Monday June 15th, 2015

LONGWAVE group

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, June 15th

The Federal Reserve reports U.S. industrial production, which includes mines and utilities, declined by 0.2% in May, led by a drop in production of consumer energy products for the third consecutive month. Stephen Stanley, an economist at Amherst Pierpont

MONDAY, JUNE 15th

Securities in Stamford, Connecticut, noted: "Since the global economic situation is far from ideal, any growth in manufacturing activity will likely be primarily driven by domestic demand."

- The Canadian Real Estate Association (CREA) reports the nation's single family home sales rose by 3.1% in May to a seasonally adjusted pace of 44,128 units, the highest number in more than 5 years. Nationally, the average price reached $493,100 (CAD), up more than 5% from a year ago.

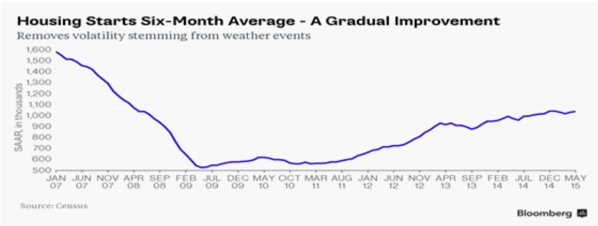
Source: CREA

- Statistics Canada reports the nation's factory sales declined by 2.1% in April to $49.8 billion (CAD), citing lower sales of food, aerospace products and parts; as well as petroleum and coal products. While sales fell in 8 of 21 industries, these sectors account for about 60% of Canadian manufacturing.

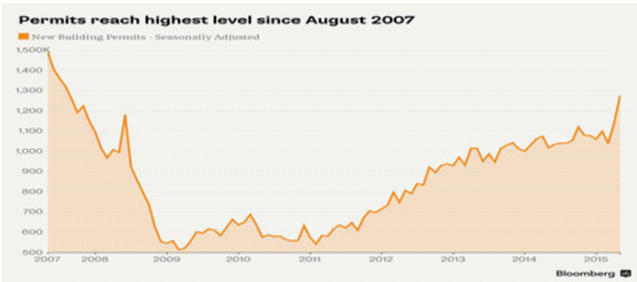
- The Federal Reserve Bank of New York reports its Empire State business conditions index fell to a reading of minus 1.98 in June from a level of 3.09 in May, citing the new orders sub-index declined to a reading of minus 2.12 in June from a level of 3.85 in May. The Empire State index covers New York State, southern Connecticut and northern New Jersey.

TUESDAY, JUNE 16TH

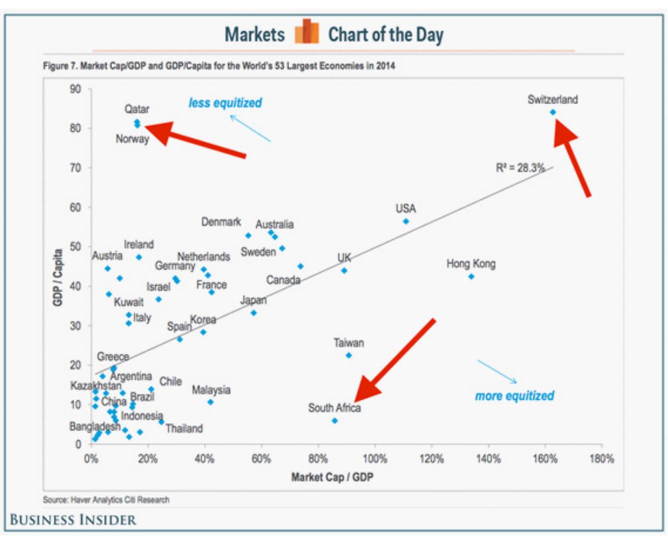
- The Commerce Department reports while U.S. housing starts declined by 11.1% in May to an annualized pace of 1.04 million units, it followed an upwardly revised annual rate of 1.17 million units in April, to highlight the best back-to-back reports since late 2007. See chart below.



- Separately, according to the Bloomberg survey median, U.S. building permits rose by 11.8% in May to an annualized pace of 1.28 million, the most since August 2007.



