

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



Monday, July 27th

The Commerce Department reports orders for U.S. durable goods – items expected to last for at least three years – rose by a seasonally adjusted 3.4% in June, led by bookings for commercial aircraft. However, orders for non-military core capital goods - a

MONDAY, JULY 27TH

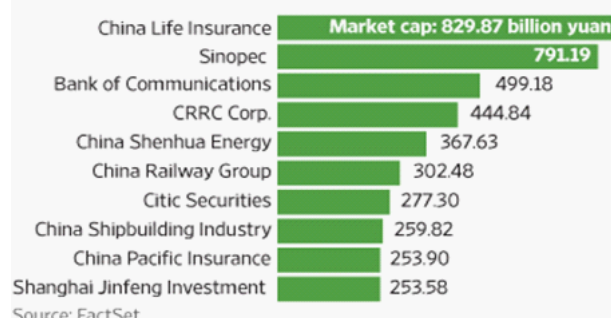
reflection of business investment – rose by a modest 0.9%, following two consecutive monthly declines in May and April.

Doug Oberhelman, CEO of Caterpillar – the world’s largest manufacturer of construction and mining machinery – commented: “While economic conditions in the United States are modestly positive, the global economy remains relatively stagnant. Many of the key industries we serve remain weak, and we have yet to see sustained signs of improvement.”

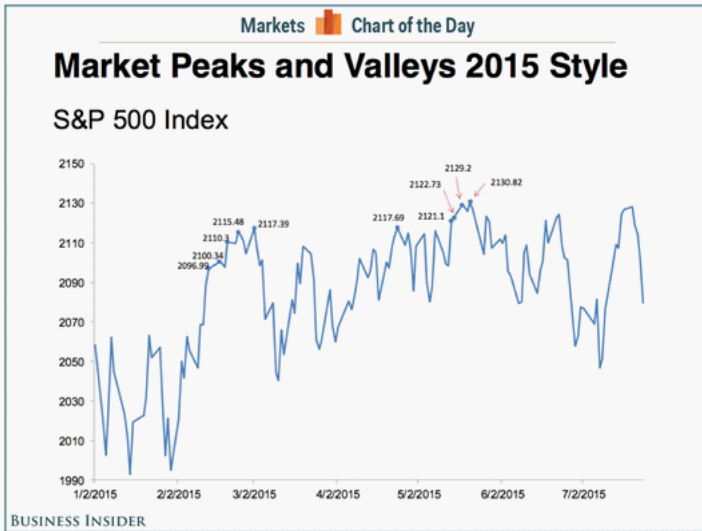
- The Munich-based Ifo Institute for Economic Research reports its index of German business confidence – a keenly watched survey of the health of Germany’s economy – rose to a reading of 108 in July from a level of 107.4 in June. Rainer Sartoris, an economist at HSBC Trinkaus and Burkhardt, observed: “The Ifo reading means the survey avoided three consecutive months of decline, which by the rule of thumb often indicates that the economy has passed its cyclical peak. Hopefully, the Ifo figures point to continued economic growth for Germany in the second half of the year.”
- Front Page Headline, Financial Times – “The Shanghai Composite Index Declines by 8.5%, Biggest One-Day Drop since 2007. Former U.S. Treasury Secretary Henry Paulson argues: China is especially vulnerable at this point because while its economy has grown and matured, its capital markets have lagged behind. It is no surprise that those ideologically opposed to markets would use recent events to make the opposite argument, i.e. to prevent market instability, Beijing should slow the pace of fi-

nancial liberalization, or perhaps even abandon market-based reforms altogether. Yet, while Beijing’s interest to protect investors is understandable, the best way of doing so is to create a modern capital market.”

Ten biggest companies to fall by 10% limit Monday



- Front Page Headline, Business Insider – “To Date, 2015 Has Simply Not Been a Fun Experience for Stock Market Investors. The S&P 500, which opened the year nearly at all-time highs, has made a new all-time high only ten times. In comparison, at this time in 2014, the benchmark index had reached 27 new all-time record levels and by year-end, it had established a new record 53 times. The following chart, forwarded to us by John Stoltzfus at Oppenheimer’s, indicates just how choppy this year has been for equity investors, who haven’t witnessed a record high since May 21st. and since then, everything else has more or less been a muddling mess.



