



The Long Wave Analyst

‘An Opportune and Strategic Investment Approach’

Volume 1, Issue 1

January/February 1998

WRITTEN BY:

Ian A. Gordon
Canaccord Capital
Suite 1200
595 Burrard Street
Vancouver, BC
V7X 1J1

The Long Wave Analyst is an investment strategy based upon historical analysis and interpretation of the “Kondratieff Cycle”. Fax interpretation available between publications on significant market developments.

Ian Gordon is a licensed Registered Representative and a Vice-President of Canaccord Capital, a Vancouver-based brokerage firm. He was educated at the Royal Military Academy, Sandhurst, U.K., and has a B.A. (History) from The University of Manitoba.

Ian Gordon

The Long Wave Defined

“It is the early 1930’s. A stooped, emaciated figure trudges in chains through the dreary Siberian landscape and disappears into history – one of the hundreds of thousands who die in Stalin’s prison camps. His name: Nicolai Dimetrieivich Kondratieff. Occupation: Economist; Crime: thinking for himself” (Forbes, November 9, 1981)

In 1926, Nickolai Kondratieff published a paper called “Long Economic Cycles”. This paper was reprinted and published as a book in 1928 by the Russian Association of Social Science Research Institutes.

Using a wealth of historical economic data, from Britain, France, Germany and the United States, which principally related to wages, interest rates, commodity prices, industrial production and international trade, Kondratieff determined that a long cycle of approximately sixty years was evident in capitalist economies. This cycle was accentuated by two waves of approximately equal duration. One wave developed a burgeoning advance and the other a series of deflationary contractions, punctuated by anaemic advances.

Unfortunately, Kondratieff’s studies only dated to the late eighteenth century, which he considered as the start of “the broad development of industrial capitalism”. He defined two and a half completed cycles. “The rising wave of the first cycle takes in the period from 1789 to 1814; that is, 25 years. The downward wave of the first cycle begins in 1814 and ends in 1849; that is, 35 years. The entire cycle in the movement of prices is completed in 60 years.”

“The rising wave of the second cycle begins in 1849 and ends in 1873; that is, it lasts 24 years... The downward wave of the second cycle begins in 1873 and ends in 1896; that is, it lasts 23 years. The entire second cycle is completed in 47 years.”

“The rising wave of the third cycle begins in 1896 and ends in 1920; that is, it lasts 24 years.”¹ The

Table of Contents

The Long Wave Defined	1
Our Current Position in the Economic Long Wave	4
The U.S. Dollar and the Long Wave	4
The New York Stock Market and the Long Wave	6
Interest Rates and the Long Wave	7
Gold and the Long Wave	8
Commodities and the Long Wave	10
Real Estate and the Long Wave	10
Conclusion	11
Parting Thoughts & Next Issue	12
Footnotes & Credits	12

downward wave of the third cycle began in 1920 and ends in 1948; that is, it lasts 52 years.

The rising wave of the fourth cycle begins in 1949 and ends in 1980; that is, it lasts 31 years. The downward wave of the fourth cycle begins in 1980 and is yet to be concluded.

Within his paper, Kondratieff noted two principles, which are important in our understanding of the Long Wave. The first is that within individual countries, “the cycles’ more or less coincide in time, although not completely”.² Secondly, those cycles are “international in character”.

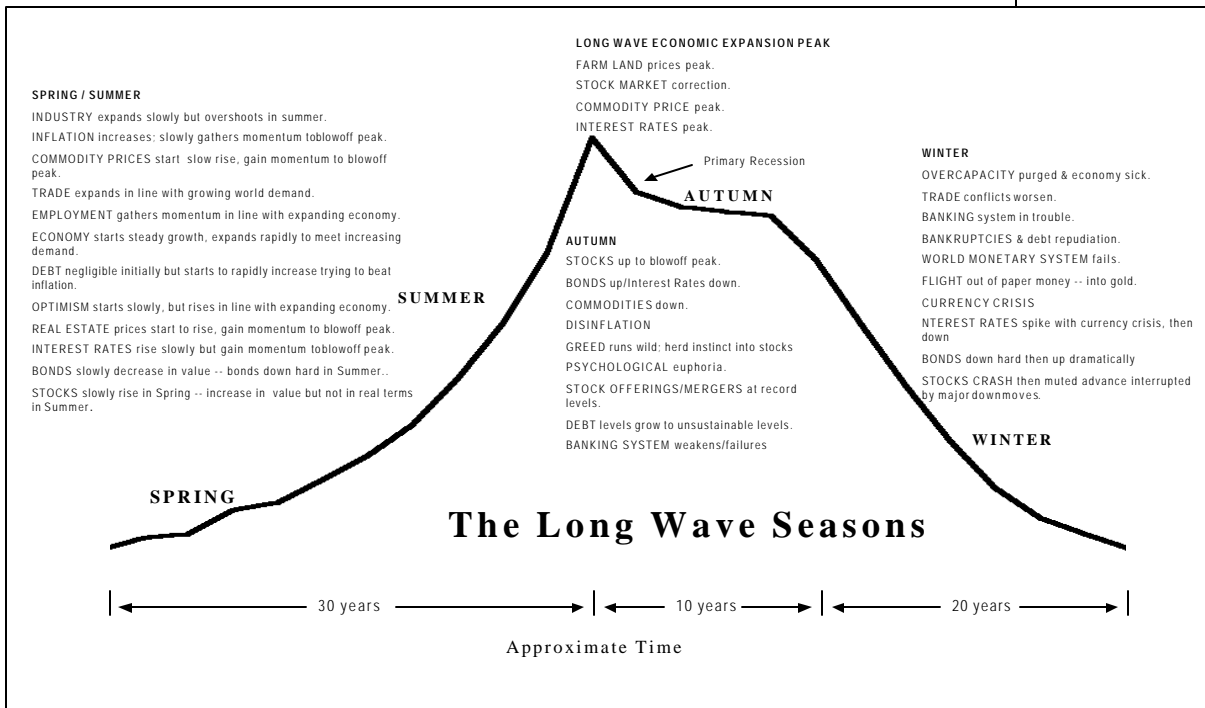
Kondratieff’s treatise has been subsequently studied and embellished by a number of Western economists, principally in the United States. My interest in the Long Wave began in 1980, when I became a subscriber to a newsletter written and published by Donald Hoppe until July 1993, which he ultimately titled “The Kondratieff Wave Analyst”.³ Much of my research on the Long Wave refers to these excellent publications.

