Monday February 17th, 2014

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, February 17th

Front Page Headline, Bloomberg News – "As Italian Premier-Designate, Matteo Renzi Sets 100-Day Agenda. Florentine Mayor Matteo Renzi, Italy's prime minister-designate, proceeds to construct a parliamentary majority by outlining a 100-day legisla-

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Presidents' Day Holiday in the United States

tive agenda, beginning with a voting law overhaul this month. After receiving a mandate to form a government from Italy's President Giorgio Napolitano, Mr. Renzi promised legislation in March to stimulate hiring. That will be followed by policies to reduce the bureaucracy and modify the tax code. Mr. Renzi, 39, will become the youngest prime minister in post-World War II Italy if he can construct coalition majorities in both houses of parliament. Mr. Renzi vowed: 'We will take all the time that's needed, knowing there's a sense of urgency within the country."

Matteo Renzi answers journalists' questions during a press conference. Source: AP

- Front Page Headline, Globe and Mail – "U.K. Fraud Agency Charges Three Former Barclays Bankers with Libor Manipulation. Britain's Serious Fraud Office has charged Peter Charles Johnson, Jonathan James Mathew and Stylianos Contogoulas with conspiracy to defraud via manipulation of the Libor (the London Interbank Offered Rate) between June, 2005 and August, 2007. The Libor rate is an interest rate reflective of the wholesale cost of short-term loans in the London banking market and is used as a benchmark rate for the pricing of a wide range of financial products on a global basis. In July, 2012, Barclays paid $450 million (U.S.) in fines and penalties to settle allegations from U.S. and U.K. regulators that it had conspired to manipulate the Libor rate; prompting the resignations of its chairman and chief executive officer and a barrage of criticism about standards and culture. Barclays refused to comment on today's allegations."

David Green, director general of the SFO.
Source: Daily Telegraph U.K.

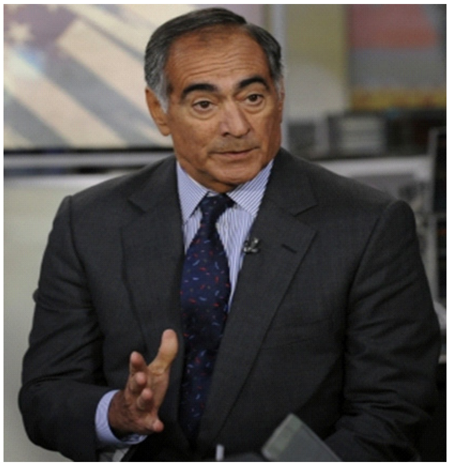
- Front Page Headline, Rolling Stone Magazine – "Former Morgan Stanley CEO Complains of Wall Street Executive Abuse. In a recent interview with Bloomberg TV, former Morgan Stanley CEO John Mack complained – in so many words – that financial executive bashing by industry news editors and media journalists was unjustified and unwarranted. Indeed, Mr. Mack stated: 'I would love to see writers stop beating up on (Goldman Sachs CEO) Lloyd Blankfein and (Morgan Stanley CEO) Jamie Dimon. I think that would make a lot of sense and I'm in favour of that.' In his Taibblog, Rolling Stone contributing editor Matt Taibbi admonishes: 'Of all people, John Mack should be quiet when it comes to the issue of public outrage over bank corruption. How about this, John: All of us malcontents will promise to stop beating up on your fellow CEOs, if you share with us the entire contents of your conversation with Pequot hedge fund honcho Art Samberg on June 29, 2001?

  Investors may recall, John Mack was at the center of the controversy involving SEC whistleblower Gary Aguirre. Mr. Aguirre is a lawyer and investigator who began working for the SEC in September, 2004. One of his first assignments was to investigate a case involving a hedge fund called Pequot Capital Management, which had made a highly auspicious series of trades just prior to, and after, a merger involving General Electric and a company named Heller Financial in the summer of 2001. The point man in the deal was legendary Pequot trader Art Samberg. As evidence into a U.S. Senate investigation into Aguirre's firing later revealed, Samberg made a huge investment in Heller on July 2, 2001, apparently without having done any research into Heller before that time. However, he had talked the previous business day (Friday, June 29th.) to John Mack, who had recently left a managerial position at Morgan Stanley and had just returned from Switzerland, where he'd interviewed for a position at Credit Suisse. Both Morgan Stanley and Credit Suisse had worked on the merger for Heller Financial and as the Senate explained: 'possessed material, non-public information about the transaction."

