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WRITTEN BY: ASHOK DHILLON

Ashok Dhillon has 40 years of front-line business experience in Canada and International markets.

Mr. Dhillon's experience includes start-ups, venture capital, seed funding, and heading companies in construction and international power development. His extensive experience gives him in-depth knowledge and intuitive insights into macro and micro, national and international, geo-political and economic realities and trends. He has been invited to speak on international business at various forums, including as an expert witness for the Standing Senate Committee, Government of Canada, on "The Rise of Russia, China and India".

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In Parts I and II, we covered Japan, China, the EuroZone and the U.K. In Part III, we will look at the most powerful economy in the World, the United States, and its geographically close and economically dependent neighbour, Canada - and Canada's political and economic look-alike, Australia.

The U.S. economy posted very strong jobs numbers in November that just about guarantee the Federal Reserve will finally undertake the most anticipated interest rate hike in the World, the raising of its key lending rate at the next FOMC (*Federal Open Market Committee*) meeting on the 16th of this month (*December*). The official unemployment rate now stands at about 5%, considered by the Fed as near full employment for the economy, and thus meeting the target of one of the two key economic indicators that were being watched by the Federal Reserve over the past years, as indicative of the economy's recovery. It has more or less met the employment target, but the other, a 2% inflation rate, is proving far more elusive, as is the new third indicator introduced by the Fed at its last FMOC meeting, '*developments abroad*'. Currently, one target has been met, the other not; and the third, '*developments abroad*' continues to deteriorate. But it's a go for the rate hike.

As select current numbers are flouted as proof positive the economy has achieved reasonably good health, one must remember that what positive indicators there are, have been artificially induced by years of excessive cash injections, and near zero-cost money-flow to the top end, and

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historically low rates to induce spending and discouraging saving. Still, with all the stimulus and easing, the American economy is in questionable health.

We had said previously that the U.S. economy would be one of the stronger of the major global economies this past year. And, there have been induced signs of strength apart from job creation, in housing sales and prices, wages and consumer spending, and auto purchases, that give the impression that all is finally on the mend. Yet, we disagree the economy is healing, as it still needs intensive care. And, the same cash injections and the near zero-cost money supply, have also created over the past seven years, layer upon layer of deep, risk-sediment, that may just break the system when it all gives way in the over inflated bonds, stocks and real estate markets.

For one thing is historically certain, too many years of too much and too cheap money to the top end of an economy, always produces excessive greed in those who are well positioned to benefit, extraordinarily, by the Government/Central Bank mandated largess. And, they get used to making '*silly money*', and then come to expect it as proof of their own brilliance, and after a while their inalienable God-given right. Such an era of easy money, worldwide, brings on heightened hubris, '*tallest*' building syndrome, ostentatious displays of wealth and consumption, frenzied speculation, and the feeling that '*this time it is really different*' and hence it'll never end.

But it never is really different, and it always ends.

Internal structural and political issues, such as the extreme concentration of wealth and the highly divisive bi-partisan governing system, are holding the U.S. economic growth rates down, and will continue to do so. To that is added global deflationary pressures, as economy after economy succumbs to the collective downward spiral of devalued currencies, hard fought over export markets, increasingly competitive labour markets, improved technological efficiencies, low commodity demand, uncertainty plagued and financially challenged consumers, gutted savers from years of '*ZIRP*' (*Zero Interest Rate Policy*), corruption (*in politics, business, financial institutions and markets*), internal violence and external wars (*it's quite the list*). And that is why we disagree that all is on the mend and will just keep getting better.

We recognize that we sound like '*glass half full*' kind of people, but so far we have been consistently right on the relentless downward direction of the majority of the major global economies, and we don't see any material change to give us comfort that the worst is over. In fact quite the opposite, *conditions in key economies have deteriorated steadily. Parts of Europe, Japan, China, Brazil, Venezuela, Argentina, Russia, and South Africa are in real trouble.* And then there are parts of Middle East and large swathes of North Africa that have been under relentless attack in the past decades, from the West, the '*Near East*' and from inflamed radicals within, that are now exporting their destroyed and desperate people to Europe, and further afield. The fact is globally, conditions are bad and getting worse. Yet, the general consensus seems to be that globally conditions are getting better, and the

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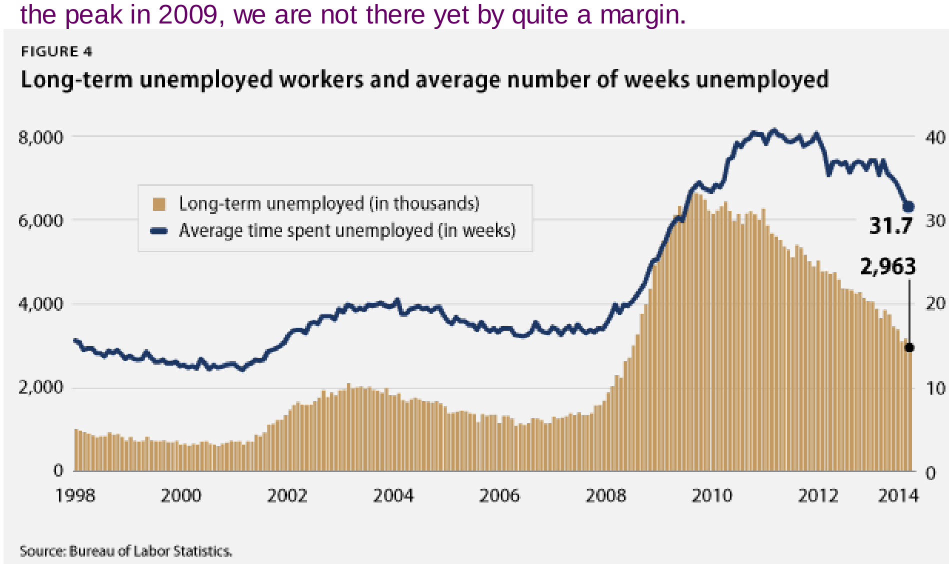
U.S. economy is a lot better, and in fact may become the global engine of growth in 2016 (*glass half full*). In our view, this consensus is wrong and the global economies and the U.S. economy are heading for a steeper decline.

The labour market in the U.S. is supposed to have recovered as the unemployment rate is currently at approximately 5%, and the November (*2015*) job creation number came in at a robust 211,000.

Source: Chartbuilder; Bureau of Labour Statistics

No doubt the unemployment rate has dropped substantially since its *peak in 2009*, at the height of the 2008 Great Recession, and it certainly gives the impression that the labour market in the U.S. has tightened to almost '*full employment*' on a historic basis. That is until one actually looks at the historic rate, pre-2008 crisis (*See Chart below*). It is only then one gets the proper perspective as to the correct status of the labour market today. From the 'historic rate' perspective, the labour market is not anywhere near historic levels, and is therefore still far from full potential.

The following Chart shows the true historic levels of the unemployed and the duration of their unemployment. Even with the strong steady decline since the peak in 2009, we are not there yet by quite a margin.



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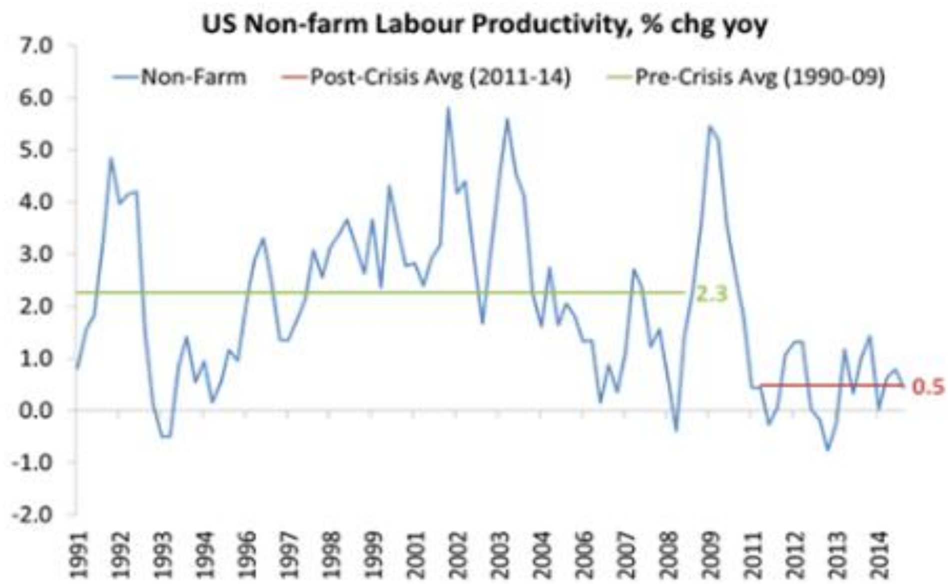
And, the year-on-year percentage change of average hourly earnings has continued to drop since the 2008 Great Recession, well into 2015, and has stayed well below the previous highs. This contradicts the perception that the labour market has tightened to pre-2008 levels, as a truly tightened market would have pushed up the average hourly earnings (*supply and demand*).

Additionally, throughout the '*recovery*' period, labour productivity has been far below previous years. This speaks to the lack of quality jobs and the general low morale of the workforce since the crisis.



