

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



Monday, April 27th

Front Page Headline, Globe and Mail – “Fitch Downgrades Japan’s Sovereign Credit Rating to ‘A’. In a press release, Fitch ratings cited: ‘the high and rising level of Japan’s government debt, which we calculate will reach 244% of gross domestic product (GDP) by

MONDAY, APRIL 27TH

the end of 2015, up from 227% in 2013. Moreover, we are citing the government’s failure to counter the loss of revenue stemming from its decision to delay a planned sales tax increase of 2% to the 10% mark this October, while simultaneously proceeding with a corporate tax cut.’ For the record, Heizo Takenaka, an economist and former government cabinet minister, has stated: ‘A consumption tax hike will not improve the fiscal situation. In order to realize fiscal consolidation, it is very important to cap expenditures.”

- Front Page Headline, Bill Holter – “In Polite Company Gold Really Does Matter. Over time, actor after actor has been paraded forth to inform the public: Gold is a useless and barbaric relic. On a daily basis, we are told that gold doesn’t pay any interest; it costs money to store it and Walmart won’t take it. It’s pretty for jewelry, but that’s about it. I ask the questions: Then why do central banks bother to hold gold? Why the secrecy of America’s own gold holdings? We are told that no audit can or will take place because it would cost too much? Why not sell a few of the useless bars to pay for the audit?”

Of course, the answers are all too obvious. Gold bullion is bad-mouthed because it is in direct competition with the U.S. dollar. America hasn’t had an audit because the numbers wouldn’t balance and it would be discovered that the nations doesn’t have the gold that it claims to possess. Simply put, the danger is that America will be uncovered as a fraud, a thief and a liar if an audit occurred. This is why investors are bombarded on a daily basis

with negative input regarding gold and why for the last couple of years the price suppression has been so openly blatant and fierce. It is all about the U.S. dollar and the privilege of issuing the world’s reserve currency; namely the American ability to retain this privilege.

While the above is U.S. centric, the view or perception is far different in the rest of the world. China and Russia are openly purchasing gold for their coffers and their governments actually encourage their citizens to buy gold. My point is this; the rest of the world knows what gold really is: it is money! I would even say that many western governments understand the game as proven by their requests to repatriate gold from New York vaults; trust is waning. Indeed, gold bullion represents trust itself, because it is not issued by any country. The reality is any country which has gold is deemed to have wealth. Ask yourself this question: which is more important, whether the U.S. consider gold to be wealth, or whether the rest of the world does? What if America decides to outlaw gold and makes it illegal to own, as was the case in 1933? This is why one should own some gold, or even the majority of one’s precious metals holdings outside of the U.S. The rest of the world clearly views gold as valuable, so one would have wealth outside of America where said wealth could either remain, or be repatriated in the form of another currency.

By now, it should be clear to investors that power is moving away from the United States. Economic trust is also moving away from the U.S. and is evidenced by the various actions of nations over the last several years: i.e. an alternative clearing system to

SWIFT; currency hubs; the AIB and other banking systems; plus their sizeable additions to gold reserves. All of these measures have progressed while the U.S. has lost more and more trust. The world now sees America in a very poor light for what it does and how it acts. Investors no longer see America as a model citizen who follows the rule of law ... As I have said previously, the 'we'll show you our gold and we demand to see yours' moment is close at hand ... Can an audit demanded by foreign central banks be denied? Moreover, suppose an audit is completed which reveals the U.S. holds less than 1,000 metric tonnes of gold bullion. Obviously, a significant amount of stated reserves would appear to be missing ... Trust matters in everything we do, from daily life to financial affairs. International trade depends entirely upon trust and living standards depend upon trade. The end game of the Bretton Woods Agreement is upon us because as leader, the U.S. has ... often abrogated the rule of law at will. I believe the defining moment will be when China, either formally applies for inclusion into the IMF's Special Drawing Rights (SDR), or when China makes a formal announcement of its total gold bullion holdings. As I understand it, if China were to apply for SDR inclusion, it must provide audited figures of its gold holdings. The Chinese are a very polite and proper people and not the third world fools the U.S. press would have investors believe. The intelligent move on China's part would be to request a gold reserves audit of the other countries included in the SDR, which would obviously include Britain and the U.S. The Chinese must know full well that such audits would not balance with reported figures, since they have purchased more gold than has been produced, so it must have come from someone's vault. In my opinion, this is the most likely way to politely expose the issuer of the world's reserve currency as fraudulently abusing its power. Gold really does matter to the rest of the world, which means when all is said and done, it will ultimately matter to the United States, whether American officials like it or not."