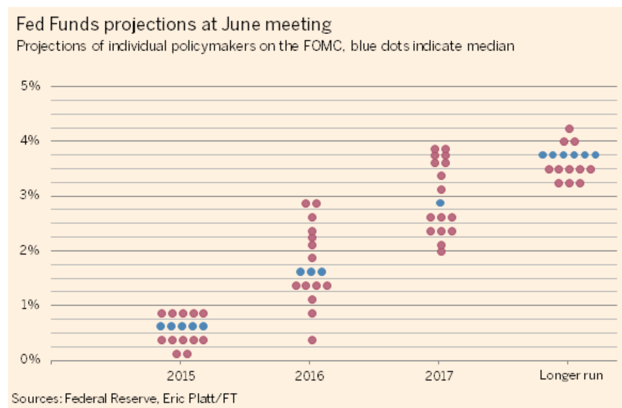
- Front Page Headline, Business Insider – "What the Size of a Country's Stock Market Says about Its Quality of Life. That's a question frontier strategist Andrew Howell aimed to answer in Citigroup's massive new report on global public assets. Howell wrote: 'Governments should encourage the growth of equity markets because they tend to be associated with economic development. Whether or not they actually create economic development – or whether the causality works the other way around – is the subject of some debate. What is undeniable, however, is that countries with larger equity markets tend to have a higher standard of living.' To illustrate this, Howell plotted the world's 53 largest economies' wealth (GDP/capital) against equitization (stock market cap/GDP). Howell observed: 'In the chart below, we see Switzerland – the world's richest country – also has one of its largest equity markets at 160% of GDP. In contrast, poor countries such as Bangladesh, Nigeria and Vietnam have much smaller equity markets, i.e. 10% of GDP.'



WEDNESDAY, JUNE 17TH

- Statistics Canada reports the nation's wholesale trade activity rose by a seasonally adjusted 1.9% in April led by automobile sales and following an upwardly revised 1.0% increase in March, previously reported as a gain of 0.8%. Motor vehicle sales increased by 9.3% in April and were 16.3% higher on a year-over-year basis.

- Front Page Headline, Wall Street Journal – "Fed Signals Fed Funds Rate to Increase at Gradual Pace. At a news conference following a regularly scheduled meeting of the Federal Open Market Committee (FOMC), U.S. Federal Reserve Chairwoman Janet Yellen signaled the FOMC is moving towards raising the Fed Funds Rate later this year, now that signs of a domestic economic slowdown are waning. However, Ms. Yellen stated that for the present, not only is it appropriate for the Fed Funds Rate to remain in the current range of 0% - 0.25%, but also, the path of rate increases could be less steep than FOMC officials had previously anticipated.



THURSDAY, JUNE 18TH

- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 12,000 to 267,000 in the week ended June 13th. while continuing claims fell by 50,000 to 2.22 million in the week ended June 6th. Douglas Porter, chief economist at BMO Capital Markets in Toronto, noted: "The job market remains very strong, since claims have been locked in this general range for some time and retain that underlying downward bias."
  Separately, the Labor Department reported the U.S. consumer price index (CPI) rose by 0.4% in May, the biggest increase since February 2013, following a gain of 0.1% in April.

- Front Page Headline, GoldMoney – "Bonds and Banks. Researcher Alasdair Macleod writes: This year has seen some big losses develop in the fixed income markets, although bond prices have stabilized in recent days.

The above chart is of the yield on one of the lowest sovereign investment risks in ten year maturities. Most other 10-year sovereign bonds have seen even sharper increases in yield, i.e. greater declines in price. This matters because the banking sector is heavily invested in sovereign bonds, not only in the short end of the yield curve where it normally invests for liquidity reasons, but also, in longer maturities between five and ten years …

The primary reason for today's excessive yield spreads between short-term issues and mid-term maturities was the recent sojourn of shorter term euro sovereign bonds into negative yield territory. Banks simply cannot make reasonable rates of return by purchasing shorter maturities. They are encouraged by banking regulators to obtain a little more yield by purchasing longer dated government bonds, instead of lending money to customers who are categorized as far more risky credits. The result is that banks may have suffered substantial losses over recent months, most of which have occurred in the current quarter. The table below summarizes the potential losses seen in the larger sovereign bond markets at the worst point last week and it is noticeable how badly euro zone bond prices were hit.

