

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



Monday, September 8th

The Federal Reserve in Washington reports U.S. consumer credit rose by \$26 billion (U.S.) in July, following an upwardly revised increase of \$18.8 billion (U.S.) in June. Non-revolving loans, which include borrowing for automobiles and college tuitions,

MONDAY, SEPTEMBER 8TH

soared by \$20.6 billion (U.S.) – the biggest increase in three years – while credit card lending rose for the fifth consecutive month. Matt Schulz, an analyst at Credit Cards.com in Austin, Texas, commented: “Consumers are clearly beginning to feel more confident and we’re probably also witnessing some pent-up demand. As long as the nation’s gross domestic product (GDP) growth remains gradual, it is reasonable to assume these numbers will continue to improve.”

- The Cabinet Office in Tokyo reports Japan’s GDP contracted by an annualized 7.1% rate in the three months ended in June – the most since the first quarter of 2009 – following the sales tax hike to 8% from 5% which became effective on April 1st. Minoru Nogimori, an economist at Nomura Securities in Tokyo, cautioned: “It is becoming more difficult to predict if Prime Minister Shinzo Abe will be able to raise the sales tax to 10%, as is scheduled for October, 2015. It won’t be an easy decision to make.”
- Statistics Canada reports the nation’s building permits rose by 11.8% to a record high \$9.16 billion (CAD) in July, citing sizeable gains for Toronto and Vancouver condominiums and apartments. Residential and non-residential permits both reached records, rising by 18% and 5.2%, respectively. Statscan elaborated: “The gain in Toronto was driven by higher construction intentions for multi-family dwellings and to a lesser extent, institutional buildings. The increase in Vancouver resulted mainly from multi-family dwellings.”

- Front Page Headline, Financial Times – “Tax Inverters Threaten U.S. Budget: Lew. In a Washington speech at an event hosted by the Tax Policy Center and the Urban Institute, U.S. Treasury Secretary Jack Lew warned: ‘Since American companies are rushing to reduce their tax bills through foreign takeovers which enable so-termed tax inversions, recent cuts to the nation’s \$492 billion (U.S.) budget deficit are being put at risk.’

Foreign corporate acquisitions have unleashed political outrage in Washington over recent weeks, as many American companies have shifted their tax domicile to a country with lower tax rates. Mr. Lew continued: ‘Effectively, by renouncing their citizenship but remaining in America, these companies are eroding the nation’s tax base. This means that all other taxpayers, including small businesses and hard-working Americans, must shoulder more of the responsibility for maintaining core public functions. I reiterate the Obama administration’s determination to take executive action in the very near future, in order to discourage such corporate activity.’



U.S. Treasury Secretary Jack Lew. Photo source: Bloomberg

- Front Page Headline, Financial Times – “Ex-SAC Capital Portfolio Manager Sentenced to Nine Years for Insider Trading. In sentencing Mathew Martoma, 40, in federal court in New York, Judge Paul Gardephe remarked: ‘Since I cannot and will not ignore that Mr. Martoma’s gains total in the hundreds of millions of dollars more than ever seen in an insider trading prosecution, a strict punishment is warranted.’ Mr. Martoma was also ordered to pay a penalty of \$9.3 million (U.S.), the equivalent of bonus money and a Florida home. Preet Bharara, the U.S. prosecuting attorney, who has garnered 81 successful convictions in a campaign against Wall Street insider trading, concluded: ‘The long and short of Mr. Martoma’s trading is that he traded his liberty, his name and his time with his family for what in the end is nothing. Today’s sentence of a lengthy prison term is well-suited to the audacity of the illegal trading in this case.’ See also, Economic Winter – Malfeasance in the Financial Services Industry, July 21, 2014.

