Monday February 3rd, 2014

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, February 3rd

The Institute for Supply Management (ISM) reports its U.S. index for the manufacturing sector declined to a reading of 51.3 in January from a level of 56.5 in December; citing harsh winter weather negatively

MONDAY, FEBRUARY 3RD

impacted the pace of shipments in the east and Midwest.

- Markit Economics reports the U.K. Purchasing Managers' Index (PMI) for the manufacturing industry fell to a reading of 56.7 in January following a level of 57.2 in December; citing a slowing in domestic demand, but higher export orders from North America, Europe, Asia, Scandinavia and Brazil.

- The National Bureau of Statistics and China Federation of Logistics and Purchasing report China's Purchasing Managers' Index (PMI) for the manufacturing sector fell to a six-month low reading of 50.5 in January, following a level of 51 in December, citing lower exports and job creation. Liu Li-Gang, an economist at Australia and New Zealand Banking Group in Hong Kong, noted: "There is no doubt that the surging money market rates have added uncertainty and dampened manufacturing industry confidence. The Bank of China will have to strike a delicate balance between cracking down on shadow banking and maintaining financial stability."

- Front Page Headline, Daily Telegraph U.K. – "Currency Crisis at China's Banks Could Trigger Global Meltdown. In an interview with the Telegraph, Charlene Chu, a former analyst at Fitch Ratings in Beijing and now the manager of Asian research at Autonomous Research, warned: 'The rapid expansion of foreign currency borrowing means a crisis in China's financial system is becoming a bigger risk for international banks. One of the reasons why the situation in China has been so stable up to this point is that unlike many emerging markets, there is very little reliance on foreign funding. As that situation changes, it obviously increases bank vulnerability to swings in the foreign investor appetite.' Figures published by the Bank for International Settlements (BIS) last October showed foreign currency loans booked in China, as well as cross border borrowing by Chinese companies, had reached $880 billion (U.S.) as of March, 2013, up from $270 billion (U.S.) in 2009 and expected to exceed $1 trillion (U.S.) soon.

  Ms. Chu continued: 'It is very difficult to work out the exposures of individual banks to the Chinese financial system; however, it seems to us there are some very large numbers on some of the banks' balance sheets. Without a doubt, foreign currency borrowing has been on the increase and was really beginning to grow quickly in the latter part of 2013 and it's only going to continue. For the time being, it is only a fraction compared to the massive size of the financial sector, but we're still talking about a growing amount of funding coming from offshore sources. If you look at the exposure numbers from the BIS and the Hong Kong banks … you're going to encounter a few foreign institutions which are going to have a sizeable exposure to China."

- Front Page Headline, Financial Times – "Treasury Secretary Lew Urges Immediate Increase in U.S. Statutory Debt Limit. Speaking at the Bipartisan Policy Center, a Washington think-tank, Secretary Lew pleaded: 'Congress should act quickly to raise the (statutory) debt limit without unnecessary delays, or political posturing which could snowball into a manufactured crisis that the American people so clearly want us to avoid. I believe that (raising) the (statutory) debt limit is the last measure that has to happen in order for people to breathe a sigh of relief that we're not going to see the kinds of (political) brinkmanship which cause anxiety; frankly not only here in America, but also, around the world.'

U.S. Treasury Secretary Jack Lew.
Photo source: Getty Images

- Front Page Headline, Washington Post – "Detroit Sues Retirement Funds to Void Pension Debt. The City of Detroit files a lawsuit in U.S. bankruptcy court seeking to invalidate $1.44 billion (U.S.) of debt sold to fund public worker pensions – a move that could also void the ill-fated interest rate swap contracts which were a factor leading Detroit into bankruptcy. The lawsuit contends that the City and its retirement systems violated Michigan law when they set up sham service corporations and funding trusts to facilitate the debt sales in 2005 and 2006. All other contracts or obligations connected to the debt are also void. Detroit asked bankruptcy Judge Steven Rhodes to issue a judgment declaring that the City is not obligated to continue making payments on the pension certificates of participation (COPs). They were issued during the term of former mayor Kwame Kilpatrick, now serving a prison term for convictions on federal corruption charges. In a statement, Kevyn Orr, Detroit's state-appointed emergency manager, noted: 'This deal was bad for the City from its outset, despite reassurances it would adequately resolve the City's pension issues."

- Front Page Headline, Le Metropole Café – "A Rash of Deaths and a Missing Reporter – With Ties to Wall Street Investigations. U.S. Senator Carl Levin's Permanent Subcommittee on Investigations is probing global banks' involvement in the U.S. commodities markets. In a span of four days last week, two current executives and one recently retired top ranking executive of major financial firms were found dead. Both media and police have been quick to label the deaths as likely suicides. Missing from the reports is the salient fact that all three of the financial firms for which the executives worked are under investigation for potentially serious financial fraud. Discovery of the deaths began on Sunday, January 26th. London police reported that William Broeksmit, a top executive at Deutsche Bank who retired in 2013, had been found hanged in his home in the south Kensington section of London. The following day Eric Ben-Artzi, a former risk analyst turned whistleblower at Deutsche Bank, was found dead. He was scheduled to speak at Auburn University in Alabama on his allegations that Deutsche Bank had hidden $12 billion (U.S.) in losses during the financial crisis with the knowledge of senior executives. Two other whistleblowers have brought similar charges against Deutsche Bank.

Deutsche Bank is also under investigation by global regulators for potentially rigging the foreign exchange markets – an action similar to the charges it settled in 2013 over its traders' involvement in the Libor interest rate benchmark. On Tuesday, January 28th. 39-year old American Gabriel Magee – a Vice President at JP Morgan in London – plunged to his death from the roof of the 33-storey European headquarters of JP Morgan at Canary Wharf. According to Magee's LinkedIn profile, he was involved in 'Technical architecture oversight for planning, development and operation of systems for fixed income securities and interest rate derivatives.' Magee's parents, Bill and Nell Magee, are not buying the official story according to press reports and are planning to travel from the United States to London to get at the truth. One of their key issues, which should also trouble the police, is how an employee attains access to the rooftop of one of the most highly secure buildings in London. Nell Magee was quoted in the London Evening Standard as saying her son was 'a happy person who was happy with his life.' His friends are equally mystified, stating he was in a happy, long-term relationship with a girlfriend. JP Morgan is under the same global investigation for potential involvement in rigging foreign exchange rates as is Deutsche Bank. The firm is also said to be under an investigation by the U.S. Senate's Permanent Subcommittee on Investigations for its involvement in potential misconduct in physical commodities markets in the U.S. and London.