  Right after Mack talked to Samberg and Samberg invested in Heller, Pequot cut Mack in on a lucrative deal involving a Lucent spinoff which resulted in more than tripling Mack's $5 million (U.S.) investment. When Aguirre asked permission to interview Mack, about all of this, he was denied such permission by his superiors at the SEC. When he pressed, they fired him. (Aguirre later won a wrongful dismissal settlement with the SEC in the amount of $755,000 U.S.). Ultimately, the government didn't interview Mack about the Pequot deal until August 1, 2006, exactly five days after the five-year statute of limitations on the incident had expired. In that testimony, Mack denied having foreknowledge of the Heller deal and claimed that Samberg had wanted him to invest in the Lucent spinoff, not the other way around – despite the fact that the SEC had e-mails from Sandberg saying Mack had nagged Samberg to let him into the lucrative deal, 'busting his chops' to get in.

  The government never really pursued the matter further and Mack's role in what the U.S. Senate termed a 'highly suspicious' trade was never fully investigated. Ultimately, he returned to Morgan Stanley to serve as the bank's CEO from 2005 to 2009. All of which means exactly nothing today, over a decade after the original incidents. By now, it's just one of a pile of stories about cases which were never pursued against Wall Street executives for questionable behaviors in the pre-financial crisis years. Still, it seems that after having been saved by the gods from the jaws of death in the Heller episode, henceforth, Mack should probably stay on the sidelines in any debate about financial corruption. That he doesn't should tell us a lot. I'm not sure these guys can even spell 'shame,' much less exercise any."

  At Long Wave Analytics, given the behavioral history of John Mack, we would suggest that the word 'shame' is an understatement. We think that 'blatant hypocrisy' is more appropriate!



John Mack, former CEO of Morgan Stanley.
Source: Getty Images

TUESDAY, FEBRUARY 18TH

- The New York Federal Reserve reports its Empire State index of manufacturing activity – a survey covering New York State, northern New Jersey and southern Connecticut – declined to a reading of 4.5 in February, following a level of 12.5 in January, citing severe winter weather disrupting production throughout the U.S. northeast.

- The New York Federal Reserve reports American household debt rose by 2.1% to $11.52 trillion (U.S.) in the 4th. quarter of 2013 from $11.28 trillion (U.S.) in the 3rd. quarter. The increase of $241 billion (U.S.) marked the biggest quarterly move since the 3rd. quarter of 2007. Wilbert van der Klaauw, an economist at the New York Fed concluded: “This quarter represents the first time since before the great recession that U.S. household debt has increased on a year-over-year basis; suggesting that after a long period of deleveraging, American households are borrowing again.”

