LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, September 16th

• Front Page Headline, Daily Telegraph U.K. – **“Fed Chair Apparent Frontrunner Withdraws from Potential Appointment.**

Monday, September 16th

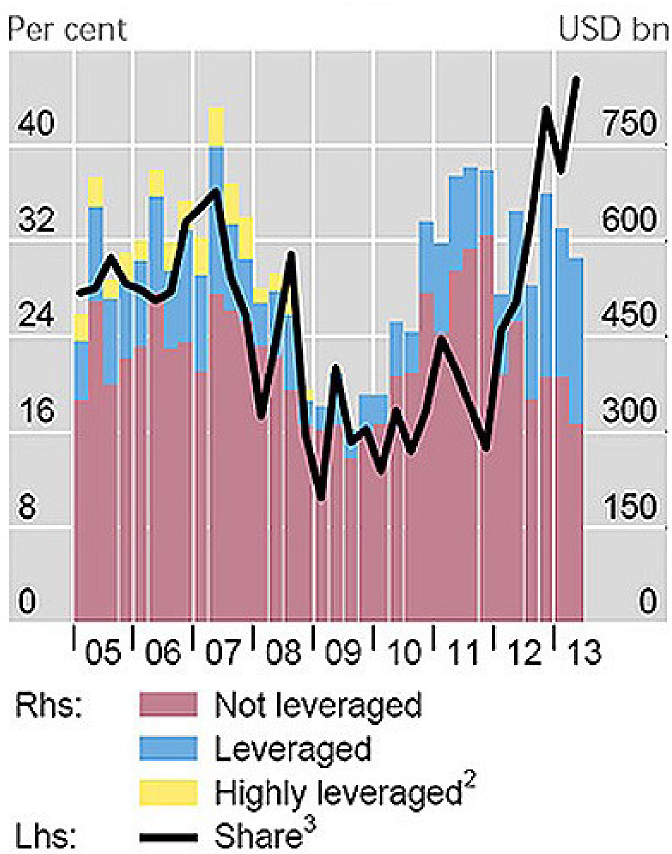
Former U.S. Secretary of the Treasury Larry Summers notifies President Barack Obama that he no longer wishes to be considered for the appointment of Chairman of the U.S. Federal Reserve: ‘I have reluctantly concluded that any possible confirmation process for me would be acrimonious and would not serve the interest of the Federal Reserve, the administration or, ultimately, the interests of the nation’s ongoing economic recovery.’ Mr. Summers’ surprise withdrawal appears to pave the way for the appointment of Janet Yellen, the Fed’s current Vice Chair. Ms. Yellen would become the first female leader of the central bank in its 100-year history.

Former U.S. Secretary of the Treasury Lawrence Summers. Source: Daily Telegraph U.K.

- The Federal Reserve reports U.S. industrial production rose by a seasonally adjusted 0.4% in August led by automobile manufacturers, while capacity utilization increased slightly to 77.8%. Production of motor vehicles and parts surged by 5.2%, following a 4.5% decline in July.

- The Canadian Real Estate Association (CREA) reports the nation's existing home sales rose by 2.8% in August from July. On a year-over-year basis, sales rose by 11.1% with nearly two-thirds of local markets across Canada posting sales gains.

- Front Page Headline, Daily Telegraph U.K. – **"Global Credit Excess Worse Than Pre-Lehman: BIS.** In its latest quarterly review, the Zurich-based Bank for International Settlements reports the hunt for yield is luring investors en masse into high risk instruments, 'a phenomenon reminiscent of exuberance prior to the global financial crisis. The issuance of subordinated debt—which leaves lenders exposed to bigger losses if things go wrong—has increased more than threefold over the last year to $52 billion (U.S.) in Europe and tenfold to $22 billion (U.S.) in America. The share of leveraged loans used by the weakest borrowers in the syndicated loan market has soared to an all-time high of 45%, ten percentage points higher than the pre-crisis peak in 2007-2008.' See Daily Telegraph chart below.