Hoppe and others have broken the Kondratieff Cycle into clearly identifiable parts. In 1984, Dr. Jay Forrester defined the Kondratieff Wave as follows: “The long wave consists of rising economic activity for two or three decades, then a broad peak some ten years wide, and then a rapid drop into a major depression that can persist for a decade. After the depression, and long term recovery starts.”

The broad peak that Dr. Forrester mentioned is now almost consistently referred to as the Plateau period. P.Q. Wall has applied Oswald Spengler’s notion of the seasons to the long wave. This provides a useful breakdown of the cycle.

P.Q. Wall has applied Oswald Spengler’s notion of the seasons to the long wave. This provides a useful breakdown of the cycle.

SPRING (1949-1965) – The capital goods sector is depressed, exhausted or obsolete. Interest rates, wages and the costs of raw materials are low. Bank liquidity is high. The upswing starts from a low level of confidence, but a slow methodical trend emerges, with the building of new factories bolstering employment and stimulating consumer demand. In turn, this leads to a renewed enthusiasm as the standard of living rises, and unemployment wanes.



SUMMER (1965-1980) – Characterized by boom and inflation – Interest rates and wages skyrocket and there are increasing demands for capital and labour. This ends with a primary recession.

AUTUMN (Plateau Period: 1980-1997) – This period produces a speculative boom in stocks, bonds and real estate. It is the only time in the entire Long Wave when stocks and bonds rise concurrently. This speculation is created by an injection of liquidity on the part of the central bank following the primary recession that terminates the expansion phase. This liquidity does not flow to productive investments such as factories because

these were overbuilt in the expansion phase. Consumers and corporations borrow heavily because real savings were almost eradicated during the expansion phase (summer). Bankruptcies increase, unemployment remains relatively low, but real wages stagnate or actually decline. Typically, during this time there is an almost universal feeling that financial investments will continue to appreciate forever, because this time it's different, even though stock prices may have appreciated 500% or more (U.S. prices have increased at least tenfold since the 1982 low and real estate prices have tripled). The period ends with a stock market crash, which is followed by a real estate crash; New York – 1929; Tokyo – 1989.

The key event marking the end of the Plateau and the beginning of the Long Wave depression will almost certainly be a financial panic in the

WINTER (1997-2009?) – This is the deflationary depression period which sets the stage for debt liquidation. From 1929 to 1932 in the U.S., there were 85,000 business bankruptcies and 10,000 commercial bank failures. Nine million personal savings accounts were eradicated. National income dropped from \$81 billion in 1929 to \$41 billion in 1932. Unemployment rose from 3

percent to 25 percent. Hourly wages declined 60 percent, dividends 50 percent and salaries 40 percent. The value of new construction fell from \$10.8 billion to \$2.9 billion during these four years. Housing starts dropped to 93,000 in 1933, one tenth of what they were in 1925.

The final phase of the downwave is a bottoming period. Debts and excessive inventories are liquidated; those banks which have survived are healthy, and the stage is set for an economic rebirth.

The key event marking the end of the Plateau and the beginning of the Long Wave depression will almost certainly be a financial panic in the securities markets. Stock market crashes at the end of the Plateau period were experienced in 1873, 1929, 1989 in Japan, and 1997 in most of Southeast Asia, including Hong Kong.