And, all numbers currently being calculated are based on a much smaller active workforce, as far less people are participating in active employment, or the seeking of it. Participation rate is calculated on the number of people working or actively looking for work. If someone gets discouraged and stops looking, for a month, they are not considered '*unemployed*' by the government in its calculation of the unemployment rate, even though *they are* unemployed. The participation rate currently is steady at 62.5%, *a 38-year-*

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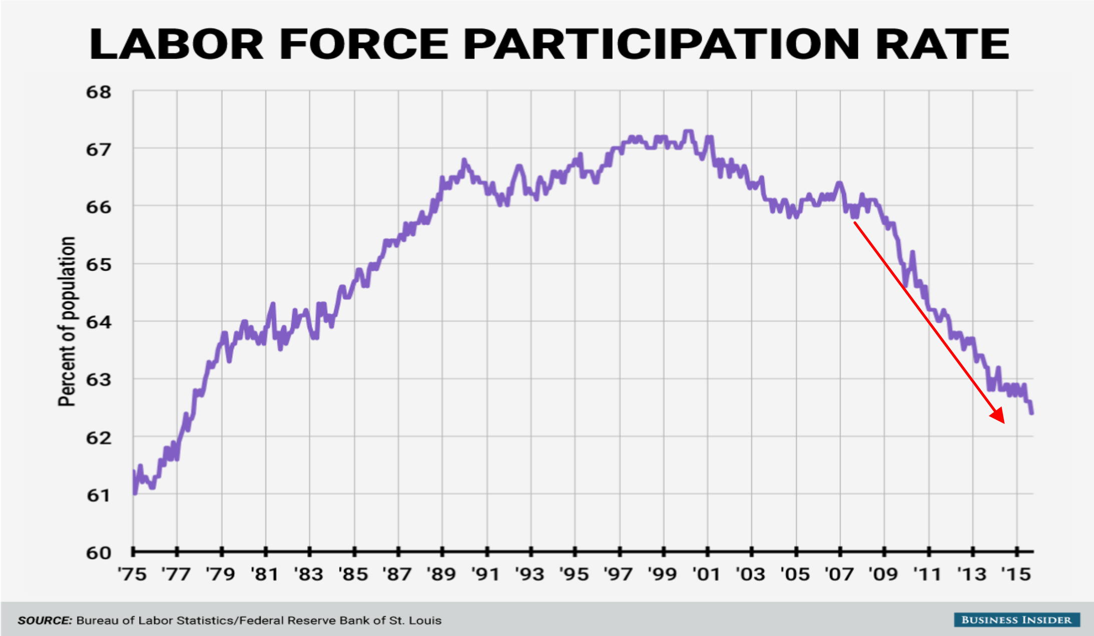
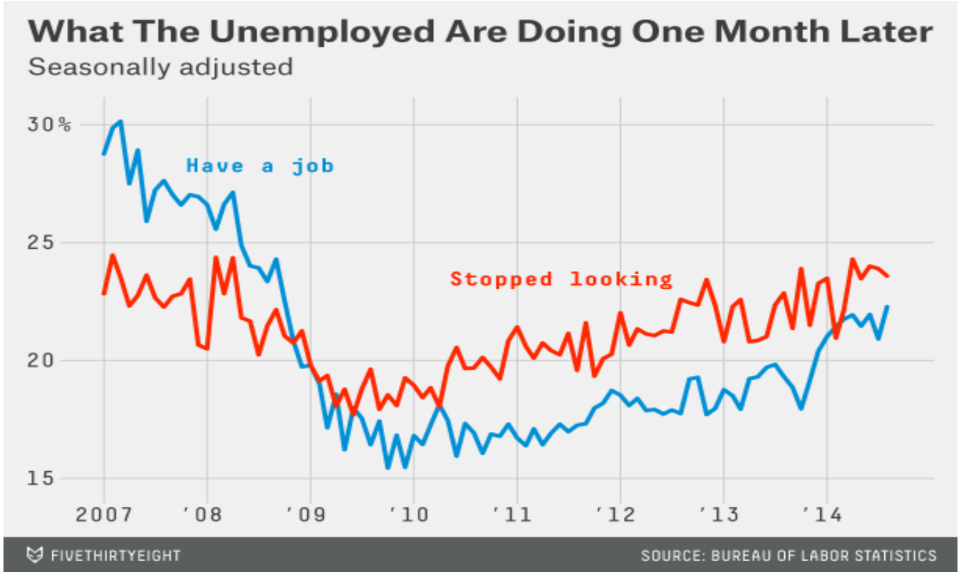
low, which skews the unemployment numbers favourably, ignoring the millions that got too discouraged and stopped looking for work, for a month or more. At the turn of the century, participation rate was well above 66%.



Below is a more accurate picture of the Labour Market. While the number of people finding work has certainly been rising through the '*recovery*' years, but so has the number of people who have stopped looking, and faster, and as they are not counted as unemployed, the unemployment numbers are off.



So while Janet Yellen is going to use the latest November jobs numbers and the overall Unemployment Number of 5%, to claim that the Labour Market is near full employment, to justify the raising of the interest rates, the Labour Market isn't at all anywhere near to previous average levels. Earnings and productivity are still well below historic levels, while less and less people are participating in the work force. Certainly, this seemingly permanent

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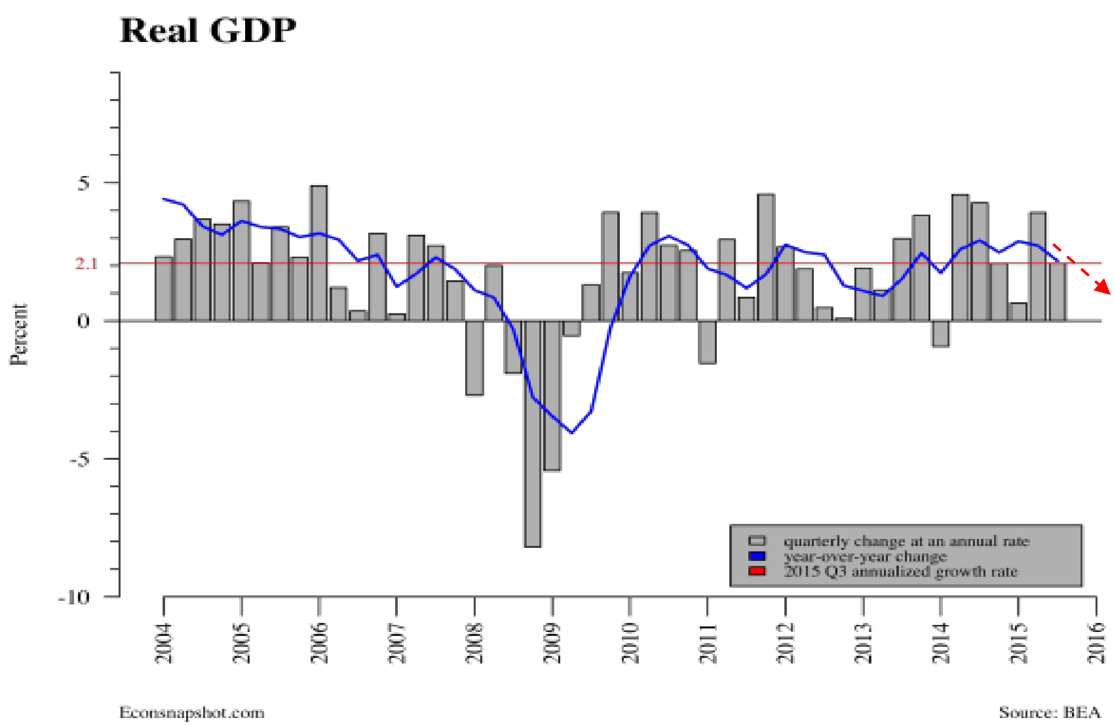
contraction of the labour market, as compared to historic levels, with its much higher levels of unemployment, lower productivity and earnings, and far lower participation rate, will, in our estimation, negatively impact GDP.

And so it has.

The American economy, after almost $4 Trillion in stimulus cash, and over 7 years of near zero percent interest rates, has posted about 2.1% GDP growth rate this year. Expectations for 2015 had been well over 3%. We had stated in our Report, earlier this year that the U.S. economic performance would be positive but soft, and the American economy is heading for a recession due to the global weaknesses. In our opinion, it is still heading that way. One can see from the Chart below that in spite of the extraordinary efforts of the Federal Reserve over 7 years, the growth rate never really picked up, solidly, and on the average economic growth has been volatile and languishing well below the historic average growth rates of 3.24% (*from 1947 to 2015*).

The current growth rates for a mature advanced economy would be understandable, and perhaps even acceptable, ***IF***, no extraordinary means had been employed to directly boost it. But in this case, the most unprecedented stimulus was applied relentlessly for 7 years, and at the end of it, not even a *sustainable* 2% plus growth rate was achieved. This speaks of continuing deep residual weakness in the real economy, in spite of the superficial and dangerous '*wealth effect*' being created in the pumped up bond, stocks and real estate (*asset*) markets in the past years.



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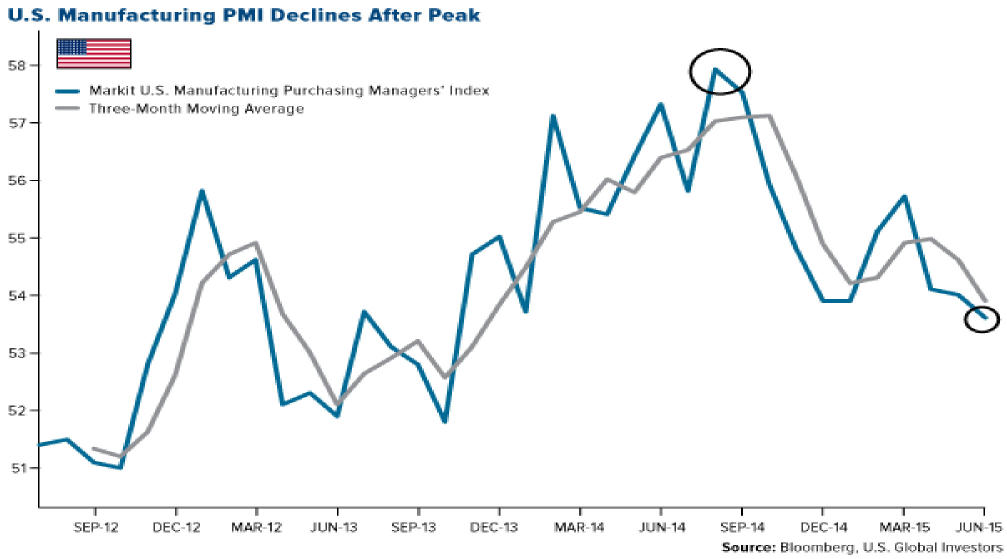
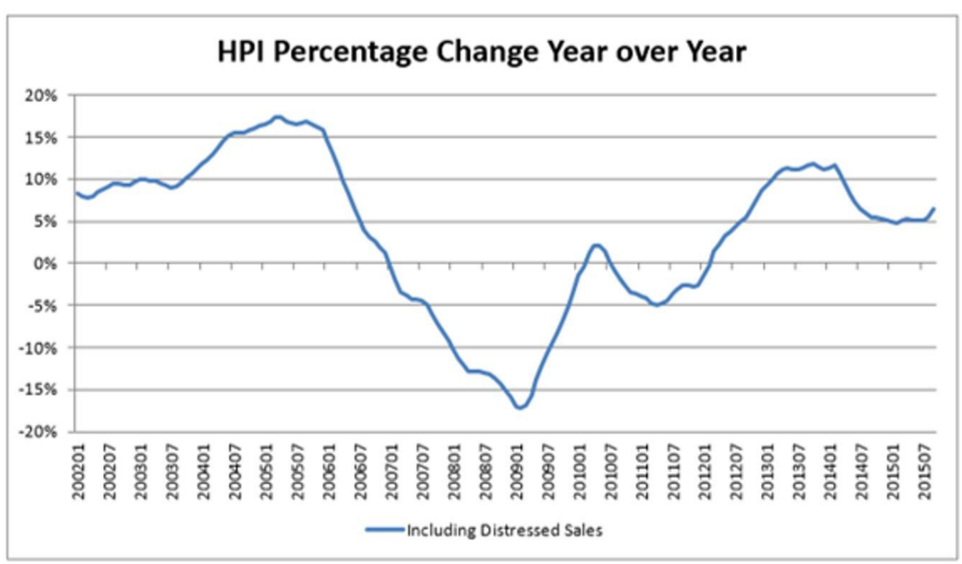
Post recession, manufacturing seems to have peaked just past mid-year, last year (*2014*), and has, except for a brief upturn in the second quarter of this year, continued to head downward since then.