Ian highly recommends you read Bill Holter's blog which is featured on the [Complementary Commentary](#) section of www.longwavegroup.com.

TUESDAY, APRIL 28TH

- The S&P / Case-Shiller group reports its U.S. 20-city home price index rose by 5% in February on a year-over-basis, compared with a 4.5% increase in January. David Blitzer, managing director and chairman of the Index Committee at S&P Dow Jones Indicies, commented: 'As U.S. home prices have continued to rise, they have recently been outpacing both the rate of inflation and wage gain levels.'

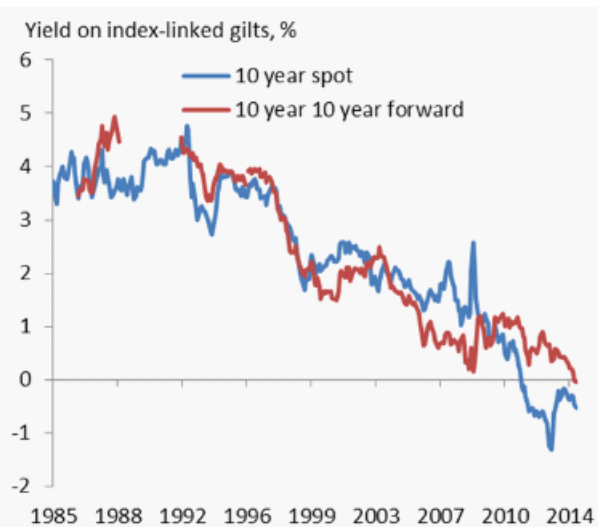
- The New York-based Conference Board reports its U.S. Consumer Confidence Index declined to a reading of 95.2 in April, a four-month low, from a revised level of 101.4 in March, citing a perceived lower level of consumer spending and a slightly weaker labor market in the 1st. quarter.
- Front Page Headline, Daily Telegraph U.K. – “Negative Bond Yields Risk World for Biggest Mass Default in History. Assistant Editor Jeremy Warner reports: Here's an astonishing statistic, more than 30% of all government notes and bonds outstanding in the euro zone – about 2 trillion euros (\$2.2 trillion U.S.) of securities in total – are trading on a negative yield basis.



Photo Source: Alamy

With the advent of the European Central Bank (ECB) quantitative easing (QE) program, what began four months ago when 10-year Swiss bond yields turned negative for the first time has snowballed into a veritable avalanche of negative yields across European sovereign government fixed income markets. In the hunt for prospective 'safe assets', investors have thrown caution to the wind and collectively determined to pay governments for the privilege of lending them money. On a country by country basis, the statistics are even more startling. According to investment bank Jeffries, some 70% of all German bunds now trade at a negative yield. In France, it's 50% and even in Spain, which was widely thought to be insolvent only a few years ago, it's 17%. Not only has this never occurred before on such a scale, but it also marks a scarcely believable turnaround on the situation at the height of the euro zone crisis just a little while ago; when some European bond markets traded at yields that reflected the very real possibility of default. Yet, far from being a welcome sign of returning economic confidence, this almost surreal state of affairs actually signals the very reverse.

How did we arrive here and what does it mean for the future? Whichever way one analyzes it, the answer to this second question is not good; not good at all.

