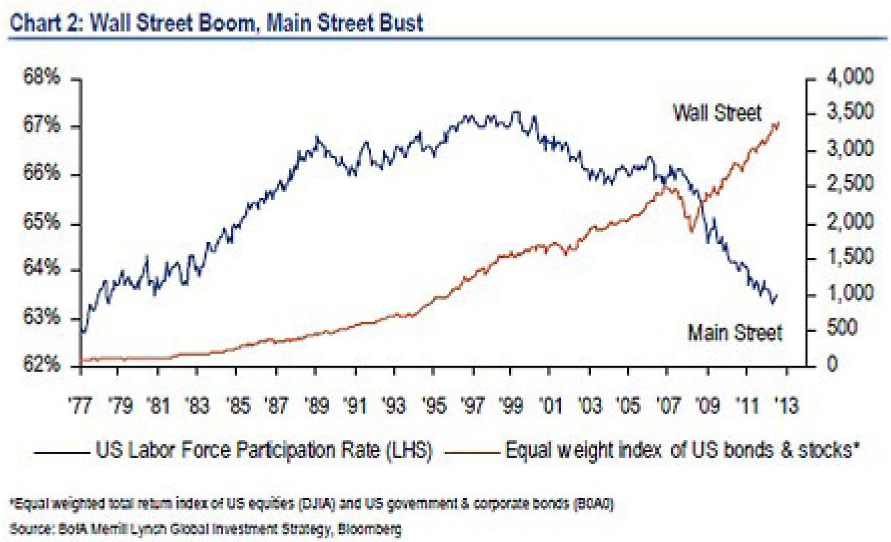
“‘When everybody is jumping up and down and partying, that is the time to worry. Once the market turns nasty we could see a negative feedback loop. Debt is always a killer in the end,’ he said.”

“Investors are betting the US Federal Reserve is about to taper bond purchases for health reasons, because the US economy is strong enough to stand on its own feet.”

“The counter-view is that the Fed is tightening for ‘unhealthy’ reasons, because it has taken to heart warnings from the Bank of International Settlements about the dangers of excess leverage and a fresh asset bubble.”

“‘The Fed is actually acting out of anxiety. They are trying to package this in cotton wool, telling us everything is alright, but we don’t think the US economy has reached escape velocity,’ said Mr. Lapthorne.

“Bank of America said there has been a dramatic divergence between ‘Main Street’ and ‘Wall Street.’ While the US economy has grown by $1.3 trillion since 2009, the US stock market has added $12 trillion.”



“The bank said nominal GDP growth over the past four quarters has been the slowest ever recorded outside a recession. This would not normally be the circumstances when the Fed took away the punchbowl and tightened credit.”

While the eurozone appears to have stabilised, this falls short of a recovery and is too little to stop the debt trajectories of southern Europe rising further. The worry is that investors have already pocketed the gains of a cyclical expansion that does not exist. ‘While the tail risk is diminished, it is not dead. Expect the unexpected,’ said Bank of America.”

We have an online subscription to The Telegraph and recommend this newspaper to our readers.

- Javier Martin-Artajo, who previously supervised the trading strategy at JP Morgan’s London office and one of his ex-employees Julien Grout have been charged by US prosecutors with attempting to conceal losses and falsify records related to the bank’s $6.2bn trading loss last year.

  In a parallel lawsuit filed in New York, the SEC accused the defendants of scheming to enhance the apparent performance of the SCP so as to curry favour with their supervisors and increase their chances for promotion and additional bonuses.

  Bruno Iskil, who executed the trades and has been called the ‘London Whale’, because of his massive trading positions, has been granted immunity from prosecution in return for his cooperation with the authorities.