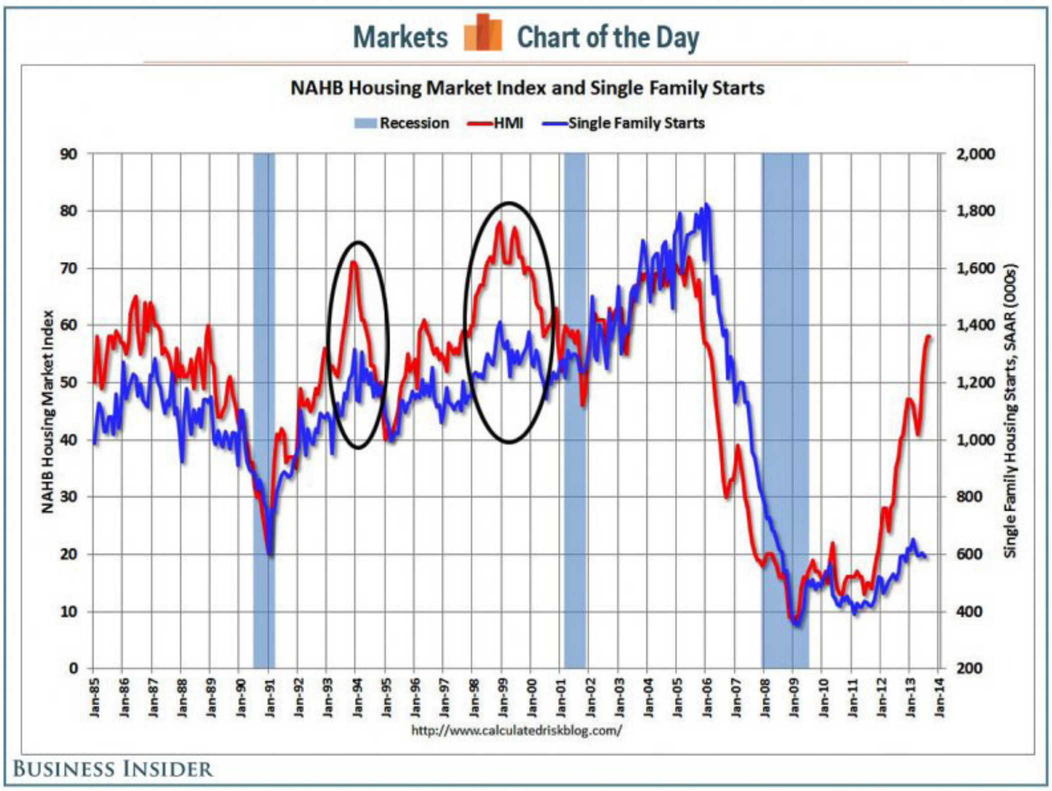


'Investors are snapping up covenant-lite loans that offer little protection to creditors, as well as form of hybrid capital for banks known as CoCos (contingent convertible capital instruments) that switch debt into equity if bank capital ratios fall too low. While CoCos help shield taxpayers from losses in a banking crisis by leaving private creditors with more of the risk, the recent appetite for such an instrument is also a warning sign. Interbank credit to emerging markets has reached the highest level on record, while the value of bonds issued in off-shore centres by private companies from China, Brazil and other developing nations exceeds total issuance by firms from rich economies for the first time, underscoring the sheer size of the debt accumulation in Asia, Latin America and the Middle East."

Tuesday, September 17th

- The Labor Department reports the U.S. consumer price index (CPI) rose by 0.1% in August, following an increase of 0.2% in July. Omair Sharif, an economist at RBS Securities in Stamford, Connecticut observed: “There’s still plenty of slack in the labor market and there isn’t very much in terms of wage inflation; so it’s not surprising that we’re seeing very little pricing power.”

- The National Association of Homebuilders/Wells Fargo reports their confidence index registered a reading of 58 in September—matching a revised reading for August—and the strongest level since November 2005. In a statement, David Crowe, the association’s chief economist noted: “Following a solid improvement in builder confidence over the past year, we are witnessing a pause in momentum as consumers become cautious; waiting to see where mortgage rates settle and as the headwinds of tight credit, shrinking inventories of lots for development and rising labor costs continue.”



- Statistics Canada reports the nation’s factory sales rose by 1.7% to $49.5 billion (CAD) in July. Robert Kavcic, an economist at the Bank of Montreal, commented: “We’re still awaiting the July results from wholesalers and retailers, but the bounce back in manufacturing sales suggests that a rebound in monthly real gross domestic product (GDP) growth is on track after a flood / strike plagued June.”