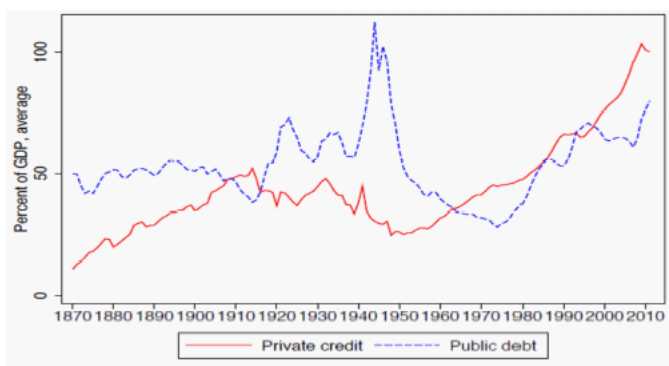


Source: Bank of England

One by one, all the major central banks have joined the money printing party. Firstly, it was the U.S. Federal Reserve and then came the Bank of England and later the Bank of Japan. Just recently, it's the European Central Bank. Now, even the People's Bank of China is considering the unconventional monetary support of bond buying; anything to keep the show on the road. It's what Chris Watling of the consultancy Longview Economics has termed: 'the philosophy of demand at any cost.' A crisis caused by excessive debt has been fought with even more of the same. Many would contend that it is central bank money printing itself which is the primary cause of today's low bond yield environment. Up to a point, it's a view which is difficult to combat, for indeed that is the whole purpose of QE; to depress the yield on government bonds to the point where investors are forced to seek higher risk alternatives. Other contributory factors include financial repression, where ever more demanding solvency regulation forces banks and insurers to hold more bonds, whatever the price. Alternatively, some part of the explanation may be down to QE having starved the repo market of the bonds it needs for collateral, even if most central banks have arrangements to lend their inventory back to markets for these purposes. No doubt, all of this official interference has influenced negative yields.

Yet, it also raises a deeper question, which is whether central banks are the primary cause of the collapse in bond yields, or whether they are merely accommodating wider forces in the global economy which they are powerless to influence, i.e. persistent sluggishness in demand and productivity growth. What's cause and what's effect? In a speech last year, Ben Broadbent, a deputy governor of the Bank of England (BOE), argued cogently that central banks are merely responding to these deeper forces. The natural, or equilibrium, administered interest rate required to keep economic growth and inflation at a particular level is simply a lot lower than it used to be, he insisted. To judge by the markets, the BOE may even have turned negative. There is some support for this view in the way that markets have responded to QE ... For all kinds of reasons, advanced economies and perhaps emerging ones also, seem to have exhausted productivity enhancing growth, therefore, they require constant infusions of financially destabilizing debt to keep them going. The flip side of the cheap credit story is soaring asset prices. The bond market bubble is just the half of it, since most other assets are valued relative to bonds, just about everything else has been going up as well. Eventually, there will be a massive correction and creditors will suffer sickening losses, but nobody knows when that moment will arrive."

What makes today's negative bond yield environment so worrying is this, to the extent that world economic demand is growing at all, it seems again to be almost entirely dependent upon rising levels of debt. The financial crisis was meant to have exploded the credit bubble once and for all, but there's very little sign of it. Rising public indebtedness has taken over where households and companies left off. Moreover, in terms of wider credit expansion, emerging markets have simply replaced Western ones. The wake-up call of the financial crisis has gone largely unheeded. The combined public debt of the G7 economies alone has grown by close to 40% to about 120% of gross domestic product (GDP) since the beginning of the crisis, while globally, the total debt of private non-financial sectors has risen by 30%, far in advance of economic growth. For public and private debt in advanced economies since 1970, see chart below.



Source: Longview Economics

WEDNESDAY, APRIL 29TH

- Front Page Headline, Bloomberg News – “FOMC Reports U.S. Monetary Policy Remains Unchanged. Following its regularly scheduled monthly meeting, the Federal Open Market Committee released the following statement: ‘Economic data received since the FOMC met in March suggests that the nation’s gross domestic product (GDP) slowed during the winter months, in part reflecting transitory factors. The pace of job gains moderated and the official unemployment rate remained steady. A range of labor market indicators suggests that underutilization of labor resources was little changed. While growth in household spending declined, households’ real incomes increased strongly, partly reflecting earlier declines in energy prices and consumer sentiment remained high. Business fixed investment softened; the housing sector recovery remained slow and exports declined.

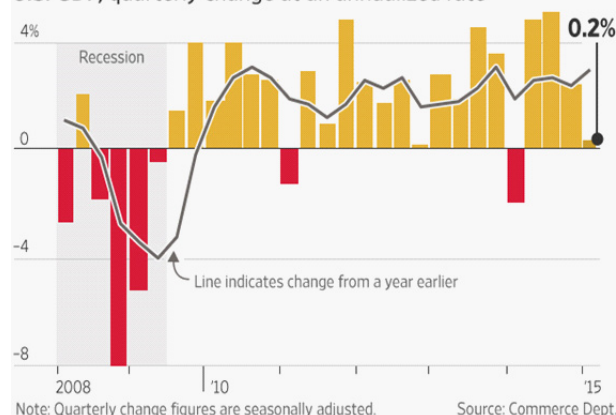
Inflation continued to run below the Committee’s longer term objective, partly reflecting earlier declines in energy prices and falling prices of non-energy imports. Market-based measures of inflation compensation remain low; while survey-based measures of longer-term inflationary expectations have remained stable. Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. Although growth in output and employment slowed during the first quarter, the Committee continues to expect that, with appropriate policy accommodation, economic activity will expand at a moderate pace, with labor market indicators continuing to move toward levels which the Committee judges consistent with its dual mandate.