In North America and Europe, stock markets, bonds, and real estate have continued to appreciate in an extended plateau. These moves and the crowd psychology which accompanied them are typical of a climax associated with the Plateau period of the Long Wave.

Our Current Position in the Economic Long Wave

FOUR LONG WAVES (U.S.)

	1	2	3	4
Spring	1789-1802	1845-1858	1896-1907	1949-1966
Summer	1803-1816	1859-1864	1908-1920	1966-1980
Autumn (Plateau)	1817-1829	1865-1873	1921-1929	1981-1997
Winter	1830-1844	1873-1896	1930-1948	1997-2009
Total	55 years	51 years	52 years	60 years

There seems to be little doubt that North America and Europe are at the end of the Plateau period of the Long Wave. During the previous Kondratieff long wave, the Plateau period was from 1921 to the U.S. stock market crash of October 1929. This Plateau followed closely the interest rate and commodity price peak in 1920, which heralded the end of the expansion phase and was signalled by a significant drop in the stock market.

It was a time of intense speculation in stocks and real estate, which is characteristic of the Plateau. The Dow Jones Industrial Average rose from a low of 66 points in mid-1921 to a high of 381 points in September 1929, for a gain of 577%. The current Plateau period commenced in 1982 following the interest rate and commodity price peak of 1980. Japan, which in effect had usurped the United States' role as the major economic power in the world, followed the script almost perfectly by ending its Plateau period in late December 1989, when the Nikkei topped at 39,000. Since that time, Japan has been in the deflationary depression stage of the long wave, with a banking system teetering on the edge of bankruptcy – much like the U.S. banking system of the early 1930's. At that time in the U.S., banks were allowed to fail, while the Japanese Government, until the failure of Hokkaido Takushoko, had not allowed any bank to fail since 1945. The recent Asian currency crisis may, however, accelerate Japanese bank losses, so more failures are almost certainly in the offing.

Meanwhile, in North America and Europe, the Plateau has been extended by compliant central banking authorities. In the U.S., the Dow Jones Industrial Average has risen more than tenfold from its 1982 lows. This is almost twice the gain experienced by the stock market in the 1920's. This time, like then, most investors are sure that "it's different". The only difference is this time there's twice as much speculation in the financial markets. Almost certainly the end of the Plateau period in North America and Europe is at hand, and will probably be finished as the foreigners sell their U.S. dollar holdings. Following the end of the Plateau period in the Long Wave, the deflationary depression phase begins. We'll examine the implications for the various investment vehicles in that environment later, but first we must address the situation with respect to the U.S. dollar, the world's reserve currency and the key to international monetary stability.

The U.S. Dollar and the Long Wave

"The history of currencies is the history of their destruction. Currencies are born to be destroyed and all paper values denominated in a currency will be destroyed with it." Franz Pick

It took the United States almost 200 years to accumulate its first \$1 trillion in debt. By 1985 – only ten years later – the national debt had risen to \$3 trillion and by 1996, it was \$5 trillion. Today the total U.S. budget deficit is \$5.3 trillion, and this does not include off-budget items such as entitlements which may balloon the overall deficit close to \$20 trillion. Recently, the Clinton Administration has boasted that by next year the Federal budget will be in balance. That remains to be seen. Should the economy fall into a deflationary depression, revenues will decline, while government expenditures will increase dramatically. Currently, the U.S. Government is in a particularly weak position to enter a deflationary depression. In 1929, the U.S. entered The Depression with a budget deficit of approximately \$16 billion, which allowed Presidents Hoover and Roosevelt significant financial leeway to introduce their New Deal programmes. Interestingly, the U.S. entered the 1930's depression as the world's largest creditor nation. That distinction is currently reserved for Japan, while the U.S. bears the stigma of being the world's largest debtor nation. It has incurred a current account deficit of about \$150 billion, including an underlying trade gap of as much as \$200 billion, for more than 12 years. In excess of \$1 trillion of this debt is owed to foreigners, with the Japanese portion being close to fifty percent. This creates two major problems for the U.S.:

"The history of currencies is the history of their destruction. Currencies are born to be destroyed and all paper values denominated in a currency will be

- ?? What happens to the U.S. dollar if foreigners sell their U.S. holdings?
- ?? How can the U.S. government finance a depression if foreigners resist purchasing U.S. debt?

