

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



Monday, May 26th

Front Page Headline, Bloomberg News – “Poroshenko Defies Russia with a Vow against Separatist Rebel Attacks. In a victory speech from Kiev, Ukrainian President-elect Petro Poroshenko vowed: ‘There will be a sharp increase in the efficiency of anti-terrorist

MONDAY, MAY 26TH

Memorial Day Holiday in the United States of America

operations. They won't last a few months, only a few hours.' Mr. Poroshenko is faced with a contracting gross domestic product (GDP) and a pro-Russian separatist movement that has captured large swathes of the Donetsk and Luhansk regions, threatening to have these eastern regions annexed by Russia, as was the Black Sea Crimean peninsula in March. In a statement from Washington, U.S. Secretary of State John Kerry reasserted: 'America respects Ukraine's sovereignty and territorial integrity, condemns and rejects Russia's occupation of Crimea and remains committed to working with Ukraine and other partners to find a peaceful resolution to the conflict.'



Ukrainian President-elect Petro Poroshenko.
Photo source: Getty Images

- Front Page Headline, Mish's Global Economic Trend Analysis – “Former Bundesbank Vice President Recommends Gold. Anyone who is thinking clearly knows the economic system being fostered by central banks today is totally and completely out of control. Repetitive rounds of quantitative easing, competitive currency debasement, interest rates at zero and sponsorship of the internet bubble; followed by the housing bubble; followed by the current stock market bubble are proof enough ... Jurgen Stark, a former vice-president of Germany's Bundesbank and a former economist for the European Central Bank (ECB) states: 'The System Is Out of Control.' Via translation from Libre Mercado, here are a few excerpts. Mr. Stark, until recently one of the big hawks at the German Bundesbank for his fierce defense of monetary orthodoxy, resigned his post in late 2011 for his outright rejection of the purchase of government bonds by the ECB, launched by the then president of the institution Jean Claude Trichet. Since then, Mr. Stark has used his rare, but valuable public appearances to warn of the risks associated with the current policies of the central banks to the economic crisis.

Mr. Stark spoke openly at a recent conference organized by the Ludwig Von Mises Institute in Austria, recommended to protect the attendees directly from a probable collapse of the global monetary system. Mr. Stark noted: 'Central banks, including the ECB, have completely lost, not only all ability to control, but also, their perspective on the economic situation ... since the whole system is pure fiction. While the monetary authorities have been groping since 2008 to avoid a second Lehman Brothers, if it were to occur, the global monetary system would not survive.

The problem is the monetary model itself, i.e. the printing of paper currency without real backing and the multiplier by which commercial banks can expand credit, uncontrolled without prior savings. Personally, I recommend allocating part of this fictional savings to investment in traditional safe havens, such as gold bullion or silver. The fragile economic recovery in Europe is not due to the absence of monetary and fiscal stimuli, but rather to the slow deleveraging process and lack of structural reforms. Far from helping, the loose monetary policy of the ECB is actually hampering the economic recovery, as in advanced free markets on multiple occasions.

The key to economic growth and the creation of jobs on solid foundations and to end the economic crisis, is to increase competitiveness. To do so, we must continue gaining flexibility. While progress has been made, it's still not enough; and while the situation has improved, the economic crisis is not over. The probability of default is too low, as reflected by the markets by the decline in bond yield spreads and insurance against defaults (CDS). While capital appreciation has enabled a stronger euro, the crisis markets remain distorted. We should not be happy with what has happened to date." See also, Economic Winter – It's Still the Debt, Stupid – March 21, 2014.

TUESDAY, MAY 27TH

- The Commerce Department reports U.S. durable goods – products expected to last at least three years – orders rose by 0.8% in April, following an upwardly revised gain of 3.6% in March. Robert Brusca, President of Fact & Opinion Economics in New York noted: "We're witnessing a nice upward trend for durable goods orders. They're going to be an important contributor to GDP growth."
- The New York-based Conference Board reports its U.S. consumer confidence index rose to a reading of 83 in May from a level of 81.7 in April. In a statement, Lynn Franco, director of economic indicators at the Conference Board, observed: "Expectations for the short-term outlook for the economy, jobs and personal finances were also more upbeat."
- Front Page Headline, National Post – "U.S. Imposes New Conditions on Keystone XL Pipeline Construction. American safety regulators have quietly placed two extra conditions on the construction of TransCanada Corp.'s Keystone XL oil pipeline after learning of potentially dangerous defects involving the southern leg of the Canada-to-Texas project. The defects – high rates of bad welds, dented pipe and damaged pipeline coating – have been fixed. However, the U.S. Pipeline and Hazardous Materi-

als Safety Administration wants to ensure that similar problems don't occur during construction of the pipeline's controversial northern segment, which has been delayed pending a decision by the Obama administration. One condition requires TransCanada to hire a third-party contractor chosen by the pipeline safety agency to monitor the construction and send inspection reports to the safety administration on whether the work is sound. The second condition requires Trans Canada to adopt a quality management program to ensure 'this pipeline is – from the beginning – built to the highest standards by both Keystone personnel and its many contractors.'