Today, stock prices closed lower for the 5th. consecutive trading session. It was the third time this year that the stock market has declined for this long a period. During 2014, there were no downdrafts which lasted longer than three consecutive trading sessions. Moreover, despite witnessing the stock market's first near-correction in over three years, in 2014 investors ultimately experienced an 11% gain for the S&P 500. As of today's close, the stock market was up by just 0.4% on a year-to-date basis.

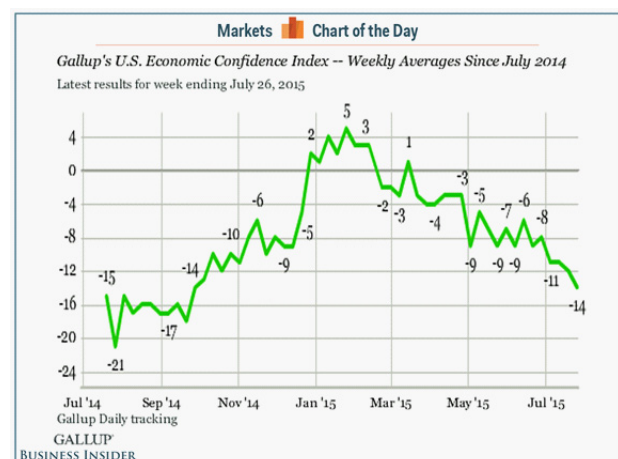
#### TUESDAY, JULY 28TH

- The New York-based Conference Board reports it U.S. consumer confidence index declined to a reading of 90.9 in July – a 10-month low – following a level of 99.8 in June. Lynn Franco, director of economic indicators at the Conference Board, commented: “While consumers continue to assess current conditions favourably, their short-term expectations seriously deteriorated this month.”
- The S&P/Case-Shiller group reports its U.S. 20-city composite house price index rose by 1.1% in May and by 4.9% on a year-over-year basis. David Blitzer, chairman of the index committee at S&P Dow Jones Indices, commented: “Nationally, single family home price increases have settled into a steady annual 4% to 5% pace, after the double-digit pattern of 2013.”
- Following a recent meeting in Toronto, the C.D. Howe Institute's Business Cycle Council, comprised of twelve prominent economists, reported: “Based upon our assessment of a review of recent data concerning gross domestic product (GDP), employment and sectoral activity, evidence was not provided that Canada has entered an economic downturn, i.e. a recession. The Council noted weak GDP data in the first four months of 2015,

primarily associated with low oil prices and declining investment in the energy and some other resource sectors. Simultaneously, the Council has highlighted resilience in labour markets, including positive job growth and a steady employment rate ... In point of fact, the Business Cycle Council defines a recession as a pronounced, pervasive and persistent decline in aggregate economic activity.” Canada has not designated an official arbiter of business cycles since Statistics Canada discontinued its Composite Leading Indicator in 2012. Since then, the Council has helped fill the void.

#### WEDNESDAY, JULY 29TH

- Front Page Headline, Business Insider – “Americans Are Losing Confidence in Their Economy. Gallup's weekly economic confidence poll, based upon a survey from the week ended July 26th. revealed that only 23% of Americans think the domestic economy is in good shape, while 32% believe it is poor shape. Regarding the outlook for the future, 39% of those surveyed think the economy is improving, but a majority of 57% responded that the economy is worsening. Gallup's Justin McCarthy reported: ‘The instability abroad could be fueling Americans' doubts about the health of the U.S. economy, not to mention that the Dow Jones Industrial Average (DJIA) closed lower on several days last week. This Gallup Poll adds another data point to the opinion that Americans are worried about the domestic economy and arrives only a day after the Conference Board's consumer confidence index reached a ten-month low reading.”