It is almost certain that foreigners, particularly the Japanese, will be forced to sell their U.S. dollar investments simply to forestall looming bankruptcies in their own countries. Even in 1933, when the U.S. dollar was the currency sine qua non and the United States was the world's largest creditor nation, it was forced to devalue by 40% and abandon the

In the early 1930's every major economic nation devalued its currency. The result was a complete collapse of world trade and a contraction of world

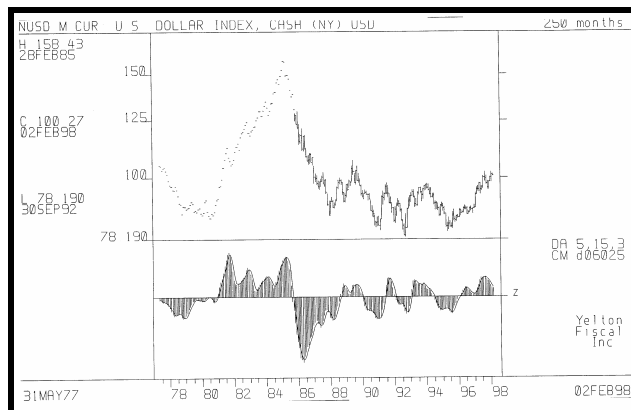
gold standard while Americans and foreigners alike fled from the U.S. dollar into gold. There is no documented case in history where a currency has been supported indefinitely by central bank intervention. There is always a limit to foreign bank support for any country's currency. That limit is usually reached when their own currencies are threatened by the accumulation of excessive currency reserves. Every debtor is beholden to his creditor. The knowledge that the U.S.'s two largest creditors are Japan and China probably gives Alan Greenspan and Robert Rubin nightmares.

As the currency crises spread, it will become as it was in the 1930's – a matter of "everyone for himself". Each country will be forced to depreciate the value of its currency in a spate of competitive devaluations. In those circumstances, there is little likelihood that any nation will continue to support a heavily indebted America.

In the early 1930's every major economic nation devalued its currency. The result was a complete collapse of world trade and a contraction of world credit.

That process has started once again with the competitive currency depreciations now occurring in Asia. It is highly unlikely that the U.S. dollar will escape these devaluations given the fact that it couldn't escape during the 1930's.

The New York Stock Market and The Long Wave



U.S. Dollar Index

Chart Source: The Notley Information Service

at an alarming rate until Nixon was forced to close the gold window in 1971. Since that time, there has been no backing of the U.S. Dollar which has been in decline, not only against the price of gold itself, but against the most stable of the foreign currencies, particularly the Swiss Franc (which incidentally is gold backed). This decline should continue in earnest as the world currency crisis engulfs the U.S. Dollar. At that time, the low of 78.1 will almost certainly be breached.

Under the Bretton-Woods Agreement, the U.S. Dollar became the world's reserve currency. Countries could exchange their dollars for gold at the official price of \$35 per ounce. Until the 1960's, most countries were content to hold dollars rather than convert.

As the U.S. increased its involvement in Vietnam, many countries initiated an exchange from dollars to U.S. gold, because they feared the U.S. would inflate in order to pay for the war. Conversion increased

“Nothing succeeds like excess” – Oscar Wilde

On August 12, 1982, the Dow closed down a few more points to 776.92. The gloom in the market was palpable. Investors had been selling equities for months. On average, shares were trading at price levels less than their book values. The common shares of companies such as Proctor and Gamble and General Electric were trading about nine times earnings and the stock market was yielding more than seven percent. Consensus thinking was that the U.S. economy had lost the initiative to Japan, which was about to assume the role of the world's leading economic power. Banks were failing, unemployment was close to 10% and long-term treasury bonds were yielding about 13%. These values and the despondent consensus are typical at bear market bottoms.

Today, values and consensus thinking are almost diametrically opposed to that which prevailed during the dark days of the summer of 1982. U.S. industry once again rules the world. Investors are buying into the equity market in record numbers as measured by dollar inputs. More than \$230 billion moved into equity mutual funds in 1997, which was \$10 billion more than the record inflows experienced in 1996. “The ‘modern cult of the equity’ has seeped into the national psyche as never before, assuming a central place in the country’s public and private life”, wrote Richard Walters in the Financial Times.⁴ It is estimated that the jump in share prices has created \$3 trillion of new wealth for America’s individual investors over the past three years; at least on paper. The prevailing mood is outrageously bullish!

***Retail investors
have approximately
\$25 trillion
committed to
equities through
mutual funds – ten
times the amount of***

In a Harris Poll conducted last year, 84% of U.S. investors believed that increases in equity prices during the next ten years would match or exceed the 14% average annual rise over the past decade. The average American household has as much wealth tied to the stock market as it had at the peak of the 1960’s market. Investment clubs are being formed in record numbers. The Internet and social gatherings of all sorts are buzzing about how easy it is to make money in the stock market. Retail investors have approximately \$25 trillion committed to equities through mutual funds – ten times the amount of a decade ago. Following the 550 point drop in the Dow on Monday 27th October, 1997, most investment funds reported new net inflows of cash. Investors see such dips as buying opportunities. This calls to mind what Fredrick Lewis Allen reported in his book, “*Only Yesterday*”, published in 1931: “As people in the summer of 1929 looked back for precedents, they were comforted by the recollection that every crash of the past few years had been followed by a recovery and that every recovery had brought prices to a new high point.”

