

# UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

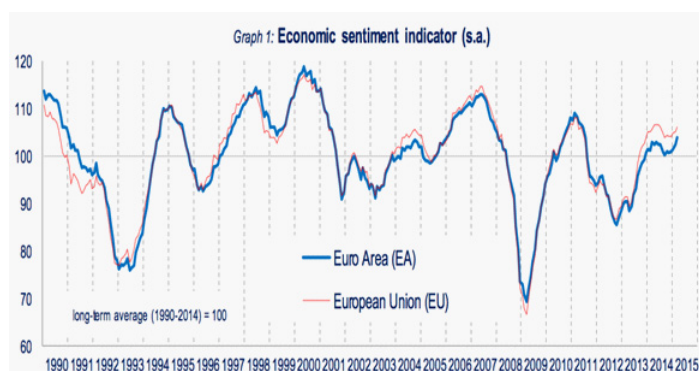
## THAT WAS THE WEEK THAT WAS



### Monday, March 30th

The European Commission (EC) reports its Economic Sentiment Indicator – a measure of business and consumer confidence – rose to a reading of 103.9 in March from a level of 102.3 in February; its highest reading since June 2011.

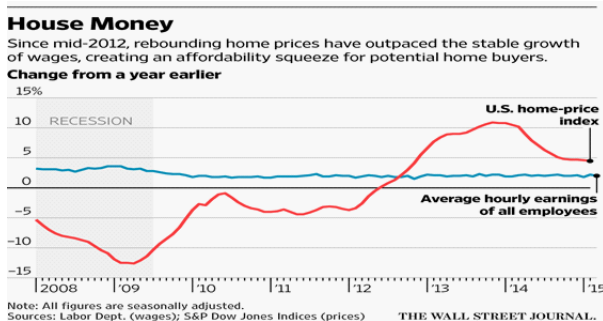
### MONDAY, MARCH 30TH



- The National Association of Realtors (NAR) reports U.S. pending home sales increased by 3.1% in February to a seasonally adjusted reading of 106.9, the highest level since June 2013. Pending home sales are a barometer of future purchases. A one or two month lag usually transpires between a signed contract and a completed sale.
- The Bureau of Economic Analysis (BEA) reports the U.S. personal savings rate rose to 5.8% in February, up from 5.5% in January and 4.9% in December; citing the cold and snowy winter weather forced consumers to spend more time on the home front in many regions across the country. See chart to the right.
- Front Page Headline, Daily Telegraph U.K. – “Bank of England Warns Global Liquidity Has Become More Fragile. The BOE’s Financial Policy Committee (FPC), which is responsible for maintaining financial stability, has warned: ‘The Committee remains concerned that investment allocations and the pricing of some securities may presume that asset sales can be transacted in a market of continuous market liquidity, although liquidity in some markets may have become more fragile. Trading volumes in fixed income markets have declined relative to market size and recent events in financial markets -- including the U.S. Treasury market in October 2014 – appear to suggest that sudden changes in market conditions can occur in response to modest news. This could lead to heightened volatility and undermine financial stability. The Bank will liaise with market participants to ensure they are alert to these risks, to price liquidity appropriately and to manage liquidity prudently.’”

TUESDAY, MARCH 31ST

- The New York-based Conference Board reports its U.S. consumer confidence index rose to a reading of 101.3 in March from a revised level of 98.8 in February, previously reported as 96.4. Lynn Franco, Director of Economic Indicators at the Conference Board noted: "This month's consumer confidence increase was driven by an improved short term outlook for both employment and income prospects. However, consumers' assessment of current business conditions declined for the second consecutive month, suggesting that GDP growth may have weakened in the 1st quarter and doesn't appear to be gaining any significant momentum heading into the spring months."
- The Standard & Poors / Case Shiller group reports its home price index for 20 U.S. cities rose by 4.6% in January on a year-over-year basis, following a 4.4% gain in December, citing tight inventory conditions and low mortgage rates continue to support higher prices. David Blitzer, chairman of the index committee for S&P Dow Jones Indices, commented: "U.S. home prices are increasing at roughly twice the pace of wages, putting pressure on potential home buyers and heightening the risk that any uptick in mortgage rates could present a major setback." The Case-Shiller index covers approximately half of American homes and measures prices compared with those determined in a January 2000 base.