- In a new estimate forwarded to Congress, U.S. Secretary of the Department of the Treasury Jacob Lew informed lawmakers that America is not at risk of breaching the statutory debt limit until the end of October. While Mr. Lew has been using so-termed extraordinary measures to fund the federal deficit, he also used this opportunity to urge Congress to raise the debt ceiling as

soon as possible. The statutory debt limit used to be raised on a routine basis, but in recent times has become the source of timely suspensions amid a bitter political tug-of-war. Prior to October 30th, investors should expect Congress to raise the statutory debt limit from today's \$17.2 trillion (U.S.) to approximately \$18.5 trillion (U.S.) i.e. \$18,500,000,000,000 (U.S.).

**Debt ceiling increases**



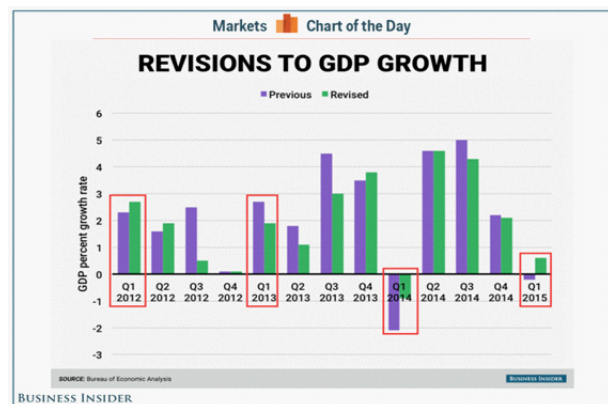
- In releasing their monthly monetary policy statement in Washington today, the Federal Open Market Committee (FOMC) left its Federal Funds rate unchanged with a target range of 0% to 0.25%, citing any increase in their administered interest rate remains dependent upon economic data. At Longwave Analytics, we reiterate our belief that the FOMC will not be raising the Federal Funds rate at any time during 2015.
- The National Association of Realtors (NAR) reports its U.S. pending home sales index declined by 1.8 to a seasonally adjusted reading of 110.3 in June, citing continued solid hiring reports and relatively low mortgage rates. According to the Federal National Mortgage Corp. (Freddie Mac), the average 30-year fixed mortgage rate was 4.04% last week, as the rate remains approximately 2% below its historical average level.

**THURSDAY, JULY 30TH**

- The Labor Department reports U.S. initial claims for state unemployment benefits rose by 12,000 to 267,000 in the week ended July 25th, while continuing claims increased by 46,000 to 2.26 million in the week ended July 18th.
- The Bureau of Economic Analysis (BEA) reports the U.S. gross domestic product (GDP) rose by an annualized 2.3% in the 2nd. quarter, while the 1st. quarter estimate was upwardly revised to a gain of 0.6%, previously reported as a contraction of 0.3%. As reported in the Business Insider, however, these are just initial

advance estimates for the current GDP growth rate, which the BEA warns: 'are based on source data that are incomplete or subject to further revision by the source agency.' The BEA regularly updates its estimates of the U.S. economy as it continues to gather more data: late survey responses, more tax information and similar other late breaking sources. In addition to their ongoing efforts to improve and correct their measurements, which result in two revised GDP estimates in the months following the advance numbers, every year the BEA does a more thorough set of corrections to the GDP for recent years. The BEA makes annual changes to their overall methodology to obtain a better picture of what's occurring in the world's largest economy. This year, one of the most anticipated features in the methodology update was a change to their seasonal adjustment factors. There are recurring annual events which greatly affect the U.S. economy, like the Christmas holiday, or the influx of high school and college students looking for summer jobs into the labor market at the beginning of each summer. Statistical agencies like the BEA and the Bureau of Labor Statistics (BLS) adjust measures like the GDP, or the unemployment rate to compensate for these mostly predictable events.

In recent years, GDP growth in the first quarter of each year has been much lower than we could have expected. Many commenters noted that part of the first quarter weakness could have been the result of somewhat seasonal adjustments on the part of the BEA and the new revisions have increased GDP growth for three of the last four 1st. quarters.