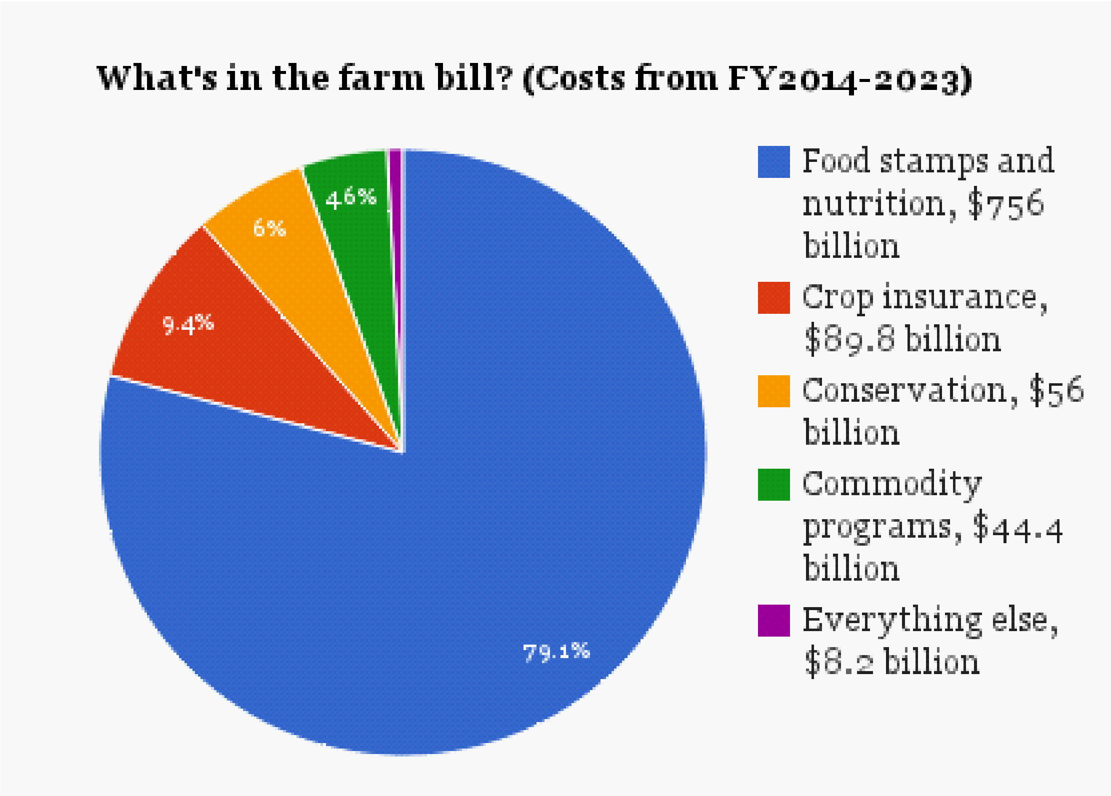
On Wednesday, January 29th. 50-year old Michael Dueker, the Chief Economist at Russell Investments, is said to have died from a 50-foot fall from a highway ramp down an embankment in Washington State. Again suicide is being presented by the media as being the likely cause. According to Dueker's official biography – prior to joining Russell Investments – he was an assistant vice president and research economist at the Federal Reserve Bank of St. Louis from 1991 to 2008. His duties there included serving as an associate editor of the Journal of

Business and Economic Statistics. He was also the editor of Monetary Trends, a monthly publication of the St. Louis Fed. Bloomberg News quotes William Poole, former President of the St. Louis Fed from 1998 to 2008, saying: 'Everyone respected his professional skills and good sense.'

According to a report in the New York Times last November, Russell Investments was one of a number of firms that received subpoenas from New York State regulators who are probing the potential for pay-to-play schemes involving pension funds based in New York. No allegations of wrong doing have been made against Russell Investments in the matter. The case of David Bird, the oil markets reporter who had worked at the Wall Street Journal for 20 years and vanished without a trace on the afternoon of January 11th. has this in common with the other three tragedies: his work involves a commodities market – oil – which is under investigation by the U.S. Senate's Permanent Subcommittee on Investigations for possible manipulation. The FBI is involved in the Bird investigation. Bird left his Long Hill, New Jersey home on that Saturday, telling his wife he was going for a walk. An intentional disappearance is incompatible with the fact that he left the house wearing a bright red jacket and without his life-sustaining medicine he was required to take daily as a result of a liver transplant. Despite a continuous search since his disappearance by hundreds of volunteers, local law enforcement and the FBI, Bird has not been located. When a series of tragic events involving one industry occur within an 18-day time frame, the statistical probability of these events being random is remote. According to several media reports, JP Morgan is conducting an internal investigation of the death of Gabriel Magee. Given that JP Morgan, Deutsche Bank and Russell Investments are subjects of investigations, a more serious, independent look at these deaths is mandatory."