- Front Page Headline, Financial Post – "Canada's GDP Posts Modest Decline. Statistics Canada reports the nation's gross domestic product contracted by a very modest 0.1% in January. Avery Shenfeld, an economist at CIBC World Markets, observed: 'The Canadian economy began the year with a modest 0.1% drop in real GDP, aided by a sharp rebound from prior weakness in mining / oil / gas output and a solid month for utilities. The latter reflected cold weather boosting, not only natural gas, but also, gains in power production and transmission. Mining rebounded by 1.4% following a 0.9% decline in December. Note that the weak energy story will be revealed in the sector's capital spending, rather than in barrels of output, which are still

likely to climb during 2015. Retail, wholesale and manufacturing output all declined as expected. While the 1st. quarter will likely record no better than 1% GDP growth, the issue for monetary policy will be mostly about how much of that weakness extends into the subsequent two quarters."

- Front Page Headline, Daily Telegraph U.K. – "Andorra on the Brink of Europe's Next Banking Crisis. Reporter James Titcomb warns: For many years, the tiny principality of Andorra enjoyed the benefits of European borders without the restrictions of European Union (EU) membership, allowing light touch regulation that has brought in tourism and wealthy expatriates from its bordering countries of France and Spain. However, in the last three weeks, the state has been gripped by a banking crisis which threatens to take it to the brink of collapse. Bankers have been thrown in jail, savers' deposits have been restricted and the country's government is scrambling to convince powerful regulators thousands of miles away that the country is not a haven for tax evasion. On Tuesday, March 10th. the U.S. Department of the Treasury's financial crime body FinCEN, accused Banca Privada d'Andorra (BPA), the country's fourth largest bank, of money laundering, citing: 'Corrupt high level managers and weak anti-money laundering controls have made BPA an easy vehicle for third-party money launderers.' According to FinCEN, three senior managers at the BPA accepted bribes to help criminals in Russia, Venezuela and China, funnel money through the Andorran system. The next day, the state took charge of BPA and dismissed three directors. On the Friday, BPA's CEO Jean Paul Miquel was arrested and jailed in La Comella, Andorra's only prison.



Andorra, nestled between France and Spain.  
Photo source: Alamy

Meanwhile, the Andorran authorities have installed new management at BPA. After international banks cut off links, withdrawals were limited to 2,500 euros per week; a limit that many people are maxing out. Banco Madrid, the Spanish subsidiary

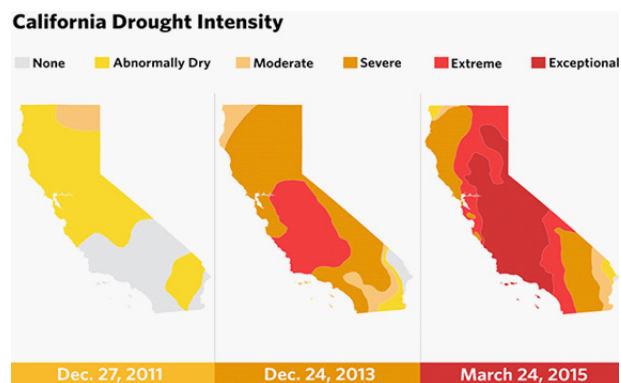
of BPA, acquired as part of an expansion spree in recent years, filed for administration on Wednesday. The Andorran government insists that BPA is an isolated case, citing it is committed to transparency and that the rest of the sector is clean. For the government's sake, it had best be right, but many experts fear this is not the case. The state's banks have assets under management 17 times bigger than the economy and the sector accounts for 20% of GDP. Almost all of the rest is from tourism. Indeed, the country faces a catastrophe if its banks fall apart. The crisis is a classic example of how countries seeking to welcome financial services by promising a hands-off approach to regulation, can become dangerously vulnerable to them. Andorra's exposures to its banks revive echoes of Iceland and Cypress ... however, unlike Cyprus, which received a last minute bailout; Andorra has no central bank to act as a lender of last resort. If its banks go under, Andorra goes under.

