LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

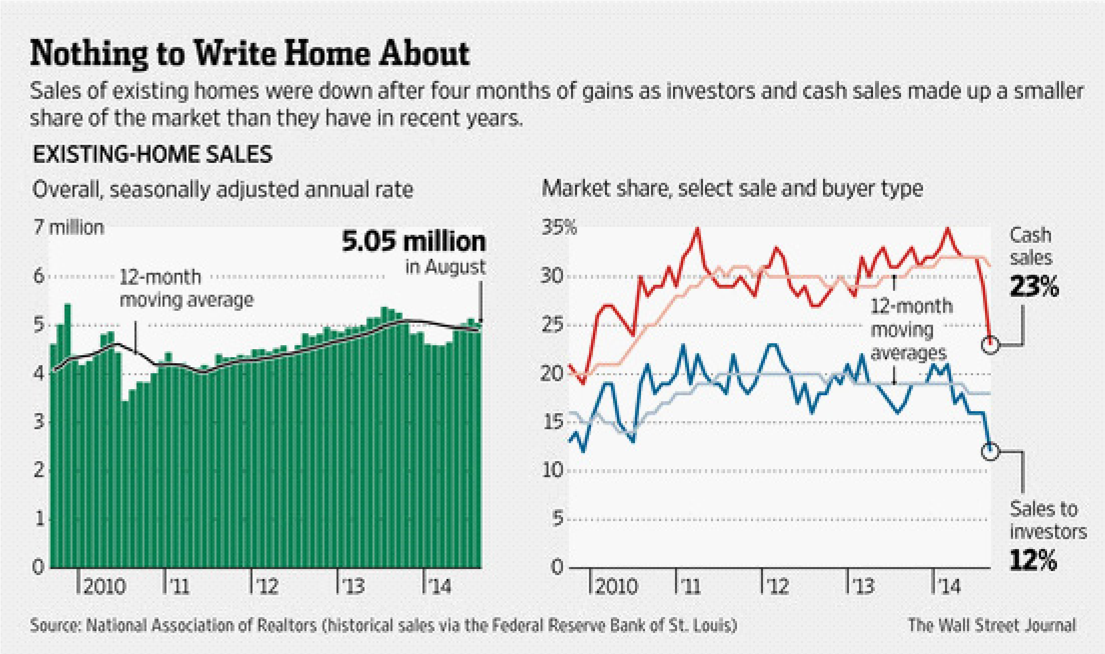
THAT WAS THE WEEK THAT WAS

Monday, September 22nd

The Washington-based National Association of Realtors (NAR) reports U.S. existing home sales declined by 1.8% in August to an annual pace of 5.05 million units, following a rate of 5.14 million units in July. At a news conference, NAR Chief Economist Lawrence

MONDAY, SEPTEMBER 22ND

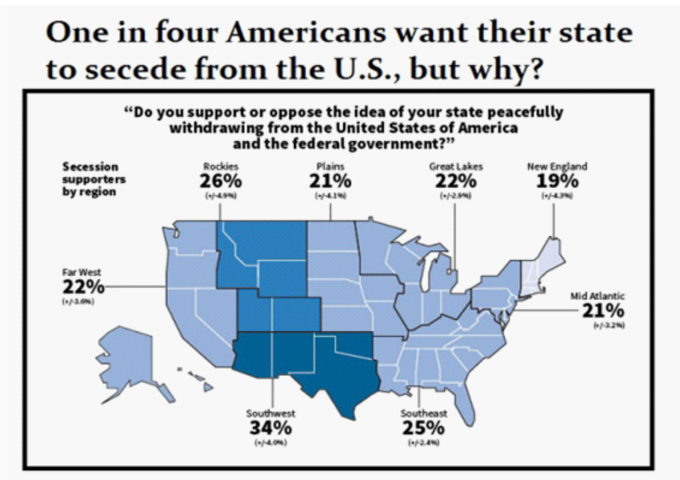
Yun stated: "The decline in existing home sales last month was primarily attributable to investors stepping out of the housing market, since all cash sales fell to about 23% of the total from the usual 33%. Separately, the demand for homes priced at $100,000 (U.S.) or less fell by 15.9% in August, reflecting a lack of inventory in distressed properties, which included home foreclosures."



