Monday May 4th, 2015

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, May 4th

The HSBC / Markit Economics group reports its purchasing managers' index for China's manufacturing sector declined to a final April reading of 48.9, following a level of 49.6 in March.

MONDAY, MAY 4TH

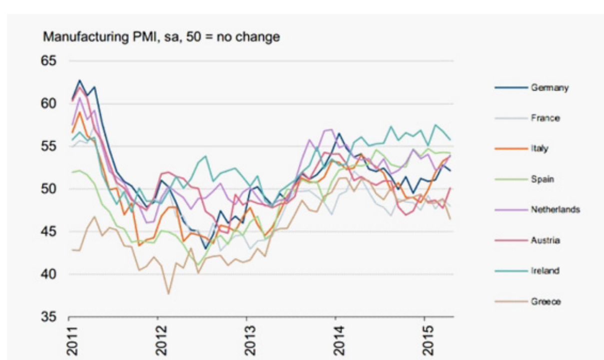
Source: Bloomberg

- The Commerce Department reports U.S. factory orders rose by 2.1% in March, the biggest increase in eight months, led by higher demand for transportation equipment, following a revised decline of 0.1% in February.

- The University of Michigan reports its consumer sentiment index rose to a final reading of 95.9 in April, following a final level of 93.0 in March.

- Front Page Headline, Financial Times – "IMF Takes Hard Line on Greek Aid. The International Monetary Fund has warned Athens' euro zone creditors that Greece is so far off course on its $172 billion (U.S.) bailout program that it faces losing vital IMF support unless European creditors write off significant amounts of its sovereign debt. The IMF warning raises the prospect that it may withhold its 50% portion of a 7.2 billion euro tranche of bailout aid which Greece needs to avoid bankruptcy. Without these funds, Greece is expected to exhaust its cash position by month end."

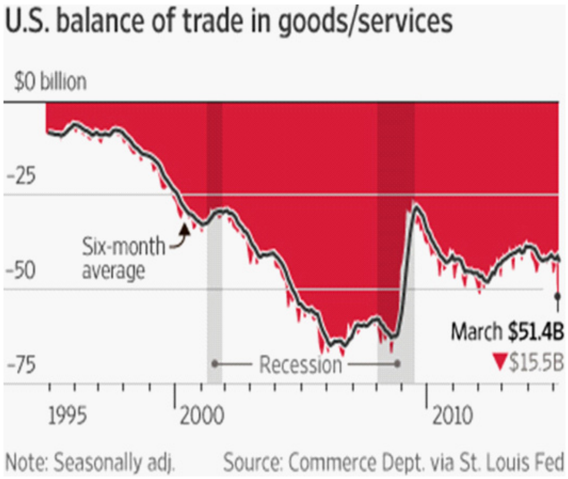
- Markit Economics reports its French manufacturing purchasing managers' index (PMI) declined to a reading of 48 in April from a level of 48.8 in March; well below the 50 mark which divides expansion from contraction. Greece's PMI fell to a reading of 46.5 from a March level of 48.9. Chris Williamson, Markit's chief economist, commented: "Warning lights are flashing particularly brightly over France and Greece, both of which experienced accelerating rates of decline at the beginning of the 2nd. quarter. Weaker rates of manufacturing growth in Germany and Ireland are also cause for concern."



Source: Markit.