The Committee continues to see the risks to the outlook for economic activity and the labor market as nearly balanced. Inflation is anticipated to remain near its recent low level over the near term, but the Committee expects inflation to increase gradually toward 2% over the medium term, as the labor market improves further and the transitory effects of declines in energy and import prices dissipate. The Committee continues to closely monitor inflation developments. In order to support continued progress toward maximum employment and price stability, today the Committee reaffirmed its view that the current 0% to .25% target range for the Federal Funds rate remains appropriate.”

- Statistics Canada reports the nation’s producer price index (PPI) rose by 0.3% in March, citing higher prices for energy and petroleum products. Of the 21 commodity sub-sectors included in the PPI, 11 rose, 7 declined and 3 remained unchanged. On a year-over-year basis, the PPI fell by 1.8%.

- The National Association of Realtors (NAR) reports its U.S. pending home sales index – based upon contract signings for purchases of previously owned homes – rose by 1.1% in March to a seasonally adjusted reading of 108.6 from an upwardly revised level of 107.4 in February. The index rose by 11.1% on a year-over-year basis. Lawrence Yun, the NAR’s chief economist, noted: ‘While the increase in the annual sales level is good news, the higher number of traditional buyers paying cash, is even better news. It indicates 2015’s activity is being driven by more long-term homeowners.’”
- The Commerce Department reports the U.S. gross domestic product (GDP) expanded at a 0.2% seasonally adjusted annual rate in the 1st. quarter, citing reduced business investment, lower exports and slower consumer spending.

U.S. GDP, quarterly change at an annualized rate

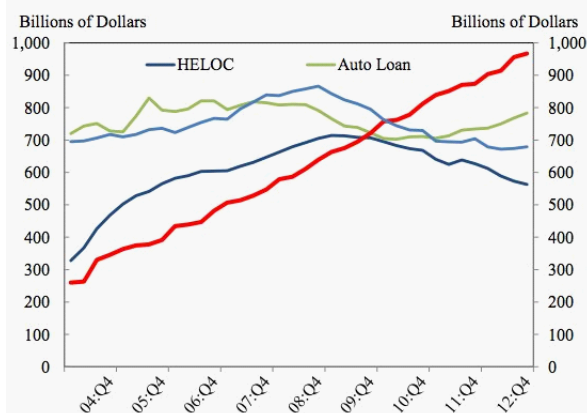


THURSDAY, APRIL 30TH

- The Labor Department reports U.S. initial claims for state unemployment benefits fell by 34,000 to a seasonally adjusted 262,000 in the week ended April 25th. – the lowest level since April 2000 – while continuing claims declined by 74,000 to 2.253 million in the week ended April 18th. In a note to clients, RDQ Economics analysts John Ryding and Conrad DeQuadros commented: “Initial jobless claims continue to signal tightening in the labor market. They suggest that the softer job growth in March may well have been a temporary blip.”
- Front Page Headline, Business Insider – “\$1.2 Trillion of Outstanding U.S. Student Loans Raises Concern on Wall Street. In a recent interview with Bloomberg News, well known hedge fund manager Bill Ackman stated he believes there is a crisis developing in the student loan business because the federal government has loaned too much money to people who can’t repay it. Mr. Ackman thinks eventually political pressure will force the government to forgive those loans, thereby doing serious

damage to an entire industry which services the loans. According to a New York Federal Reserve presentation of earlier this month, the student loan fallout is spreading to both the housing market and consumer spending levels; as a sluggish domestic economic recovery forces borrowers to either miss payments, or tap relief programs. Apparently, only 37% of borrowers are current in their payments and reducing their outstanding balances.” See chart below.

Figure 2: Non-mortgage balances reported on consumer credit reports



The red line in this chart represents student loans.