While Housing prices and sales have been climbing for most of the post recession years, the trajectory is now flattening in 2015. And with the possibility of even minimally raised interest rates, along with the general conditions deteriorating, we are of the opinion that housing sales and prices will continue to moderate going into the next year (*next two Charts*).

National Home Price Change



Source: CoreLogic Sep 2015

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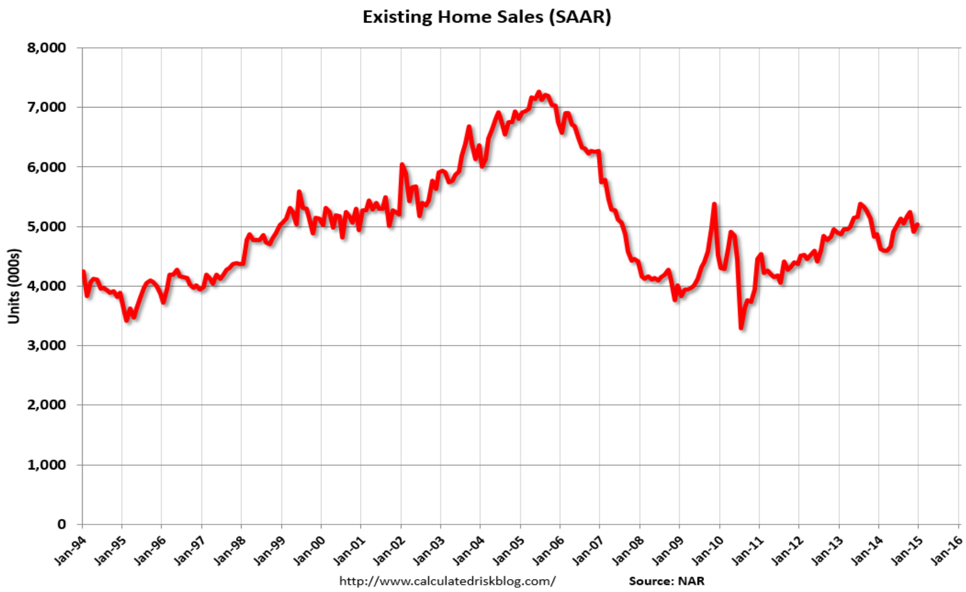
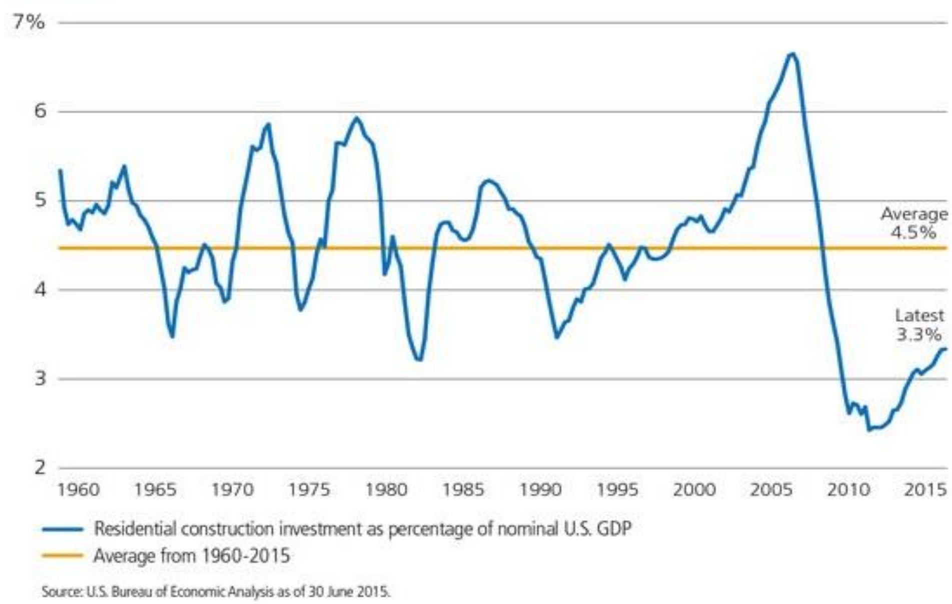


Again, though the rebound in housing, prices and sales, was very healthy, the investment in the housing sector remains well below historic peaks, and averages.

FIGURE 1: U.S. ECONOMY'S INVESTMENT IN HOUSING REMAINS BELOW LONG-TERM AVERAGE



Even though business profitability climbed steadily post-2008, due to lower costs – significantly lower commodity prices, lower wages, ultra low interest rates and therefore lowest financial costs, share buybacks boosting net income per share, and record cash hoardings, earnings and profitability turned increasingly negative this past year (*Chart on Next Page*).

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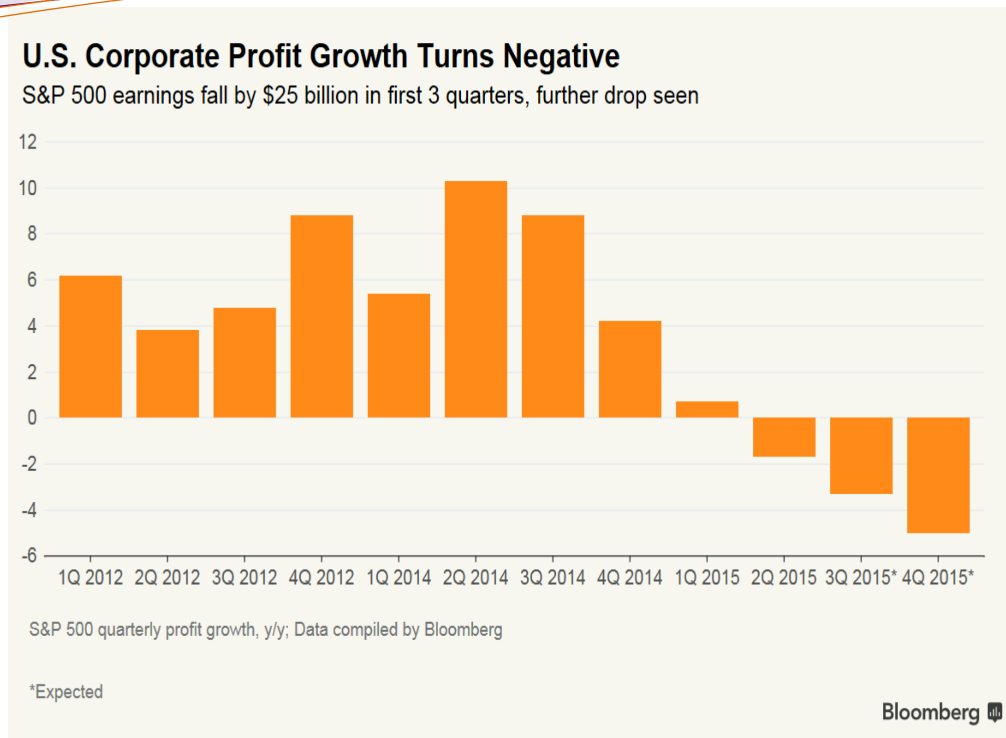
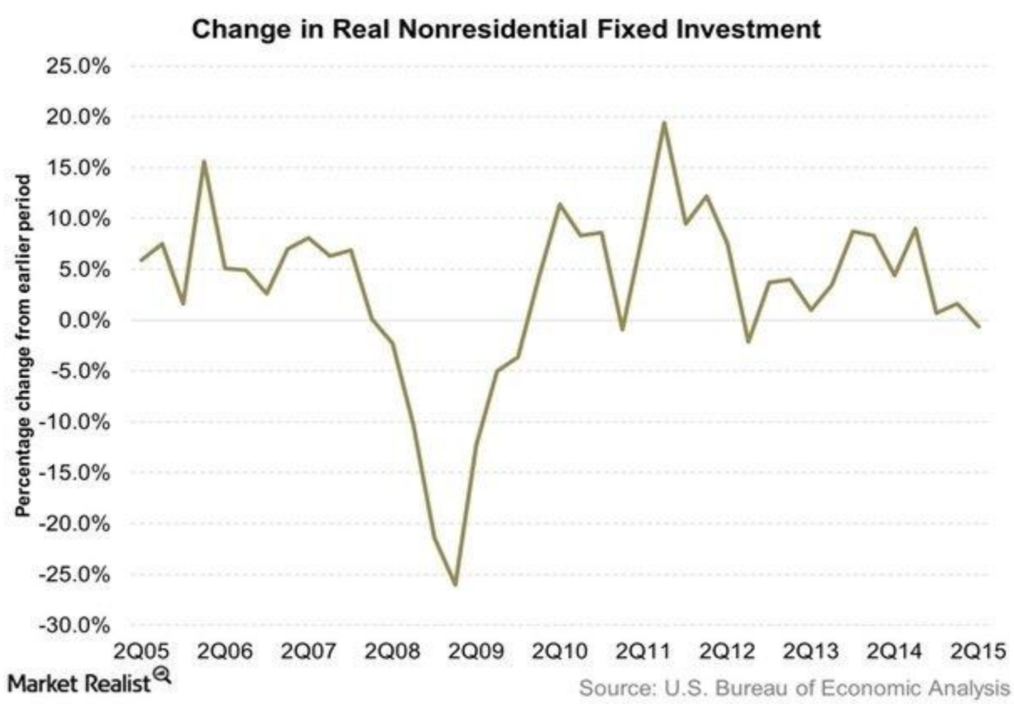


Understandably, with profits turning negative, fixed investment also turned down sharply.