TUESDAY, FEBRUARY 4TH

- Front Page Headline, Daily Telegraph U.K. – "Shocking U.S. Factory Orders and Chinese Bank Woes Trigger Global Flight to Safety. U.S. factory orders suffered their steepest decline in 33 years in January and also slowed further in China, raising new concerns about the strength of the world's two largest economies. Yesterday, the shocking figures set off a renewed flight to safety in New York, where the yield on 10-year U.S. Treasurys fell to a three-month low of 2.60%. The Dow Jones Industrial Average (DJIA) tumbled 326 points, breaking through crucial technical support levels. The Japanese yen rallied as funds unwound carry trade positions in Asia in order to reduce risk. Emerging market currencies slumped to a five-year low. America's Institute for Supply Management's manufacturing index fell to a reading of 51.3 in January from a level of 56.5 in December; the biggest one-month decline since the Lehman crisis … It was unclear whether the collapse could be blamed on polar (weather) conditions across the U.S., or whether deeper forces were at work. There was a sharp slide in orders for machines and white goods in December even before the cold snap. On his Project Syndicate blog, Yale University's Stephen Roach discerned: 'The robust (economic) growth in the U.S. over recent months had been bloated by an unsustainable surge of (inventory) restocking. If final sales to consumers and businesses are used as a guide, the underlying rate of (U.S. GDP) growth is closer to 1.6%. American households have not yet finished the epic purge needed to bring loan levels back to historic levels. The debt-to-income ratio has dropped from 135% to 109% since the sub-prime bubble burst in 2007, but it still has another 35 percentage points to go, implying powerful headwinds for the U.S. economy for years to come. American consumers' balance sheet repair is, at best, only about half finished."
- In China, the PMI gauge of manufacturing fell to its lowest level since last May, as the authorities continued to bear down on the country's $24 trillion (U.S.) credit boom. The new export orders component index declined to a reading of 49.3, below the expansion line of 50. Zhiwei Zhang, an analyst at Normura, commented: 'We believe the negative impact of tighter liquidity conditions is showing on the real economy."
- Front Page Headline, Washington Post – "U.S. Senate Passes Five Year Farm Bill. Following three years of arduous debate, by a vote of 68 to 32 the U.S. Senate passed a $956.4 billion (U.S.) 5-year farm bill – already passed last week by the House of Representatives – which will now be forwarded to President Obama for signature. While the legislation continues to subsidize soybeans, corn and other crops, it cuts about $8 billion (U.S.) from food stamp funding over 10 years by revising eligibility rules. In a Sunday C-SPAN interview, Debbie Stabenow (D-Mich.), Chairwoman of the Senate's Agricultural Committee, declared: 'We are the only part of the federal government to produce savings – estimated to be about $16 billion (U.S.) by the Congressional Budget Office (CBO) – in our own areas of jurisdiction and we eliminated about one hundred different programs, or authorizations, that no longer made sense."