Inspections by the safety agency last year found TransCanada wasn't using approved welding procedures to connect pipes. The company had hired welders who weren't qualified to work on the project because TransCanada used improper procedures to test them. In order to qualify to work on a pipeline, welders must have recent experience using approved welding procedures and pass a test of their work. Robert Bea, a certified welder who acted as an expert consultant on the construction of the Trans Alaska pipeline in the 1970s; and who is now professor emeritus of civil and environmental engineering at the University of California, Berkeley, commented: 'Not only were the weld failure rates horrible, but also, the level of defects is indeed cause for alarm and indicative of something that is occurring within the Keystone organization which isn't satisfactory. In high-risk projects such as nuclear submarines or nuclear power plants, even one tenth of one per cent of bad welds is a cause for deep concern. In this case, we are talking about a pipeline which has requirements on its performance that rival those of a nuclear power plant. Coatings protect the pipeline from corrosion, but if dented or damaged, they can become serious defects which weaken pipes and lead to failures.'



Welders secure a joint between two sections of pipe near Prague, Ok. Source: Bloomberg

- The S&P/Case-Shiller group reports their index of property values for twenty U.S. cities rose by 12.4% in March on a year-over-year basis – the smallest 12-month gain since July 2013 – following an annual increase of 12.9% in February. Michael Gapen, an economist at Barclay’s Capital in New York, commented: “The upward trajectory of home prices remains in place, but with a slower rate of appreciation. There’s still some reason to suspect that home prices will rise moderately, given improving credit availability and progress in the labor market.”
- Front Page Headline, Financial Times – “Lagarde and Carney Level Warnings at Financial Sector. Speaking at a London conference on inclusive capitalism, International Monetary Fund (IMF) Managing Director Christine Lagarde warned: ‘Fierce industry resistance by the financial sector is delaying much-needed reforms and risks destabilizing the global economy. Progress on building a safer financial system has been too slow, primarily because of industry attempts to halt the introduction of tougher new rules. Also, continued misconduct within the financial services industry has not changed fundamentally in a number of dimensions since the onset of the financial crisis; including money laundering and the manipulation of benchmark interest rates such as the London Interbank Offered Rate (Libor). Some prominent firms have even been mired in scandals which violate the most basic ethical norms. While some behavioral changes are happening ... the industry still prizes short-term profit over long-term prudence; that is to say, today’s bonus over tomorrow’s relationship.’”



IMF Managing Director Christine Lagarde. Source: Financial Times

Speaking at the same conference, Bank of England Governor Mark Carney warned: ‘Rising inequality and recent demonstrations of corruption have damaged the social fabric. When combined with the longer term pressures of globalization and technology on the basic social contract, an unstable dynamic of declining trust in the financial system and growing exclusivity of capitalism threatens.’ Mr. Carney, who also chairs the International Financial Stability Board, cautioned: ‘The scandals

highlighted a malaise in the corners of finance which must be remedied. We must explore potential moves to improve the principles of fair markets, codes of conduct for specific markets and even regulatory obligations within that framework.”

WEDNESDAY, MAY 28TH

- The Nuremberg-based Federal Labour Agency reports the number of Germans out of work increased by a seasonally adjusted 23,937 to 2.905 million in May, but the official unemployment rate remained unchanged from April at 6.7%. Andreas Scheuerle, an economist at Dekabank in Frankfurt, commented: “We must acknowledge that the peak of economic momentum is behind us.”
- Edinburgh-based Royal Bank of Scotland Group Plc – Britain’s largest state-owned bank – announces plans to cut hundreds of U.S. jobs while reducing its mortgage trading business by two-thirds within the next 12 to 18 months. RBS spokesman Scott Eichel stated: “Now it’s back to normality, which is origination, distribution and financing business.”
- Front Page Headline, Wall Street Journal – “Spain Still Suffering Fallout from Housing Bust. Xacobo Rodriguez is 38 years-old, unemployed and with an infant child living in a constant state of dread: ‘You always fear the day when there will be a knock on the door and then you will be evicted from your home.’ Mr. Rodriguez is one of the many Spaniards who cannot afford the pricey mortgages taken out before a property bubble burst in 2008. Worse still, his mother who guaranteed his mortgage with her own home, is also at risk. Mr. Rodriguez acknowledges: ‘I fear we both might sink.’ Six years after the collapse of the real estate market wrecked Spain’s economy, no end is yet in sight to a housing crisis which has triggered tens of thousands of foreclosures and left many homeowners living with the threat of losing their properties. Last week, the Bank of Spain reported that banks had repossessed 38,961 primary residences in 2013, a minimal decline of less than 1% from 2012. When second residences are included, the total number of houses seized last year increased by 11%.