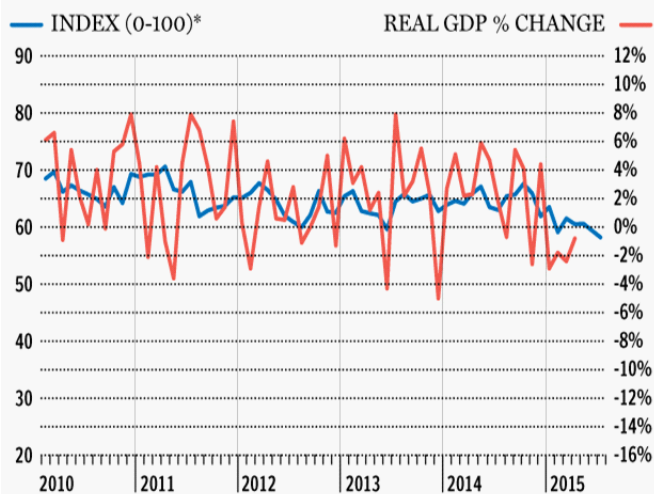


- The Canadian Federation of Independent Business (CFIB) reports its monthly Business Barometer – a key indicator of economic health which is closely watched by government policy-makers – declined to a reading of 58.2 in July from a level of 59.4 in June. Ted Mallett, CFIB's chief economist, observed: 'The Canadian economy still appears to be adrift and with only limited power. While the general mood patterns across the country remain the same, it appears the malaise on the Prairies

and in Canada's under-performing central core is beginning to weigh down sentiment in British Columbia. The resources sector continues to show the lowest levels of optimism, but reduced sentiment in manufacturing, construction, wholesale and retail are offsetting fairly good trends elsewhere in the services sector.'

### THE BUSINESS BAROMETER

*Canada's economy still appears to be adrift and with limited power. Small business confidence fell more than a point in July to 58.2, its lowest level since mid-2009 and just below the point that corresponds with zero real GDP growth (59.8 using the past six years of monthly data).*



\*Measured on a scale between 0 and 100, an index level above 50 means owners expecting their business' performance to be stronger in the next year outnumber those expecting weaker performance. According to past results, index levels normally range between 65 and 75 when the economy is growing.

SOURCE: CANADIAN FEDERATION OF INDEPENDENT BUSINESS

- Front Page Headline, Financial Times – “The Land of Free Markets Is Being Tied Down by Red Tape. Columnist Gillian Tett writes: Every nation needs a unifying idea. Americans, who love to see themselves as champions of free markets and entrepreneurial zeal, have long been more welcoming to entrepreneurs than has most of the western world. However, the 2008 financial crisis tarnished America's self-image – with for example, the eyesore of state support for mortgages. The entrepreneurial halo is beginning to slip also, since increasing quantities of red tape are making life for start-ups, relative to the past and to the rest of the world. Take a look at a striking report issued by the White House this week on occupational licensing, the rules which force workers to obtain qualifications to perform certain jobs. Five decades ago, occupational licenses were required only in specialist arenas such as nursing. However, in recent years they have proliferated so dramatically that 25% of all American workers must secure one from individual states. Sometimes this is justified, such as airline pilots need licenses. However, oftentimes as in the

three years of training required to become a security guard in Michigan, or the thousands of hours required for hairdressers in Utah, the rationale is less clear.

The process of securing these licenses is often so costly and cumbersome that one recent study estimated costs for consumers at \$200 billion (U.S.) a year. More importantly, licenses deter many aspiring workers and entrepreneurs. A separate World Bank report is even more sobering. Last year it ranked countries according to their levels of support for the corporate world. This put America in seventh place in terms of the overall ease of doing business. However, the U.S. was ranked 46th. in terms of how easy it is to start up a company. Interestingly, this is worse than Estonia, Malaysia, Georgia and even France. One important reason for this dismal position is that in America on the average, entrepreneurs need to navigate six different legal and regulatory hurdles to begin a company. In New Zealand and Canada, which top the league, there is just one procedure. The complexity faced by Americans means that it takes them about six days to create a start-up; but in many other countries the process is much faster and cheaper. Of course, this World Bank league does not tell the whole tale.