Thursday, August 15th

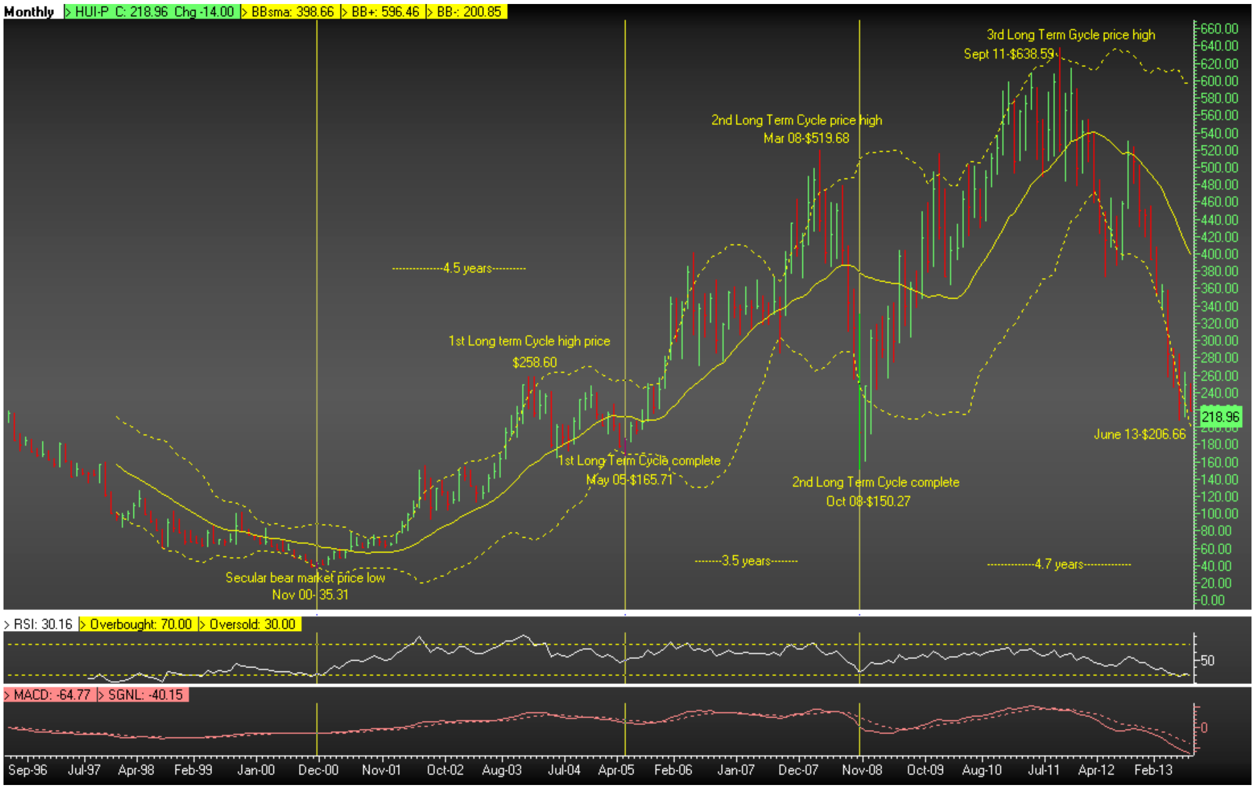
- According to the World Gold Council demand is moving strongly from West to East. Demand in India and China is expected to account for 45% to 50% of the total gold market by the end of 2013. Each country is expected to achieve an equivalent demand of 900 to 1000 tonnes. The previous record demand in China was 776 tonnes. Year to date these two countries have increased their gold demand by 45% to 50% and according to Marcus Grubb of the Gold Council, “They are remarkably close together; they are still within about 35 tonnes of each other, which is very similar to where they were in the first half of last year, in spite of being 50% larger this year.”

Conversely, the amount of gold held by ETF's predominately in the US fell by 400 tonnes.

"The takeaway for me is that this gold is heading mainly eastward and is heading into strong hands," Grubb says, adding, "it also represents a perfect example of consumers' recognition around the world that gold is below fair value and its equilibrium price and moving in to absorb the gold that was put into the market from the redemptions from the ETFS."

In a Special Edition of Ian's Investment Insights, which is scheduled to be published on Friday August 23rd, I will be showing this chart, which displays the Long Term Cycles within the Secular gold stock bull market, which commenced in May 2000. The point being, is that I can tell you with a high degree of confidence that the 4th Long Term Bull market for precious metals and precious metals shares has started, effective the end of June 2013. What this means is that over the next 2 – 2 ½ years the price of gold and the prices of gold equities will reach record highs.