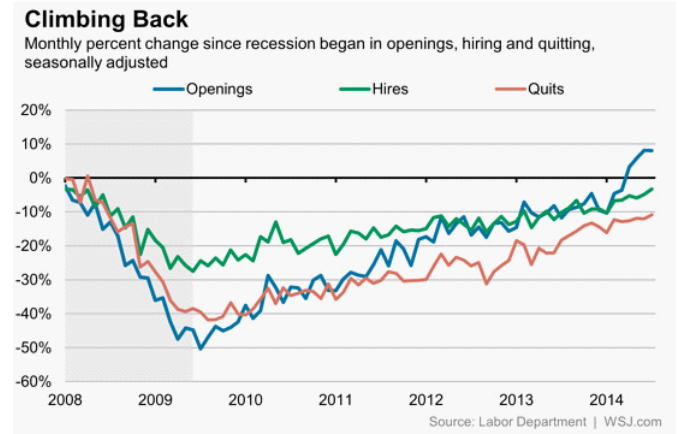


Mathew Martoma (center) and his wife Rosemary arrive at federal court today. Photo source: Bloomberg

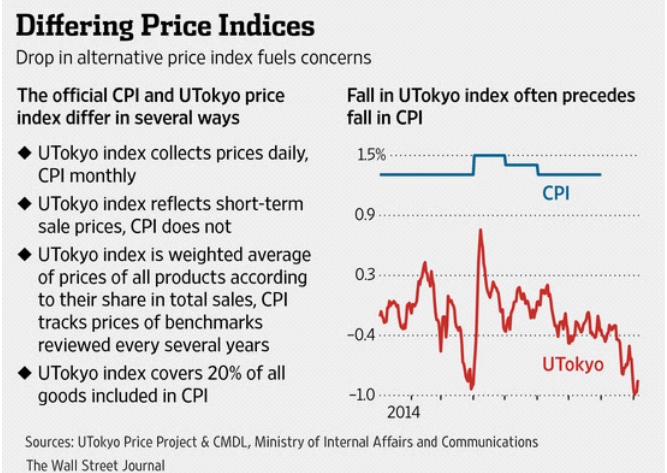
TUESDAY, SEPTEMBER 9TH

- Canada Mortgage and Housing Corp. (CMHC) reports the nation recorded an annualized rate of 192,400 housing starts in August, following 199,800 starts in July. In a research note, CIBC World Markets Economist Nick Exarhos cautioned: “Despite recent resiliency, we still expect housing’s contribution to gross domestic product (GDP) growth to gradually wane as we progress through this business cycle. Affordability concerns and a weak labour market should continue to put pressure on the building sector.”
- Front Page Headline, Wall Street Journal – “U.S. Hiring Level in July Highest Since 2007. In its monthly Job Openings and Labor Turnover Survey, the Labor Department reported U.S. employers hired 4.9 million workers in July, as well as set 4.7 million job openings, a 13-year high. In addition, the survey disclosed

the number of workers who have voluntarily quit their jobs has hovered at 1.8% for the last six consecutive months. The hirings rate stood at 3.5% in July, matching its highest level in six years.”



- Front Page Headline, Wall Street Journal – “UTokyo Daily Price Index Has Been Gradually Declining Since Early May. This private Japanese index – an alternative to the government’s Consumer Price Index (CPI) – is compiled from supermarket sales data of everyday goods. Although less comprehensive, since it only includes 20% of the items which comprise the CPI, the private index has its advantages. Since the UTokyo Index tracks prices on a daily basis, it includes changes caused by limited-time discounts. The government’s CPI doesn’t factor in such temporary changes. Tsutomu Watanabe, a University of Tokyo professor who jointly created the index, explained: ‘Basically, the index is an early indicator of economic conditions. For example, a limited-time-only sale means a store will lower the price of a product by 20 yen, but when the sale ends and the store wants the price to change to its prior level, it often doesn’t, otherwise customers won’t return. While past data reveal a high correlation between the UTokyo Index and the CPI, during phases of falling prices, the UTokyo Index has preceded the government data by about three months.’