The American national average conceals significant geographical variations because it is municipalities that set many of the business rules. Thus, research by Thumbtack, a West Coast website which connects consumers with local businesses and the pro-entrepreneurship Kauffman Foundation shows that it is much easier to start a company in Texas than California. Moreover, red tape is only one factor which determines start-up activity; what also matters is whether there is access to capital, as well as a culture of respect for entrepreneurs.

Nevertheless, the data represent policy challenges; doubly so since data from the Kauffman Foundation also shows that the rate of new business creation today is well below historical trends, even though it rose this year, following several years of decline. The White House has attempted to respond to the problem: this week U.S. President Obama urged states to reduce the number of occupational licenses. Last month, Mr. Obama launched a 'Start Up In a Day' initiative in order to slash the length of time it takes to create a business and is offering a \$1.5 million (U.S.) prize to anyone who uses technology to streamline the process.

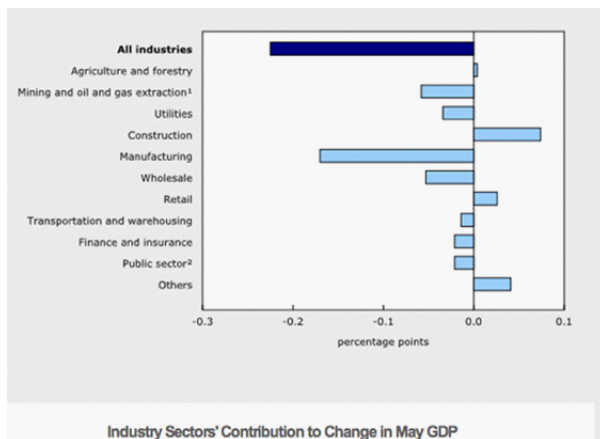
However, it is clear that far more needs to be done. One idea that policymakers ought to discuss is whether it is time to introduce a 'sunset' principal for business regulations; an assumption that regulations should automatically expire after a given period

unless specifically renewed. This concept flies in the face of current practice, which tends to leave rules on the books unless they are deliberately repealed. Sunset does come with some drawbacks: i.e. renegotiating regulations can introduce business uncertainty and endless lobbying fights.

Be that as it may, some policymakers are talking seriously about the idea. Indeed one congressman, Chris Collins, introduced a bill this week calling for a seven-year sunset approach. The concept needs to be discussed, if nothing else it might begin a proper conversation about which start-up rules and occupational licenses are worth keeping and which are not; as well as how to stop the sprawl of red tape.

## FRIDAY, JULY 31ST

- Statistics Canada reports the country's gross domestic product (GDP) declined by 0.2% in May – the fifth consecutive month of contraction – citing weakness in manufacturing, mining, quarrying and oil and gas extraction; as well as wholesale trade.



Source: Dominion Lending Centres

Douglas Porter, chief economist at the Bank of Montreal commented: "This is yet another downside surprise for the Canadian economy, which all but locks in a second quarterly setback for the GDP. While we believe the five-month string of declines is likely to end in the next monthly report, that's cold comfort following a run of disappointment. More important is whether the domestic economy can begin to recover in the second half of the year. Hopefully, we think it will amid an improving U.S. economy, stronger auto production, some fiscal stimulus and generous financial conditions ... No doubt, this will keep the Canadian dollar heavily on the defensive."

- The Reuters / University of Michigan group report their final consumer sentiment index for July declined to a reading of 93.1, down from a level of 96.1 in June.
- Front Page Headline, Washington Post – "Congressional Recess for the Month of August Sets the Stage for an Autumn Showdown. All the elements are in place for another debt and spending showdown in the fall, when funding deadlines for federal agencies and highway programs are expected to collide within weeks of when the U.S. Department of the Treasury's borrowing authority will expire. Add to the mix the desire to extend billions of dollars in special tax breaks by the end of December and a rising call from some lawmakers for a rewrite of the international tax laws in order to fund federal programs and the likelihood of a government shutdown looms larger by the day. Congress set the latest piece of this potential logjam in place yesterday, when the Senate approved an extension of highway funding which lasts at least until Halloween, but might have enough money to make it into mid-December. That vote followed the House's approval of the same plan Wednesday, after the Republican majorities in the chambers fought for weeks and ended in a stalemate over competing ideas for a longer term plan.