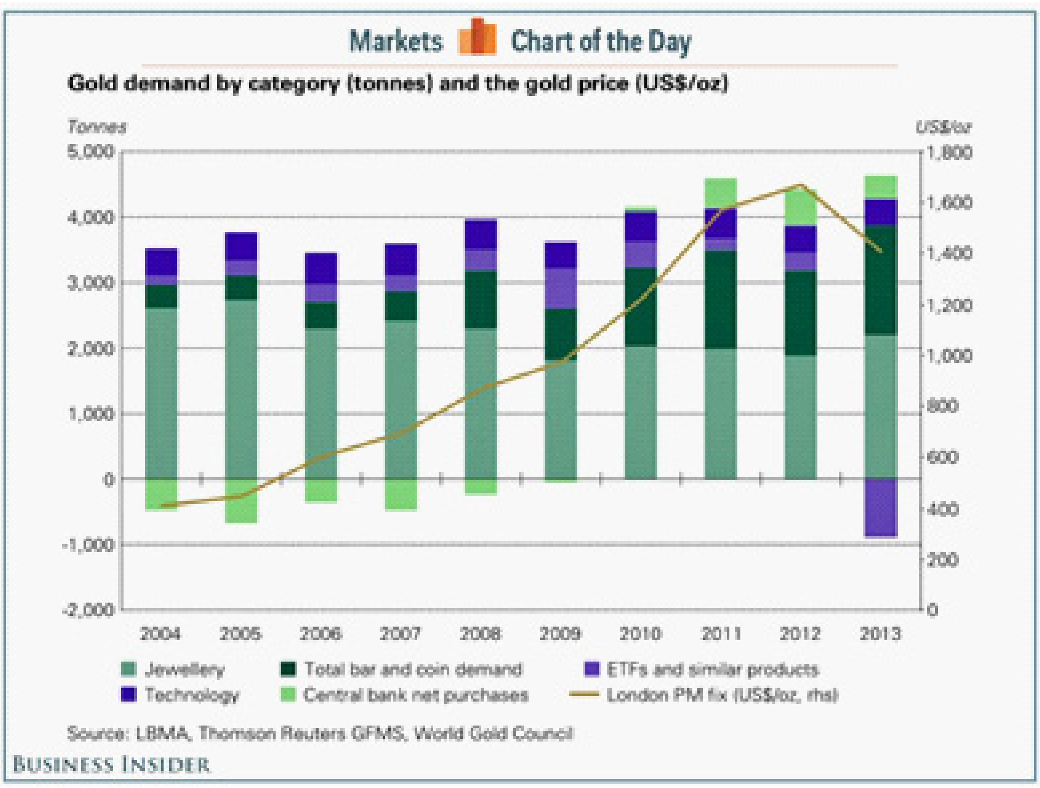
- In its new Gold Demand Trends Report, the London-based World Gold Council (WGC) concluded: “2013 proved to be the year of the consumer, with gold jewellery demand close to pre-crisis levels and investment in small bars and coins reaching a record high. The result was annual gold demand of 3,756.1 metric tonnes, valued at 170 billion (U.S.). However, outweighing the impressive consumer demand were the effects of exchange traded funds (ETF) outflows and reduced central bank purchases; resultant in 2013 demand 15% below the strong volumes recorded in 2012.” Chinese consumers set a new annual record, while Indian demand was resilient in the face of import restrictions. The sharp decline in the price of gold bullion in the 2nd. quarter elicited a strong and swift (buyer) response from consumers in Asia and the Middle East; an effect which extended out to western markets in the final quarter of the year.”

- The National Association of Home Builders (NAHB) / Wells Fargo group reports its U.S. home builder confidence index declined to a reading of 46 in February from a level of 56 in January, citing severe winter weather along the eastern seaboard, fewer potential buyers resulting in lower sales trends and a dwindling supply of available properties for development. NAHB Chairman Kevin Kelly commented: “Significant weather conditions aside, builders have additional concerns about meeting ongoing and future demand due to a shortage of lots and (skilled) labor.”

WEDNESDAY, FEBRUARY 19TH

- Citing harsh winter weather conditions, the Commerce Department reports U.S. privately-owned housing starts declined by 16% in January to a seasonally adjusted annual pace of 880,000 units, following an upwardly revised December estimate of 1,048,000 units. Moreover, building permits declined by 5.4% in January to a seasonally adjusted annual rate of 937,000, following a revised December pace of 991,000.

- Front Page Headline, Daily Telegraph U.K. – Britain’s Wages Increase but Remain below Inflation. The Office for National Statistics (ONS) reports U.K. average weekly income – including bonuses – edged higher by 1.1% in the 4th. quarter of 2013, up slightly from the 0.9% rate of increase in the three prior months to the end of November.



Source: Daily Telegraph

However, the government's preferred inflation measure – the consumer price index (CPI) – currently stands at 1.9%, slightly below the Bank of England's 2% target. The increase in income will be encouraging for Bank of England Governor Mark Carney, who last week adjusted his 'forward guidance policy' to include wage growth as one of the key indicators which will help the Bank to decide when to raise administered interest rates. The Bank wants to eliminate excess capacity in the economy and increase productivity, which will foster stronger wage growth. ONS data also included a slight 0.1% increase in the unemployment rate to 7.2%. George Buckley, an economist at Deutsche Bank commented: 'We expect to see a further acceleration in average weekly earnings growth in the months ahead. Wages are important to the extent that they provide some indication of domestic inflationary pressures and thereby, potentially reveal information about the degree of spare capacity in the labour market."