TUESDAY, SEPTEMBER 23RD

- Markit Economics reports the preliminary reading for its U.S. manufacturing Purchasing Managers' Index (PMI) was unchanged at 57.9 in September – a 52-month high – citing manufacturers increased their hiring pace by the fastest rate since March 2012.

- Front Page Headline, Armstrong Economics – "American Secession Movements. Martin Armstrong warns: 'At the Berlin Conference, we also stated that we would see the U.S.A. split as well along political, economic and religious grounds. Reuters has now published the results of polls asking: Should your state secede from the United States? Here are the results. On the average, 25% of Americans feel that they should secede from Washington, D.C. We will see the same trend of secession emerge post the 2016 presidential election. Civil unrest is coming to America sooner than investors think. This will also ignite old feelings of discontent, which are both religious and racial in America."



WEDNESDAY, SEPTEMBER 24TH

- The Commerce Department reports U.S. new single family home sales surged by 18% in August to a seasonally adjusted annual pace of 504,000 units; the highest level since May 2008. July's sales were upwardly revised to a gain of 1.9% from a previously reported drop of 2.4%.

- Front Page Headline, Wall Street Journal – "America's President Obama Addresses Threat from ISIS. In his annual address to the United Nations Assembly in New York, U.S. President Barack Obama cited: 'The cancer of violent extremism in the Middle East is the single global issue which could derail future global progress and as such, the world is at a crossroads. Collectively, we must take concrete steps to address the danger posed by religiously motivated fanatics and the trends which fuel their recruitment. This is what America is prepared to do: to take action against immediate threats … Confronting this challenge will require a broad international coalition to combat the Islamic State, the Sunni militant group in Iraq and Syria which is also known as ISIS and ISIL and for Middle Eastern nations in particular, to address conditions in the region that fuel extremism."

- The Munich-based Ifo Institute for Economic Research reports its German business confidence index – based upon a survey of 7,000 corporate executives' economic outlook for the next 6 months – fell to a reading of 104.7 in September. Carsten Brzeski, an economist at ING in Frankfurt, noted: 'Increased EU geopolitical tensions with Russia are taking a toll in German factory output.' Germany is Russia's biggest EU trading partner."

Munich-based MAN SE, Europe's third biggest truck manufacturer, is scaling back production by reducing hours for 4,000 workers, partly due to a drop in Russian demand.
Photo source: Bloomberg

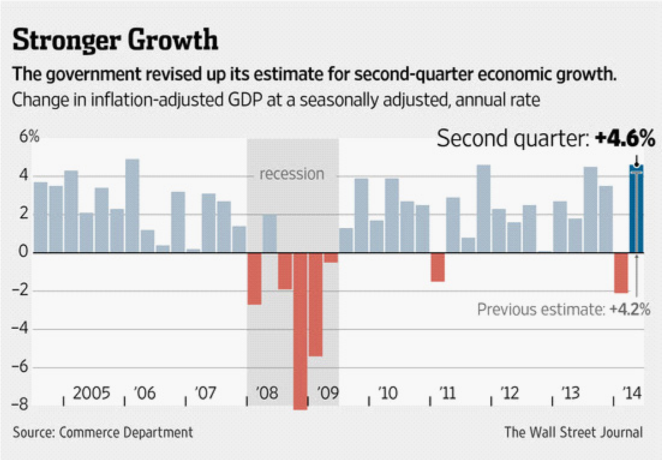
THURSDAY, SEPTEMBER 25TH

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 12,000 to 293,000 in the week ended September 20th. while continuing claims rose by 7,000 to a seasonally adjusted 2.44 million in the week ended September 13th.

- The Commerce Department reports U.S. durable goods – those expected to last for at least three years – declined by 18.2% in August, citing a major drop in demand for aircraft. Meanwhile, bookings for non-military capital goods, excluding aircraft, rose by 0.6% following a 0.2% decline in July.

FRIDAY, SEPTEMBER 26TH

- The Commerce Department reports the U.S. gross national product (GDP) grew at an upwardly revised annual rate of 4.6% in the 2nd. quarter, previously estimated at a pace of 4.2%. Brittany Baumann, an economist at Credit Agricole CINB in New York, commented: "We can definitely see momentum in the domestic economy. Consumer spending should benefit from strengthening labor conditions and improved business investment."



- ADP Payroll Services reports U.S. corporate employers added 204,000 jobs to their payrolls in August, following a revised 212,000 hires in July.