And personal consumption, which aided by the high dollar (*cheaper imports*) has been climbing the past three years, has also turned soft this year. There are certain exceptions, as in the auto sector, but on the whole we see personal consumption continuing to weaken this holiday season, and into the

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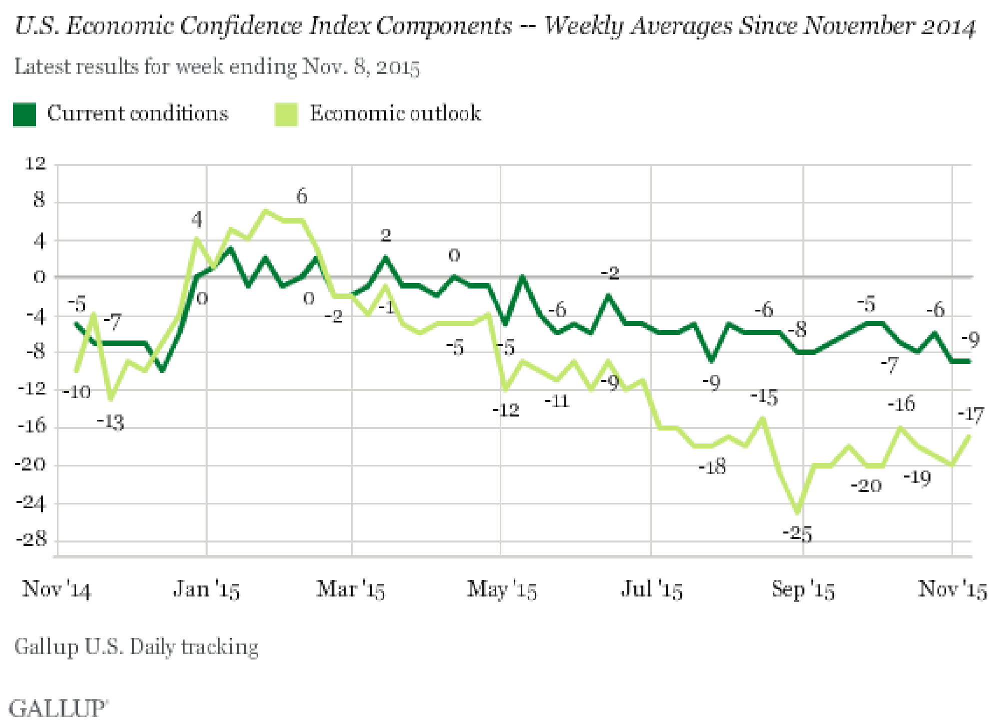
coming year as the population become more wary of increasing uncertainty and volatility.

The weekly Gallup polls show the American people positive about the prospects of the economy at the start of this year, and then becoming increasingly negative in their outlook as the year progressed, and even more so regarding the future prospects.



The American economy and the American dollar have been one of the strongest amongst the advanced economies and currencies these past 2 years. And while GDP cannot be compared on a '*growth rate*' basis with the

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likes of China and India, or other faster growing emerging economies, yet, given its maturity as an economy and the less than enlightened political and economic policies, it has put in a credible performance. But, it's been called '*the cleanest shirt amongst the dirty laundry*', in other words, neither the American Economy nor the Dollar are by themselves in that good a shape, but that other comparable economies and their currencies may be in worse shape. It is hardly a ringing endorsement of the global economic conditions.

America is the biggest and most powerful economy, and military power, in the World. So much so that to think that countries like China are even competition, at this time, or even remotely in the same league is simply – well, not realistic. If there is general rot in the American economic system, then China is surely off the scale. But like all overwhelmingly dominant powers historically, America has been actively sowing the seeds of its own eventual downfall, if it doesn't correct itself before too long.

Its foreign policy over the past decades has materially hurt it, internally and internationally. Its inability to deal with powerful internal self serving interests, be they individual, corporate, political, military, or the combination of some or all, at the cost of national good, has become legendary. Endless and powerful lobby groups are shredding the possibility of good governance, and the moral fabric of the nation, once known for strong moral fiber in the past. This deterioration in general conditions and particularly in leadership quality are starkly visible in the current races underway for the nomination of the Republican Party. The deck is stacked by light weight candidates, led at the moment by Donald J. Trump, which seems so appropriate, as it captures so perfectly America's current problems, those of hubris, self interest over national interest, irrationality and self-inflicted damage.

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Even now, the economic policies are high-jacked by the most powerful financial interests that have used the 2008 crisis to, in broad daylight, affect the greatest wealth transfer to the fewest (*top 10%*) from the most (*the tax payers*). Well, it has been said by someone (original source unknown) and last used by former White House Chief-of-Staff Rahm Emanuel: '*never let a good crisis go to waste*'; the last crisis was taken full advantage of by Wall Street's biggest and best. And while the American population languishes (*economically*) and the top-end few revel in silly money, another major financial crisis looms.

We are sure the coming crisis will also be similarly exploited just as well by the few, at the cost of the many. The economic indicators are pointing to a soft underbelly of the American Economy that is ill prepared for the next crisis, whether it emanates from within, or from without, and right now the possibilities of a crisis looms big on both fronts.

Canada is entering into its autumn of economic growth, and that seasonal change was brought on by the prolonged collapse of commodity prices, the significant slowdown in China, and the general weakness of the American Economy. On top of all that, the dramatic collapse in the global price of oil only hastened the oncoming change in the seasons for Canada. Endowed with abundant natural resources and being a primary exporting country, and heavily dependent on the U.S. (*its primary trading partner*), and on Europe's and China's economies, Canada is now being increasingly impacted internally, as exports continue to shrink due to the general global contraction.

After the 2008 crisis, Canada became the poster boy of economic well-being when most other advanced economies went into severe tailspins, from which some of them are still struggling to come out of. Canada during most of those years seemed to sail through relatively unscathed. Well, those good days are seemingly over as the global deflationary cycle catches even the strongest of economies, sweeping them into a deepening vortex of other sinking economies, in spite of the major Central Banks' expanding stimulus programs, and shrinking interest rates. The weakening global growth rates along with strong and steady contraction of China have since 2011 depressed commodities demand from their previous super-cycle highs, negatively affecting Canada.

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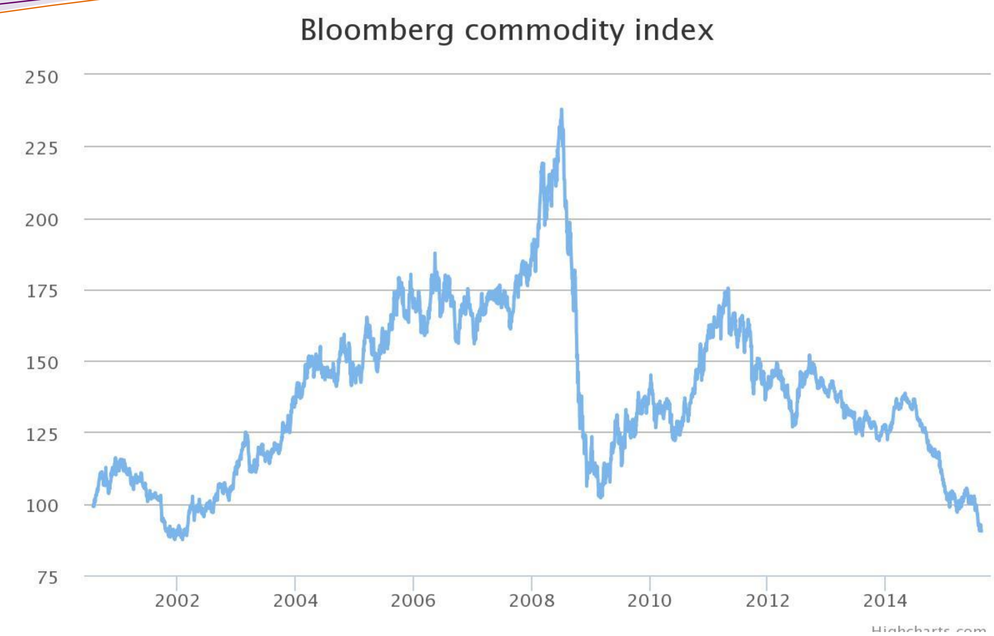
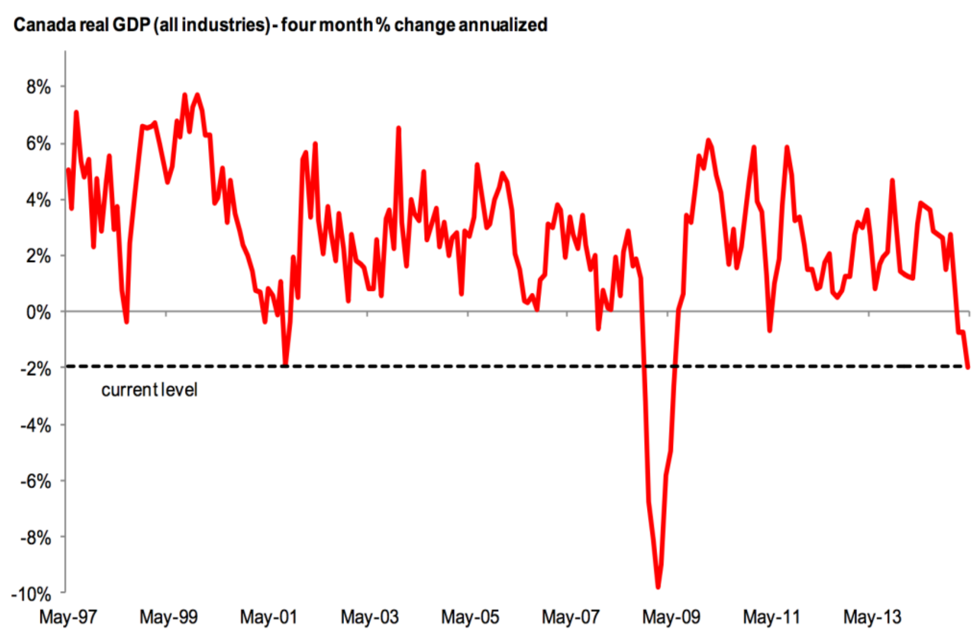


With the price of commodities collapsing, particularly oil, of which Canada is a major exporter, and with general demand muted in the U.S., its largest customer by far, and in the rest of the World, including China, Canada's seemingly invincible economy is starting to show signs of increasing stress. Economic output has turned down sharply due to the growing weakness in commodities and manufacturing.