Source: N.Y Federal Reserve

FRIDAY, MAY 1ST

- The Tempe, Arizona-based Institute for Supply Management (ISM) reports its U.S. index for the manufacturing sector remained unchanged at a reading of 51.5 in April from March, while the new orders sub-index rose to a reading of 53.5 from 51.8 and the employment sub-index declined to a level of 48.3 from 50; the lowest level since September 2009.
- The Commerce Department reports U.S. construction spending declined by 0.6% in March to an annual pace of \$966.6 billion (U.S.), citing a 1.6% drop in private residential construction spending, a decline in single-family home construction of 1.8% and a 2.1% fall in multi-family home building.
- RBC reports its Canadian manufacturing purchasing managers' index (PMI) – a measure of manufacturing business conditions – rose slightly to a seasonally adjusted reading of 49.0 in April from a level of 48.9 in March.

The index has been below the 50 mark since February, indicating a contraction in business conditions. Indeed, the new orders component fell to a reading 47.5 in April from 48.4 in March, citing weaker demand from energy clients.

- Front Page Headline, GoldMoney – “Why Deflation Is Unlikely. Researcher Alasdair Macleod writes: Financial markets are becoming aware that the U.S. economy is stalling, so increasingly, investors are taking the view that with domestic demand likely to stagnate, or even decline, prices for goods and services will drift lower. This is already threatening to be the situation in a number of other advanced economies, where negative bond yields to combat it are becoming commonplace. For this reason, gold and silver priced in U.S. dollars are expected to trend lower by many traders. Placing the prices of precious metals aside for a moment, there are some serious issues with this analysis. Let us assume that the U.S. economy does stall; the textbooks inform us that supply and demand for goods and services will rebalance at lower prices. Effectively, this is what happened in the wake of the Lehman crisis; when energy, metals and precious metals all declined sharply and large discounts for manufactured capital goods became available. This does not necessarily mean that during the second time round, the same thing will reoccur. Indeed, central banks already have a plan to contain the next recession based upon their Lehman Crisis experience. It involves the rapid expansion of the money supply, which on the recent experience of the Federal Reserve System, at the least has been proven to have little or no inflationary consequences whatever. Therefore, we now know something which we did not realize in the wake of August 2008, when the imminent collapse of the global banking system drove everyone to increase their cash balances ... Next time we can expect possible guarantees of up to \$13 trillion (U.S.) to be provided by the Fed, backed by hard cash on demand. Forget bail-ins; they are for dealing with one-off bank insolvencies, not a wider systemic crisis. Of course, it's tempting to think that a new financial and economic crisis will drive us toward selling anything we can for cash. However, this has not necessarily been the experience of previous monetary inflations. After printing money fails to raise the animal spirits, the consensus often expects a decline in prices, only for the opposite to occur.

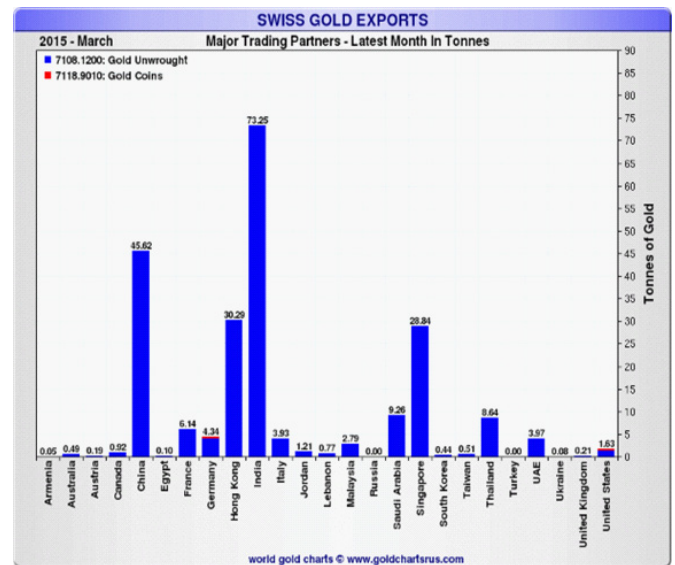
Indeed, this was the case in Germany and Austria after the First World War, when economic burdens from the combined destruction of infrastructure and wealth, the loss of productive lives, the end of military spending and the burden of reparations were all expected to overwhelm their respective economies. The result was that people briefly preferred to retain their savings rather than spend. How wrong they were. While the political situation then was very different from that of today, there was an important economic similarity. The rapid acceleration of money supply growth failed to stimulate the German economy in the preceding seven years. It's the same today. The mistake is the one identified by Frederik Bastiat nearly 200 years ago with

his fallacy of the broken window. We witness the dynamics of a failing economy and draw our conclusions from that observation alone. We tend to disregard the previous monetary inflation and we have yet to see the more rapid expansion of money and credit to come. This is why we do not anticipate the growing certainty that the purchasing power of money will decline and not increase, embarking on the same value-path as the German Reich mark and Austrian crown in 1920-23. If another financial crisis is to be averted, the best we can hope for is an economy moving sideways rather than expanding.