Selected bond market losses - 2015 Q2

	Yield change % 31 Mar to 11 June		*Price change %*	
	5-year	10-year	5-year	10-year
France	0.012 - 0.446	0.476 - 1.407	-2.06	-8.50
Germany	-0.101 - 0.273	0.185 - 1.059	-1.78	-8.03
Italy	0.575 - 1.254	1.253 - 2.420	-3.15	-10.28
Spain	0.537 - 1.159	1.230 - 2.401	-2.90	-10.17
Switzerland	-0.397 - -0.396	-0.042 - 0.284	0.00	-3.15
UK	1.190 - 1.565	1.579 - 2.164	-1.73	-5.14
US	1.372 - 1.811	1.927 - 2.500	-2.01	-4.95

©2015 GoldMoney

It is worth bearing in mind that euro zone banks have a close working relationship with their national governments and are expected to assume the lead manager position in the funding of new issues. Furthermore, Basel Committee regulations make this easier by treating sovereign bonds as preferred investments. So, imagine the losses faced by the average Italian or Spanish bank, when their sovereign bond prices declined by these amounts in the space of ten weeks (as per the above table) … Unless the current recovery in bond prices holds by the end of June, these banks could be forced to record systemically destabilizing losses at the quarter end."

Wake-up call for Alasdair Macleod: Firstly, euro sovereign bond traders and investors displayed classic stupidity by bidding outstanding euro sovereign bond issues into negative yield territory. This anomaly is known as 'The Greater Fool Theory' – usually limited to a specific bond market and very short-term in nature – and you will note it did not occur in North American bond markets. This writer has been involved in the fixed income markets for over 55 years as a bond trader, investment advisor, portfolio manager and editor and has witnessed 'greater fool' activity in the past, but never on a negative yield basis. Secondly, no euro zone bank can realize any losses on bond investments until it actually sells the holdings in its portfolio. Thirdly, your article assumes that all euro zone banks had cost prices of their holdings when sovereign bond yields were in negative territory. Quite likely, this is a wrong assumption, since their euro sovereign bond holdings could have been purchased months, if not years ago. So, not only do we not know what their specific costs are, but also, some euro banking bondholders might have actually mustered the common sense trade to sell some euro sovereign bond holdings while yields were in negative territory and purchased comparable Government of Canada 'AAA' rated sovereign bonds, or 'AA' rated U.S. Treasurys thereby; not only realizing substantial capital gains, but also, picking up over 100 – 150 basis points in yield, respectively!

FRIDAY, JUNE 19TH

- Statistics Canada reports the nation's consumer price index (CPI) rose by 0.9% in May on a year-over-year basis, up slightly from 0.8% in April. Separately, Statscan reported the country's retail sales declined by 0.1% in April, citing lower demand for food and electronics. Doug Porter, chief economist at BMO Capital Markets, commented: 'The Canadian economy is likely to remain sluggish, so we're maintaining our gross domestic product (GDP) forecast of 0.5% for the current quarter.'

LONGWAVE group

CLOSING LEVELS FOR FRIDAY, JUNE 19TH.		WEEKLY CHANGE
Dow Jones Industrial Average	18,014.28	+ 115.44 points
Spot Gold Bullion	$1,201.90 (U.S.)	+ $22.70 per troy oz.
Spot Silver	$16.06 (U.S.)	+ $0.13 per troy oz.
S&P / TSX Composite	14,653.12	– 88.03 points
10 – Year U.S. Treasury Yield	2.26%	– 13 basis points
Canadian Dollar	81.53 cents (U.S.)	+ 0.30 cent
U.S. Dollar Index Future	94.065	– 0.907 cent
WTI Crude Oil Futures	$59.61 (U.S.)	– $0.35 per barrel
DJIA / Gold Ratio	14.988	– 0.191 point
Gold / Silver Ratio	74.838	+ 0.818 point

Ian A. Gordon, The Long Wave Analyst www.longwavegroup.com

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