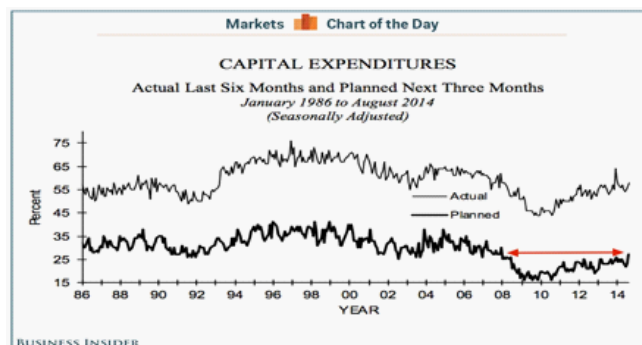


- Front Page Headline, Business Insider – “The End of Fracking Is Closer Than Widely Believed. Working in concert with the Post Carbon Institute – a sustainability think-tank – Canadian geologist David Hughes concluded that the production depletion rates of fossil fuel wells, on the average, amount to 85% over a three-year period. Hughes meticulously researched and analyzed industry data from 65,000 U.S. shale oil and natural gas wells which utilize the standard method of hydraulic fracturing, colloquially termed fracking. This process involves drilling horizontally as well as vertically, then pumping a toxic mixture of pressurized water, sand and chemicals deeply underground to break apart the rock formations which hold deposits of oil and gas. Hughes noted: ‘Typically, in the first year of operation, there may be as much as a 70% depletion rate of potential production, increasing to an 85% rate after three years for most of these wells. There is no doubt that the shale revolution has been an energy game-changer in the short term, but it is not sustainable over the long-term.’”



Pump jacks dot the scenery at the Midway Sunset oilfield in California. Source: Reuters

- Front Page Headline, Business Insider – “NFIB Capital Spending Returns to Pre-Recession Levels. The Nashville, Tennessee-based National Federation of Independent Business reports its small business optimism index rose to a reading of 96.1 in August, the second-highest reading since October 2007. The outlook for capital spending – the percentage of owners planning capital outlays over the next three to six months – increased to 27%, the highest level since December 2007.