The crisis has now led Standard & Poor's (S&P) to downgrade the credit rating of the principality's sovereign debt. Two weeks ago, S&P observed: 'The risk profile of Andorra's financial sector, which is large relative to the size of the domestic economy, has increased beyond our expectations. In our opinion, the absence of a central bank or lender of last resort in the Andorran financial system exacerbates the risks. The Andorran government, which functions on an annual budget of about 400 million euros, would have almost no chance of supporting BPA, which has assets in excess of 3 billion euros. While the FinCEN allegations are specific to BPA, the escalation of events has underlined more uncertainty concerning access to funding and liquidity than was previously factored into the Andorran banks' ratings; in particular, in view of their relatively high dependence on non-residential customer deposits and the absence of a lender of last resort. Despite a swift and strong response to BPA's crisis by all parties involved, the reputation of the system – ergo the banks' franchises – may be damaged.' Accordingly, last week S&P placed Andbank, MoraBanc and Credit Andorra on negative credit watch.

### WEDNESDAY, APRIL 1ST

- Automatic Data Processing (ADP) reports U.S. private sector payrolls increased by 189,000 in March, following a revised gain of 214,000 jobs in February. Mark Zandi, chief economist at Moody's Analytics, noted: "The ADP report indicates there are some good reasons to think that job growth has slowed, so we may not see monthly job gains of 300,000 for a while."

- The RBC Canadian Manufacturing Purchasing Managers' Index (PMI) – a measure of manufacturing business conditions – rose marginally to a seasonally adjusted reading of 48.9 in March from a record low of 48.7 in February. A reading below 50 indicates contraction in the sector. Craig Wright, chief economist at RBC, commented: "The PMI report signals that the manufacturing sector continues to face headwinds. However, at RBC we remain confident that as the U.S. economy continues to strengthen and the Canadian dollar becomes more competitive, there will be an uptick in exports which will be a good sign for domestic manufacturers but we need some time in order to see this materialize."
- Front Page Headline, Wall Street Journal – "California Orders Unprecedented Mandatory Water Reductions. Governor Jerry Brown has ordered the State Water Resources Control Board to implement mandatory water reductions of 25% across the Golden State, after the latest measurements show the state's mountain snowpack – which accounts for roughly a third of California's water supply – has receded to a record low 5% of normal for this time of year. After accompanying state surveyors into the Sierra Nevada Mountains in order to manually verify electronic readings which show an average snow water equivalent of 1.4 inches – the lowest ever recorded on April 1st. – Governor Brown announced: 'Today we are standing on dry grass where there should be five feet of snow. This historic drought demands unprecedented action.'



Source: Wall Street Journal

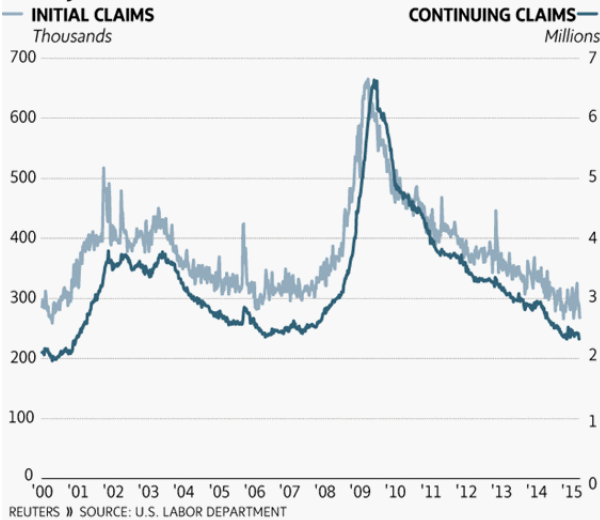
- The Tempe, Arizona-based Institute for Supply Management (ISM) reports its purchasing managers' index (PMI) for the U.S. manufacturing sector declined for the fifth consecutive month in March to a reading of 51.5 from a level of 52.9 in February, citing severe winter weather, higher health care premiums and a strong U.S. dollar which has a negative impact on exports.



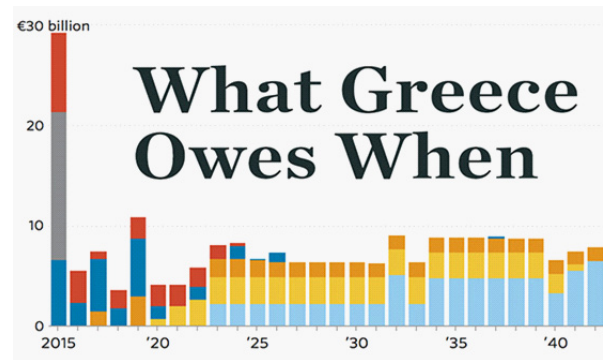
THURSDAY, APRIL 2ND

- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 20,000 to a seasonally adjusted 268,000 in the week ended March 28th. while continuing claims fell by 88,000 to 2.33 million in the week ended March 21st. – the lowest number since December 2000.