Source: Daily Telegraph

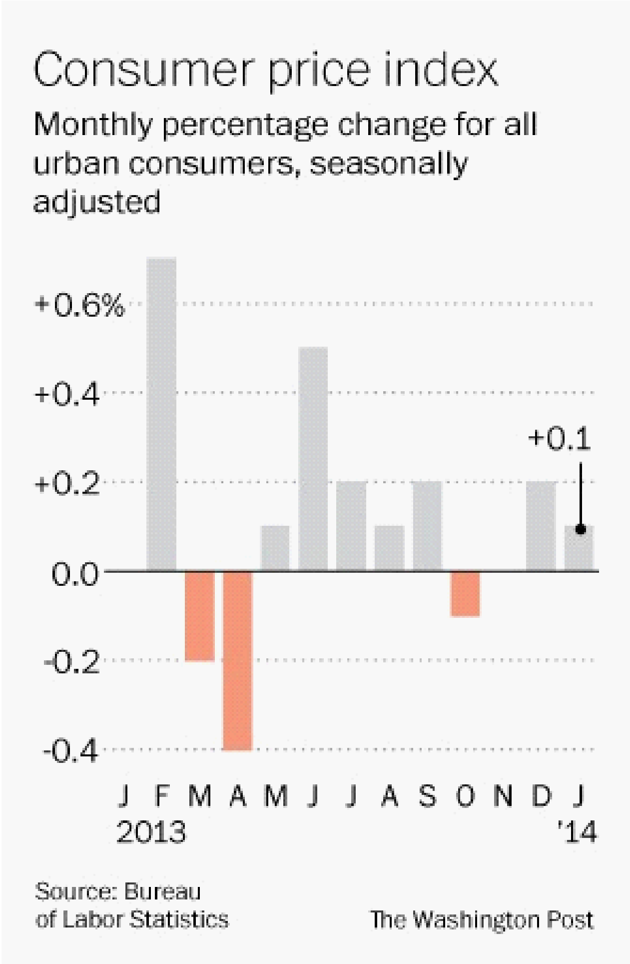
- The Labor Department reports the U.S. producer price index (PPI) rose by 0.2% in January, citing higher prices for food and pharmaceuticals. Today's data mark the debut of the PPI following its first major overhaul since 1978; which more than doubles its economic range by including prices received for goods, services, government purchases, exports and construction. Russell Price, an economist at Detroit-based Ameriprise Financial Inc. observed: "Overall, businesses have very weak pricing power, so pipeline pressures remain muted."

- In releasing the minutes of its January 28th. and 29th. meetings, the Federal Open Market Committee (FOMC) issued a statement from which the following comments are excerpted: "The FOMC expects that, with the appropriate (monetary) policy accommodation, U.S. economic activity will expand at a moderate pace and the unemployment rate will gradually decline toward levels the Committee judges are consistent with its dual mandate. The Committee sees the risks to the outlook for the (domestic) economy and the labor market as having become more closely balanced. The Committee recognizes that if inflation persists below its 2% objective, it could pose risks to economic performance, so the Committee is monitoring inflation developments carefully, for evidence that inflation will recede toward its objective over the medium term …In light of the cumulative progress toward maximum employment and the improvement in the outlook for labor market conditions, the Committee decided to make a further measured reduction in the pace of its asset purchases. Beginning in February, the Committee will add to its holdings of agency mortgage-backed securities at a pace of $30 billion (U.S.) per month rather than $35 billion (U.S.) per month; and will add to its holdings of longer term Treasury securities at a pace of $35 billion (U.S.) per month rather than a pace of $40 billion (U.S.) per month."