TUESDAY, MAY 5TH

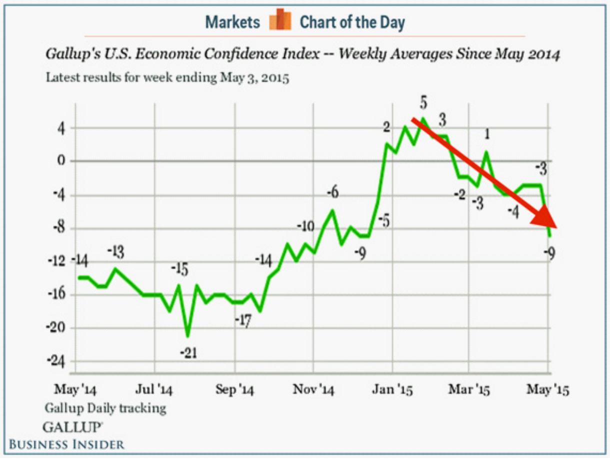
- The Commerce Department reports the U.S. trade deficit widened by 43.1% in March to $51.4 billion (U.S.), the highest level since October 2008, citing a record surge in imports consisting of packaged foods, capital goods and consumer products. Michael Feroli, an economist at JP Morgan Securities in New York, commented: 'The ending of the port strike seems only to have materially affected imports. When one sifts through the data, it seems while trend in imports is moving higher, the trend in exports looks rather soft.'



- Statistics Canada reports the nation's trade deficit widened to a record $3 billion (CAD) in March, following a downwardly revised deficit of $2.2 billion (CAD) in February, previously reported as $984 million (CAD). In a research note, Nathan Janzen, an economist at the Royal Bank of Canada, observed: 'The deterioration in the trade deficit appears to have been entirely the result of lower export prices, led by weaker energy prices.'

- The Tempe, Arizona-based Institute for Supply Management (ISM) reports its U.S. non-manufacturing purchasing managers' index (PMI) rose to a reading of 57.8 in April, following a level of 56.5 in March. Anthony Nieves, who oversees the ISM survey, commented: 'The index's trend has established a consistent pattern of slow incremental growth.'

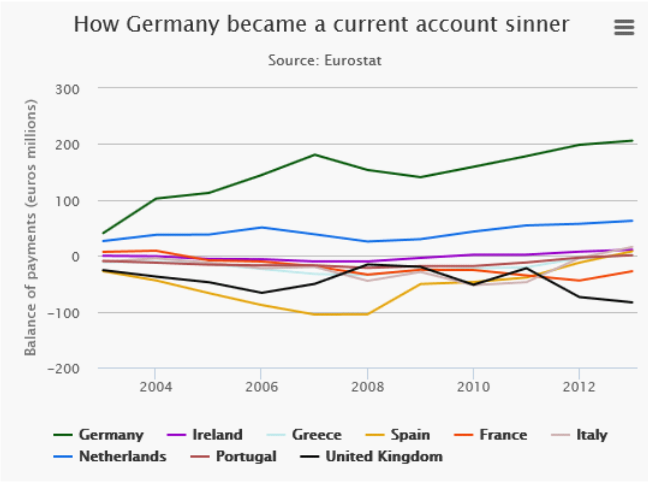
- Front Page Headline, Business Insider – "Americans Are Losing Confidence in the Domestic Economy. In its latest poll, Gallup reports its U.S. economic confidence index declined to a reading of minus 9, its lowest level since December 2014. Gallup analyst Justin McCarthy writes: The recent downtick in Americans' economic confidence – which is being depressed largely by the lower economic outlook component – is likely the culmination of a variety of economic factors … However, the prices Americans were paying for gas increased in the latter half of April with the U.S. Energy Information Administration (EIA) reporting an increase of 17 cents per gallon over two weeks. Gallup has discovered that Americans' confidence in the domestic economy is somewhat related to how much they pay at the gas pump."



- Front Page Headline, Daily Telegraph U.K. – "Germany's Record Trade Surplus Represents Bigger Threat to Euro than Greece. International Business Editor Ambrose Evans-Pritchard writes: Germany's current account surplus is out of control. The European Commission's (EC) spring forecasts indicate that it will smash all previous records this year, reaching a modern-day high of 7.9% of gross domestic product (GDP) and it will still be 7.7% in 2016. Vague assurances that the surpluses would decline over time have once again come to nothing. Germany is now the single biggest violator of the euro zone stability rules. It would face punitive sanctions if European Union (EU) treaty law was enforced. A year ago, Brussels told Germany to do its homework, but recoiled from taking any action. We will see if Jean-Claude Juncker's EC does any better this time.