- Front Page Headline, Globe and Mail – **“SEC Charges 23 Institutional Investors for Short Sale Violations.** The U.S. Securities and Exchange Commission reports these investment firms / funds will collectively pay about $14.4 million (U.S.) in sanctions to settle civil charges in connection with a broad investigation by federal regulators into illegal short selling practices. Specifically, in a statement: ‘The SEC has issued these charges for violations of a rule which prohibits institutional investors from shorting a stock within a five-day window of a public offering and then covering the position via purchases in the new issue public offering.’ Canadian institutions among those settling the charges include Hudson Bay Capital Management and the Ontario Teachers’ Pension Plan.”

- Front Page Headline, Globe and Mail – **"Moody's Warns B.C. Against Impairing Finances on a Permanent Basis.** In its annual report for the Province of British Columbia, Moody's Investors Service stated: 'Due to the significant debt reduction achieved by the province over the last decade, B.C. faced the recent (economic) downturn with improved fiscal flexibility and has been able to absorb the recorded and anticipated increases in debt burden. With cash financing requirements expected over the next three years, the province's debt burden is expected to increase moderately to roughly 98% of revenues in 2015-16.' Jennifer Wong, Moody's lead B.C. analyst, elaborated: 'British Columbia—currently rated 'AAA' with a negative outlook—has a strong track record of meeting budget targets and will need to maintain this resolve and discipline to ensure that deficits arising from the recent economic downturn remain temporary and do not impair the province's finances on a permanent basis."

Wednesday, September 18th

- The Commerce Department reports U.S. housing starts rose by 0.9% in August to an annual pace of 891,000 units, following a downwardly revised annual rate of 883,000 units in July.

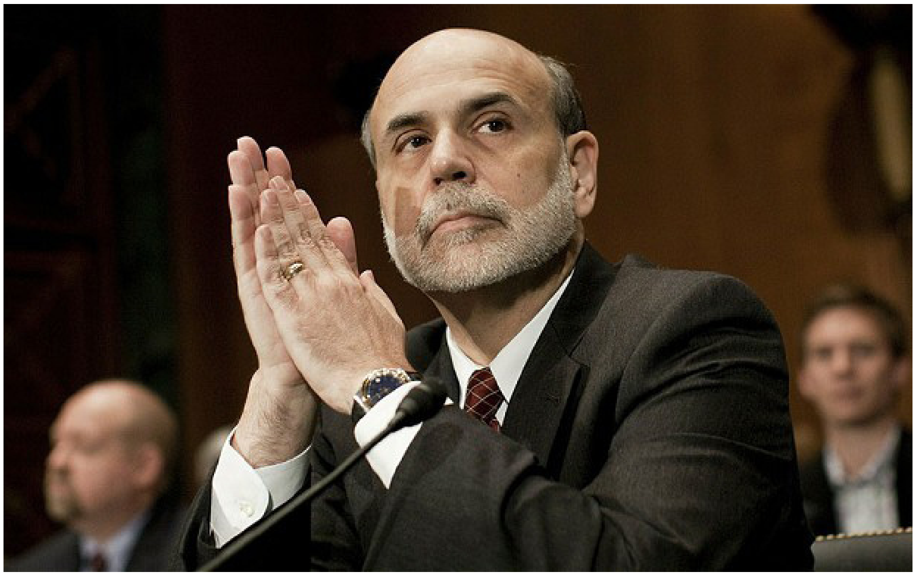
- Front Page Headline, Wall Street Journal – **"Greek Public Sector Begins Two-Day Strike.** Greek public servants begin a two-day walkout protesting job cuts required as part of the next European Commission (EC) bailout package. Teachers, doctors and court officials participated in the walkout on the streets of Athens which totaled about 10,000 demonstrators, according to police estimates. Tania Karagiannis, spokeswoman for the civil service union ADEDY remarked to the press: 'We are protesting against the government's continuing austerity policies that foresee layoffs in the public sector.'

High school student shout slogans in support of striking teachers. Source: AP

- Front Page Headline, Financial Times – **"Brussels Plans End to Self-Regulation of Market Benchmarks.** In the wake of the recent London Interbank Offered Rate (Libor) scandal, European Union (EU) Commissioner Michel Barnier unveiled the European Commission (EC) draft blueprint of new regulations covering thousands of benchmarks underpinning markets ranging from oil, rice, cocoa to credit indicies and mortgage rates and valued at more than 1 quadrillion euros. The EC blueprint goes further than any other international jurisdiction in ending self-regulation and places tight legal obligations on all those who compile and contribute to benchmarks. The proposal is published at a late stage in the Brussels legislative calendar. Mr. Barnier pared back some politically sensitive provisions with the aim of accelerating an agreement, but the reforms will be challenged to pass before the European Parliament closes for elections in March 2014.