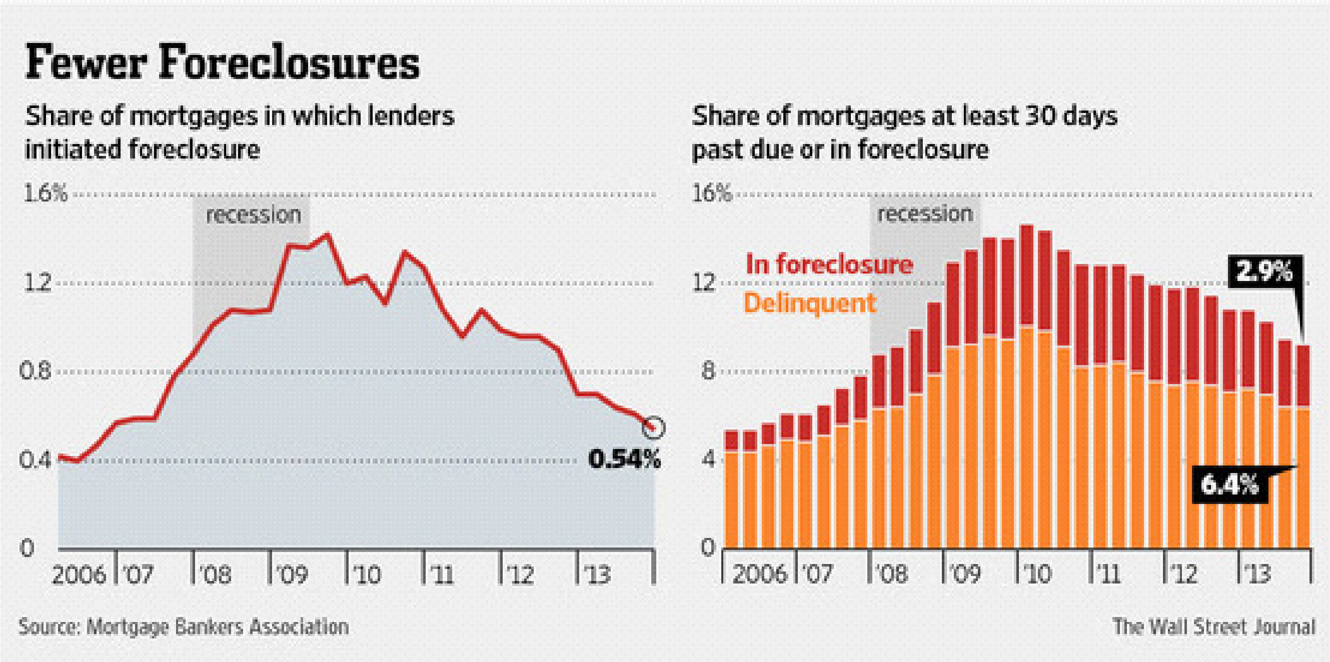
THURSDAY, FEBRUARY 20TH

- The New York-based Conference Board reports its U.S. index of leading economic indicators – a gauge for the domestic economic outlook for the next 3 to 6 months – rose by 0.3% in January, following a December survey reading which was unchanged from November.

- The Labor Department reports the U.S. consumer price index (CPI) rose by a seasonally adjusted 0.1% in January, citing higher costs for electricity, heating and housing. On a year-over-year basis, both the CPI and the core rate – which excludes food and energy costs – have increased by 1.6%.



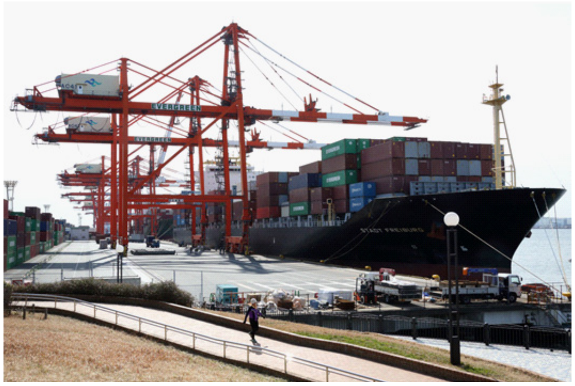
- Front Page Headline, Wall Street Journal – "U.S. Mortgage Problems Approach Pre-Recession Levels. According to a new report by the Mortgage Bankers Association, five years after the official end of the U.S. recession, the number of Americans who are behind on their mortgages and the backlog of homes in the foreclosure process are finally narrowing to pre-recession levels. The U.S. mortgage delinquency rate – mortgage loans which are one payment or more behind but not yet in foreclosure – fell to 6.39% of total mortgages outstanding in the 4th. quarter of 2013, down from 7.9% a year ago and the lowest rate since the early months of recession, in the 1st. quarter of 2008. The backlog of foreclosure inventory also declined to its lowest level since 2008, while the number of mortgage loans on which mortgagees initiated foreclosure was the lowest since 2006. Recent reports of housing sales indicate a downturn following a sharp acceleration in sales and prices during 2013. In the 4th. quarter of the year, the combination of rising prices and higher mortgage rates eroded housing affordability and pushed many buyers to the sidelines."



- Markit Economics reports its preliminary U.S. purchasing managers' index (PMI) for manufacturing rose to a reading of 56.7 in February, up from January's level of 53.7. Chris Williamson, chief economist at Markit, noted: "Production has rebounded from the weather-related slowdown experienced in January, recording the largest increase in backlogs of work seen since prior to the financial crisis; as well as a steep decline in inventories. Both point to ongoing growth of production and hiring in March."