The prospect of the collision has some lawmakers envisioning December as a mini-replay of the fiscal cliff debates of 2012, when trillions of dollars of tax cuts were set to expire on New Year's Day and tens of billions in automatic spending cuts, known as sequestration, were slated to commence two days later. Despite the major pileup ahead, no serious talks have begun about the fiscal clash. The House left on Wednesday for a 40-day break and will return after Labour Day while the Senate's recess begins late next week. Senate Majority Leader Mitch McConnell (R-Ky.) told reporters yesterday: 'When we return in September, we'll discuss the way forward about getting the government funded.' The current debate among House and Senate Republicans is whether to attempt to turn the emerging legislative pileup into the source of a single huge negotiation with President Obama, or to carve it up into more manageable pieces which would prevent it from becoming a huge target of opposition, therefore impossible to pass.

Rep. Tom Cole (R-Okla.) an ally of House Speaker John Boehner (R-Ohio), stated: 'At the end of the day, we've got the national debt, the statutory debt limit, the highway transportation fund and the sequester as triggering events. So, I think we're heading for a deal in November or December. Personally, I'd prefer to cast one tough vote rather than five or six.' Senator Roy Blunt (R-Mo.), a lieutenant in Senator Mitch McConnell's leadership team, strongly disagreed: 'We need to be very focused in at-

tempting to keep each of these issues on a narrow path.'



Sen. Charles Schumer, flanked by Sen. Elizabeth Warren (left) and Sen. Debbie Stabenow. Photo source: Associated Press

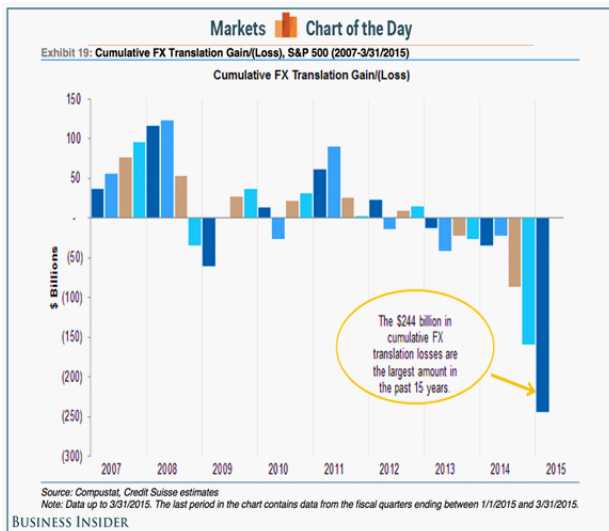
- Front Page Headline, Business Insider – “King Dollar Has Cost S&P 500 Companies \$244 billion (U.S.) of Balance Sheet Pain. The strong U.S. dollar is one of the biggest stories in the global financial markets right now. At 97.47 the U.S. dollar index future is 19% higher than a year ago. While this is good news for importers, it is bad news for exporters.

losses have grown considerably over the past couple of quarters as the U.S. dollar has strengthened against many other currencies and are now \$244 billion (U.S.) in the aggregate. That's the highest level in the past 15 years.'

Zion continued: 'The FX transaction gain or loss initially bypasses the income statement and is reported in shareholder's equity as part of accumulated other comprehensive income (AOCI). It's not until the business is sold or liquidated that the cumulative transaction gain or loss, which had been stored in equity, is transferred to earnings.'

Zion added: 'As for the income statement: Even though the transaction gain or loss is not initially reported on the income statement, the FX transaction process can still have an impact on earnings. The transacted revenues and expenses will fall – all else equal – if the reporting currency is strengthening against the functional currency and vice versa, when the reporting currency weakens. As a result, the stronger dollar tends to cause reported revenues and earnings to drop for many U.S. multinationals. Although the margins in percentage terms stay the same –functional currency vs. reporting currency – bottom line earnings can be impacted.'