From the high yield and low valuations that the stock market enjoyed in the gloom of August 1982, there has been a complete turnaround today. Shares on average trade at about 31 times earnings and close to six times their book value. The stock market yields a miserly 1½ percent, which is even lower than the yields achieved at the market top in 1929. Long-term Treasury bonds are yielding below 6% and unemployment is below 5%. From the gloom of 1982, the stock market has today achieved a collective euphoria and valuation level more indicative of a significant market top.

As a country moves out of the long wave Plateau period into the deflationary depression stage, it is almost always signalled by a significant stock market crash, which is followed by an extensive bear market period.

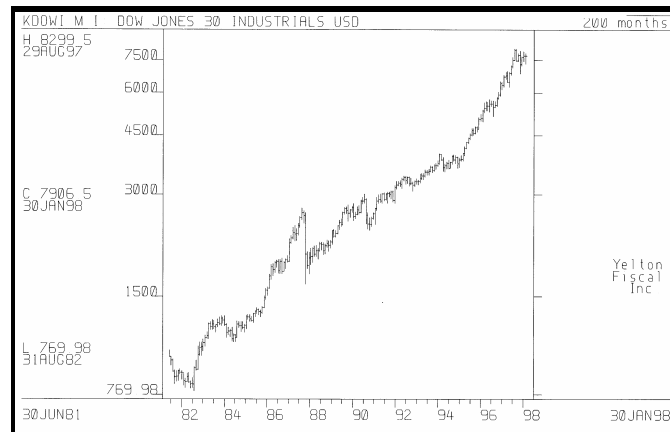
Turning points in markets often follow signs of monetary friction or changes in global capital flows. In 1929, credit strains in London caused British and other foreign banks to call outstanding loans to American stockbrokers just before the 1929 crash. Today, the Asian currency crisis is itself a serious sign of monetary friction, which may lead to those Asian countries and Japan calling their loans to the U.S. Government.

The 1929-1932 bear market wiped out the entire advance from the lows of 1922 (the

beginning of that Plateau period). “That you will see a 1929 type crash begin sometime in the next eleven months, is in our work as close to 100% as you will find in financial trend analysis.”⁵ If the same were to occur today, the Dow would drop below 770 and the Dow Transports would bottom somewhere around 400.

Interest Rates and the Long Wave

After the October 1929 stock market crash, the Federal Reserve Board cut the discount rate from 6% to 1½ percent by early 1931. But, by the spring of 1931 the international credit system and the gold standard had begun to collapse so that the Fed was forced to intervene



From the low of 769.98 in August 1982, which signalled the beginning of the U.S. Plateau Period, the Dow Jones Industrials have increased more than tenfold. The start of the U.S. Deflationary depression stage of the cycle will likely be signalled by a stock market crash which, in all likelihood, will initiate a move by the Dow Jones Industrials below the level from which it started this Plateau period; that is, below 770 points

Dow Jones Industrials The Plateau Period (June '81-present)

Chart Source: The Notley Information Service

in order to stabilize the U.S. dollar. The discount rate was increased to 3½ percent by the end of 1931. The rate dropped back to 2½ percent in 1932, but the Banking Crisis of 1933 saw a return to 3½ percent for a short time. Thereafter, the discount rate returned to 1½ percent where it remained until 1937, when it was reduced to 1% following the secondary stock market collapse.

By late 1931, U.S. Treasury Bill rates had fallen to ¼ percent and, even during 1933, never rose above 1%. From 1937 until 1940, Treasury Bill yields remained flat.

Long-term AAA corporate bonds yielded 6% prior to the 1929 crash and these yields ultimately fell to 4% by the mid-1930's. During the 1931 and 1933 crises, yields spiked up as high as 10%. Junk bond yields went even higher, reaching as much as 16% and many issuers defaulted.

The long-term chart of the Dow Jones 20 Bond Average shows bonds bottoming at 74.94 in 1921, which was the interest rate and commodity price peak of the previous long wave expansion. Typical of plateau periods, this bond average rose to 100 by 1928. By 1932, because of the global currency crisis, the average spiked down even lower than they had been in 1921. In 1981, this same bond index bottomed at 54.99 (considerably lower than the 1921 bottom or with yields a lot higher). This provides us with good insight into potential bond price action in the coming depressionary downwave.

In October 1981, U.S. Treasury prices bottomed at a yield level of 14.68%. If U.S. interest rates in the coming deflationary depression emulate those of 1931, U.S. Treasuries will yield in excess of 15%, brought about by a U.S. Dollar crisis.

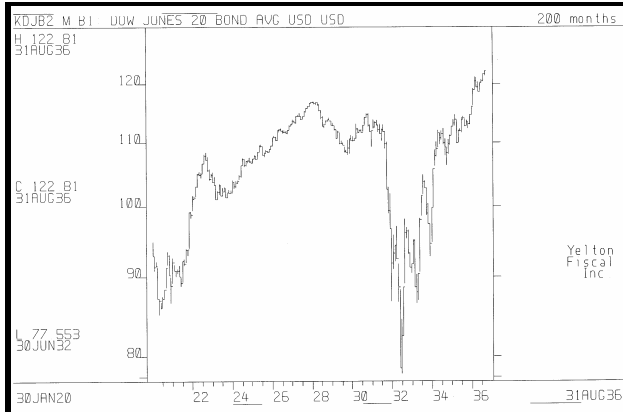
Before readers view this as a ridiculous forecast, given the anticipated depressionary state of the economy, let me remind them that this is exactly how U.S. interest rates performed

in the early 1930's; at a time when the U.S. enjoyed the status of the world's largest creditor nation. This time, the U.S. enters the winter phase of the Long Wave as the world's largest debtor nation.