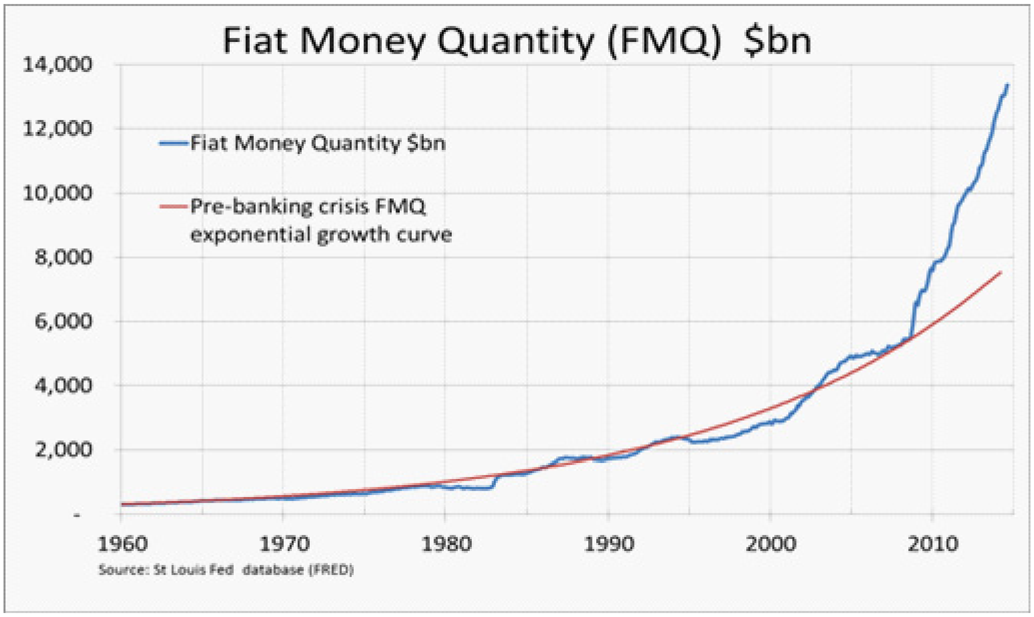
- Front Page Headline, GoldMoney – "The Misinterpretation in the Valuation of Gold Bullion. Researcher Alasdair Macleod writes: 'Today's financial markets are built upon the sand of unsound currencies. Consequently, brokers, banks and investors are wedded to monetary inflation and have lost both the desire and the ability to understand gold and properly value it. Furthermore, governments and central banks in welfare-driven states see the markets themselves as the biggest threat to the successful management of their respective economies; a threat which needs to be tamed. This is the backdrop to the outlook for the price of gold bullion today and of the forces against which a gold investor is pitted.

At the heart of market control is the substitution of unsound currency for sound money, which historically has been gold. Increasing the quantity of currency and encouraging banks to increase credit out of thin air is the principal means by which central banks operate. No matter that adulterating the currency impoverishes the majority of the population; central banks are working from the Keynesian and monetarist manual of how to manage markets.

In this environment, an investor risks all he possesses if he insists on fighting the system and nowhere is this truer than in the gold market. Gold bullion is not about conventional investing in this world of fiat currencies; rather it is about insurance against the financial system collapsing under the weight of its own delusions. Regarded as an insurance premium against this risk, gold is common sense and there are times when it is appropriate for an investor to increase his insurance. In making that decision, an individual must be able to evaluate three things: the relative quantities of currencies to gold, the likelihood of a systemic crisis and the true cost of insuring against it. Let us consider each of these.

The Relationship of Currency to Gold

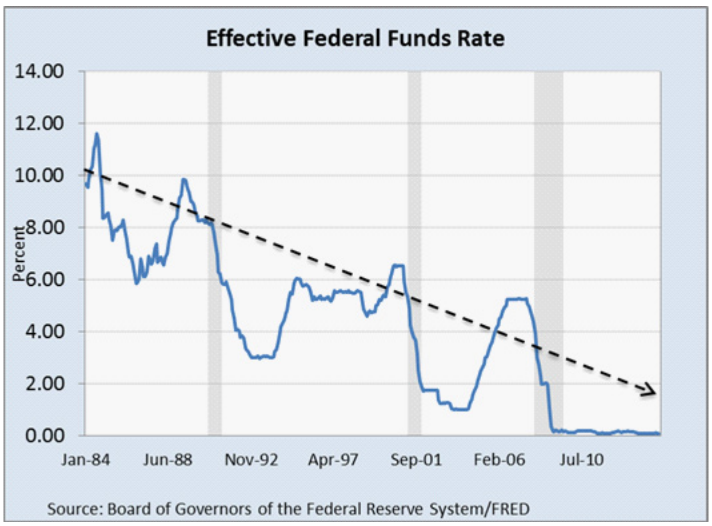
Since the Lehman Bros. crisis of 2008, not only has the quantity of global currency and bank credit expanded dramatically, but also, it is clear that this is a trend that cannot now be reversed, without triggering financial chaos. In other words, we are already committed to monetary hyperinflation. A glance at the chart below reveals the dramatic growth in the quantity of U.S. dollar fiat money since the Lehman crisis.