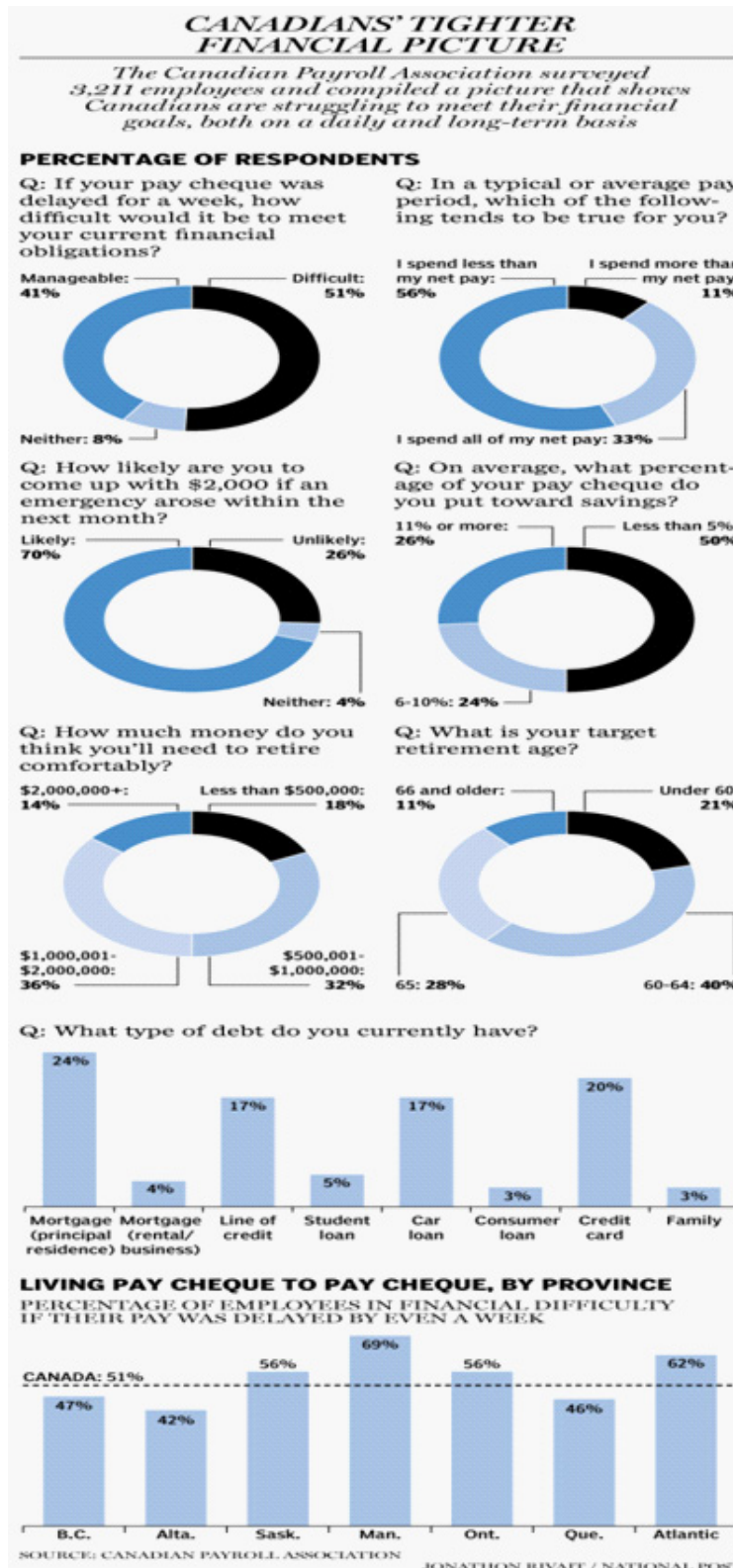
WEDNESDAY, SEPTEMBER 10TH

- Front Page Headline, Financial Post – “More Canadian Workers Are Living Paycheque to Paycheque: CPA. In its sixth annual survey – consisting this time of 3,211 employees – the Canadian Payroll Association reports it discovered not only, are more Canadian workers living paycheque to paycheque, but also, even more are falling behind in meeting their retirement goals. For those surveyed between the ages of 18 to 29, over 63% reported living paycheque to paycheque. Moreover, 26% of respondents said they probably could not muster \$2,000 (CAD) over the next month if an emergency expense arose. Regrettably, more than half of those surveyed reported saving just 5% or less of their paycheque versus the 10% recommended by financial planning experts, while 79% expected to delay retirement until age 60 or older, up from an average of 70% over the past three years. The report identified the number one reason cited for retiring later in life is that employees are not able to save enough money.

Accordingly, workers continue to raise the bar in terms of what they think they will need in order to retire comfortably. For example, only 18% of respondents felt that savings under \$500,000 (CAD) would be sufficient in retirement, down from an average of 21% over the past three years; while 68% now think savings of between \$500,000 (CAD) and \$2,000,000 (CAD) will be required, up from 60%. Yet despite upward adjustments in perceptions of what constitutes an adequate nest egg, the vast majority of employees are nowhere near reaching their goals. Approximately, 75% say they have put aside less than one quarter of what they will need in retirement, up from an average of 73% over the past three years.”

Longwave Analytics editor's note: The CPA online survey of 3,211 employees included a wide range of industry sectors across Canada and was conducted between June 17th. and August 1st. by the market research and strategic planning firm Framework Partners. The Marketing Research and Intelligence

Association – the polling industry’s professional body – states that online surveys cannot be assigned a margin of error because they do not randomly sample the portion of the population surveyed.



- Front Page Headline, Bloomberg News – “S&P Downgrades New Jersey’s Credit Rating Again. Ratings agency Standard & Poor’s has just handed N.J. Governor Chris Christie his eighth credit rating downgrade, a record for a Garden State governor. The downgrade to A – the eighth highest credit rating level – with a stable outlook, follows a September 5th. downgrade by Fitch Ratings. The new rating for New Jersey is the same as the general obligation grade for California, which is on track for a potential upgrade. In a statement from New York, S&P analyst John Sugden commented: ‘The State of New Jersey continues to struggle with structural imbalance. The Governor’s decision to delay pending funding, while providing the necessary tools for cash management and budget control, has significant negative implications for the state’s liability profile.’ Governor Christie, a 52-year old Republican in his second term, broke his promise this year to make \$2.5 billion (U.S.) in extra pension payments in fiscal 2014 and 2015 to help trim unfunded obligations. He has also called for more changes for the plan, as costs for employee benefits crowd out other spending plans.”
- Statistics Canada reports the nation’s industrial capacity utilization rate rose to 87.2% in the 2nd. quarter, marking the fourth consecutive quarterly increase and the highest rate since mid-2007. The manufacturing sector, which accounts for nearly half of the country’s industrial output, was the main driver as transportation equipment makers were at a record 93.7% capacity utilization rate. Jayson Myers, President and CEO of the Canadian Manufacturers and Exporters Association noted: ‘Since the last quarter of 2013, we’ve seen a lot more demand for Canadian goods in the U.S., particularly in autos, aerospace, consumer goods and machinery.’
- Front Page Headline, Wall Street Journal – “U.S. President Obama Announces Expanded Military Offensive against ISIS. ‘America’s objective is clear: We will degrade and ultimately destroy ISIS through a comprehensive and sustained counter-terrorism strategy. Firstly, we will conduct a systematic campaign of airstrikes against these terrorists. Secondly, we will increase our support to forces fighting these terrorists on the ground. Thirdly, we will continue to draw upon our substantial counter-terrorism capabilities to prevent ISIS attacks. Fourthly, we will continue to provide humanitarian assistance to innocent civilians who are displaced.”
- Front Page Headline, New York Times – “France Won’t Meet Budget Deficit Target until 2017. France’s Finance Minister Michel Sapin announced: ‘The country won’t be able to meet targets for reducing the budget deficit for at least another two years in the face of flagging gross domestic product (GDP) growth.’