Gold and the Long Wave

Donald Hoppe lists five phases in the 1930's credit crisis. They are important since it is likely that a similar set of circumstances will occur during this pending crisis:

1. Flight from questionable securities into stronger securities;
2. Intense liquidation of inventories and commodities;



Dow Jones 20 Bond Avg (Jan. 1920-Aug. 1936)

Chart Source: The Notley Information Service

In the previous U.S. deflationary depression stage (Winter) of the Long Wave, bonds made a lower low (higher yields) than the low made at the top of the commodity price/interest rate peak in the expansion phase (Summer) of that particular wave. If this is repeated during this anticipated deflationary depression stage, given the vulnerability of the U.S. Dollar, there is every reason to expect that this would be repeated; i.e., long-term U.S. interest rates will rise above 15%.

3. Flight from weak currencies into stronger currencies;
4. Flight from bank deposits into cash and gold;
5. Flight from strong currencies into gold.

The ultimate monetary unit of choice at that time was gold. The second stage of the credit crisis from April 1931 to March 1933 saw a great rush to gold. Foreigners cashed in, not only their American stock and bond holdings, but also their U.S. dollars, which they converted into gold. Americans converted their U.S. dollars and bank deposits into gold coins and stashed them away at home.

Owners of gold shares reaped huge benefits, as you can see from the table on Page 9. "Gold in the ground is just as good as gold in the bank. In fact, the only way you can safely hold a claim on a large quantity of gold is through the purchase of shares in gold mining companies with large ore reserves." Donald Hoppe.

After Roosevelt raised the exchange price of gold to \$35 U.S. per ounce, there was a significant rush to gold in Canada and in the United States. By 1940, according to the Bureau of Mines, there were some 9,000 operating gold mines in the U.S. alone.

As we have seen in the second stage of the credit crisis during the last deflationary wave, foreign investors sold their U.S. investment holdings and fled to gold. Today, it is estimated that the Japanese alone own \$1.75 trillion of U.S. investments. This would be more than enough to buy the entire gold reserves of all the world's central banks. Putting it another way, \$1.75 trillion U.S. would buy every gold stock listed on every stock exchange in the world three times over!

"Gold in the ground is just as good as gold in the bank. In fact, the only way you can safely hold a claim on a large quantity of gold is through the purchase of shares in gold mining companies with large

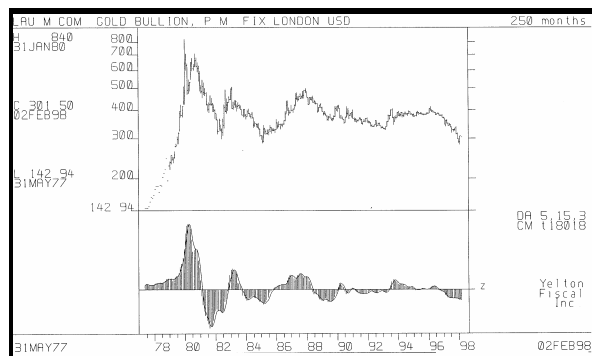
NYSE Stock Exchange Prices: 1929-1937

	HOMESTAKE MINING		DOME MINES		Dow Jones
	Stock Price	Dividend	Stock Price	Dividend	Industrials
Low 1929	\$65	\$7.00	\$6	\$1.00	381.17 High
High 1930	\$83	\$8.00	\$10 3/8	\$1.00	157.51 Low
High 1931	\$138	\$8.45	\$13 1/2	\$1.00	73.79 Low
High 1932	\$163	\$10.60	\$12 7/8	\$1.30	42.22 Low
High 1933	\$373	\$15.00	\$39 1/2	\$1.80	50.16 Low
High 1934	\$430	\$30.00	\$46 1/4	\$3.50	85.51 Low
High 1935	\$495	\$56.00	\$44 7/8	\$4.00	96.71 Low
High 1936	\$544	\$36.00	\$61 1/2	\$4.00	143.11 Low
High 1937	\$430	\$18.00	\$57 1/4	\$4.50	113.64 Low

During deflationary times, gold always performs better than it does during inflationary times because the market flees paper assets that are falling in price. Gold never defaults and compared with paper, is unbelievably scarce. In the Great Reckoning, James Davidson and Lord William Rees Mogg wrote, "Five great credit cycles have come to an end of the past three centuries, the last in 1929. On average, the price of gold in real terms rose within four years of the end of the cycle to exceed its high of a decade earlier by 8.5 percent in real terms. This implies that the inflation- (or deflation) adjusted price of gold would exceed \$925 in 1980 dollars. That comes to about \$1,600 in December 1990 dollars." (p.455-456) In 1998 dollars, this would be approximately \$2,100 U.S. per ounce.