**U.S. jobless claims**



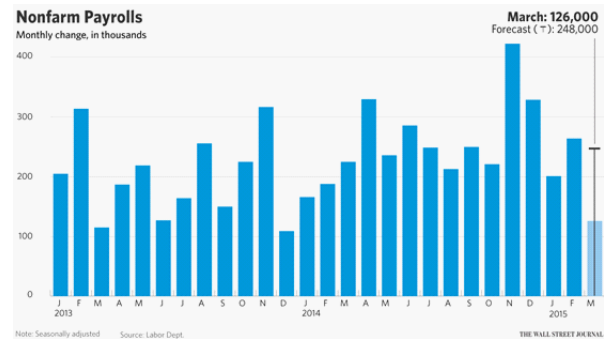
- Statistics Canada reports the nation's merchandise trade deficit narrowed to a seasonally adjusted \$984 million (CAD) in February from a revised deficit of \$1.5 billion (CAD) in January, previously reported as \$2.5 billion (CAD), citing a rebound in energy export prices from multi-year lows.
- Front Page Headline, Reuters News – “Greece Informs Creditors It Will Soon Be Exhausted of Funds. At an Athens teleconference of euro zone deputy finance ministers yesterday, Greece informed its creditors that the country will be exhausted of funds on April 9th., appealing for more loans before reforms – upon which new disbursements are contingent – are agreed and implemented. However, euro zone officials confirmed that the request was rejected. Greece’s appeal echoed remarks by Interior Minister Nikos Voutsis who stated: ‘Greece will have to choose either to repay 450 million euros to the International Monetary Fund (IMF) on April 9th., or pay salaries and pensions. I believe that Greece will likely choose the latter.’”



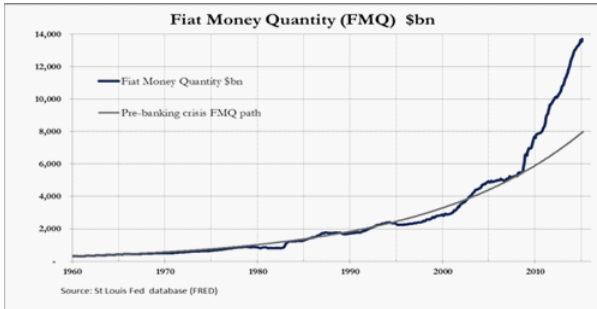
FRIDAY, APRIL 3RD

Good Friday Holiday in Canada and Great Britain

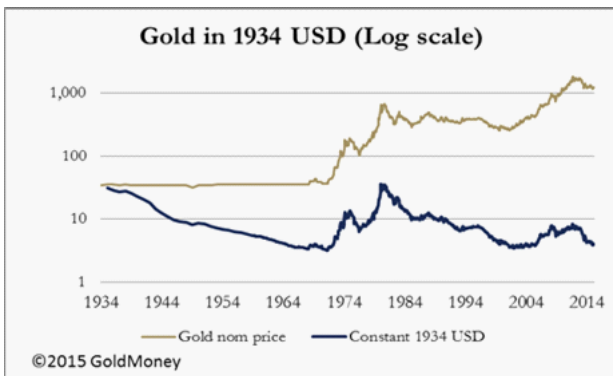
- The Labor Department reports U.S. non-farm payrolls increased by 126,000 in March, the smallest gain since December 2013; citing the weakness was concentrated in the manufacturing sector since exports have been adversely affected by the strong U.S. dollar. Millan Mulraine, an economist at TD Securities in New York, commented: ‘The payroll report confirms the emerging narrative of slowing GDP growth momentum seen in other domestic economic indicators. It will weaken the argument for a mid-year increase in the Federal Funds Rate target.’”