The French economy is now expected to expand at a tepid 0.4% pace in 2014, well below the 1.7% rate which the government forecast earlier this year. The public deficit will remain at about 4.4% of GDP, up from 2.2% in 2013. Mr. Sapin added: ‘However, France will not introduce measures that would exacerbate the slowdown in GDP growth that we have already experienced and further add to disinflation.’

THURSDAY, SEPTEMBER 11TH

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 11,000 to a seasonally adjusted 315,000 in the week ended September 6th. while continuing claims rose by 9,000 to 2.49 million in the week ended August 30th.
- Front Page Headline, Globe and Mail – “Ottawa Reducing Unemployment Insurance Premiums for Small Businesses. At a Toronto press conference, Canadian Finance Minister Joe Oliver announced: ‘The Small Business Job Credit will commence on January 1, 2015 for a two-year period. It will be administered as an automatic credit through the Canada Revenue Agency, effectively reducing the employment insurance (EI) premium rate for employers from \$1.88 (CAD) per \$100 (CAD) of insurable earnings to \$1.60 (CAD). Almost 90% of all E.I. premium-paying businesses in Canada will receive the credit.”

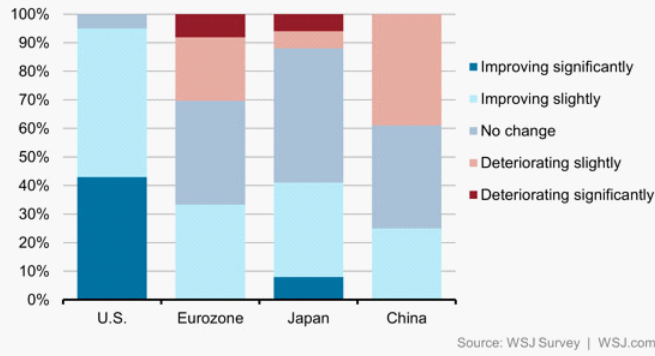


Canada’s Finance Minister Joe Oliver. Source: Globe and Mail

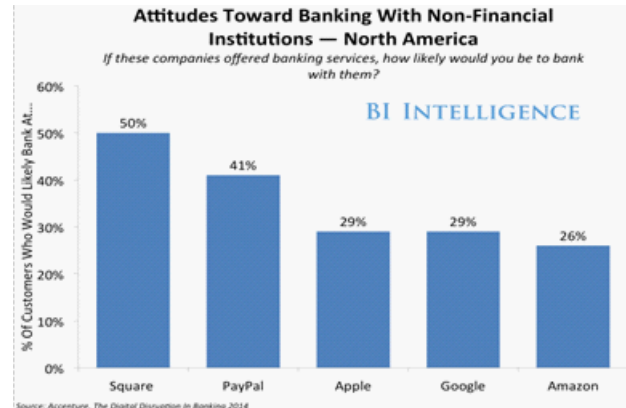
- Front Page Headline, Wall Street Journal – “U.S. Economic Outlook Improving, but Worries Loom Abroad: WSJ Survey. The Wall Street Journal reports its ‘Monthly Forecasting Survey’ polled 48 economists about whether their outlook for the world’s largest economies had improved or deteriorated. The survey revealed a resounding majority of the economists believe U.S. gross domestic product (GDP) growth will improve over the coming year, versus the first half of 2014. However, their attitudes towards the euro zone, Japan and China were mixed. See chart below. See also, Economic Winter, It’s Still the Debt, Stupid – March 21, 2014.