Fig 1 YTD Canada's real GDP decline has been as severe as in 2001 recession



Source: Statistics Canada, Macquarie Research, June 2015

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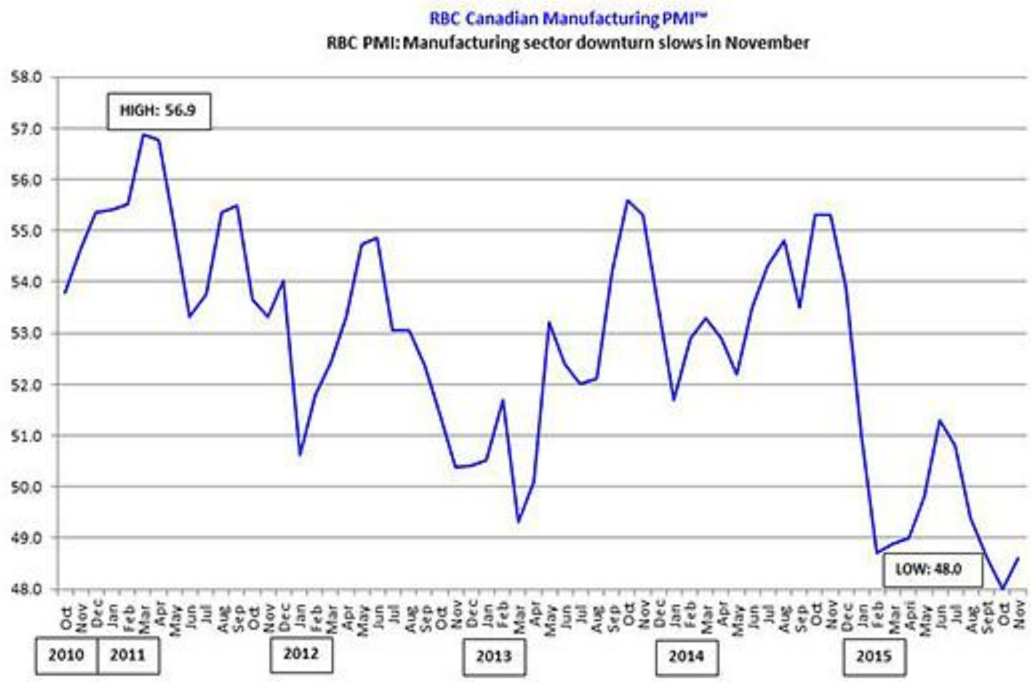
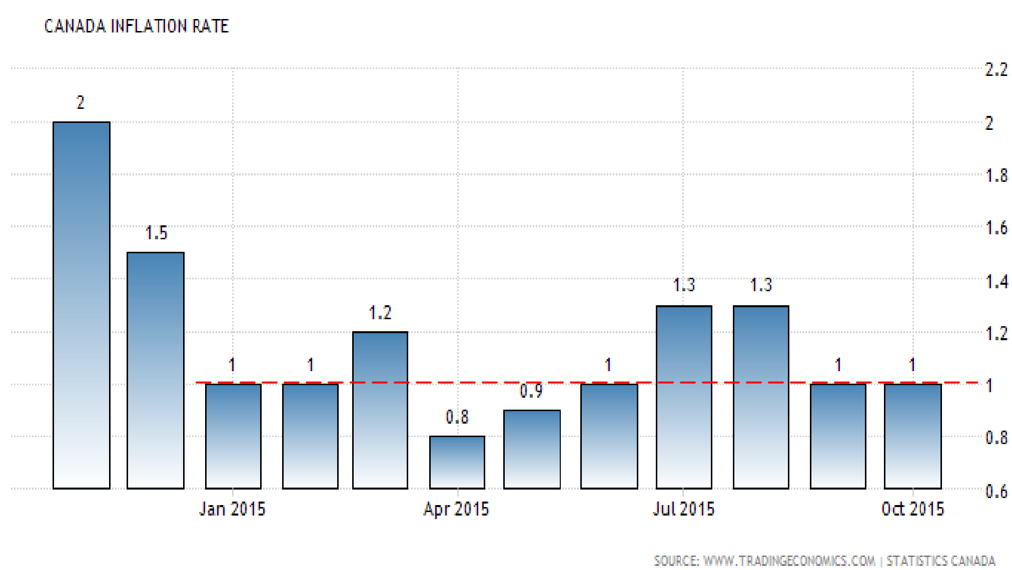
A lot of what Canada manufactures goes to the U.S. Of its total exports almost 79% is sold in the American market. The less than robust markets south of the border have sharply and negatively impacted Canada's manufacturing activity this year.



With most sectors of the economy slowing this year, inflation rate has dropped to an almost uniform 1%. The long term average inflation rate of Canada has been well above 3%. As the economy tightens further and prices continue to soften worldwide, we expect the inflation rate to continue to drop.



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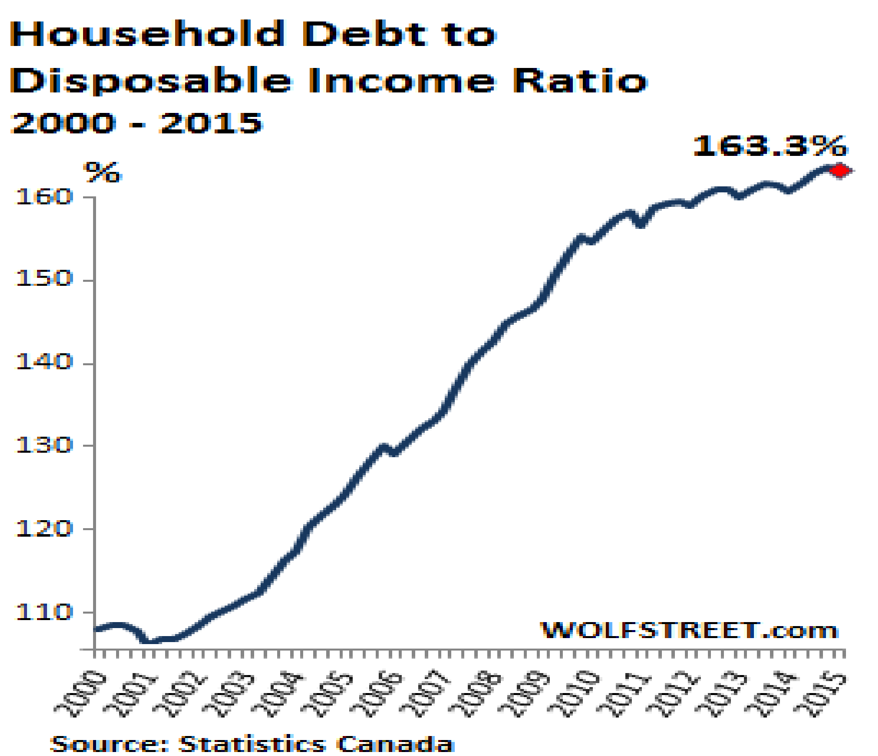
Jobs growth, which had held fairly steady for most of the year, is starting to stall and unemployment rate is starting to climb as the ongoing slowdown starts to bite and companies start to shed jobs, particularly in the oil patch.

While Canada's economy is heavily export dependent, internally Canadian consumers have been most helpful in keeping the economy humming, even post-2008 crisis, with nary a break in taking on debt. Meanwhile, the American counterparts have been deleveraging (*Chart on the Next Page*). The fact that Canadians are indebted as never before makes them particularly vulnerable in a serious downturn.