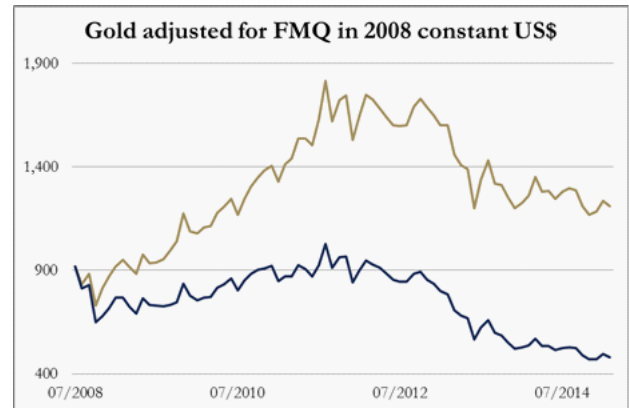
- Front Page Headline, GoldMoney – “Valuing Gold and Fiat Money Quantity. Researcher Alasdair Macleod writes: There is only one way to value gold and that is to quantify the expansion of the fiat currency in which it is priced. That is the sole purpose of the Fiat Money Quantity (FMQ), which since last writing about it five months ago, has increased by \$375 billion (U.S.) to \$13.7 trillion (U.S.). This is despite the end of quantitative easing which had been tapered down before being abandoned altogether. The long-term chart of FMQ is outlined below.



- FMQ is the total instant-access cash and deposits in the U.S. commercial banks, plus their reserves at the Federal Reserve and the temporary means by which those reserves are changed. Its purpose is to quantify the difference between sound money and fiat currency by including the steps by which gold has been progressively absorbed into the banking system from private ownership and into government vaults via the commercial banks and the Fed. The pace of FMQ creation from 2008 continues well above the pre-Lehman crisis trend and it is now \$8.259 trillion (U.S.) higher than at that time; an increase of 152% in 78 months. Who would have thought that a temporary provision of money and credit to stabilize the financial system in the wake of the Lehman crisis would have developed such permanency? As a measure of monetary inflation, FMQ differs from more conventional metrics by including liquid bank assets held on the Fed's balance sheet. By including money parked out of sight in this way, a truer position is obtained. Critics of this approach deem it is double-counting, because bank reserves recorded at the Fed are also recorded at the commercial banks as customer deposits. Undoubtedly, this is true but the whole fractional reserve system involves multiple counting of the same underlying money; so it is hardly disqualified on these grounds. The next chart indicates how FMQ has deflated the price of gold, as measured in constant 1934 U.S. dollars. This was the year that President Roosevelt devalued the dollar from \$20.67 (U.S.) to \$35.00 (U.S.) per troy ounce of gold.



The gold price is depicted in nominal U.S. dollars and also in constant 1934 dollars adjusted for the increase in FMQ. The disparity between these two prices has widened over the years to \$1,211 (U.S.) and \$3.91 (U.S.), respectively. The two previous times the adjusted gold price reached these low levels were in April 1971 at \$3.31 (U.S.), four months before President Nixon was forced to suspend the Bretton Woods Agreement and in October 2001 at the beginning of the last gold bull market when it was down to \$3.45 (U.S.). This time, the higher rate of increase in FMQ suggests the price today is more undervalued than the previous two times on a forward looking basis. The last chart is of the gold price since the Lehman crisis and in July 2008 constant dollars, when FMQ accelerated above the long-term trend as shown in the first chart.



While the nominal price taken in 2015 was \$1,211 (U.S.), the adjusted price was \$480.00 (U.S.), representing a 45% decline from the \$918 (U.S.) in July 2008. In summary, FMQ shows that gold bullion is substantially underpriced in U.S. dollars on a long-term basis. In the past, this level of underpricing has been followed by major gold price shocks to the upside on both occasions.”

CLOSING LEVELS FOR FRIDAY, APRIL 3RD.		WEEKLY CHANGE
Dow Jones Industrial Average	17,763.24	+ 50.58 points
Spot Gold Bullion	\$1,200.90 (U.S.)	+ \$1.10 per troy oz.
Spot Silver	\$16.70 (U.S.)	– \$0.25 per troy oz.
S&P / TSX Composite	15,026.62	+ 214.20 points
10 – Year U.S. Treasury Yield	1.84%	– 12 basis points
Canadian Dollar	80.11 cents (U.S.)	+ 0.74 cent
U.S. Dollar Index Future	96.742	– 0.768 cent
WTI Crude Oil Futures	\$49.14 (U.S.)	+ \$0.27 per barrel
DJIA / Gold Ratio	14.792	+ 0.029 point
Gold / Silver Ratio	71.910	+ 1.126 points

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