Sounds preposterous, outrageous and ridiculous? Reflect upon the 1930's and, instead of looking at gold prices which were fixed by Government decree, look at the value of gold stocks. For example, from a 1929 low of \$65, Homestake rose to a high of \$544 in 1936 -- \$590 if the dividend for that year is included. This is better than a 900% move over those seven years. The move which I am projecting for gold itself in this prospective deflationary depression is approximately 700%. However, a 700% move for the metal itself probably translates to a 2000% or better move for gold stocks themselves, since the equities are reputed to move in a three to one ratio to the metal.

The best performing gold stocks will be the shares of those companies which can "grow their gold"; that is, add to their reserves. This means that several junior mining and exploration companies with "low risk property potential" have a real chance of significantly outperforming mature producing companies.



In 1980, gold traded at \$840 on the basis of its perceived commodity value. It is likely to trade much higher than that on the basis of its perceived monetary value when the currency crisis visits the U.S. Dollar.

Gold Bullion

Chart Source: The Notley Information Service

Commodities and the Long Wave

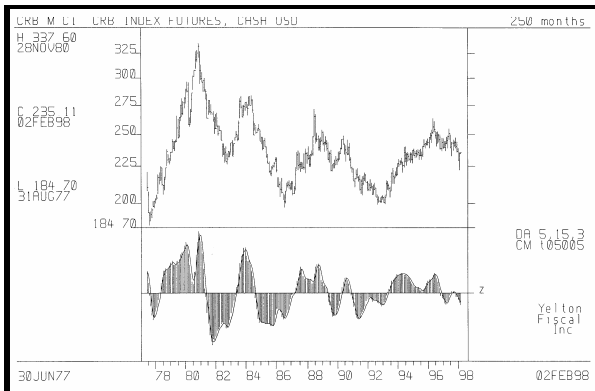
The function of the Long Wave deflationary/depression stage is to eliminate the huge level of debt accumulated during the latter days of the expansion phase (Summer) and during the entire Plateau Period (Autumn). As this debt is unwound, business failures accelerate, unemployment mushrooms and the prices of commodities fall precipitously.

There is ample evidence to suggest that the erosion of commodity prices has already begun — initiated by the emerging depression in Asia. Oil reached a high of \$40.95 a barrel in October 1990. A rally from a subsequent price low of \$14 took the price back above \$25 a barrel in 1997. Since that time, the price has fallen to just above \$17 a barrel. Oil prices are likely to test and even penetrate their 1986 lows of \$10 a barrel during the next stage of the Long Wave.

*business failures
accelerate,
unemployment
mushrooms and the
prices of
commodities fall
precipitously*

Real Estate and the Long Wave

In the deflationary depression stage of the cycle, real estate values drop dramatically. One only has to look at what has happened to real estate prices in Japan since the stock market crash at the end of 1989 and the unravelling of property prices currently underway in Hong Kong, to understand the effect of the Long Wave depressionary stage of the cycle. (In our



Commodities reached their high of 337.50 on cue at the blowoff top of the long wave expansion phase in November 1980. Since then, in keeping with the Plateau Period, the commodity index has drifted lower into a trading range between 200 and 250. During the deflationary period, the commodity index is likely to trade considerably below the 200 support level.

Commodity Research Bureau Index

Chart Source: The Notley Information Service

March/April issue, we will devote more time to the real estate prices and the Long Wave Cycle.)

Conclusion

“That thing that hath been, it is that which shall be; and that which is done is that which shall be done and there is no new thing under the sun. Ecclesiastes, Chapter 1, Verse 9.

I think it was Henry Ford, who might have thought he was God, who said, “all history is bunk”, but there is strong evidence to suggest that George Santayana’s interpretation is the

correct one – “Those who refuse to learn from history are doomed to repeat it.” Economic boom has followed bust on a regular basis and there is evidence of recurring business cycles identified by men such as Juglar, Kitchen, Schumpeter, and, of course, Kondratieff. History is replete with investment stories of bubbles from which each succeeding generation has failed to learn. The South Sea Bubble, Tulipmania, The Mississippi Scheme, Ponzi, and, more recently, the 1929 Stock Market Crash, and the current Japanese real estate debacle.

When Kondratieff identified a series of repeating long economic cycles he had only two and a half completed cycles to research. Nevertheless, his work anticipated the timing and extent of:-- the 1930’s depression, the start of the new upwave (c. 1949); the Plateau period (c. 1980); and the start of a new downwave some ten years later; which happened on schedule for Japan, which by then had replaced the United States of the 1920’s as the world’s leading economic power.