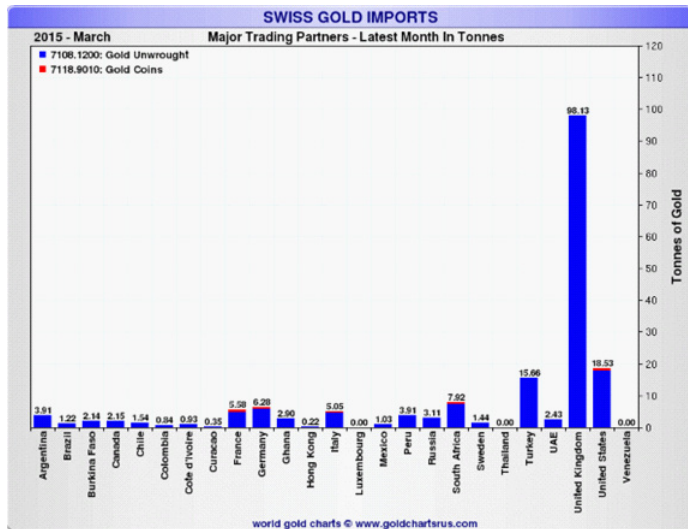
However, there are dangers associated with this hope, partly from equity markets which are dangerously over-valued and partly from the limitations on further private sector debt creation. In point of fact, we are living with an economic situation which is highly vulnerable to an exogenous shock. Meanwhile, the prices of gold and silver reflect the deflationary view to the exclusion of the likely outcome. There is no doubt that many dealers believe that gold and silver are merely commodities, otherwise they would be chasing those prices upwards in a dash for cash. Future historians should be puzzled. Perhaps someone will write a history with a snappy title, such as 'Extraordinary Popular Delusions and the Madness of Crowds.' No, it has already been authored and published by the late Charles Mackay in 1841."

- Front Page Headline, Mark O'Byrne – "Gold Flows East – China, India Import Massive Quantities of Gold from Switzerland.

In what future generations will likely see as a major, potentially catastrophic blunder of monetary policy, the West and particularly the City of London continue to hemorrhage huge volumes of gold bullion which is flowing eastward to Singapore, India and China from London via Switzerland. The increasingly affluent masses in China and India continue to have a voracious appetite for gold bullion as a store of value. Lawmakers in China and Russia have also made gold a cornerstone of their monetary policy. According to Bloomberg News: 'Gold exports to China from the refining hub of Switzerland almost doubled to 46.4 metric tonnes in March, up from 23.6 metric tonnes in February. Gold flows to India rose before April's Akshaya Tritiya Festival, considered a traditional day to buy precious metals.'