Statistics have sparked renewed debate about the efficacy of government measures to assist mortgagors, as existing government relief programs are obviously inadequate to cope with the scope of the problem. Amid growing protests and some high profile suicides of indebted homeowners in 2012, the government decreed a two-year moratorium on the eviction of families who meet hardship criteria, such as having a disabled family member, expired unemployment benefits, or very young children. A law passed last year fleshed out some of the measures

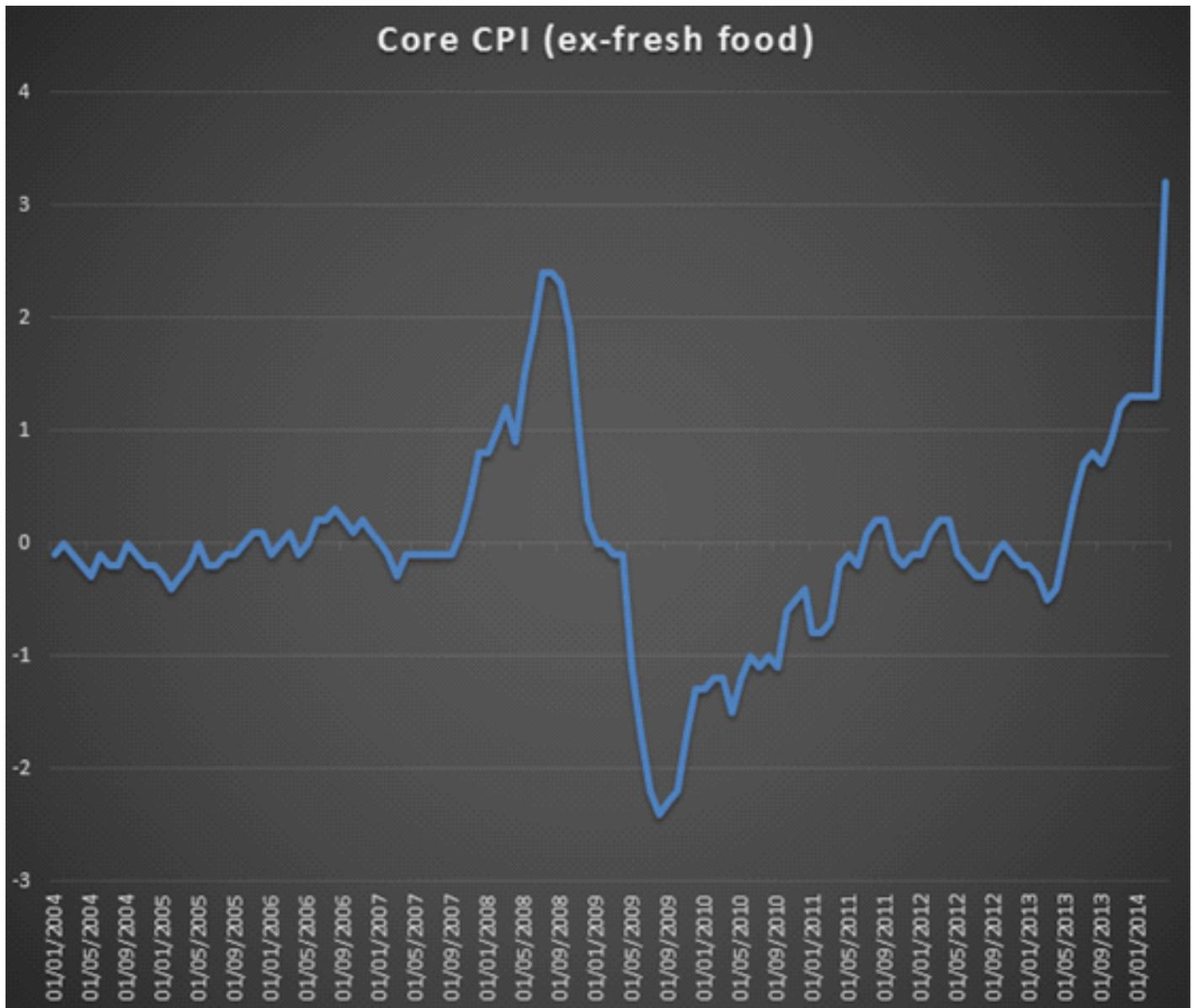
in the decrees, including the creation of a Social Housing Fund with 6,000 units for debtors needing a place to live. However, those policies have proven to be inadequate given the dimension of the problem.”