American Exceptionalism?

How would you rate the economic outlook for the following regions over the next four quarters compared to the first half of 2014?



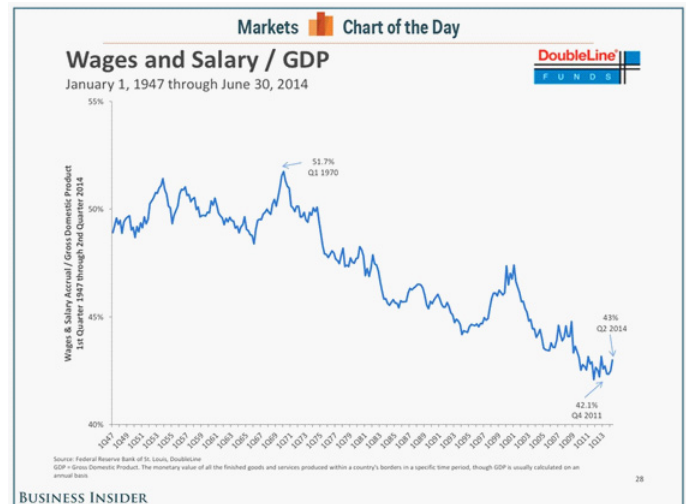
relevant, banks will be forced to rethink the channels through which they reach their customers and to whom they will provide the services.



FRIDAY, SEPTEMBER 12TH

- The Commerce Department reports U.S. retail sales rose by 0.6% in August, following an upwardly revised gain of 0.4% in June, previously reported as an increase of 0.2%. Gus Faucher, an economist at PNC Financial Services Group in Pittsburgh noted: “The consumer is in decent shape right now. I believe we are looking at solid economic growth in the current quarter.”
- Front Page Headline, Bloomberg News – “Russia Considers Response as U.S. and EU Impose Additional Sanctions. The European Union has added fifteen Russian companies – including OAO Gazprom Neft, OAO Rosneft and OAO Transneft – plus 24 people to the list of those affected by its sanctions against Russia. Yesterday, U.S. President Barack Obama announced: ‘America will also deepen and broaden its sanctions against Russia’s financial, energy and defense industries.’ In an interview with state TV, Russian Foreign Minister Sergei Lavrov stated: ‘Inasmuch as we believe the move to expand sanctions undermines the peace process in Ukraine, Russia will respond calmly and appropriately.’”
- The University of Michigan / Thomson Reuters group report their U.S. preliminary consumer sentiment index rose to a reading of 84.6 in September – the highest level since July 2013 – from a final reading of 82.5 in August.
- Front Page Headline, Business Insider – “Mobile Is Attracting Customers from Branch and Online Banking. The relationship between consumers and their banks is in a period of dramatic upheaval, influenced by the rapid pace of technological innovation. Banks are facing looming competition from tech giants such as Square, PayPal, Apple and Google. For example, 50% of North Americans polled say they would like to bank with Square, should the company offer a banking service. To stay

- Front Page Headline, Business Insider – “U.S. Central Bank Unlikely to Raise Fed Funds Rate Anytime Soon. Last Tuesday, DoubleLine’s Jeff Gundlach presented his latest webcast, outlining his views on the U.S. markets and the domestic economy. Among his key points was his belief that the Fed would not raise the Fed Funds Rate anytime soon. Federal Reserve Chairwoman Janet Yellen has long stated that the Federal Open Market Committee (FOMC) remains focused on the health of the labor market. In her most recent public comments at Jackson Hole, Ms. Yellen said: ‘Given the current state of the labor market, there is no simple recipe for an appropriate monetary policy in this context.’ Gundlach also noted that real wages for the bottom seven deciles of earners had declined between 2007 and 2014: ‘With so many Americans losing purchasing power on a year-over-year basis, it seems unlikely that the FOMC would raise the Fed Funds Rate at this time.’” See chart below.