  If not, cynics might justifiably conclude that big countries play by their own rules in Europe and that Germany can defy all the rules. The European Monetary Union (EMU) punishment machinery is highly political, in any case. The story of the EMU debt crisis is that the authorities persistently enforce a creditor agenda, rather than macroeconomic welfare, which is an entirely different matter. This is the fifth consecutive year that Germany's surplus has been above 6% of GDP. The EU's Macroeconomic Imbalance Procedure states that the EC should launch infringement proceedings if this occurs for three consecutive years, unless there is a reason to the contrary.

There are few extenuating circumstances in this case. Germany's surplus is not caused by a one-off shock. The surplus remains huge even if adjusted for lower energy import costs. It is a chronic structural abuse, rendering monetary union unworkable over time and is surely more dangerous for euro zone unity than anything transpiring in Greece. Simon Tilford at the Centre for European Reform states: 'The European Commission should stop pulling its punches: Germany should be fined. Its current account surplus should be treated in the same way as the southern deficits were treated earlier, as a comparable threat to euro zone stability. What is so worrying is that the surplus would normally be falling rapidly at this stage of the economic cycle."



WEDNESDAY, MAY 6TH

- The Roseland, New Jersey ADP Research Institute reports U.S. private companies added 169,000 hires to their payrolls in April, the smallest monthly gain since January 2014. Scott Brown, chief economist at Raymond James Financial in St. Petersburg, Florida commented: "While the April ADP report is disappointing, I don't think it's necessarily a disaster. In a normal situation a gain of 169,000 would be great, but the economy has a lot of slack in the labor market still lingering from the recession."

- Front Page Headline, Wall Street Journal – "Equity Market Valuations Generally Are Quite High: Yellen. In a speech to a conference sponsored by The Institute for New Economic Thinking and held at the International Monetary Fund's headquarters in Washington, U.S. Federal Reserve Board Chair Janet Yellen stated: 'Risks to financial stability are moderated, not elevated at this point. Moreover, regulators have sharpened their tools for overseeing the domestic financial system.

- However, I would highlight that equity market valuations generally are quite high, but not so high when one compares returns on equity to returns on safe assets like bonds, which are also very low; but there are potential dangers there. Other areas of possible concern are low differentials among the yields of riskier corporate bonds and safe-haven U.S. Treasurys and high levels of debt in the leveraged loan market. There was a great deal that we missed before the economic crisis, but I think we are better prepared now."

Federal Reserve Board Chair Janet Yellen.
Sources: Agence France Presse/Getty Images.

- Front Page Headline, Daily Telegraph U.K. – "Brexit Threat Looms over Britain's Election and Europe's Fate. International Business Editor Ambrose-Evans Pritchard writes: Chanceries, political elites and business federations across Europe, regardless of whether they are on the Left or the Right, are hoping the Conservative Party loses this week's general election. All the better if a motley Labour government is strapped to a bloc of triumphant Scottish Nationalists, guaranteeing a double-lock against any further flirtations against Brexit, or so goes the argument.

  They should be careful what they wish for because David Cameron is perhaps the only man who can ultimately prevent Britain from breaking away from the European Union (EU); thereby preventing a fatal body blow to an ailing project which lost its emotional hold over Europe's people long ago and no longer has a plausible claim to economic legitimacy. Lest we forget – carried away by a short-term cyclical rebound – the euro zone is only just beginning to recover from an economic slump which has proven deeper and more intractable over the last six years than the Great Depression, with four sovereign insolvencies and mass unemployment to match. Nor should we forget that the second leg of this episode was entirely caused by policy blunders and the unworkable structure of European Monetary Union (EMU) governance. A Labour-SNP arrangement would be inherently weak and unstable, like the string of Gladstone governments dependent upon the swing vote of the Irish Home Rule movement of the late 19th. century.