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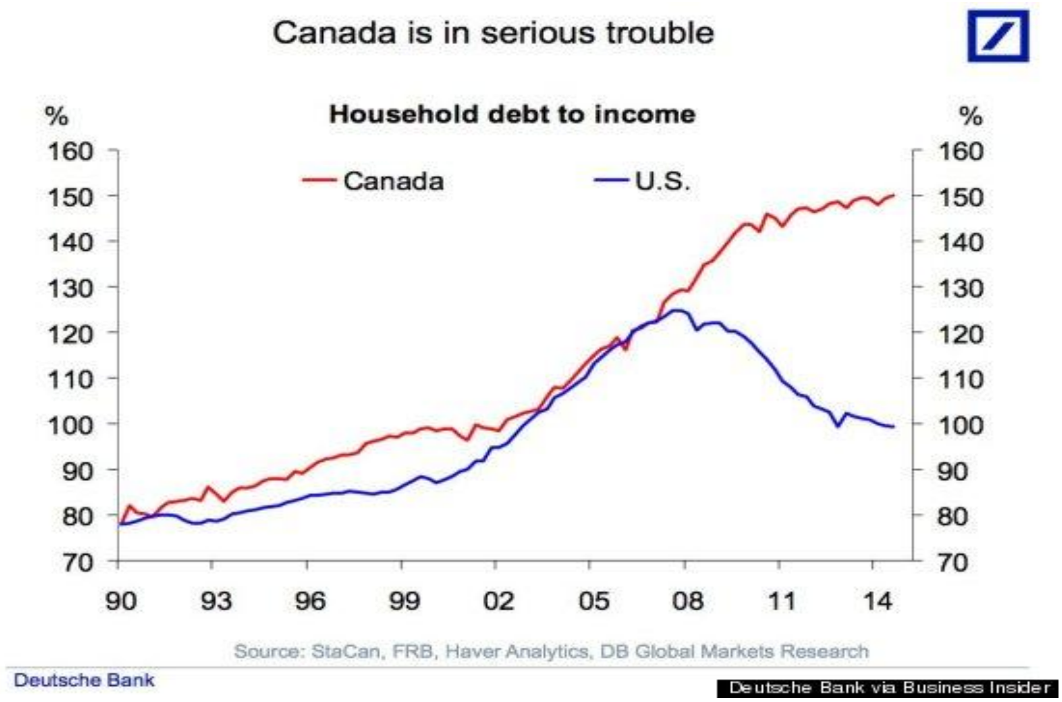
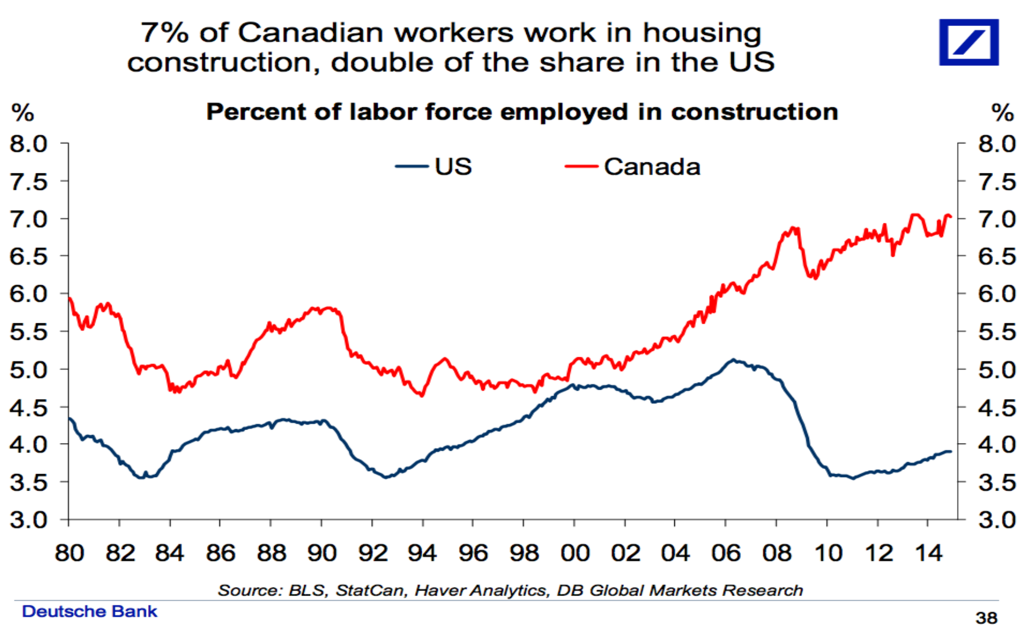


Canada's hereto hot and famed real estate market has strongly and steadily contributed to job creation, with barely a dip post-2008, and it continues to show strength for now. But Canada's housing market is considered one of the most expensive in the World, and by some too inflated, and overdue for a correction. We agree with that sentiment. Canada's real estate market was buoyed by ultra low interest rates and foreign investment; capital that sought political safety and stability. Low interest rates may persist, but foreign capital flows may ease as wealth shrinks abroad. That and internal general economic tightening are setting up Canada's real estate for a correction.



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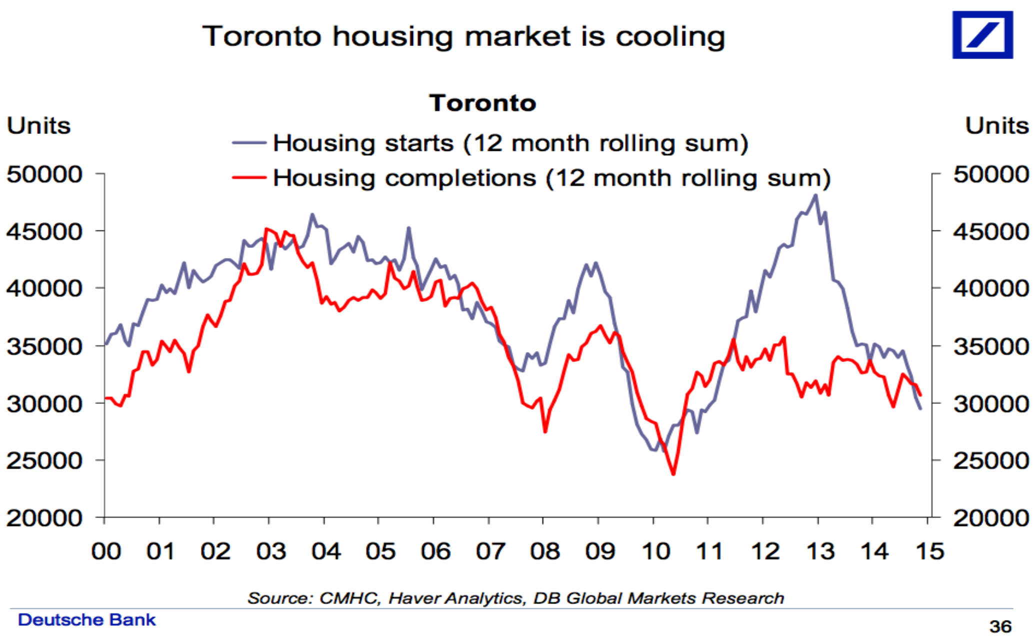
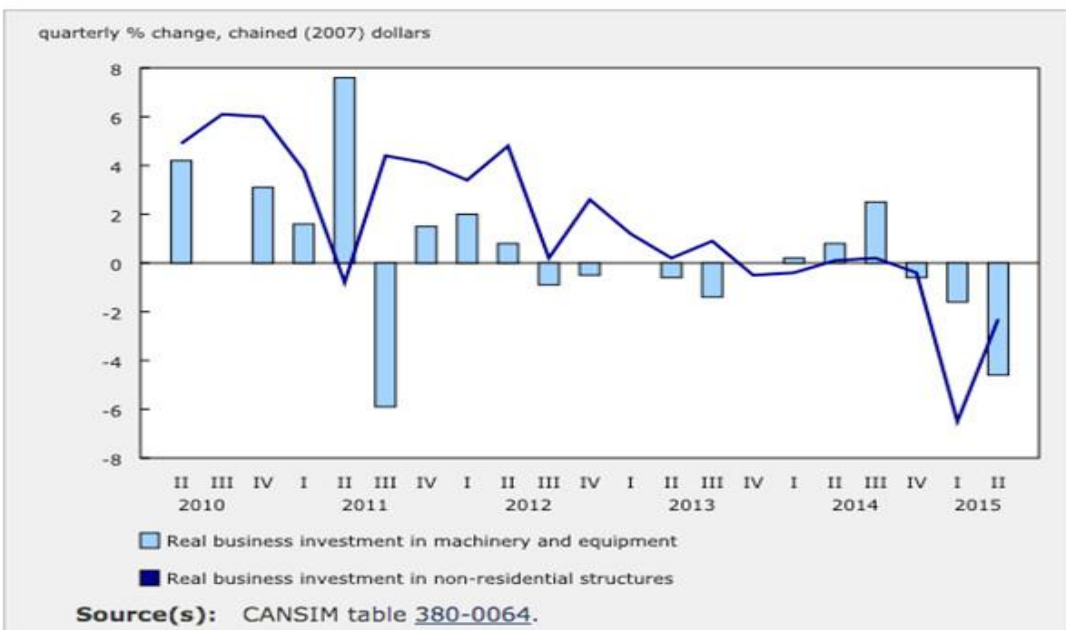
One of Canada's hottest real estate markets starts to cool. We expect the rest to follow.



Business investment has been on a downward trajectory since the break in commodity prices, in 2011. And while Canada's economy is well diversified, with a very strong service sector, the weakness in manufacturing and mining, coupled with external tightening, are contributing to the steady decline in overall business investment.



Canada is a major trading nation, with exports making up approximately 45% of its GDP, and almost 80% of its exports going to the United States. Still, Canada is a net importer, running a monthly trade deficit of approximately $3.0 Billion. Canada's declining exports speak to the weakness in the U.S.

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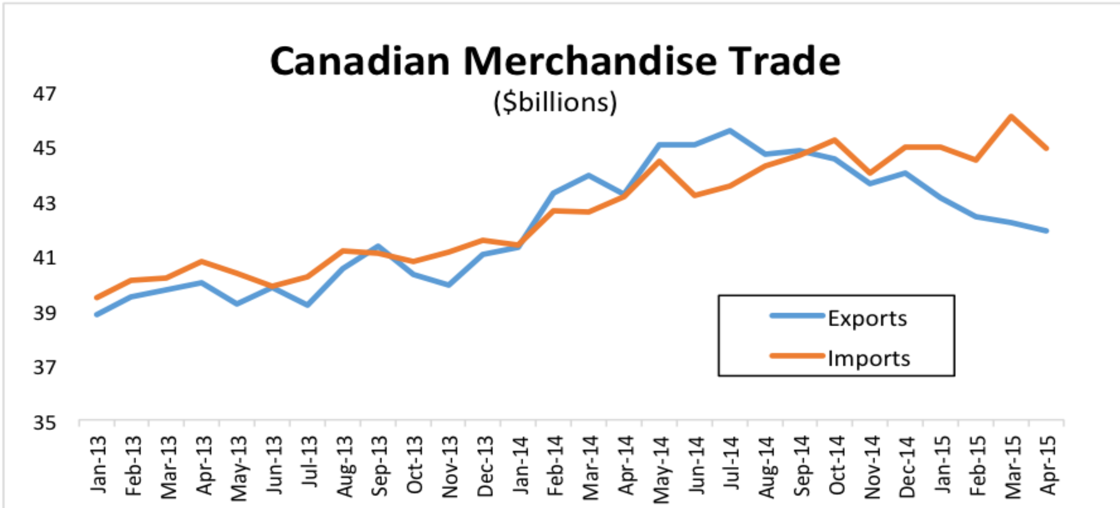
and the global economies, and more lately, its declining imports speak to the growing weakness in Canada's economy, and hence consumer spending.



Canada's economy had an almost charmed life, along with Australia's, post-2008 crisis, when compared to the other advanced economies and their struggles. Both countries benefitted from the over-shoot of China and the other Emerging Markets (*EM*) after the crisis, and both are now feeling the downdraft of China's and other EMs' economic contraction.