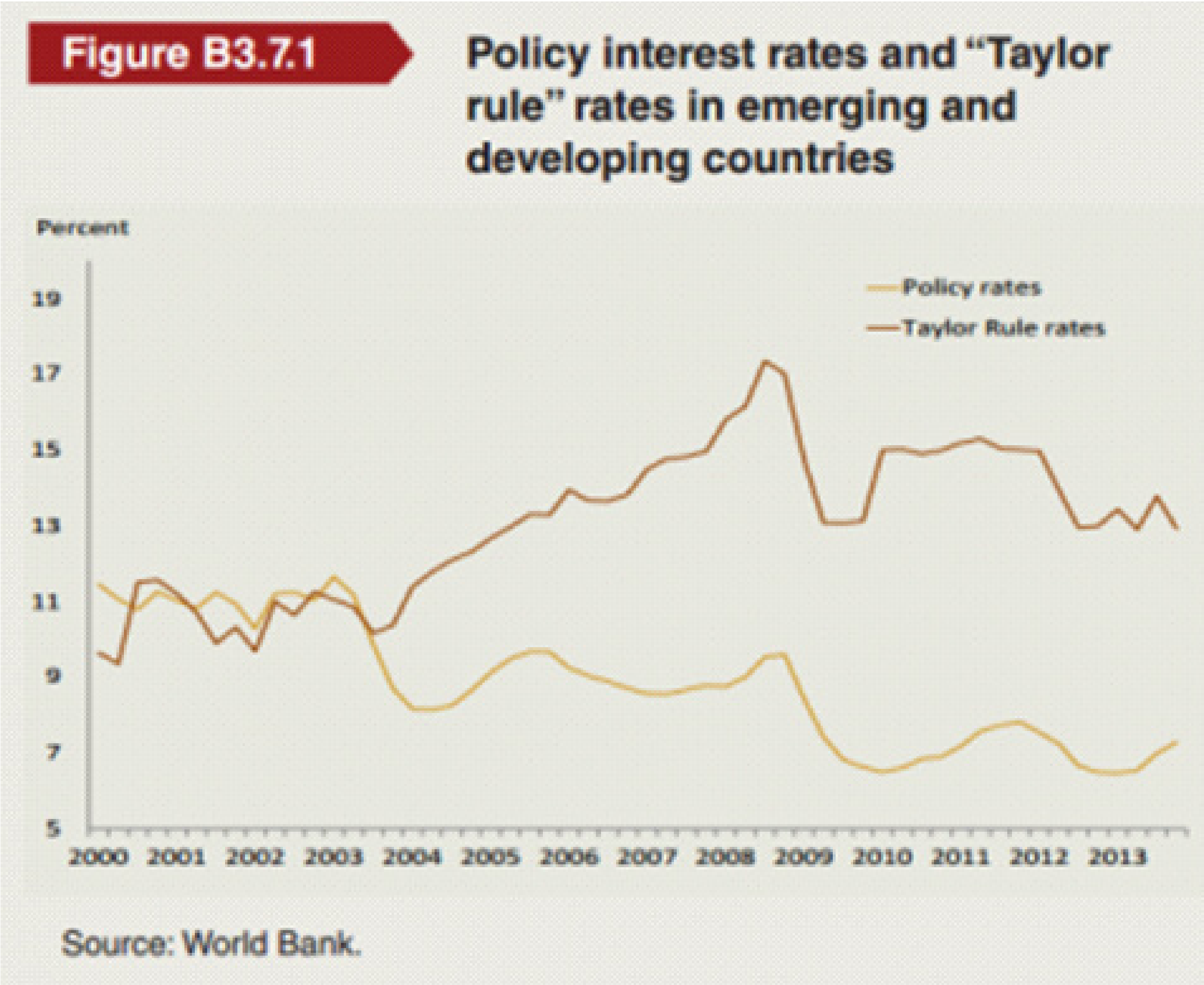


The newly passed U.S. Farm Bill. Source: CBO

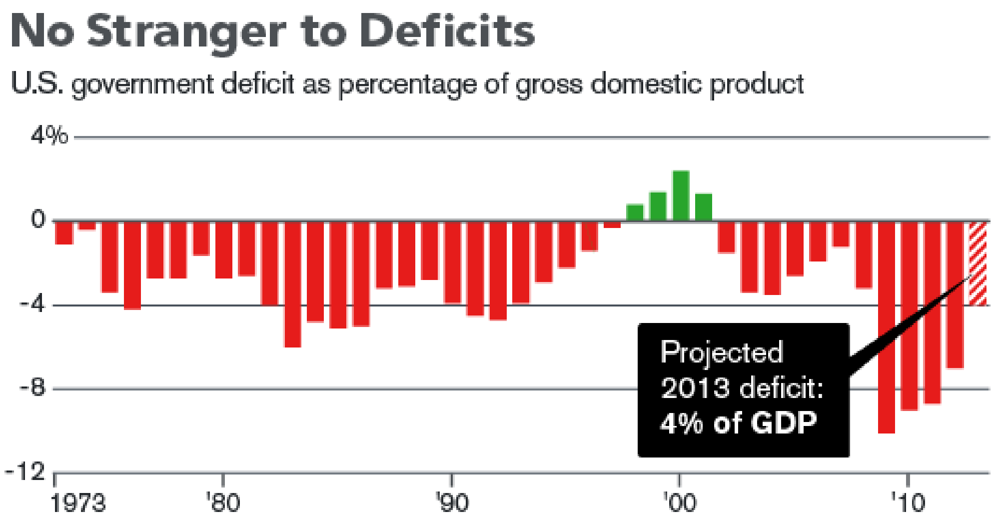
- Front Page Headline, Daily Telegraph U.K. – "Emerging Markets Risk Repeating Euro Zone Blunder of Synchronized Tightening. Where have we seen this screenplay before? A string of countries tighten (monetary) policy at the same time – some drastically – in order to prevent capital flight and show investors their intrinsic toughness. Turkey, India and South Africa have all raised their (administered interest) rates last week. Brazil and Indonesia did so before. While Chile, Peru, Hungary and others need to loosen (monetary policy, they) dare not do so. Russia is spending $2 billion (U.S.) in foreign exchange reserves propping up the rouble, automatically tightening its internal credit conditions in the process. The tougher these countries are, the more praise they garner from emerging market analysts. The following was written by Bartosz Pawlowski at BNP Paribas: 'Much of the media (not just on the financial pages) seems to be vying to produce the most bearish story on emerging markets. Arguments against owning anything in emerging markets are being thrown around carelessly and hardly anyone is reporting the other side of the story … Policy responses in countries such as Turkey, India, South Africa and even Brazil should be sufficient to show that central banks mean business and that if there is a need to do more, they will deliver. Bartosz is right in a sense. Many of these countries had (monetary) policies that were far too loose for years."

They became complacent, taking global liquidity for granted and letting credit bubbles do their worst. They certainly need to get a grip. However, there is a big problem when countries containing two billion people, all try to prove that they mean business at the same time. What may make sense for one economy, does not (necessarily) make sense for the international system as a whole. (This is a variant from our old friend from the 1930's, the beggar-thy-neighbour syndrome). This is more or less the same flawed strategy that has bedeviled the European Union for the last four years. While austerity / deflation policy might work for Ireland or Portugal in isolation, such a policy is madness when applied to the whole of southern Europe together. It creates bad feedback loops all over the place. One must never argue from the micro (national) to the macro (global). We now have a situation where the world's two biggest economies – the U.S. and China – are both winding down stimulus in lockstep. Call it simultaneous G2 tightening if you will. Europe is tightening passively as its balance sheets shrink and M3 money (supply) fizzles out. So, let's call it G3 tightening (even if the Europeans are doing it by mistake).

This amounts to something of a shock to large parts of the emerging market nexus. Therefore, is it proper for these emerg-



ging market states to further compound the shock with pro-cyclical monetary or fiscal tightening and to do so on a scale that could ultimately push the global economy closer to a deflation trap?"