- Front Page Headline, Daily Telegraph U.K. – **"FOMC Surprises Markets by Delaying QE Tapering.** Emerging from two days of meetings, the Federal Open Market Committee had been widely expected to outline the timetable for tapering its $85 billion (U.S.) monthly bond purchasing policy, currently employed to artificially stimulate growth in the American economy. However, it decided to leave the current monetary policy in place stating: 'Information received since the FOMC met in July, suggests that economic activity has been expanding at a moderate pace. Some indicators of labor market conditions have shown further improvement in recent months, but the unemployment rate remains elevated. Household spending and business fixed investment advanced and the housing sector has been strengthening; but mortgage rates have risen further and fiscal policy is restraining economic growth. Apart from fluctuations due to changes in energy prices, inflation has been running below the Committee's longer-run objective, but longer term inflation expectations have remained stable.

  To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee decided to keep the target range for the federal funds rate at 0 to 1/4% and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6 1/2 %."



U.S. Federal Reserve Board Chairman Ben Bernanke. Source: Getty Images

- Front Page Headline, Mish's Global Economic Trend Analysis – **"Move over Detroit: The Fiscal Crisis in Chicago Is Much Bigger.** Listed in point form:

  1. Municipal pensions are only 31% funded.
  2. Moody's downgrades Chicago's credit rating by 3 levels.
  3. Chicago's credit rating outlook on negative watch.
  4. Chicago's pension liability is $61,000 (U.S.) per household ($23,000 per capita)
  5. Chicago has lost more than 200,000 residents in the last decade
  6. Chicago's public services are faltering, especially in terms of education
  7. Chicago's crime rate is among the worst in the nation

  Chicago taxpayers are on the hook for more than $63 billion (U.S.) in pension, health insurance and other debt. That's the total debt of the City and its sister governments; as well as Chicagoans' share of Cook County debt.

Thursday, September 19th

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 15,000 to 309,000 in the week ended September 14th. from an upwardly revised 294,000 the prior week; while continuing claims declined by 28,000 to 2.79 million in the week ended September 7th. Those people who have exhausted their traditional benefits and are now receiving emergency or extended benefits from state or federal programs were unchanged at about 1.46 million in the week ended August 31st.

- The National Association of Realtors reports U.S. existing home sales rose by 1.7% in August to a 5.48 million annual pace, the most since February 2007, following a revised gain of 0.5% in July. Gus Faucher, an economist at PNC Financial Services Group in Pittsburg commented: "We should continue to see increases in home sales and prices, although not as strong as in August."

- Front Page Headline, Financial Post – **"Ottawa, B.C. and Ontario Agree to Establish Cooperative Capital Markets Regulator (CCMR).** The Government of Canada and the Provinces of Ontario and British Columbia pledge: 'to use their best efforts to follow a July 1, 2015 timeline' to commence operations of their newly proposed common securities regulator. To date, regional concerns over federal oversight, as well as constitutional issues, have blocked efforts by Canada's Finance Minister Jim Flaherty to create a Canadian equivalent of the U.S. Securities and Exchange Commission (SEC). The CCMR will be based in Toronto—the financial hub of Canada—and assume responsibility for overseeing common national rules."

B.C.'s Mike De Jong, Canada's Jim Flaherty and Ontario's Charles Sousa (L-R). Source: CP