Meanwhile, the quantity of above-ground stocks of gold bullion is growing at an annual rate of less than 2%. Therefore, gold is becoming cheaper relative to the U.S. dollar day-by-day. One must remember that fiat money quantity (FMQ) is the sum of all fiat money created both on the Federal Reserve's balance sheet and in the commercial banks.

The Increasing Likelihood of a Systemic Crisis

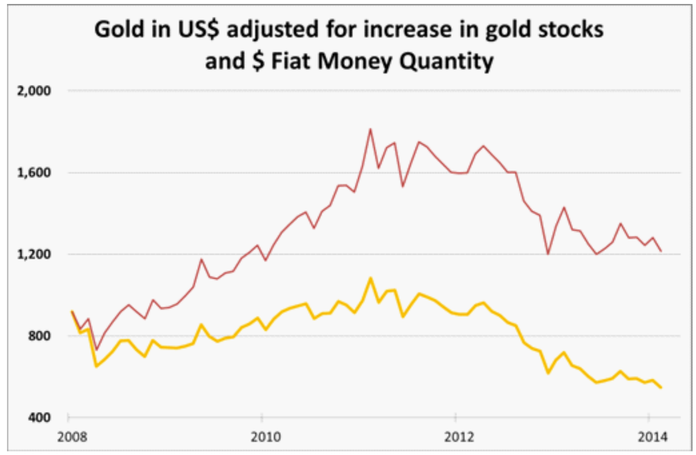
One must pose the question: how high would administered interest rates have to rise before a systemic crisis is triggered? The clue to the answer is illustrated in the chart below, which outlines how lower interest rate peaks have triggered successive recessions (blue shaded areas are official ones).



The reason is simple: it is the accumulating burden of debt. The sum of U.S. federal and private sector debt stands at about $30 trillion (U.S.), so a 1% rise in administered interest rates and Treasury yields would simply cost $300 billion (U.S.) annually. The increase in administered interest rates during the 2004 – 2007 credit boom added annual debt servicing costs of slightly more than $600 billion (U.S.) annually; precipitating the Lehman crisis in 2008. This time, while America might possibly weather a 2% to 3% Federal Funds Rate under improving domestic economic conditions, much less would be required to tip other G8 economies into financial and economic chaos.

The Real Cost of Insurance

By this we mean the real price of gold, adjusted by the rapid expansion of fiat currency. One approach is to adjust the nominal price by the ratio of U.S. dollars in circulation to U.S. gold reserves. This raises two problems: which measure of money supply should be used and given that the Fed has never been audited, are the official gold reserves to be trusted as reported?



Source: GoldMoney

The best option is to adjust the gold price by the growth in the quantity of fiat money (FMQ) relative to the growth of above-ground stocks of gold. FMQ is constructed in order to capture the reversal of gold's demonetization. This is shown in the above chart for both the adjusted and nominal dollar price of gold. Taken from the month before the Lehman collapse, the real price of gold adjusted in this way is $550 (U.S.) today, based upon a nominal price of $1,220 (U.S.) per troy oz. So in real terms, gold has declined by 40% from its pre-Lehman level of $920 (U.S.) and has roughly halved from its adjusted high in 2011.

Summation

1. We already have monetary hyperinflation, defined as an accelerating debasement of the U.S. dollar. So, all other currencies which are referenced to it are on a similar course; a condition which is unlikely to be halted except by a final systemic and currency crisis.
2. Attempts to stabilize the purchasing power of currencies by raising administered interest rates will develop very quickly into financial and economic chaos.
3. The insurance cost of owning gold is anomalously low, being considerably less than at the time of the Lehman crisis, which was the first inkling of systemic risk for many investors.