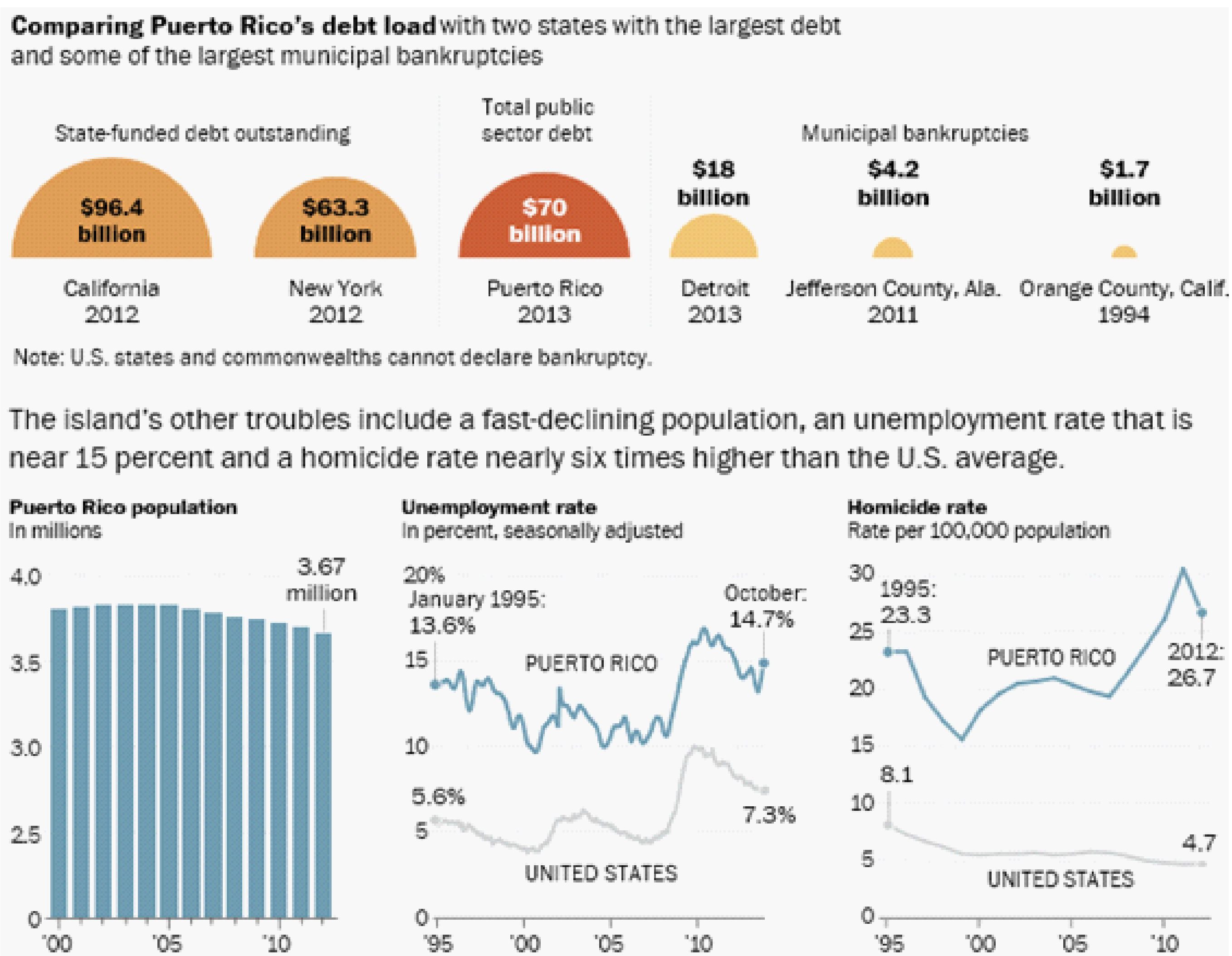
Source: CBO

- Front Page Headline, Bloomberg News – "Federal Deficit to Decline to $514 Billion (U.S.): CBO. According to a new report, the Congressional Budget Office is projecting the American federal government deficit to fall to $514 billion (U.S.) for the fiscal year ending September 30, 2014. Such a figure would represent 3% of the country's gross domestic product (GDP), down from $680 billion (U.S.) in fiscal 2013. While the CBO report forecasts a short-term narrowing of the deficit, the agency also projects deficits to escalate again over the next decade, as a result of rising health care costs and increasing interest payments to service outstanding issues of U.S. Treasury notes and bonds. The CBO report forecasts the deficit will exceed $1 trillion (U.S.) again in 2022 and reach $1.074 trillion (U.S.) or 4% of GDP in 2024; at which time publically held debt will reach $21.3 trillion (U.S.), or 79.2% of GDP; up from $12.7 trillion (U.S.), or 73.6% this year."

- Front Page Headline, Reuters –"S&P Downgrades Puerto Rico's Credit Rating to Junk Status. Standard and Poor's downgrades Puerto Rico's sovereign debt credit rating from 'BBB' (Low) to 'BB' – one level below investment grade. With about $70 billion (U.S.) of general obligation debt outstanding, the Commonwealth has been under the threat of a rating downgrade for months. S&P stated: 'We are worried that Puerto Rico has not only, a limited ability to issue more debt in the American municipal bond market, but also, faces possible cash shortages. We believe these liquidity constraints do not warrant an investment grade credit rating."

- Front Page Headline, Financial Times – "New York Regulator Opens Currency Probe. New York's Department of Financial Services (DFS) – the State's top banking regulator – has demanded documents from more than a dozen banks, opening a new front in the sprawling global investigation into alleged for-

WEDNESDAY, FEBRUARY 5TH



Sources: New York and California Treasury Departments, Governing Magazine, Morningstar, U.S. Census Bureau, United Nations, U.S. Bureau of Labor Statistics, World Bank, Puerto Rico Police Department, Washington Post.

eign exchange manipulation, according to an informed source who requested confidentiality. DFS Superintendent Ben Lawsky has sent requests for documents to several banks including Deutsche Bank, Goldman Sachs, Lloyds, Standard Chartered, Barclays and the Royal Bank of Scotland. The intervention by Mr. Lawsky comes just a day after the U.K.'s Serious Fraud Office confirmed allegations that traders colluded to rig prices in the $5.3 trillion (U.S.) spot market were every bit as bad as Libor rigging claims; which have resulted in over $6 billion (U.S.) of fines … Mr. Lawsky – a former U.S. prosecutor – joins an already sprawling investigation that includes the U.S. Department of Justice (DOJ) and the Commodity Futures Trading Commission (CFTC); as well as the U. K.'s Serious Fraud Office and Financial Conduct Authority. At least 15 banks are either co-operating with regulators globally or are conducting their own internal investigations."

THURSDAY, FEBRUARY 6TH

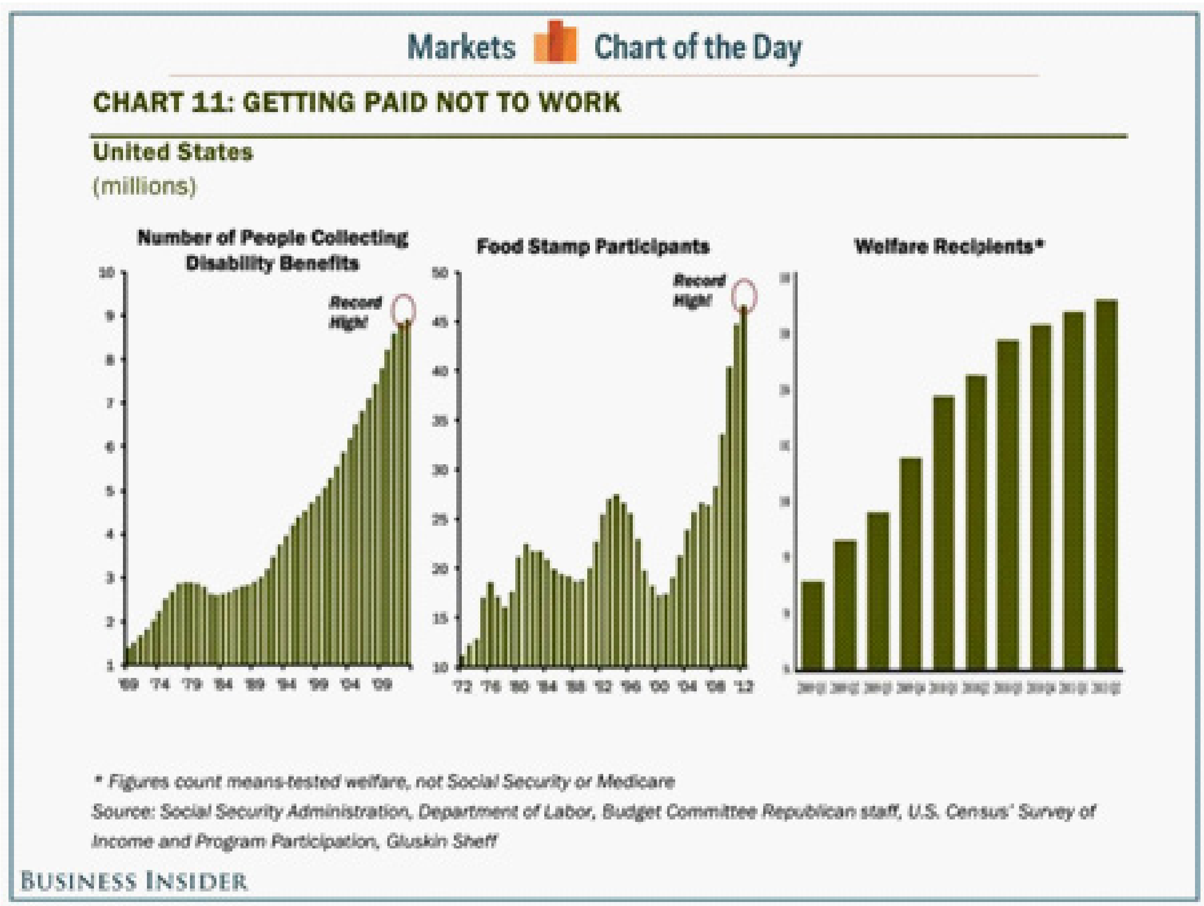
- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 20,000 to 331,000 in the week ended February 1st. while continuing claims increased by 15,000 to 2.96 million in the week ended January 26 th. Meanwhile, the U.S. Senate failed to advance a bill that would renew expired benefits for the longer-term unemployed. Democrats needed 60 votes to advance a three-month extension of benefits but fell one vote short. While more than 1.3 million Americans lost emergency or extended unemployment benefits as of January 1st., at least 70,000 additional people will not receive longer-term benefits with each passing week.