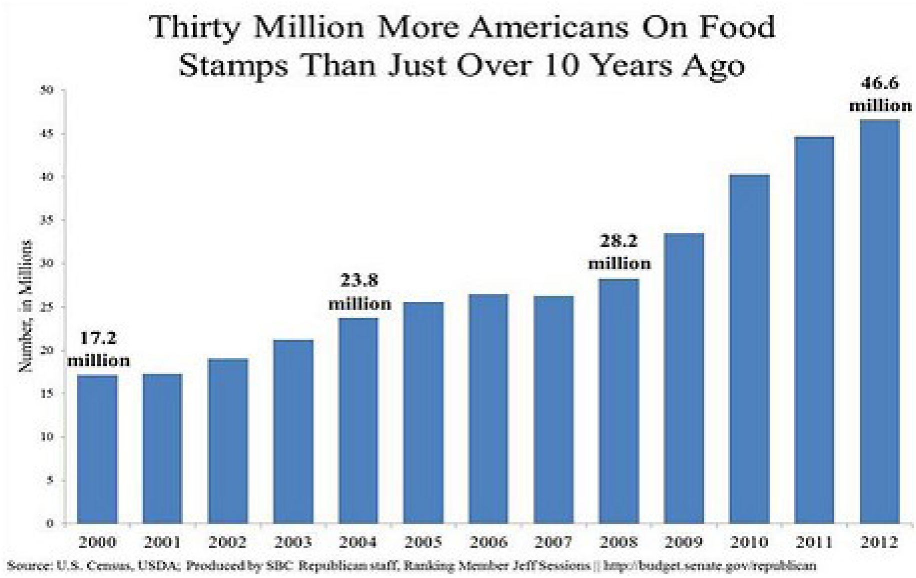
- Front Page Headline, Daily Telegraph U.K. – **"JP Morgan Fined $920 million (U.S.) over 'London Whale' Scandal.** The American banking giant was fined 138 million pounds by the Financial Conduct Authority (FCA) for what regulators deemed to be 'serious failings in its Chief Investment Office' that led to the unit losing $6.2 billion (U.S.), as a series of high risk trades went wrong last year. In addition to the U.K. fine, the U.S. Federal Reserve, Securities and Exchange Commission and the Office of the Comptroller of the Currency imposed further penalties of $200 million (U.S.), $200 million (U.S.) and $300 million (U.S.), respectively, taking the total fine to $920 million (U.S.). JP Morgan CEO Jamie Dimon admitted: 'We have accepted responsibility and acknowledged our mistakes from the start; and we have learned from them and worked to fix them. We will continue to strive towards being considered the best bank—across all measures—not only by our shareholders and customers, but also, by our regulators. Since these losses occurred, we have instituted numerous changes that have made us a stronger, smarter, better company.'

- Front Page Headline, Telegraph U.K. – **“Fed Recoils from 1937 Tightening Error as Jobs Evaporate.** The shocking Federal Reserve monetary policy decision yesterday to delay the tapering of bond purchases is recognition of what should have been obvious. ‘Rising mortgage rates and the tightening of financial conditions could slow economic growth,’ the Fed noted … America’s labour participation rate declined to 63.2% in July, the lowest level since the late 1970s. The rate for men is at an all-time low. The (official) unemployment rate has been falling, but chiefly because so many people are giving up hope and dropping off the rolls.

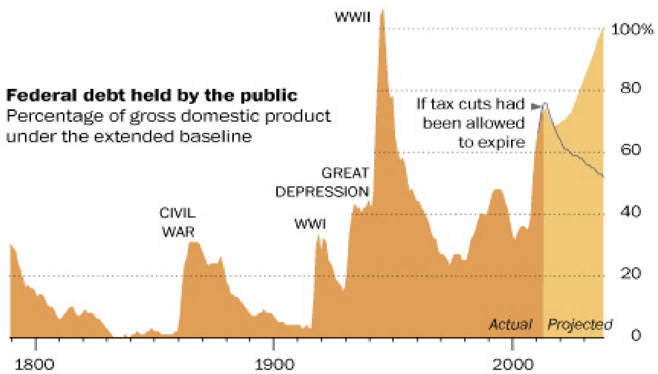
U.S. Labor Force Participation Rate (Percentage)

Source: Daily Telegraph U.K.

American labour specialists denote a chronic lack of (domestic) demand is the real villain in this jobs slump. Stanford University’s Edward Lazear observes: ‘The problem is not that the labour market is underperforming; it is because the (economic) recovery has been very slow. A record 20.2% of U.S households are now on food stamps. That is how they survive.’



The main concern within the U.S. Federal Reserve seems to be the fear that quantitative easing (QE) is stoking another asset bubble and that the risk of this game now outweighs the rewards. This is a legitimate worry. As the Telegraph reported earlier this week, the Bank for International Settlement's former guru William White believes the global debt structure is (now) more dangerous than ever: 'To me, this looks like 2007 all over again, but even worse. All of the previous imbalances are still there. Total public and private debt levels are 30% higher as a share of gross domestic product (GDP) in the advanced economies than they were then; and we have added a whole new problem with bubbles in emerging markets." See Washington Post chart below.