- HSBC Holdings Plc and Markit Economics report a preliminary reading for China's manufacturing index declined to a seven month-low reading of 48.3 in January. A reading below 50 indicates contraction. Ding Shuang, an economist at Citigroup in Hong Kong remarked: "While it's relatively difficult to pursue two policy goals simultaneously, China is expected to delever on the one hand, while ensuring a certain level of economic growth on the other hand."

- The Ministry of Finance reports Japan's trade deficit widened to a record 2.97 trillion yen ($27.3 billion U.S.) in January; as surging imports rose by 25% and exports grew by only 9% on a year-over-year basis. Exports have achieved only limited gains from the yen's slide of more than 20% against the U.S. dollar over the past two years, as import costs have increased while the nation's nuclear reactors remain shuttered. Naohiro Niimura, a partner at Market Risk Advisory Co. in Tokyo, commented: "Japan is paying the price for the transformation of its energy policy. This trend in Japan's trade balance will (likely) continue for a while, (gradually) eroding the strength of the economy."



A container ship moored at a shipping terminal in Tokyo Bay. Photo source: Bloomberg

- Front Page Headline, Daily Telegraph U.K. – "France Is Staring Right Down the Barrel of Deflation. French President Francois Holland must now pay the price for caving into the contraction monetary policies of the euro zone. His country is sliding into a deflationary state. French consumer prices fell by 0.6% in January from December and would have declined even further without one-off tax increases. Prices of manufactured goods fell by 3% and clothing prices declined by 15.4% as retailers slashed prices to unload inventory. France's core consumer prices have been dropping for months with that index basically a flat zero on a year-over-year basis. One year ago, this outcome is exactly what the Observatoire Economique predicted would happen under the euro zone's contractionary structure; suffice to say, under the triple squeeze of fiscal austerity, passive monetary tightening and draconian bank deleveraging. Surprise, surprise, the euro zone M3 money supply has been contracting since March 2013. Investors laughed at the Observatoire, but no one is laughing any more. As the IMF stated yesterday, Europe is one external shock away from a lurch into outright deflation: 'A new risk to (economic) activity stems from very low inflation in advanced economies, especially in the euro zone, which if below target for an extended period, could destabilize longer-term inflation expectations. Low inflation raises the likelihood of deflation in case of a serious shock to economic activity. Within the euro zone, low inflation also complicates the task in the periphery, where the real burden of both public and private debt would increase as real interest rates rise."

FRIDAY, FEBRUARY 21ST

- The National Association of Realtors (NAR) reports U.S. existing home sales declined by 5.1% to an annual pace of 4.62 million units in January – the lowest level since July 2012 – citing the combination of cold weather and the lack of housing inventory sidelined potential buyers.

- Front Page Headline, Globe and Mail – "Moody's Upgrades Spain's Sovereign Debt Credit Rating. Moody's Investors Service upgraded Spain's credit rating from Baa3 – the lowest investment grade rating – to Baa2, citing: 'The upgrade largely reflects a rebalancing of the Spanish economy towards a more sustainable growth model. This is being underpinned by structural improvements in the country's external competitiveness and the ongoing deleveraging within the domestic economy. However, Spain remains constrained by a relatively weak banking system, a significant budget deficit – about 7% of gross domestic product (GDP) – and a high debt-to-GDP ratio, which we expect will peak in 2016."

- Front Page Headline, Daily Telegraph U.K. – "Ukraine Likely to Default: S&P. Ratings agency Standard &Poor's has downgraded Ukraine's sovereign debt credit rating from CCC (High) to CCC citing: 'We now believe it is likely that Ukraine will default in the absence of significantly different circumstances, which we do not anticipate. The downgrade reflects our view that the political situation in Ukraine has deteriorated significantly. We believe this raises uncertainty regarding the continued provision of Russian financial support over the course of 2014 and puts the government's capability to meet debt servicing at an increased risk."

CLOSING LEVELS FOR FRIDAY, FEBRUARY 21ST.		WEEKLY CHANGE
Dow Jones Industrial Average	16,103.30	– 51.09 points
Spot Gold Bullion	$1,326.60 (U.S.)	+ $8.00 per oz.
S&P / TSX Composite	14,205.72	+ 150.96 points
10-Year U.S. Treasury Yield	2.73%	– 1 basis point
Canadian Dollar	89.82 cents (U.S.)	– 1.23 cents
U.S. Dollar Index Future	80.256	+ 0.204 cent
WTI Crude Oil Futures	$102.20 (U.S.)	+ $1.90 per barrel

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