

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS



Monday, September 28th

Xerox announces plans for a takeover of Affiliated Computer Services, an outsourcing services company for \$6.4 billion (U.S.)

MONDAY, SEPTEMBER 28TH

- Spain's government introduces tax increases intended to raise an additional \$16.16 billion (U.S.) in an attempt to reduce its burgeoning budget deficit. In what Spain's Finance Minister, Elena Salgado, terms an "austerity" budget for 2010, a 400 euro annual tax rebate granted only two years ago has been abolished and from July next year, the main VAT tax rate will increase by two percentage points to 18%; plus new taxes will be imposed on unearned income and annual earnings in excess of 3,000 euros. Given the depressed state of Spain's economy and the likelihood of worsening unemployment in 2010, this budget will do nothing to either, improve the lot of the consumer, or the terrible state of the Spanish economy. In short, these are desperate measures for Spain's desperate times. See also Winter Warning, April 27 /09 – Weak Sisters in the Eurozone / The Kingdom of Spain.
- Shaw Communications raises \$1.25 billion (CAD) via a 5-year bond issue bearing a 5.65% coupon and priced at a discount to yield of 5.692% and at a yield spread of 234 basis points over comparable Government of Canada bonds
- In a speech at the School for Advanced International Studies, World Bank President, Robert Zoellick, stated that " the United States would be mistaken to take for granted the dollar's place as the world's predominant reserve currency"

- American pharmaceutical giant Abbott Laboratories announces plans to acquire the prescription drug unit of the Belgian company Solvay for \$6.6 billion (U.S.)

TUESDAY, SEPTEMBER 29TH

- The Conference Board's U.S. consumer confidence index declined to a reading of 53.1 in September from a revised level of 54.5 in August
- The S&P/Case-Shiller home price index of 20 major U.S. cities rose by 1.2% in July to a reading of 143.05; but home prices are still 13.3% below July /08
- In a Bloomberg interview from Newport Beach, California, Bill Gross, fixed income manager of the world's largest bond fund at Pacific Investment Management (PIMCO) discloses he's been buying long-term U.S. Treasuries recently as protection against deflation. "There has been significant flattening at the long end of the (yield) curve and this reflects the re-emergence of deflationary fears. The United States is at the center of delevering, as opposed to accelerating growth."
- The Conference Board of Canada reports its consumer confidence index rose by 2.5 points in September, the seventh consecutive monthly gain, marking the longest streak of increases since 2002

- Japan's consumer price index (ex-fresh food products) declined by 2.4% in August on a year-over-year basis. In a recent research report, Goldman Sachs economist Tetsufumi Yamakawa comments that he sees "no end to the vicious (deflationary) spiral leading from price declines to wage declines."
- The European Bank for Reconstruction and Development (EBRD) has appealed for a 50% capital injection to mitigate the impact of the global economic crisis on central and eastern European countries

WEDNESDAY, SEPTEMBER 30TH

- The Commerce Department reports that the U.S. economy contracted at a 0.7% annual rate in the April – June quarter, compared with the 1% estimated decline reported in August
- The Institute for Supply Management-Chicago Inc. reports its purchasing managers' index declined to a reading of 46.1 in September from a level of 50 in August, citing near record excess manufacturing capacity and spending gains induced mostly by government stimulus programs.
- Statistics Canada reports that Canada's gross domestic product (GDP) was unchanged in July, citing mine closures, lower oil and gas production, a decline in construction activity and a civic workers strike in Toronto.
- The Toronto Globe & Mail reports that "deflation is taking root in global economies. Fuelled by continuing overcapacity, shrinking credit, reduced corporate spending and falling consumer demand, deflation is on the rise in its old stomping ground in Japan and taking root in the battered U.S. and European economies."
- The ADP private sector employment report reveals a decline of 254,000 jobs in September from a revised drop of 277,000 jobs in August
- Pratt and Whitney announces 250 job layoffs in Quebec
- Trans Canada Pipelines announces plans to construct a \$1.2-billion (CAD) 900 megawatt, natural gas-fired power plant in Oakville, Ontario

- The Office of National Statistics reports that Britain's gross domestic product (GDP) declined by 0.6% in the second quarter versus an estimated decline of 0.7% reported previously
- Ken Lewis, President and CEO of the Bank of America, announces his retirement, effective December 31 /09
Let not our hearts be troubled because the American Bankers Association (ABA) will not be holding any tag days for this chief executive. Mr. Lewis stands to collect pension benefits worth \$53.2 million (U.S.), largely from a supplemental executive retirement plan (SERP) that was frozen in 2003. Mr. Lewis will also walk away with \$81.8 million (U.S.) in company stock and other compensation that he accumulated over his career. See also Winter Warning, February 2 /09 – The Clash of Cultures.
- In its semi-annual Global Financial Stability Report, the International Monetary Fund (IMF) warns that banks around the world still have to reveal about half their likely write downs resulting from the financial and economic crisis in 2007-2010; now estimated by the IMF to be about \$3.4 trillion (U.S.), downwardly revised recently from \$4 trillion (U.S.)
- The European Union Statistics Office reports consumer prices in the 16-country Eurozone declined by 0.3% in September on a year-over-year basis