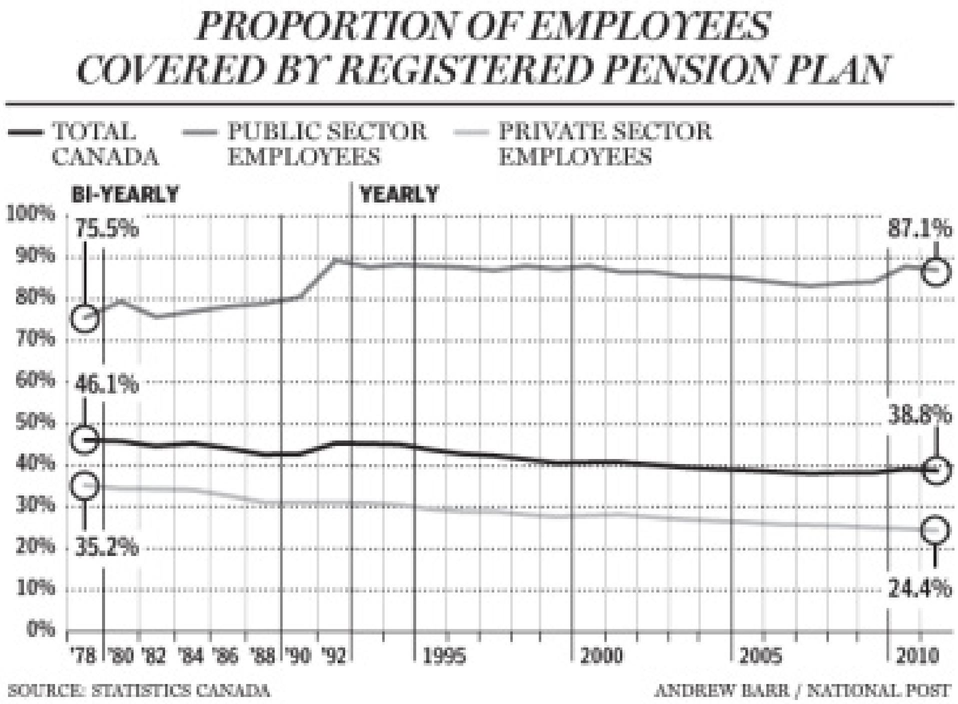
Note: The extended baseline adheres to current law with 10-year budget projections through 2023 and extends the baseline concept through 2038. Long-term projections do no reflect the economic effects of policies underlying the baseline.

Friday, September 20th

- Statistics Canada reports the nation's consumer price index (CPI) was flat during August. On a year-over-year basis, the index declined to 1.1% from 1.3% in July, citing higher costs for rent and natural gas. The core rate, excluding food and energy, rose by 0.2% in August and by 1.3% on an annual basis.

- Front Page Headline, Financial Post – **"The Public—Private Pension Divide.** Canadians routinely hear about growing divides within Canadian society. However, here is one rift that often goes unmentioned: the divide between the pension benefits of public sector employees and everyone else. Such inequality incurs real costs, where ordinary taxpayers pay ever more for above-market, guaranteed pension benefits that ever fewer (people) in the private sector possess. Consider some facts. In 2011, 87% of public sector employees were enrolled in registered pension plans. That was up from 75% in 1978 (the earliest year for which this statistic is available). By comparison, just 24% in the private sector possessed such plans and that was down from 35% in 1978. That trend reveals one divide. Here is another: the type of pension plan offered to government public sector employees and those in the private sector.