- Front Page Headline, Bloomberg News – "Ex-SAC Fund Manager Martoma Found Guilty in Insider Trading Case. Former SAC Capital Advisers fund manager Mathew Martoma is found guilty in the most lucrative insider trading scheme ever uncovered on Wall Street. Indeed, federal prosecutors have now won seven convictions in the six-year probe of the SAC hedge fund and its billionaire founder Steven A. Cohen. Jurors in Manhattan federal court found Martoma, 39, used secret tips on clinical trials of an Alzheimer's disease drug called bapineuzumab to trade Wyeth and Elan Corp. shares. By so doing, Martoma reaped a $275 million (U.S.) benefit for the hedge fund. He chose to risk a jury trial after rejecting federal offers of a deal for co-operation. The jury reached a verdict within three days of deliberations. Martoma faces a maximum of 20 years in prison on the most serious counts. In a Bloomberg interview, Anthony Sabino, a law professor at St. John's University in New York, commented: 'The Martoma conviction is a major win for the government. It may embolden prosecutors to go after Mr. Cohen (himself).'

Former SAC Capital Advisors portfolio manager Mathew Martoma. Source: Bloomberg

- The Commerce Department reports America's trade deficit widened by 12% in December to $38.7 billion (U.S.). David Sloan, an economist at 4 Cast Inc. in New York observed: "There's still a slight tendency for the trade deficit to be narrowing. The reduced U.S. dependence upon imported energy is quite an important factor."

- Front Page Headline, Business Insider – "The Stunning Rise of Disability, Food Stamp and Welfare Benefits. In the wake of the financial crisis and great recession, the U.S. unemployment rate has declined precipitously from 10% to 6.7% in just four years. In testimony to the U.S. Senate Budget Committee, Gluskin Sheff Economist David Rosenberg expounded: 'Only three other times in the past six decades has the unemployment rate fallen this far this fast: in the early 1950s when (GDP) growth averaged 6.7% per annum; in the late 1970s when GDP growth averaged 4.8% and in the mid-1980s when GDP growth averaged 5.2%. Today we accomplished this feat with only a 2.4% (GDP) growth rate, which is disturbing because it means that it is not taking much in the way of incremental economic activity to drain valuable resources out of the labour market … One theory which deserves examination is that we may have an abundance of separate benefits programs which provide for the disenfranchised in a very piecemeal and inefficient manner, which perhaps are also abused or overly relied upon by some, which may lead to a distortion of work incentives." Mr. Rosenberg is talking about disability, food stamps and welfare etc. Whether or not these programs are being used legitimately, it is none the less stunning to see how much these programs have expanded."