THURSDAY, OCTOBER 1ST

- The U.S. Labor Department reports that initial claims for state unemployment benefits increased by 17,000 to 551,000 in the week ended September 26th. from a revised 534,000 the prior week; while continuing claims fell by 70,000 to a seasonally adjusted 6.09 million for the week ended September 19th. from a revised number of 6.16 million the previous week.
While this drop in continuing claims could reflect some re-entry into the work force, there also exists the strong probability that an host of claimants may have exhausted their unemployment benefits
- The Commerce Department reports that U.S. personal income rose by 0.2% in August compared to July, while personal spending increased by 1.3% boosted by back-to-school sales; but the personal savings rate declined to 3%

- U.S. pending home sales rose by 6.4% in August from July, representing an increase of 12.4% over August /08
- The Institute for Supply Management manufacturing index posted a reading of 52.6 in September, slightly lower from a level of 52.9 in August
- In testimony before the House Financial Services Committee, Federal Reserve Chairman Ben Bernanke endorses the establishment of a Council of Regulators to be charged with monitoring systemic threats to the U.S. financial system. Mr. Bernanke also reassures the Committee that the U.S. dollar's status as the world's reserve currency isn't in immediate danger, but he warns that the situation could change if America doesn't carefully manage its economic affairs, including reining in its \$1.6 trillion dollar deficit for the fiscal year ended September 30 /09.
"If we don't get our macroeconomic house in order, that will put the dollar in danger, and ... the most critical element there is long-term fiscal stability."
As the U.S. national debt rapidly approaches \$12 trillion dollars, we suggest that you and your colleagues best gird your loins for future deficit battles. See Winter Warning, September 28 /09 – The American Greenback Will Be Cast into the Hazard.
- U.S. construction spending rose by 0.8% in August versus a revised decline of 1.1% in July
- Ford Motor reports its U.S. vehicle sales declined by 8.9% in September compared to a year ago
- Chrysler reports its U.S. vehicle sales declined by 44.4% in September compared to September /08
- General Motors reports its U.S. vehicle sales declined by 45% in September compared to a year ago
- Eurostat, the European Union's statistical office, reports that the EU seasonally adjusted unemployment rate rose to 9.6% in August, the highest since March /99
- Cisco Systems, the world's largest manufacturer of networking equipment, acquires Norwegian video conferencing services firm Tandberg for \$3 billion (U.S.)
- Ford Canada reports its vehicle sales increased by 24% in September compared to a year ago, marking the company's fourth consecutive monthly sales increase
- The Bank of Japan's Tankan diffusion index, which reflects business sentiment among the country's large manufacturers, recovered to a reading of minus 33 in the July – September quarter, from a level of minus 48 in the April – June quarter. However, the recovery in sentiment among large manufacturers is not being supported by higher capital spending plans.

FRIDAY, OCTOBER 2ND

- The Labor Department reports that U.S. non-farm payrolls declined by 263,000 in September, citing job losses in construction, manufacturing, retail and government. The August report was revised to a minus 201,000 from a previously stated minus 216,000 and the U.S. unemployment rate rose to 9.8%, a 26-year high, from 9.7% in August.
- U.S. factory orders declined by 0.8% in August compared to a revised increase of 1.4% in July
- The Province of Ontario launches a \$2 billion (U.S.) 10-year global bond issue bearing a 4% coupon and priced 73 basis points in yield over the comparable U.S. Treasury maturity. In the domestic market, the Province also issued \$750 million (CAD) of 10-year bonds bearing a 4.4% coupon and priced 63 basis points in yield over the comparable Government of Canada bond.
- Japan's unemployment rate declines to 5.5% in August from 5.7% in July

- The City of Hamilton, Ontario, is suing Deutsche Bank AG (Germany's largest bank) for \$10 million (CAD), plus \$2 million (CAD) in punitive and exemplary damages, claiming the City purchased non-bank asset backed commercial paper (ABCP) notes from the Bank in the name of Devonshire Trust (an Ontario fund) believing the notes were a safe investment. The City's suit alleges that "the defendants misrepresented that the Devonshire notes constituted a safe and secure investment" when in fact they "were a volatile, complex, unsecured investment with no real capital structure supporting them." In addition to Deutsche Bank, the City is suing Barclay's Bank Plc, the asset provider for the notes; Metcalfe & Mansfield Alternative Investments; the Trustee; and the Dominion Bond Rating Service (DBRS), a Toronto-based rating agency, for rating the notes as investment grade.

Banks that marketed short-term ABCP won immunity from Canadian lawsuits in January /09; as part of a court-approved restructuring plan that converted short-term notes to 8-year maturities. What makes the Hamilton suit interesting is the fact that Devonshire Trust was not a party to the ABCP restructuring plan; therefore it does not have any immunity from lawsuits. Doubly interesting is the inclusion of DBRS in this lawsuit because it was the only rating agency that rated ABCP over many years. Recognizing potential liquidity problems, American rating agency Moody's, as well as Standard & Poors both refused to rate the paper. This meant that DBRS had a virtual monopoly in terms of rating ABCP. Accordingly, revenues came through the DBRS front door like a lion from the rating fees and likewise through the side door from client subscription fees. Rating agencies are regulated in the United States by the Securities & Exchange Commission (SEC), but are unregulated in Canada. In our opinion, if the plaintiff's lawyers can prove premeditated negligence on the part of DBRS, expect other Devonshire Trust note holders, such as the National Bank of Canada and the Caisse de depot et placement du Quebec, to be contacting their legal counsel. See also Winter Warnings: January 19 /09 –If You Aren't Skeptical, Then You Are Liable to be Gullible / February 16 09 – Your First Loss Is Always Your Smallest.

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