  In 2011, of those in the public sector with a pension plan (i.e. most), 94% were in a defined benefit plan. (Defined benefit plans promise certain retirement benefits regardless of the rate of return on invested contributions). That has barely changed from 99% in 1974. In the private sector, just 52% of enrollees were in a defined benefit plan in 2011, down from 88% in 1974. The rest are either in defined contribution plans, or in some hybrid combination. So, look at the raw numbers: three million public sector workers were enrolled in defined benefit plans in 2011, a doubling from the 1.5 million workers who possessed such plans in 1974 (the lowest year). Meanwhile, the number of private sector enrollees in defined benefit plans totaled just 1.5 million in 2011, down from a high of 2.4 million in 1990. Talk about ships passing in the night. The private sector has moved away from guaranteed levels of retirement benefits for a simple reason: it is impossible to guaranty exact benefits for 30 to 50 years in the future. That only continues in the public sector because the public treasury can be raided to make up any shortfalls. For example, in Newfoundland and Labrador in 2006, the provincial government injected $2 billion (CAD) into the Teachers' Pension Plan and in 2007, it deposited $982 million (CAD) in the Public Service Pension Plan. In Alberta, the province deposited a supposed one-time extra contribution of $60 million (CAD) in the Teachers' Pension Plan in 2002 and in 2009, the province made another special deposit of $1.2 billion (CAD). Even where such extra payments from taxpayers have not occurred, such as in British Columbia, the contribution rates for public sector pension plans have continually increased over the past decade, in order to pay for previously promised benefits and the bill ends up residing with taxpayers."



- Front Page Headline, Globe and Mail – **"Blackberry Suffers Huge Loss as Sales Collapse.** Blackberry Ltd. announces 4,500 employee layoffs (40% of its workforce) and a 2nd. fiscal quarter (ended August 31st.) write down exceeding $900 million (U.S.). The Waterloo, Ontario-based company reported the inventory charge is largely related to its Z10 touchscreen phone, which it unveiled in January at a promotional event in New York. Sales of that device have been so dismal that Blackberry revealed its smartphone revenue will be less than $800 million (U.S.) in the quarter, less than half the $1.7 billion (U.S.) it reported a year earlier. The extreme measures underscore the uncertainty surrounding the company's future. During the summer, Blackberry announced it had hired investment bankers and legal advisors to examine strategic options, including a possible sale. That process is continuing ... In a statement, Chief Executive Officer Thorsten Heins divulged: 'We are implementing the difficult, but necessary operational changes announced today to address our position in a maturing and more competitive industry and to drive the company toward profitability.' Blackberry also announced it was scaling back its efforts in the consumer market which it dominated prior to Apple and Google introducing powerful, consumer-friendly mobile platforms in the late 2000s, leaving Blackberry trailing badly in the smartphone it had created ... James Gellert, CEO of Rapid Ratings, commented: 'Blackberry's core handset business is really a business competition that it has lost. Now, it's a question of whether the other businesses and technology that Blackberry has, can be relied upon to drive the company going forward."

- Front Page Headline, Daily Telegraph U.K. – **"Who Do You Think You're Kidding, Mr. Schauble?** In a Financial Times article this week, German Finance Minister Wolfgang Schauble declared: 'Rejoice at the positive economic signals that the euro zone is sending almost continually these days ... The euro zone is clearly on the mend, both structurally and cyclically.' The fact that five years after the collapse of Lehman Brothers, the U.S. Federal Reserve still finds itself unable to end its monthly injection of quantitative easing, demonstrates that nowhere is the world economy even remotely fixed, least of all in the euro zone. This is where Germany's disciplinarian mixture of austerity and structural reform has manifestly failed on a monumental scale ... The euro zone periphery countries are never going to restore meaningful economic growth, job creation and debt reduction as long as they remain trapped in a monetary union with Germany. That Mr. Schauble cannot see this—or rather, chooses not to—demonstrates a bloody-minded disregard for the accepted rules of economics. Worse still, that he can declare a minor cyclical rebound—most likely caused by restocking—as evidence that Europe is on the mend is silly. Not only is it far too soon to make such a determination, but it would also cause virtually all of us to reconsider our world view, if he turns out to be right."

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	CLOSING LEVELS FOR FRIDAY, September 20th	WEEKLY CHANGE
Dow Jones Industrial Average	15,451.09	+ 75.03 points
Spot Gold Bullion	$1,332.50 (U.S.)	+ $23.90 per oz.
S&P / TSX Composite	12,806.47	+ 83.07 points
10 - Year U.S. Treasury Yield	2.73%	– 16 basis points
Canadian Dollar	97.10 cents (U.S.)	+ 0.50 cent
U.S. Dollar Index Future	80.43	– 1.03 cents
WTI Crude Oil (October)	$104.75 (U.S.)	– $3.88 per barrel

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

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