There might be no issue with an EU withdrawal in 2017, but that would settle nothing. 'While a Labour victory might reduce the prospect of Brexit over the next five years, it could increase them over the next ten,' writes the think-tank Open Europe. A Tory defeat would flush out the last EU dreamers and leave a post-Cameron party with even less tolerance for the posturing of European Commission (EC) chief Jean-Claude Juncker, who this week accused the Anglo-Saxon world of trying to destroy the euro and vowed to stop Britain from 'imposing its exclusive agenda on all the other member states of Europe.' There is a high likelihood that such a party would let it rip on Euro skepticism while in opposition and then come roaring back in five years' time, led by Boris Johnson if the bookies are right, fully-immunized against the illusionary seductions of europhilia by his childhood in Brussels. His economic report on the pros and cons of Brexit concluded that the City of London could continue to flourish in a free-trade world outside the EU. He argued while such an outcome might not be ideal, the worst of all worlds would be for Britain to remain shackled to a political construction that failed to reform. This is a warning shot. The back-and-forth of competing studies on the implications of Brexit leave me cold. It is impossible to either quantify the variables, or to model the counter-factuals.

The Confederation of British Industry's (CBI) claim that EU membership is worth 78 billion pounds, or 4% to 5% of gross domestic product (GDP), relies on wooden assumptions and random figures plucked out of thin air. These sorts of reports work from the assumption that the EU would carry on much as before if the British walked away, but one could equally argue that the whole ideological edifice would begin to crumble. Brexit would wreak havoc with the EU's internal chemistry, leaving France even more exposed to the ill-disguised power of a reunified Germany which is already uncomfortably dominant and wants no such hegemony for itself. The small Nordic countries which tuck into UK-led coalitions on free trade and open markets would be set adrift and might ultimately be tempted away themselves into an emerging Atlantic constellation."

THURSDAY, MAY 7TH

- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 3,000 to 362,000 in the week ended May 2nd. while continuing claims declined by 28,000 to 2.23 million in the week ended April 25th. Ray Stone, an economist at Stone & McCarthy Research Associates in Princeton, New Jersey noted: "Jobless claims are the timeliest indicator of labor market conditions; so on the margin things look pretty decent. Claims at this level should be consistent with a strong April non-farm payroll number."

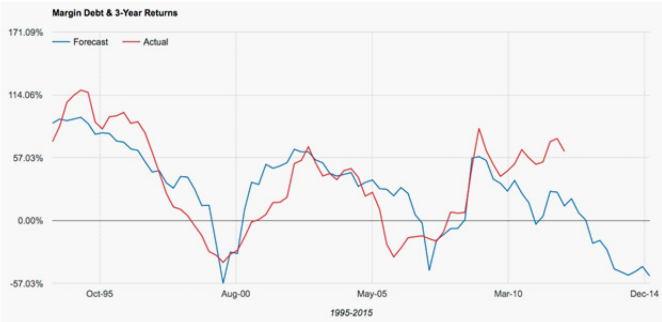
- Statistics Canada reports the value of the nation's building permits rose by 11.6% in March to \$6.87 billion (CAD), the biggest increase in six months, citing a 19.6% increase in construction plans for multi-family homes, which primarily includes apartments and condominiums.

- Front Page Headline, Wall Street Journal – "American Consumers Set Fastest Borrowing Pace in March since July. The U.S. Federal Reserve reports total outstanding consumer credit balances – excluding mortgages – increased by a seasonally adjusted \$20.52 billion (U.S.) in March to \$3.36 trillion (U.S.). The debt expansion was broadly based, citing revolving credit – consisting mainly of credit card debt – rose at a 5.92% annual rate in March, compared with a 5.33% annual pace in February."

- Front Page Headline, Business Insider – "Record High Margin Debt. Researcher Jesse Felder reports: Over the past twenty years, the level of margin debt relative to the economy has experienced nearly an 80% negative correlation to future 3-year returns in the stock market. It means the higher the level of margin debt relative to gross domestic product (GDP), the lower the returns for the stock market over the coming 3 years and vice versa.