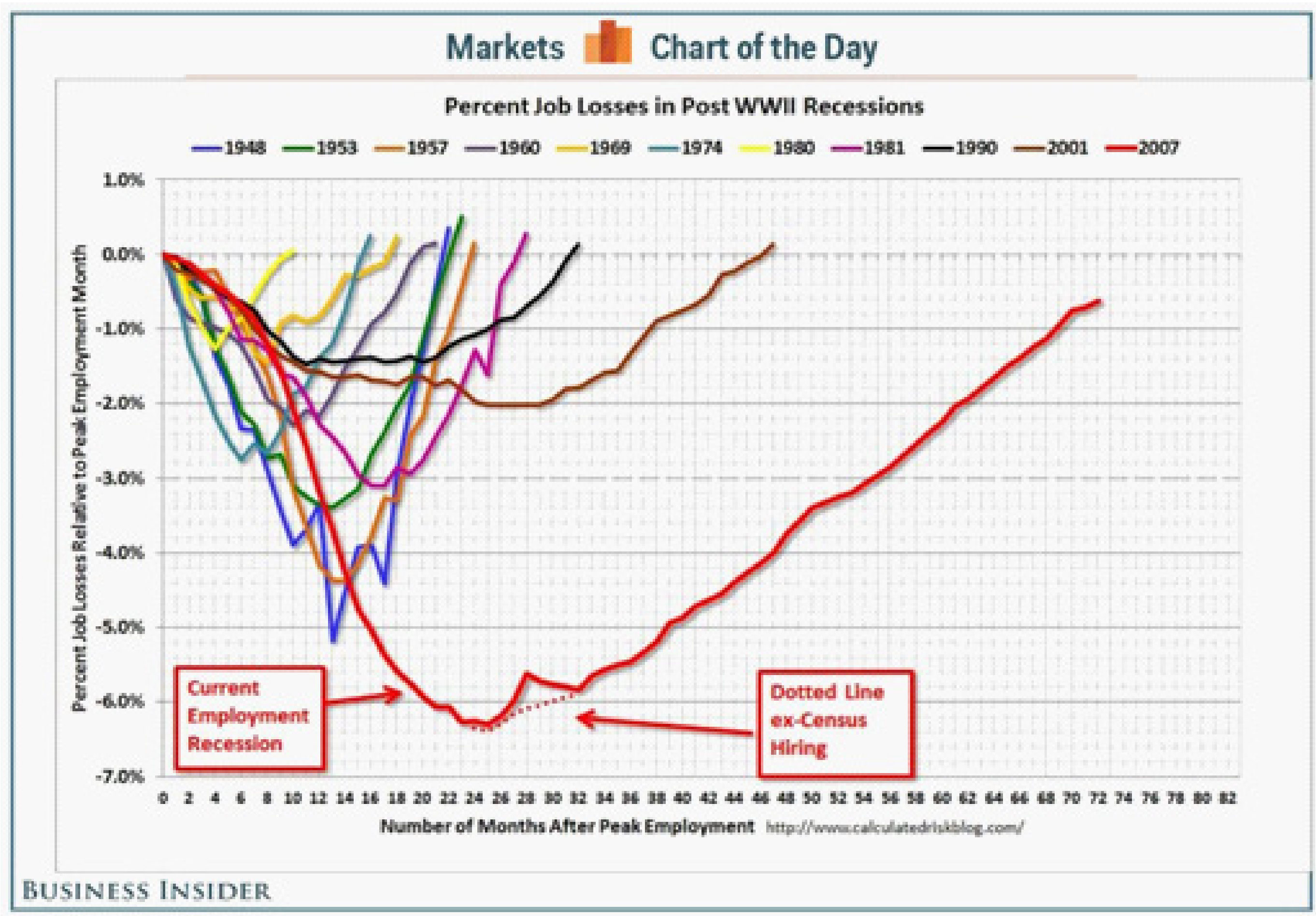


FRIDAY, FEBRUARY 7TH

- Front Page Headline, Mish's Global Economic Trend Analysis – "Spain Misses Budget Deficit Targets for 2013. Via translation from Libre Mercaado, Spain's Treasury announced a deficit of 5.44% of GDP in November, but official data elevated that number to 5.96%. Taking a December shortfall estimate into consideration, the deficit estimate is about 6.9% of GDP for 2013. Spain's Economy Minister Luis de Guindos recently stated: 'The 2013 deficit will converge toward the target of 6.50% of GDP through improved tax collection and lower debt servicing costs.' The deficit is not the only accounting chicanery. Tax data used to calculate GDP has little or nothing to do with reality … Until June 2013, the general government deficit target for 2013 was 4.5% of GDP and not 6.5%. The government of Mariano Rajoy managed to smooth the path of fiscal consolidation after pressing insistently to Brussels. In any case, the final deficit figure will not been known for possibly some time yet, after the successive and traditional budget and GDP revisions specific to the Spanish authorities are calculated, as per usual."

- The Economy Ministry in Berlin reports German industrial production declined by a seasonally adjusted 0.6% in December, following a revised increase of 2.4% in November. Today's report also revealed manufacturing output fell by 0.5% in December and investment goods production dropped by 2.5%. However, the Economy Ministry commented: "Perspectives for industrial production in 2014 remain positive amid lively order intake and an improvement in business confidence."

- The Labor Department reports U.S. non-farm payrolls increased by 113,000 in January, following a revised gain of 75,000 in December. The official unemployment rate declined slightly to 6.6% from 6.7% in November. Bill McBride at Calculated Risk plots a monthly chart which puts the U.S. employment recovery into better perspective: "This graph (below) shows the (U.S.) job losses from the beginning of the employment recession – in percentage terms – compared with previous WWII recessions. The dotted line represents ex-Census hiring. This illustrates the depth of the recent employment recession – worse than any other post war recession – and the relatively slow economic recovery due to the lingering effects of the housing bust and financial crisis."



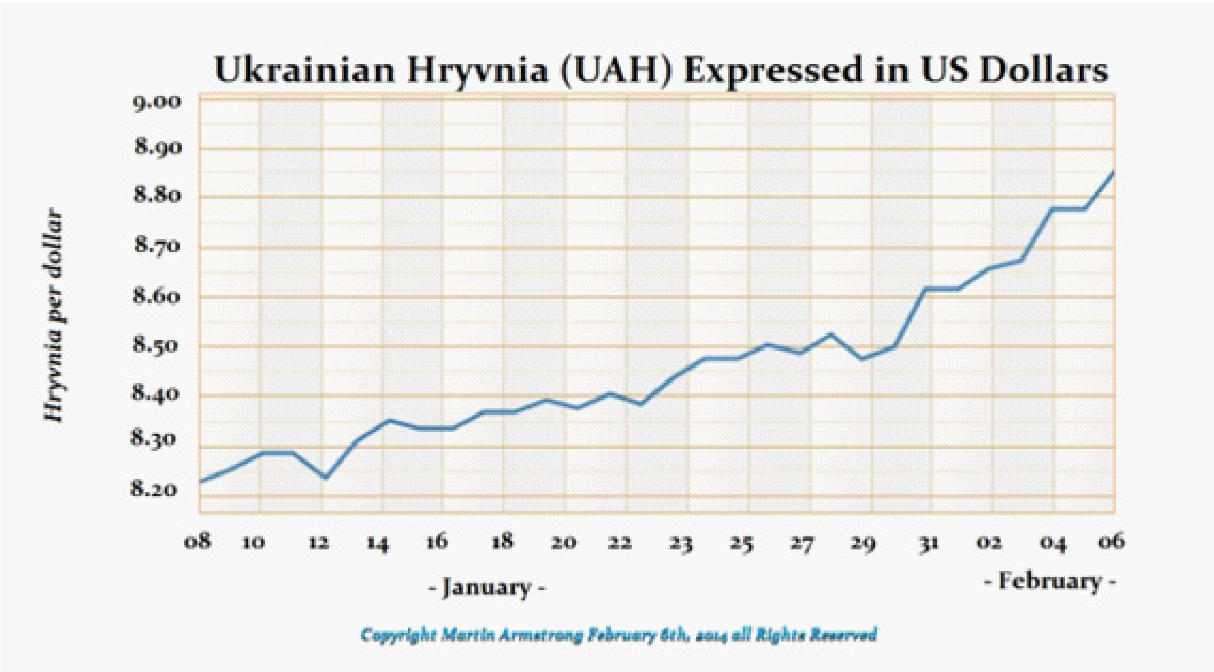
- Front Page Headline, Armstrong Economics – "Ukraine Forced to Float Its Hryvnia Currency.