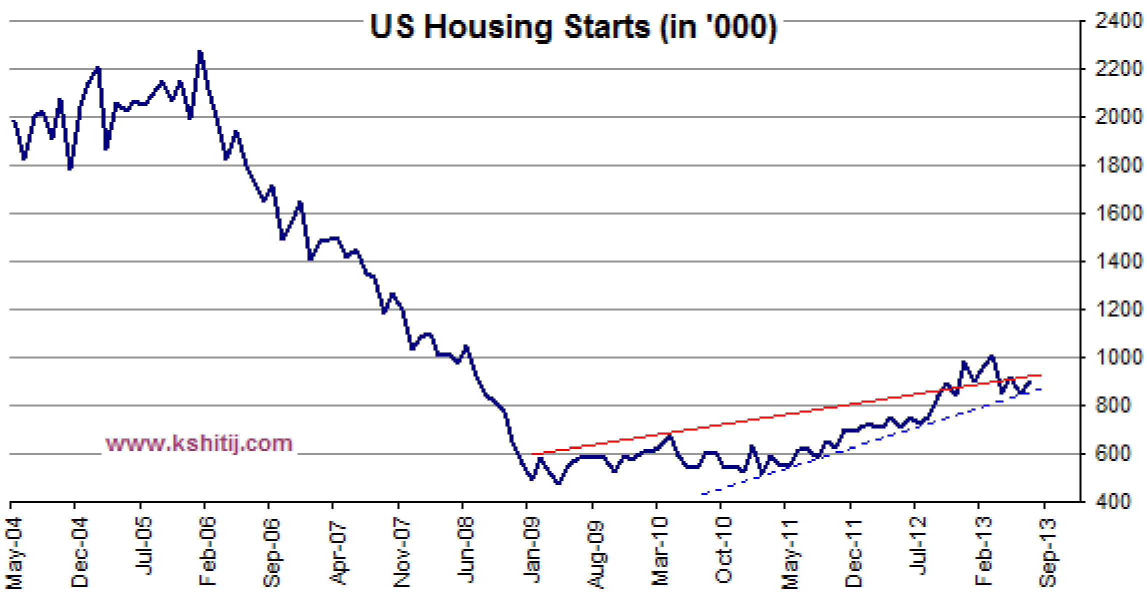
HUI Gold Bugs Index, Monthly chart



Source: Thomson Reuters

Friday, August 16th

- "July housing starts reporting remained consistent with the renewed business downturn starting in second-quarter 2013. Despite the usual lack of statistical significance in the month to month changes in the housing starts activity, aggregate patterns of monthly reporting suggest that the slight uptrend seen in the stagnation and bottom-bouncing of the last four years (total housing starts and single-unit starts) hit a relatively near-term peak in first-quarter 2013. Activity then turned to contraction, as of second- quarter 2013. Revised detail published with July's data showed second-quarter 2013 housing starts declined at an annualized pace of 31.1% versus first-quarter 2013. The difference between average second-quarter 2013 starts and July 2013 activity was statistically insignificant." John Williams, www.shadowstats.com



- Headline, The Globe and Mail - **"Home Sales Gaining Momentum in Canada**. More houses were sold last month than a year ago when Finance Minister Jim Flaherty changed mortgage rules."

  "For the first time in a year, the number of homes that changed hands over the Multiple Listing Service last month came in higher than one year earlier driven by rebounding markets in Vancouver and Toronto."

  "The gains are partly due to the fact that last month's sales are being compared with a weaker market. It was in July, 2012, that sales plunged after Finance Minister Jim Flaherty changed the rules, cutting the maximum length of an insured mortgage to 25 years from 30." **That's obviously not a fair comparison.**

- Headline, Financial Times - **"Capital Battle backfires on The Rupee."**

  The Rupee, India's currency, sank to a record low and the stock market reached its lowest level in almost two years following the government's efforts to halt the flight of capital.

  "Investors have been shaken by a series of announcements from the reserve bank of India and the government designed to strengthen the currency, including rises on import duties on gold and the threat of higher tariffs on imported electronic goods." Financial Times

  "India's surprise decision to reimpose capital controls on local companies and individuals this week to protect the ailing rupee was prompted by warnings of an imminent surge in capital flight, according to senior policy makers in the capital." Financial Times

Monday August 12, 2013

CLOSING LEVELS FOR FRIDAY, August 16th		WEEKLY CHANGE
Dow Jones Industrial Average	15,081.47	- 344.04 points
Spot Gold Bullion (December)	$1,375.90 (U.S.)	+ $63.70 per oz.
S&P / TSX Composite	12,736.92	+ 194.79 points
10 - Year U.S. Treasury Yield*	2.829%	+ .31 %
Canadian Dollar	96.75 cents (U.S.)	+ 0.008 cent
U.S. Dollar Index Future (Spot Price)	81.290	– 0.164 cent
WTI Crude Oil (September)	$107.29 (U.S.)	– $1.32 per barrel

*** BEWARE: Rising Interest Rates**

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

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