How Is the Global Economy Performing?

If the global economy begins to grow again, a small increase in administered interest rates would collapse bond markets and bankrupt over-indebted businesses and over-leveraged banks. Alternatively, a contracting global economy will increase the debt burden in real terms, again threatening its implosion. So, the last thing central banks will welcome is a change in the global economic outlook. Falling commodity prices and a flight from other currencies into the U.S. dollar appear to be signaling the greater risk is that we are sliding into a global economic slump. Even though large financial speculators appear to be driving commodity and energy prices lower, the fact remains that the global economy is being undermined by diminishing affordability for goods and services. In other words, the debt burden is already too large for the private sector to bear, despite a prolonged period of zero official administered interest rates.

An economic crisis was halted when stock prices collapsed after Lehman went bankrupt. At that time it was the creation of unlimited money and credit by the Fed that saved the day. Preventing an economic slump is a central banker's raison d'etre. It is the reason why Ben Bernanke wrote about distributing money by helicopter as the final solution. It is why we have seen zero administered interest rates for the last six years. In 2008, gold and oil prices declined heavily until it became clear that monetary stimulus would prevail. Equity prices also fell with the S&P 500 Index down 60% from its 2007 high; but this index had already declined by 24% by the time Lehman failed. The precedent for unlimited creation of cash and credit has been set and is undisputed. At present, stock markets are buoyed by a sea of post-Lehman liquidity, since they are not discounting any trouble and are ignoring the signals from falling commodity prices. If the global economic downturn shows any signs of acceleration, the adjustment is likely to be brutal, involving a complete and sudden reassessment of financial risk.

This time, gold has been in a bear market ahead of the event. This time, the consensus is that insurance against financial and systemic risk is wholly unnecessary. This time, Russia, China and the rest of Asia are buying up physical gold bullion being sold by western investors. Consistently, we are being advised to sell gold by analysts working at investment banks. However, do bear in mind that the investment industry is driven by trend-chasing recommendations, because that is what investors demand."

- Front Page Headline, Armstrong Economics – "Secret Tapes Expose Goldman Sachs' Special Treatment from Fed. U.S. Senator Elizabeth Warren (D.Mass) is insisting that hearings be held on Capitol Hill regarding secret tapes, which allegedly reveal that the Fed is exempting Goldman from various regulations above all other banks. As disclosed by Reuters, the tapes appear to show 'an unwillingness' on the part of some Fed supervisors to not only, demand specific information from Goldman regarding a transaction with Banco Santander, but also, to strongly criticize what former Fed bank examiner Carmen Sagarra concluded was the lack of an appropriate conflict-of-interest policy at Goldman. This has been a legendary problem which has plagued Goldman Sachs through numerous conspiracy theories. It would appear that the tide is beginning to turn against the New York banks and once the Economic Confidence Model turns 75 in 2015, the downside may not look very appealing to the bankers this time around."

U.S. Senator Elizabeth Warren. Photo source: Armstrong Economics

- Front Page Headline, Financial Times – "New York Fed Rejects Claims of Being Too Soft on Goldman Sachs. The Federal Reserve Bank of New York strongly rejected allegations that it was too soft on Goldman Sachs in a transaction involving Banco Santander, after secret recordings of officials at the agency discussing the deal were made public. The recordings were made by former bank examiner Carmen Sagarra, who filed a lawsuit against the New York Fed last October claiming she was fired after she criticized Goldman on its handling of conflict of interest matters. The lawsuit was dismissed by a U.S. federal judge in April of this year.

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CLOSING LEVELS FOR FRIDAY, SEPTEMBER 26TH.		WEEKLY CHANGE
Dow Jones Industrial Average	17,113.15	– 166.59 points
Spot Gold Bullion	$1,215.40 (U.S.)	– $1.20 per troy oz.
Spot Silver	$17.62 (U.S.)	– $0.20 per troy oz.
S&P / TSX Composite	15,026.77	– 238.58 points
10 – Year U.S. Treasury Yield	2.53%	– 4 basis points
Canadian Dollar	89.65 cents (U.S.)	– 1.70 cents
U.S. Dollar Index Future	85.676	+ 0.88 cent
WTI Crude Oil Futures	$93.54 (U.S.)	+ $1.13 per barrel
DJIA / Gold Ratio	14.08	– 0.13 point
Gold / Silver Ratio	68.98	+ 3.71 points

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