Source: World Gold Charts

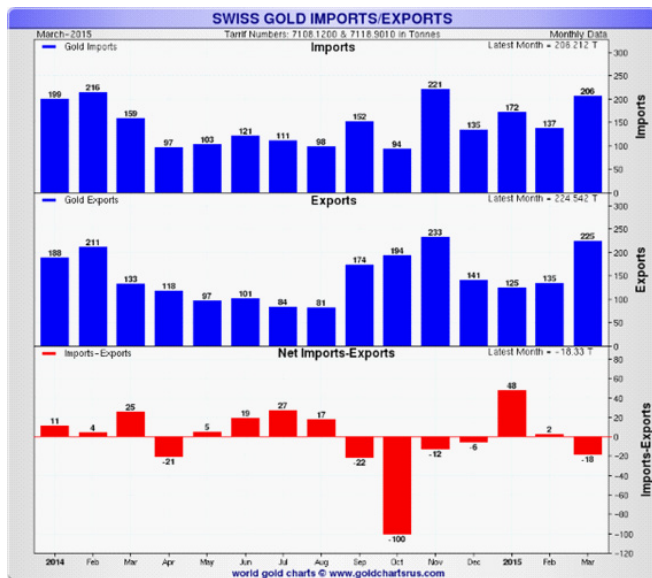


Source: World Gold Charts

The Asian demand for Swiss refined gold was partly met by very large gold imports from the U.K. Bloomberg reports that Swiss imports from the U.K. increased six fold during the same period to 97.2 metric tonnes. This figure dwarfs Swiss imports from other nations. The U.S. and Turkey exported just over 18 metric tonnes and 15 metric tonnes respectively, and these amounts greatly exceed the shipments coming from all the other countries from which Switzerland imports gold. It is likely that London good delivery bars – i.e. 400 troy ounces – favoured by western institutions including bullion banks and central banks are being imported into Switzerland. The bars go to the Swiss refineries to be smelted and refined into kilobar format, which is increasingly popular in Asia and traded on the Shanghai Gold Exchange (SGE). Bloomberg also reports: 'Global sales from gold-backed funds totaled 55.7 metric tonnes in March.' This would indicate that the gold travelling to Asia is either coming from official holdings, or the liquidation of gold ETFs. Some of the holders selling

the ETFs are opting to acquire physical allocated bullion and are storing it in vaults in Zurich, Singapore and Hong Kong.

Singapore is fast becoming an important gold hub and a favourite location for allocated bullion storage among risk conscious bullion buyers. Hong Kong experienced a decline in its market share as Chinese investors increasingly opted to use the SGE for buying and trading gold in general. SGE data revealed that shipments to Hong Kong declined by 26% to 30 metric tonnes, whereas trading volume for gold bullion soared by 60% in March from February's volume. The SGE deals solely in physical gold bars and not paper contracts or unallocated bullion bank accounts, which can be used to divert and reduce actual demand for physical gold and cap gold prices. Among them, China, India and Singapore ... imported almost 150 metric tonnes of the 223.3 metric tonne total of gold bullion exported from Switzerland in March; the highest monthly amount in at least two years. While investor sentiment towards gold bullion in the west remains abysmal, even as the price of gold languishes at a record low level when adjusted for inflation, the Asian demand continues to be insatiable.



Source: World Gold Charts

It would be wise for investors to become better informed about this trend. Demand for gold in Asia is often discounted by Westerners as an irrational impulse of uneducated Asian peasant farmers and field workers. This is quite unfair to gold buyers in Asia, since many of whom have experienced currency devaluations, therefore are opting to own gold as a savings mechanism and a superior store of value. However irrational holding gold may appear, the alternative of holding paper currencies, which are continually being devalued through QE and inflation ... is even more irrational. The fact that China's state policy continues to accumulate vast volumes of gold and that the Chinese government has urged its citizens to own gold, indicates that bullion is not the fringe asset of irrational investors.

The fact that Western central banks continue to hold, consolidate and repatriate gold underlines the strategic importance placed on gold by the very entities which issue the currencies we use. People need to protect themselves from potential economic and monetary crises where existing currencies may be devalued. In the event of either serious problems, or even the collapse of the unsustainable debt-based international monetary system, an allocation to gold will protect wealth; both the savings of peasants in India and those of the middle classes and high net worth individuals in the western world. Separately, last Monday the London Bullion Market Association (LBMA) revealed it isn't likely to move to an exchange because it would increase costs and reduce liquidity. Also, Ruth Crowell, the LBMA's chief executive officer, announced: "Today, I have commissioned Ernst & Young to conduct a study and prepare recommendations about how to develop the gold market. In the future, there may be more regular transaction reporting and a return to publishing gold forward offered rates and the forward curve."

| CLOSING LEVELS FOR FRIDAY, MAY 1ST. | | WEEKLY CHANGE |
|-------------------------------------|--------------------|-----------------------|
| Dow Jones Industrial Average | 18,024.06 | – 56.08 points |
| Spot Gold Bullion | \$1,174.50 (U.S.) | – \$0.50 per troy oz. |
| Spot Silver | \$16.14 (U.S.) | + \$0.46 per troy oz. |
| S&P / TSX Composite | 15,339.77 | – 68.56 points |
| 10 – Year U.S. Treasury Yield | 2.11% | + 20 basis points |
| Canadian Dollar | 82.26 cents (U.S.) | + 0.09 cent |
| U. S. Dollar Index Future | 95.269 | – 1.666 cents |
| WTI Crude Oil Futures | \$59.15 (U.S.) | + \$2.00 per barrel |
| DJIA / Gold Ratio | 15.346 | – 0.041 point |
| Gold / Silver Ratio | 72.77 | – 2.166 points |

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