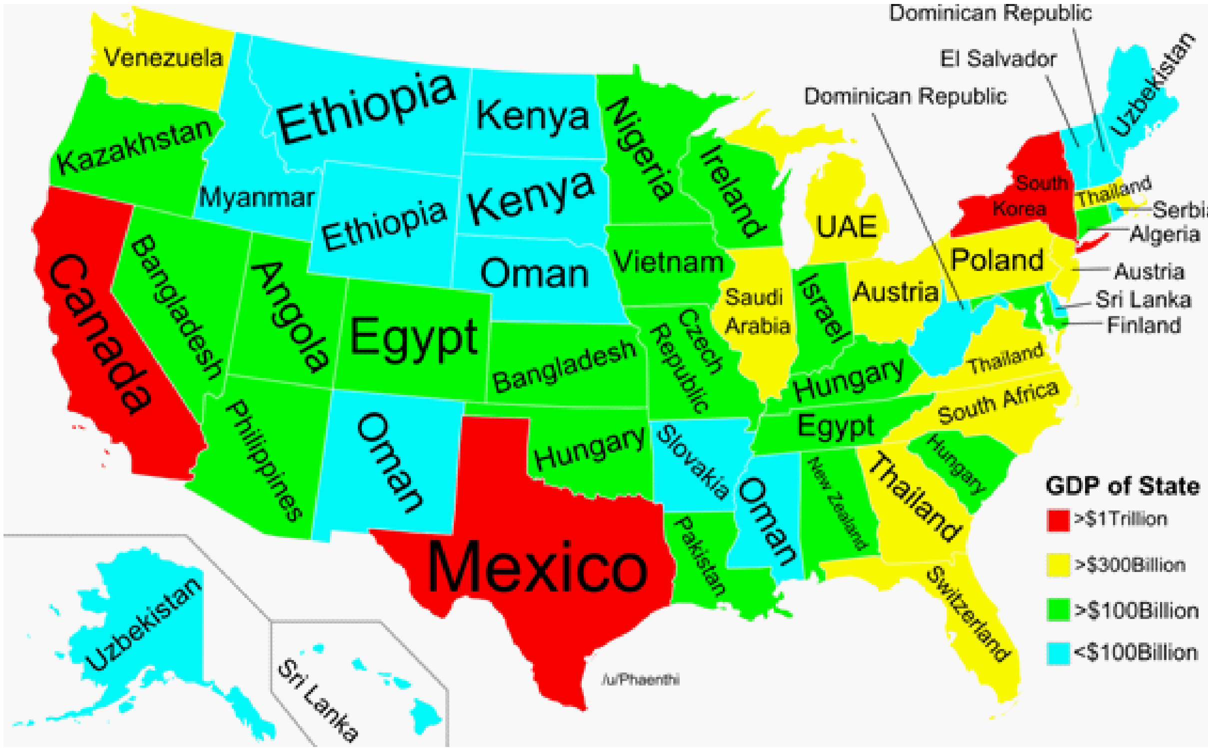
Source: Armstrong Economics

The increasing fear of war in Ukraine has propelled people to buy U.S. dollars to the point where the government has now placed restrictions on their acquisition. Ukraine's currency reserves have declined so dramatically that the national currency, the hryvnia, is now hanging in mid-air. The National Bank of Ukraine has been forced off the official exchange rate for the overvalued currency, because it would have been depleted of all reserves by pretending there is nothing awry.

Therefore, on February 7th. the central bank introduced a new exchange rate for the hryvnia at 8.708 to the U.S. dollar, in what appears to be an attempt to meet the lending requirements of the International Monetary Fund (IMF). The currency will now float and that will result in a further decline against the U.S. dollar. This geopolitical crisis is reflected in the currency and is what we've been trying to explain, that it is always a matter of confidence. This crisis is also having a negative impact on Russian banks which ventured into Ukraine for business reasons prior to the Lehman Brothers crisis of 2008. The ripple effect in the currency market will be profound. This will cause a contagion that will further hit the emerging markets, since any conflict between Russia and the U.S. will accelerate into the sum of all fears everywhere. Keep in mind, this is government against government."

- Front Page Headline, Business Insider – "The GDP of U.S. States Compared to Countries around the World. While the map below is not adjusted for population size, California is the obvious powerhouse, with a GDP of about $2 trillion (U.S.) in 2012, compared to Canada's 2012 total of about $1.82 trillion (U.S.). The 2012 GDP of Texas was about $1.4 trillion (U.S.), making it considerable bigger than Mexico's $1.18 trillion (U.S.). New York saw a 2012 GDP of about $1.2 trillion (U.S.) compared to South Korea's $1.12 trillion (U.S.). Illinois ($695 billion U.S. 2012 GDP), driven by private industries and manufacturing, is comparable to Saudi Arabia ($711 billion U.S.) and its oil-driven economy. The 2012 GDP of America in total was about $16.2 trillion (U.S.)."





CLOSING LEVELS FOR FRIDAY, FEBRUARY 7TH.		WEEKLY CHANGE
Dow Jones Industrial Average	15,794.08	+ 95.23 points
Spot Gold Bullion	$1,262.90 (U.S.)	+ $23.10 per oz.
S&P / TSX Composite	13,786.50	+ 91.56 points
10-Year U.S. Treasury Yield	2.68%	+ 4 basis points
Canadian Dollar	90.59 cents (U.S.)	+ 0.81cent
U.S. Dollar Index Future	80.72	– 0.532 cent
WTI Crude Oil Futures	$99.88 (U.S.)	+ $2.39 per barrel

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