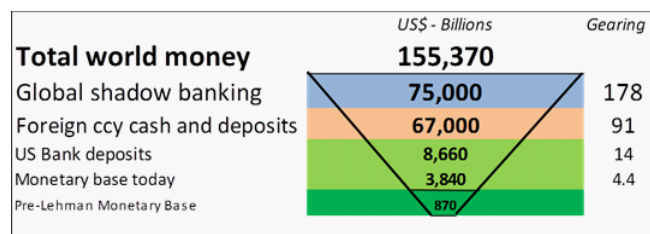


- Front Page Headline, GoldMoney – “Currency Turbulence. Researcher Alasdair Macleod writes: ‘The U.S. dollar has recently strengthened against the other three major global currencies as our chart outlined below shows.



The U.S. dollar is the risk-free currency for international accounting because it is the currency upon which all the others are based. Three months ago, dollar exchange rates against the euro, British pound and Japanese yen began to strengthen notably. However, each of these currencies has its own specific problems causing it to weaken. The yen is the embodiment of financial kamikaze with the Abe government destroying it through debasement, as a cover-up for a budget deficit that is beyond its control. The pound is being pole-axed by a campaign to keep Scotland in the Union which has backfired; plus a deferral of interest rate expectations. Moreover, the European Central Bank (ECB) offers negative deposit rates in the belief they will prevent the euro zone’s deflationary clouds from gathering, which if they develop unchecked, will threaten the stability of Europe’s banks. The U.S. economy, which is officially due to recover this year, still looks like it’s going nowhere. This is the context within which we must judge how currencies are behaving.

Also, there remains an interpretation which is still very worrying: we may be witnessing the beginnings of a major flight out of other currencies into the dollar. This is a risk because the global currency complex is based upon a floating dollar standard and has been since U.S. President Nixon ended the Bretton Woods agreement in 1971. This has led to a growing accumulation of currency and credit everywhere, which ultimately could become unstable. The relationship between the dollar and other currencies is vividly captured in the following illustration.



Source: GoldMoney

The leveraging of total world money and credit on today’s monetary base is forty times, but this follows a rapid expansion of the Fed’s balance sheet in recent years. Compared to the Fed’s monetary base prior to the Lehman crisis, world money is now nearly 180 times leveraged, which leaves very little room for continuing stability. It may be too early to determine whether this inverse pyramid (shown above) is toppling over, because it has not yet been fully confirmed by money flows among bond markets. However, during the last few days, euro zone sovereign bond yields have begun rising. To date, it can be argued that these bonds have been overvalued and a price correction is overdue. However, if this new trend is fueled by international banks liquidating non- U.S. credit bond holdings, we will certainly have a problem. We can be certain that central bankers are following the situation closely. Since the 1930s, nearly all economic and monetary theorists have been preoccupied with preventing self-feeding monetary contractions, which today will be signaled by a flight into the dollar. When this happens, the cure is obvious to them: just issue more dollars.

This can be easily done by extending currency swaps between central banks and by coordinating currency interventions; rather than new rounds of plain old quantitative easing (QE). To date, market traders seem to have been assuming that the dollar is strengthening for less defined reasons, marking down key commodities and gold as a result. However, the relationship between the dollar, currencies and bond yields bears watching, since they may be commencing to signal that something more serious is afoot.”

CLOSING LEVELS FOR FRIDAY, SEPTEMBER 12TH.		WEEKLY CHANGE
Dow Jones Industrial Average	16,987.51	– 149.85 points
Spot Gold Bullion	\$1,231.50 (U.S.)	– \$35.80 per troy oz.
Spot Silver	\$18.64 (U.S.)	– \$0.58 per troy oz.
S&P / TSX Composite	15,531.58	– 38.34 points
10 – Year U.S. Treasury Yield	2.61%	+ 15 basis points
Canadian Dollar	90.14 cents (U.S.)	– 1.76 cents
U.S. Dollar Index Future	84.173	+ 0.345 cent
WTI Crude Oil Futures	\$92.27 (U.S.)	– \$1.02 per barrel
DJIA / Gold Ratio	13.79	+ 0.27 point
Gold / Silver Ratio	66.07	+ 0.13 point

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