Compared to most of the advanced economies, including the U.S. and the U.K., which have been posting positive growth in the past years, albeit modestly, Canada has not had to struggle mightily to maintain growth, and also did not have to take on a lot of debt to stimulate its economy, unlike the others whose Debt to GDP ratios are far higher than Canada's. This bit of good fortune has stood Canada in good stead and its dollar has reflected it. But, this year with global conditions deteriorating further, the Bank of Canada preemptively (*and surprisingly*) lowered its key lending rate twice this year to try and forestall the slowdown, and lower the exchange rate of the Canadian dollar versus the U.S. dollar, which of course helps the exports, which are under increasing pressure.

Additionally, and perhaps even more startlingly, the Governor of the Bank of Canada, Stephen Poloz, during a recent speech, just happened to mention

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that the Bank of Canada would be willing to lower its key lending rate to below zero (*negative rates*) if Canada faced another crisis.

Now, he stressed that this was just a hypothetical situation he was addressing, and didn't see it being at all necessary, but we think it is an important indicator of a possible eventuality. Heads of Central Banks are not prone to make careless off-the-cuff remarks about something that important, and possibly that negative. We think that in-spite of his customary reassurances as to the health of the Canadian economy, and its generally bright prospects for the coming year, Stephen Poloz just did another preemptive strike to prepare the business and financial community, about *the possibility* of another impending crisis. He assured the audience of the Bank's preparations for it with its new and improved tool kit, that includes the possibility of taking interest rates negative. We don't think we are reading too much into it when we say, it is the signs of the times for Canada.

Australia did relatively well after the 2008 crisis due to its proximity to Asia, which had the fastest growing economies, including China, India, Vietnam, Philippines, Malaysia, etc. Like Canada, Australia is a natural resource rich country with a well diversified advanced economy that has been resilient to global economic gyrations for the past decades. But, again like Canada, the accelerating external weaknesses in its major markets, particularly China, may now re-test that resilience. This year the pressure is starting to show in the initial down turn of its erstwhile and perennially upward climbing economic indicators.

The Chart on the following page shows the inherent strength and resilience of the Australian economy as an advanced economy, having an enviable record of not being in a recession for over 20 years. The current economic growth rate is still well in the positive territory, certainly on par with the U.S., U.K., and Canadian growth rates, but, at an annualized 2.5% growth rate (*Reserve Bank of Australia*) for 2015, it has certainly started to slow of late.

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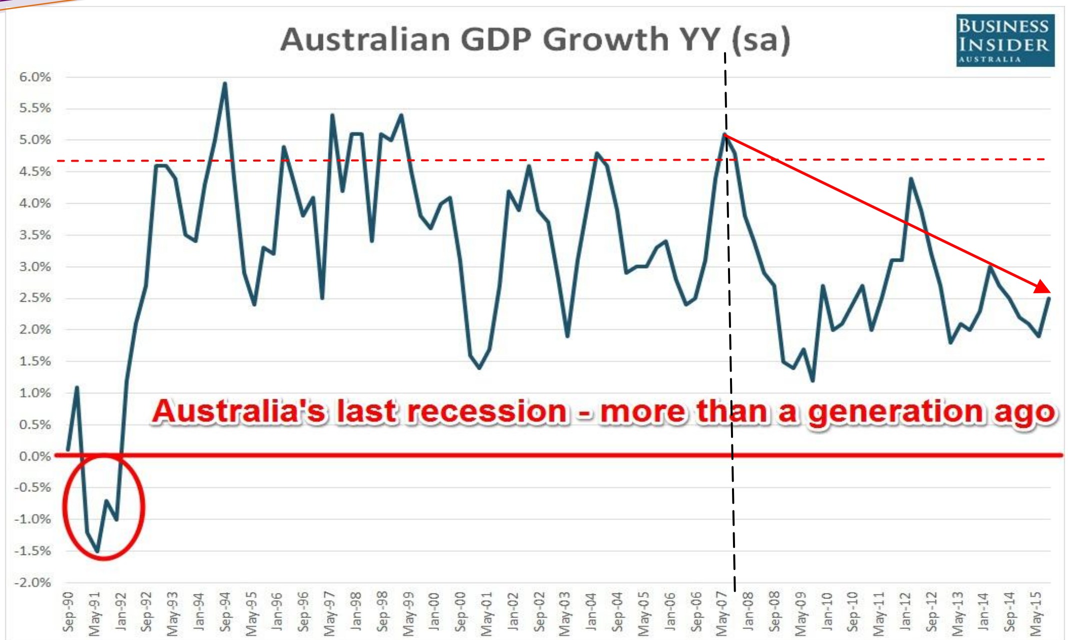
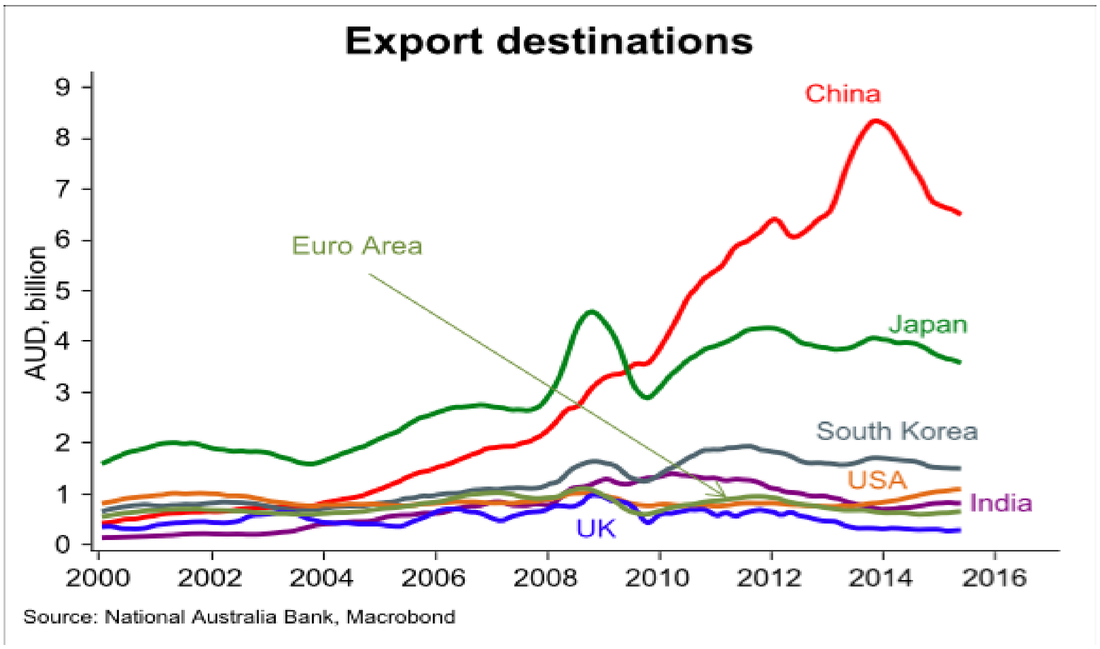


Externally, the danger to Australia comes from additional deterioration of its major export markets in Asia that by far represent the bulk of its exports. China's sharp slump and Japan's continued stagnation will weigh heavily on Australia's growth possibilities. If conditions deteriorate further in China and the rest of Asia, Australia may find itself battling to keep the additional fall in exports from tipping its other internal industries, as revenues fall and ripple through the economy.



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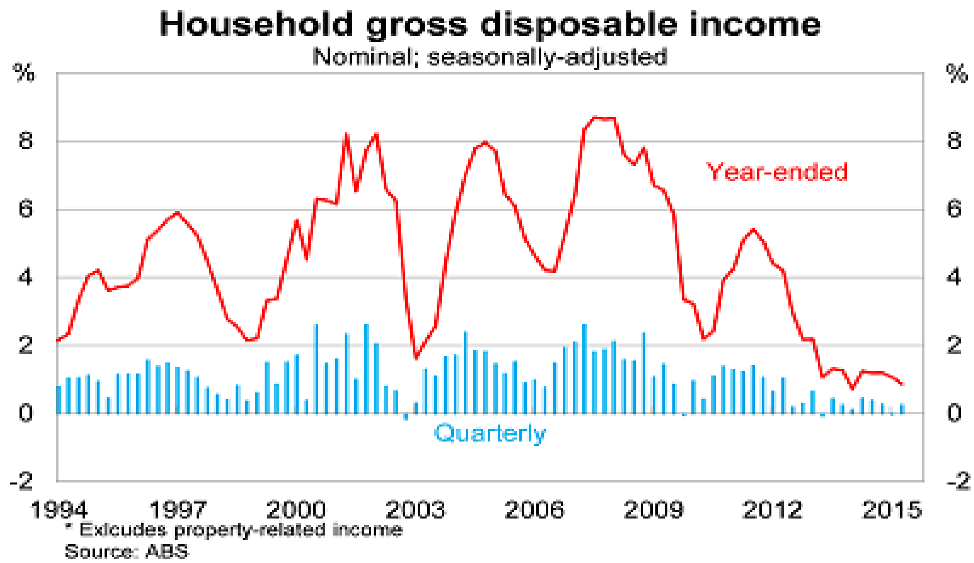
Evan though the average Household disposable income has been declining since the 2008 recession, the trend downwards seems to be deepening.



Australia has had a red hot real estate market, very similar to Canada's, that also has had predictions of an overdue major correction. But, like Canada's, so far, it has defied the odds and has just kept on going. As in Canada, the warnings of the prices being too high are persistent.