- Front Page Headline, GoldMoney – “China's 1929 Moment. Researcher Alasdair Macleod writes: Anyone with a nose for markets will tell you that the Chinese government's attempt to rescue the country's stock markets from collapse is far from succeeding. Bubbles collapse, period; while government interventions don't stop them. Furthermore, we are beginning to see a crack widen in the foundations of China's capital markets that could result in undermining the entire economy. Since the government owns the banking system, some of the knock-on effects will doubtless be concealed. A consequence for China is that domestic financial instability could threaten her current plans for the international development of her currency. Here the timing couldn't be worse because in a few months The International Monetary Fund (IMF) is due to announce its decision about the inclusion of the renminbi in the Special Drawing Rights (SDR). The odds were in favour of China succeeding in this quest, on the basis that China was deemed to have fulfilled the necessary conditions and the IMF has also been supportive. A 1929-style collapse in China's stock markets would change this delicate balance. In mainstream macroeconomic theory, the only way China can resolve her excessive financial imbalances is to devalue the renminbi.



It's also rough on the U.S.-based multinational companies that do a lot of business abroad. This is a big deal for the S&P 500 as well. According to S&P index analyst Howard Silverblatt, S&P 500 companies generated 47.8% of 2014 sales abroad. In a detailed 44-page research note, Credit Suisse accounting and tax analyst David Zion took a close look at how currency swings impact differently every line item on a company's balance sheet and income statement. Of the balance sheet impact, Zion stated: 'For the S&P 500 companies, the cumulative FX transaction

However, such devaluations against other SDR currencies would hardly be a good start for a new member. The IMF, likely

to be urged by the Americans, could be forced to defer its decision again, reviewing it in 2020. This would represent a bad outcome, given that China has set her sights on joining the IMF's top table. There can be little doubt that the recent announcement increasing her gold reserves by only 600 metric tonnes was made in the context of her desire for the currency to be included in the SDR. If she is rejected, China could swing the emphasis more firmly towards gold, which she owns and mines in abundance.

If Plan A fails, it is time for Plan B. It is almost certain that China has substantial undeclared holdings of physical gold bullion. The enabling regulations for China's gold accumulation program date back to 1983 and the State will have acquired the bulk of its bullion before it permitted its own citizens to purchase from 2002 henceforth. Western analysts seem generally unaware that the bulk of China's gold acquisitions were in the late 20th. century. This was the last time the West was dishoarding huge quantities

of gold bullion into a prolonged bull market and she had massive capital inflows followed by trade surpluses to offset. This was the basis for my speculation last October that her government gold holdings could have grown to 20,000 metric tonnes by 2002, which explains why public ownership was then permitted.

The Chinese government almost certainly views gold as the ultimate money. The time is approaching for Plan B when a higher gold price would serve her interests better than membership in the SDR. It would reduce China's debt levels expressed in the ultimate money, without currency intervention and it would also boost the personal wealth of her people. In short, it would be popular with ordinary people, at a time when the authority's credibility is threatened by internal financial developments. It must be tempting. The effect on western capital markets, having been drained of physical bullion and left with uncovered gold liabilities, could be very interesting. After all, the Chinese curse was for us to live in interesting times."

## CLOSING LEVELS FOR FRIDAY, JULY 31ST.

## WEEKLY CHANGE

Dow Jones Industrial Average	17,689.86	+ 121.33 points
Spot Gold Bullion	\$1,095.10 (U.S.)	+ \$9.60 per troy oz.
Spot Silver	\$14.72 (U.S.)	+ \$0.01 per troy oz.
S&P / TSX Composite	14,468.44	+ 282.20 points
10-Year U.S. Treasury Yield	2.18%	- 8 basis points
10-Year Gov't. Canada Yield	1.43%	- 5 basis points
10-Year Sovereign Yield Spread	75 basis points	- 3 basis points
Canadian Dollar	76.45 cents (U.S.)	- 0.27 cent
U.S. Dollar Index Future	97.192	- 0.007 cent
WTI Crude Oil Futures	\$47.12 (U.S.)	- \$1.02 per barrel
DJIA / Gold Ratio	16.154	- 0.031 point
Gold / Silver Ratio	74.40	+ 0.607 point

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