Source: The Faber Report

- So, what is the current level of margin debt suggesting in the next 3 years for stock returns? Considering that margin debt-to-GDP is near an all-time record high, it forecasts returns over the coming 3 years could very well be as severe as any bear market we have witnessed over the past 20 years. Specifically, it forecasts a negative 3-year return of 50% … In my view, margin debt is a very good method of taking the stock market's temperature. The extreme level of margin debt-to-GDP clearly indicates that investors have become recklessly confident. Prudent investors should react by becoming more cautious. Moreover, from a contrarian standpoint, the fact that popular bloggers are dismissing this idea despite its mathematical validity, adds an exclamation point to that idea!



Source: The Faber Report

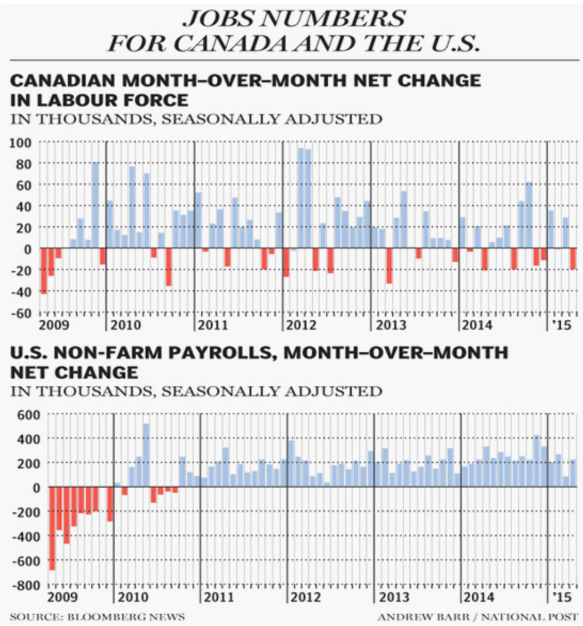
- Front Page Headline, GoldMoney – "Controlling Copper and Silver Prices. There is an unwarranted assumption that market prices are always right and represent fair value. In the case of commodities, particularly metals, this is not necessarily true because regulated financial markets make it too easy for government agencies and large banks to interfere with the system. Take the case of a country like China, which is the world's largest consumer of copper. Does China passively purchase its copper through the marketplace? No, instead it strikes a price with a supplier, such as a Zambian copper miner, based on the London market price but bypassing the marketplace entirely. If China plays no part in setting the reference price in London, the Zambians can be satisfied that the price is fair; however, if China or her agents suppressed the price of copper in the market before the price is set, the Zambians would be rightfully upset. Now, we do not know if China or her agents drive down the copper price by placing a relatively small paper sell order in the market, so that the large off-market physical deal is priced favourably. However, it is obviously in China's interest to do so. Another metal marketplace where this could also apply is that of silver.

  One needs to bear in mind three things about China and silver. She is the world's largest industrial user, almost certainly the world's largest refiner and the Chinese government owns all the refineries. China not only imports large quantities of dore, (a dore bar is a semi-pure alloy of gold and silver) but also base metal ores containing silver. So, how China goes about this business is highly relevant to the silver price and the following is an example of how it works. In the case of foreign silver mines, a qualified agent assesses the silver content of concentrates or dore on site and agrees upon a payment amount with the mine manager. Two further considerations then arise: the mine manager will want payment up front because he has wages and other costs to meet; so the agent will seek out the most cost effective refining option. The first consideration is addressed by getting a bullion bank to advance the money against delivery of the concentrates or the dore when refined and the second will often involve a government-subsidized Chinese refiner. There now exists a relationship between the Chinese government and the bullion bank because the former must deliver refined silver to the latter; or alternatively, it must provide paper cover, since it may be subsequently agreed between them. As owner of the refining industry, China's interest is primarily strategic rather than profitability. Whether it is to subsidize the solar cell industry, or to build a strategic stockpile matters not; the temptation to suppress the silver price is the point. The problem with price suppression is that it only works when buyers stand aside. However, as we witnessed in the 30 months following October 2008 when the silver price soared from below $9 (U.S.) per troy oz. to almost $50 (U.S.) per troy oz., when buyers step in, huge price movements can occur relatively quickly. To the extent such price suppression does occur, today's commodities must be underpriced, just as bonds and stocks have become overpriced, through central banks and other government agencies interfering with the markets. In any event, investor opinion is bearish for commodities and bullish for the U.S. dollar. Therefore, in a general market correction of valuation extremes, commodities should recover strongly, depending on whether or not prices have been artificially suppressed in the way described above. Deflationists should take note: when bond and stock markets crack, after initial confusion the prices of key commodities such as silver could rise more strongly than imaginable if they have been artificially suppressed."