Global Economies 2015 – Once More Off-the-Cliff, Dear Friends…III

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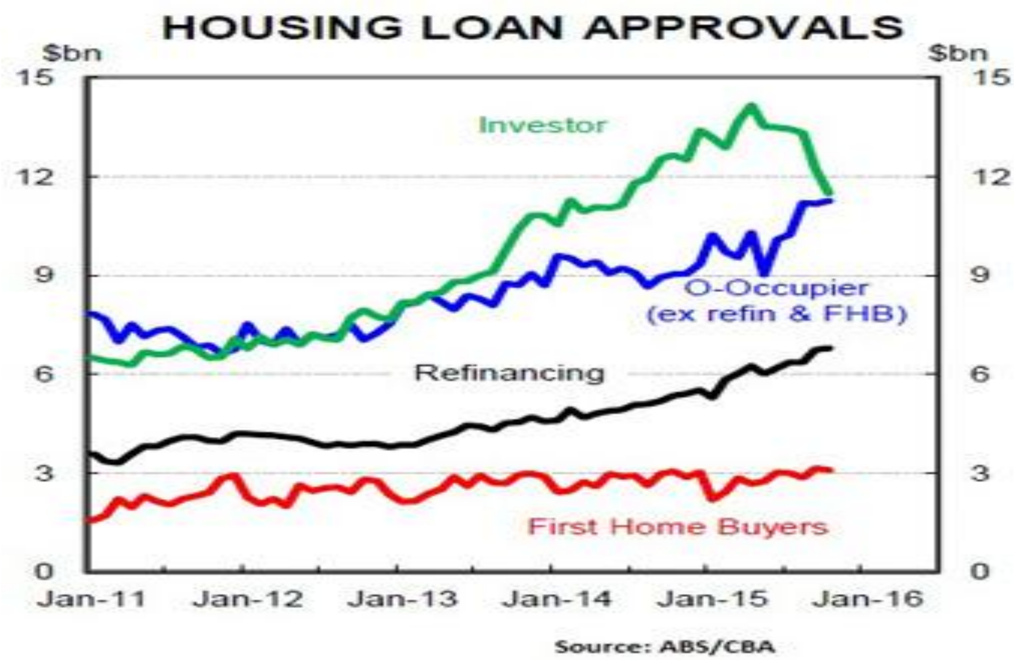
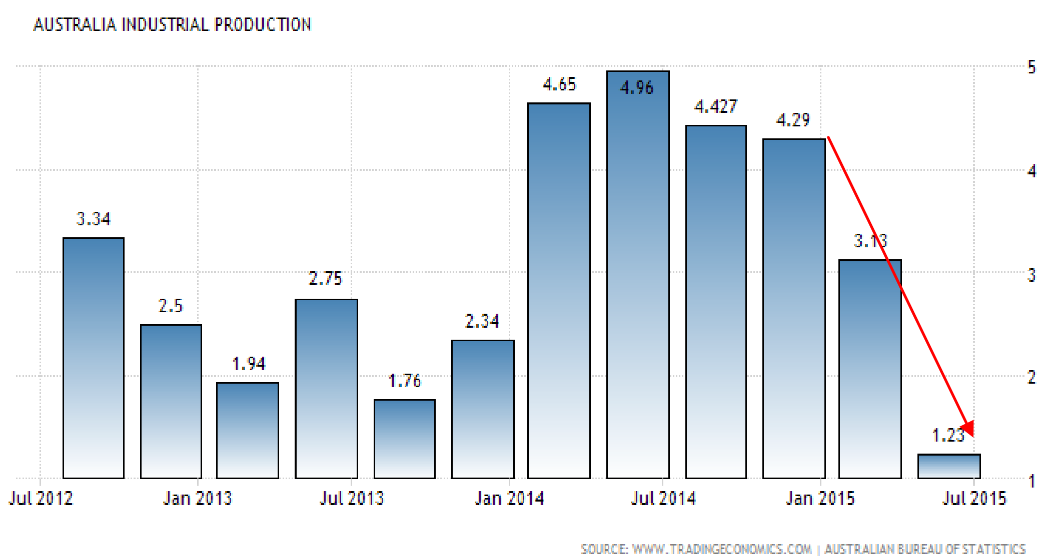
But as the Chart below shows, loan approvals are still climbing in all categories, except in the '*Investor*' category. The drop in the investor category could mean the banks are getting cautious about lending for speculative investment, and two, foreign investors, who were significant participants in Australia's hot real estate, especially from China, may have retreated due to negative external and internal economic conditions, which would translate into less wealth for investment, and greater caution.



As conditions weaken in the economy, industrial production is reflecting that weakness in its dramatic drop this year.



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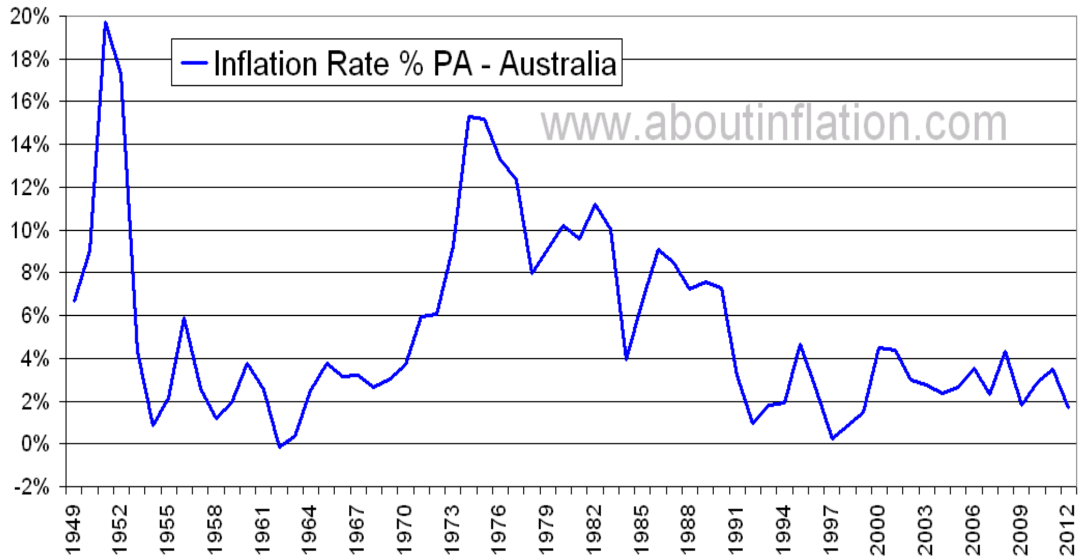
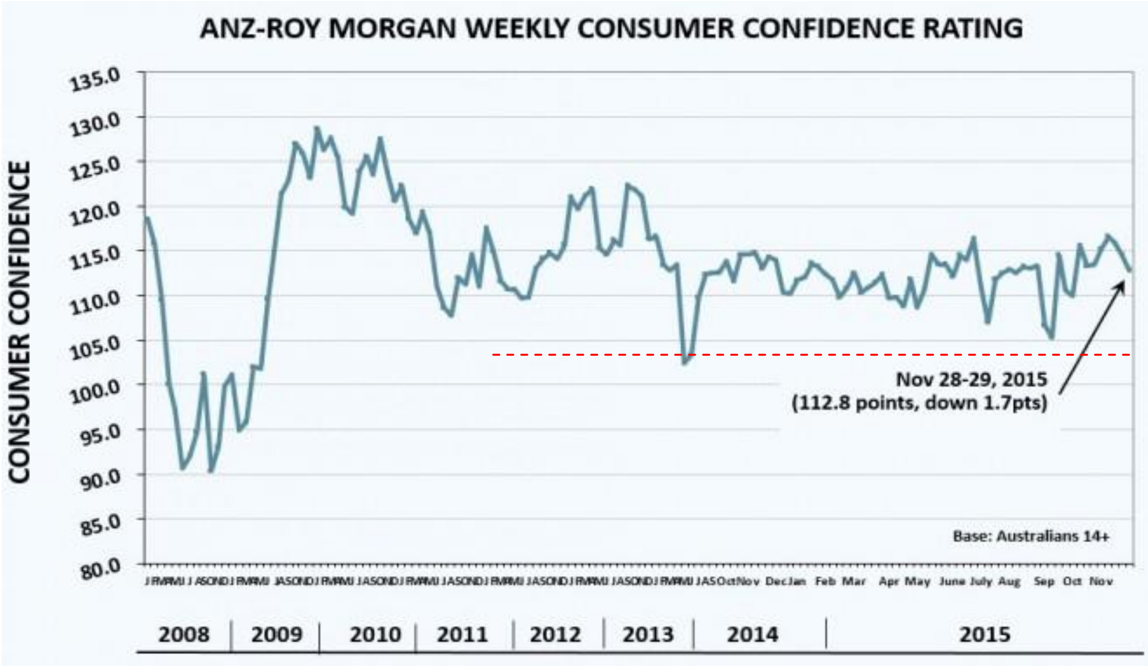
The inflation rate has been on a downward trajectory since about mid 1970s, and is currently estimated by the Reserve Bank (*RBA*) to be at 1.5%. As a point of interest, Australia's average rate of inflation is estimated at *5.16%* from 1951 to 2015 (*Australian Bureau of Statistics*).



As we observe in the Chart below, since 2011 consumer confidence has been generally positive, albeit, the trend has been drifting downward. It would seem, the negative turn in the Australian economy and the various indicators that show it, are still not dramatic enough to cause the public any real worry. The consumer confidence rate shows a turn for the worse recently, but it is still higher than the drop in the month of September, and therefore may turn up again. The general sentiment in Australia seems to be still solidly optimistic, so far. But that will change quickly as the downturn accelerates.



Global Economies 2015 – Once More Off-the-Cliff, Dear Friends…III

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Australia, with 58% of its economy being based on services, 9% on construction, 7% on manufacturing and only 7% on mining, is holding up fairly well up till now, although there are signs of stresses in various sectors and in the total output (*GDP*) numbers. The softening economy is resulting in generally lower prices (*except in real estate in the large cities*), but particularly in commodities, which is dropping the inflation rate far lower than the average long term level. The general consensus within the relevant authorities, however, is that economic conditions for Australia's economy will be worse in the coming year. We agree.

We feel that Australia, very much like Canada, is particularly vulnerable to external economic deterioration, because of their relatively small populations and vast natural resources, which they export in large measure. Both countries are also home to the hottest housing markets (*pardon the pun*) that are generally considered to be overvalued, and overdue for a healthy correction. It will probably be an external event that will trigger such a correction, as internally the economies are still stable, and the interest rates are at all times lows. The overheated asset markets of the U.S., particularly the stock and bond markets, and or, the exceptionally over leveraged and swiftly deteriorating financial conditions within China, may provide such an event in the near future.

Of the three economies, the U.S., Canada and Australia, in our view, the U.S. economy is the more unstable of the three, and is the most vulnerable to an *internal* black swan event. Canada and Australia are more stable internally, but are vulnerable to external black swan events. Canada is most exposed to the instability of the U.S., and Australia to China's continuing implosion.

To be continued…