It was the Asian currency crisis which alerted me to the fact that the Plateau period might be ending for the rest of the world. Certainly, Asia’s Plateau period has ended with the various stock market crashes in that region. Yet European and North American investment markets continue to defy gravity, oblivious to an obviously deflationary slowdown occurring in the East. These markets are living on borrowed time. The high degree of speculation and total disregard of events which are now occurring in Asia and likely to spread westwards, are ample evidence of a Plateau nearing its end, which culminates in a mind-numbing stock market crash.

.. it has become an exceptional long wave study of appropriate investment strategy; based upon a correct interpretation of where we are positioned in the cycle.

Dr. Joseph Schumpeter, who undertook an extensive study of business cycles at Harvard University in the 1930’s wrote, “The Kondratieff Wave is the single-most important tool in economic forecasting.” Clearly, The Wave itself provides identifiable business seasons and points at which those seasons change. The most obvious seasonal turning points are the end of the Plateau (Autumn) which is invariably heralded by a stock market crash and the end of the Summer (expansion) phase, evidenced by the climax in interest rates and commodity prices.

The seasons themselves are recognized either by the event that precedes them, such as the climax in interest rates and commodity prices that anticipates the Plateau (Autumn); or the stock market crash at the end of the Plateau that plunges world economics into the deflationary depression stage:-- or by the unique economic characteristics of the seasons themselves.

Kondratieff’s study of the Long Wave was essentially a study of the capitalist economic system, but it has become an exceptional long wave study of appropriate investment strategy; based upon a correct interpretation of where we are positioned in the cycle. Overwhelming evidence suggests that we are currently in the climax of the Plateau period.

Parting Thoughts & Technical Comments

Alas, regardless
of their doom,
The little victims
play;
No sense have
they of ills to
come,
Nor care beyond
today.
Yet ah! Why
should they
know their fate,
Since sorrow
never comes too
late,
And happiness
too swiftly flies?
Thought would
destroy their
paradise.
No more: where
ignorance is
bliss,
'Tis folly to be

DOW JONES INDUSTRIAL AVERAGE

Technically, the U.S. stock market looks bullish. The current move suggests an impulse wave that could take the Dow Jones Industrials to 8800-9000. This would be negated by a weekly close below 7350. Whatever! The over-valuations in the market are as extreme as they have ever been, and no amount of justification can take away that particular fact.

An old market adage says:— “Buy on extreme weakness — sell on extreme strength” and we all know which of these valuations applies to the stock market and, conversely, which to gold shares.

Technical indicators suggest a new low risk intermediate

T.S.E. GOLD INDEX

upmove for the Toronto Stock Exchange Gold Index. There is some resistance to this move around 9250 to 9450. Given the heavily oversold condition for these stocks and the fact that monthly technical indicators are also giving a buy signal, this move should see the Index attacking the old highs just above 13,000, perhaps as early as the end of this year.

Next Issue—due mid-April 1998

The currency crisis revisited and probable outcomes; real estate, now and in 1929-1930; current analysis — stocks, bonds, gold, U.S. dollar, commodities.

All enquiries concerning investment accounts or junior gold mine financing may be directed to:

Ian Gordon

*604-643-0280 Phone
604-643-0152 Fax
ian_gordon@canacco
rd.com*

*I will not accept account queries from US citizens. These may be directed to my colleague, Rick Langer
1-800-667-5771
rick_langer@canacco
rd.com*

Footnotes and Credits

¹ Kondratieff, Nicolai., *The Long Wave Cycle*, translated by Guy Daniels, Richardson & Snyder 1984, pps 37 & 38

² Ibid, p. 60

³ Hoppe, Donald: *The Kondratieff Wave Analyst*, Box 513, Crystal Lake, IL 60014

⁴ Waters, Richard, *Where the Money Is*, Financial Times, December 31, 1997, p. 9

⁵ Wall, P.Q.: *P.Q. Wall Forecast Inc.*, P.O. Box 15558, New Orleans, LA 70175-5558

⁶ Gray, Thomas, 1742, On a distant prospect of Eton College

The above commentary reflects the opinions of the author and may or may not reflect the opinion of Woodstone Capital Inc., and/or its officers, directors, employees and research department. Directors, shareholders or employees of Woodstone Capital Inc. may be beneficial owners of the securities referred to herein. The information contained herein was obtained from sources which we believe to be reliable; however, such information is provided on the understanding of Woodstone Capital Inc. is not responsible for financial losses or damages of any kind whatsoever resulting from action taken in reliance thereon or from inaccuracies therein.

This document is not and should not be construed as an offer or the solicitation of an offer to purchase or subscribe or sell any investment.

Any recommendations contained in this document are intended for professional investors only. Other recipients of the report should consult their investment advisors before following the recommendations, which may not be appropriate for their personal circumstances.

The contents of this report are protected by copyright. Reproduction in whole or in part without permission is prohibited. Brief extracts may be made with proper acknowledgement.