FRIDAY, MAY 8TH

- Statistics Canada reports the Canadian economy lost 19,700 jobs in April, the biggest decline in eight months, despite the official unemployment rate remaining unchanged at 6.8%, since many people stopped looking for work. Andrew Fields, a Statscan labour market analyst, noted: "Since the Alberta jobs peak last September, natural resources employment is lower by 21,000 workers, or by 11%. So for certain that trend has continued."

- The Labor Department reports U.S. non-farm payrolls increased by 223,000 in April, following a revised gain of 85,000 in March, as the official unemployment rate fell slightly to 5.4% from 5.5%. In an interview, U.S. Labor Secretary Tom Perez commented: "This is a very solid payroll report indicating steady job growth. At the same time … I not only recognize the unfinished business of wage growth, but also, I am mindful that everyone who wants to return to the work force should have the opportunity to do so."



- Canada Mortgage and Housing Corp. (CMHC) reports the nation's seasonally adjusted annual rate of housing starts declined to 181,814 units in April, from a downwardly revised 189,546 units in March. In a research note, Robert Kavcic, an economist at BMO Capital Markets, observed: "Smoothing out the gyrations leaves Canada's housing starts sitting at an average pace of 187,000 units over the past year and 176,000 through the first four months of this year. In a nutshell, the housing starts story continues to reflect that we're building what we need in Canada."

- Front Page Headline, Washington Post – "Conservatives to Retain Power in British Elections. Having been elected to another term as British Prime Minister, David Cameron must avoid going down in history with an altogether different title: founding father of Little England. The maintenance of the status quo at 10 Downing Street masked the dramatic transformations roiling Britain, ones which threaten to leave this country more isolated than at any time in its modern history.

British Prime Minister David Cameron
Source: Washington Post

- Thursday's election may become just the first in a trilogy of rapid fire votes that set this island adrift from Europe, dividing it in half along national lines of ancient identity and ultimately leave behind a rump state. David Torrance, a British political analyst commented: 'Today is V-E Day, with the U.K. celebrating its finest hour. Seventy years later, it could be contemplating the beginning of its end in its current form. The next five years will encompass a twin debate about two unions – the EU and the U.K.' The questions of whether Britain stays whole and whether it remains in the EU are deeply entangled, with the outcome of one expected to heavily influence the other."

LONGWAVE group

CLOSING LEVELS FOR FRIDAY, MAY 8TH.		WEEKLY CHANGE
Dow Jones Industrial Average	18,191.11	+ 167.05 points
Spot Gold Bullion	$1,188.90 (U.S.)	+ $14.40 per troy oz.
Spot Silver	$16.44 (U.S.)	+ $0.30 per troy oz.
S&P / TSX Composite	15,170.02	– 169.75 points
10 – Year U.S. Treasury Yield	2.15%	+ 4 basis points
Canadian Dollar	82.71 cents (U.S.)	+ 0.45 cent
U.S. Dollar Index Future	94.818	– 0.451 cent
WTI Crude Oil Futures	$59.39 (U.S.)	+ $0.24 per barrel
DJIA / Gold Ratio	15.30	– 0.046 point
Gold / Silver Ratio	72.318	– 0.452 point

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