THURSDAY, MAY 29TH

- Front Page Headline, Financial Times – “Japan’s Inflation Rate Jumps to 3.2% Due to Sales Tax Hike. Japan’s core consumer prices rose to their highest level in over a decade in April, resultant from a 3% consumption tax increase which retailers passed along to their customers.”

- The Commerce Department reports the U.S. gross domestic product (GDP) declined by a downwardly revised annualized rate of 1% in the 1st. quarter, citing inventories expanded at less than half the pace than in the final quarter of 2013; thereby cutting 1.6% from the GDP while business fixed investment also contracted.

- The Washington-based National Association of Realtors (NAR) reports its U.S. pending home sales index rose by 0.4% in April to a reading of 97.8 on a seasonally adjusted basis, following a 3.4% increase in March. A reading of 100 corresponds to the average level of contract activity in 2001, or ‘historically healthy’ home-buying traffic, according to the NAR.



Source: Bank of Japan

- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 27,000 to 300,000 in the week ended May 24th. while continuing claims fell by 17,000 to 2.63 million in the week ended May 17th. The unemployment rate among people eligible for benefits held steady at 2% in the week ended May 17th.

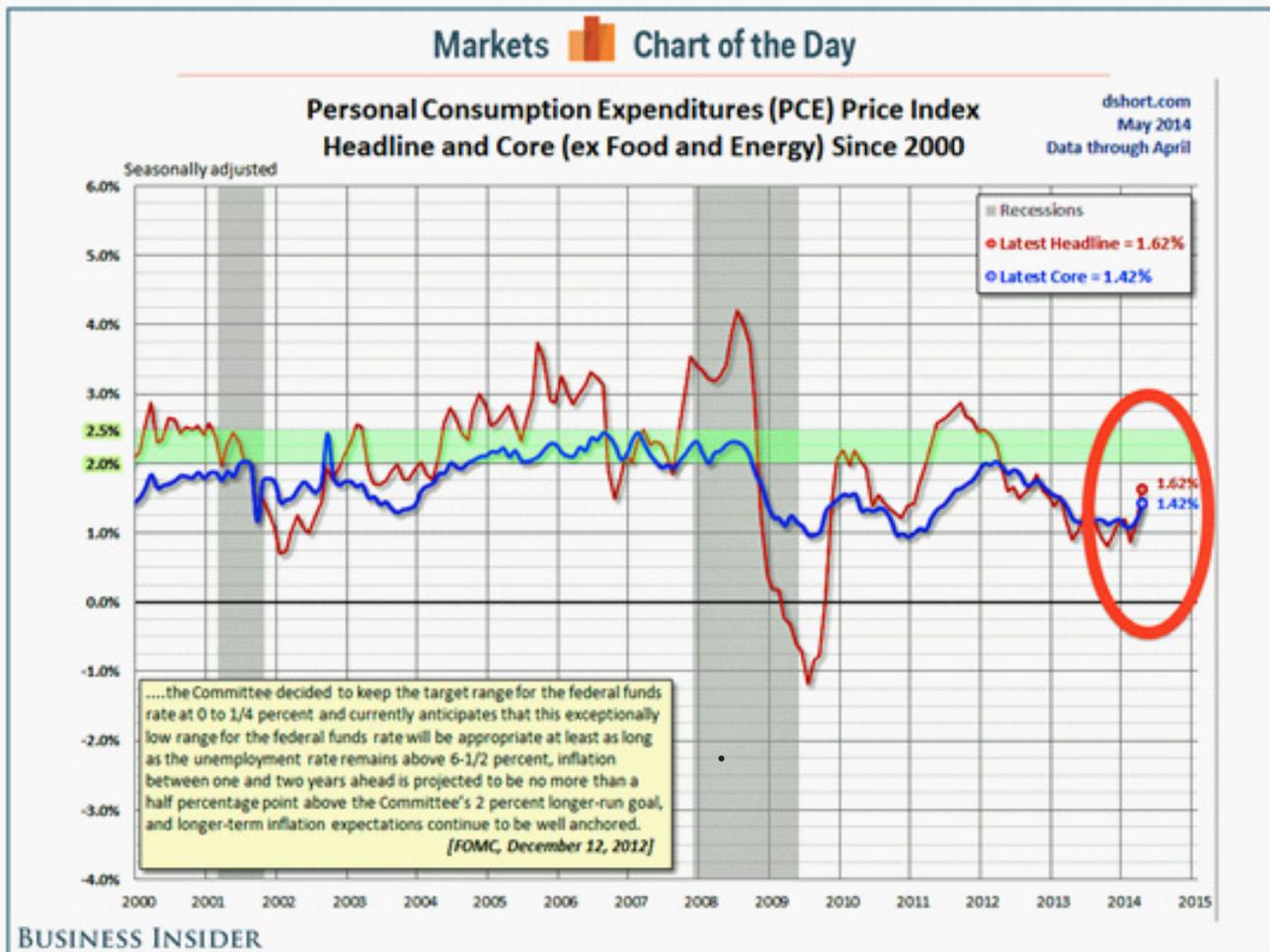
- Statistics Canada reports the nation's current account deficit narrowed to \$12.39 billion (CAD) in the 1st. quarter, citing a stronger export sector particularly for energy shipments. Total exports rose by \$6.51 billion (CAD) to \$127.72 billion (CAD), the highest level since the 3rd. quarter of 2008. Canadian investment in foreign securities was \$10.36 billion (CAD) higher than foreign investment in Canadian securities.



Students train to become electrical linemen at Los Angeles Trade-Technical College. Photo source: Bloomberg

FRIDAY, MAY 30TH

- Front Page Headline, Business Insider – “PCE Price Index Is on the Rise. The Federal Reserve’s favourite gauge of U.S. inflation is the Personal Consumption Expenditures (PCE) Price Index. According to the April report from the Bureau of Economic Analysis (BEA), the PCE Index rose by 1.6% on a year-over-year basis, while the core rate – excluding food and energy – increased by 1.4%. This represents a notable acceleration from the 1.1% and 1.2% respectively, registered in March. Chris Rupkey, an economist at the Bank of Tokyo Mitsubishi, commented: ‘If the U.S. inflation rate is climbing closer to the Fed’s 2% target ... more normal administered interest rates are out there on the



the horizon and one won't need a pair of binoculars to see it coming."

- Statistics Canada reports the nation's gross domestic product (GDP) grew at an annual rate of 1.2% in the 1st. quarter – following a 2.7% annual pace of growth in the final quarter of 2013 – citing slower growth in final domestic demand i.e. lower spending levels by consumers, governments and businesses.
- The Thomson Reuters / University of Michigan group reports their index of consumer confidence declined to a final reading of 81.9 in May from a level of 84.1 in April. The economic conditions sub-index fell to a reading of 94.5 from 98.7 and the economic outlook index declined to a level of 73.7 from 74.7.
- Front Page Headline, Financial Times – “BNP Paribas Faces Possible \$10 Billion (U.S.) Fine by American Regulators. The investigation by U.S. authorities focuses on whether BNP violated sanctions and anti-money laundering rules between 2002 and 2009, by disguising transactions in U.S. dollars with countries including Iran, Sudan and Cuba. The settlement could include a suspension of BNP's ability to clear U.S. dollar transactions, which would be a serious blow to the bank, hurting its ability to serve clients of its wholesale bank; as well as its large U.S. retail bank. Yohan Salleron, a Paris-based fund manager at Mandarine Gestion, cautioned: “While we don't know the exact amount of the fine, \$10 billion (U.S.) would be very bad news. BNP may have to cut its dividend for this year and possibly next year also.”

CLOSING LEVELS FOR FRIDAY MAY 30TH.

		WEEKLY CHANGE
Dow Jones Industrial Average	16,717.17	+ 110.90 points
Spot Gold Bullion	\$1,246.00 (U.S.)	– \$45.70 per oz.
S&P / TSX Composite	14,604.16	– 103.94 points
10 – Year U.S. Treasury Yield	2.48%	– 5 basis points
Canadian Dollar	92.23 cents (U.S.)	+ 0.23 cent
U.S. Dollar Index Future	80.391	+ 0.037 cent
WTI Crude Oil Futures	\$102.71 (U.S.)	– \$1.64 per barrel

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