

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE
THAT WAS THE WEEK THAT WAS



Monday, January 31ST

The Institute for Supply Management-Chicago reports its index of business activity increased to a reading of 68.8 in January from a level of 66.8 in December

MONDAY, JANUARY 31ST

- Moody's Investors Service downgrades Egypt's sovereign debt rating to Ba2 from Ba1 with a negative outlook, citing the significant rise in political risk, amid concern that the government's response to mounting anti-government protests could undermine Egypt's already weak public finances
- In a Haaretz Israeli newspaper op-ed, reporter Aluf Benn predicts U.S. President Obama will go down in history as the President who lost Egypt: "The street revolts in Tunisia and Egypt showed that the United States can do very little to save its friends from the wrath of its citizens. Now Obama will come under fire for not getting close to the Egyptian opposition leaders soon enough and not demanding that Egyptian President Hosni Mubarak release his opponents from jail. He will (also) be accused of not pushing Prime Minister Benjamin Netanyahu hard enough to stop the settlements, thus indirectly, quell the rising tides of anger in the Muslim world."
- Statistics Canada reports the nation's gross domestic product (GDP) grew by 0.4% in November, citing expansion in the oil and gas, retail, real estate and financial sectors; outweighing declines in manufacturing and construction. Stewart Hall, an economist with HSBC Securities Canada, commented: "However, while domestic demand is holding up, torqueing up Canada's GDP picture amounts to turning around the picture on net trade."
- Eurostat, the European Union's statistics office, reports the inflation rate in the euro zone rose by 2.4% in January on a year-over-year basis, following a 2.2% annual increase in December. Howard Archer, an economist at IHS Global Insight commented: "The European Central Bank (ECB) will probably step up its anti-inflation rhetoric and stress that it is prepared to hike interest rates despite (economic) growth risks, if the current (upward) spike in euro zone consumer price inflation shows any significant sign of leading to a significant increase in secondary round of inflationary effects, such as rising wage settlements."
- A regulatory enhancement task force has recommended to the Alberta Government that it initiate a major overhaul of its energy enforcement system, including the establishment of a single energy regulator, in an effort to minimize the complexity and duplication of a process derided by the energy industry as too slow. Diana McQueen, parliamentary assistant for energy, commented: "These actions will ensure the regulatory system supports the development of Alberta's oil and gas resources."
- The latest warning against soaring national debt burdens has the Beijing-based Dagong Global Credit Rating agency suggesting: "China and other emerging market countries may need to reduce their U.S. Treasury holdings to avoid unpredictable losses on their own interests (portfolios)."

- The Commerce Department reports U.S. consumer spending rose by a seasonally adjusted 0.7% in December while personal income rose by 0.4%. Accordingly, the personal savings rate declined to 5.3% of disposable income from 5.5% in November
- Chrysler Group LLC reports a net loss of \$199 million (U.S.) in the 4th. quarter, compared to a loss of \$2.69 billion (U.S.) in the same period a year ago

TUESDAY, FEBRUARY 1ST

- New York Governor Andrew Cuomo brings down his first budget with a restructuring plan for State finances, citing New York had been locked into annual increases in education and Medicaid, which had little bearing on actual costs. Declaring the State “functionally bankrupt,” Gov. Cuomo recommended a 2.7% reduction to overall spending and suggested a much slower pace for the long term growth of health care and education, sectors that have long been above national state averages. Without concessions, Gov. Cuomo stated he may be forced to resort to job layoffs, proposing to dismiss up to 10,000 State employees, about 2% of the work force. Moreover, an advisory panel which the Governor appointed last month has less than two months to form a plan that generates \$3 billion (U.S.) in savings from the health care industry.
- In a new report entitled “Inequality, Leverage and Crisis,” The International Monetary Fund’s (IMF) Managing Director Dominique Strauss-Kahn warns: “Global unemployment remains at record highs, with widening income inequality adding to social strains. It is not the (economic) recovery we wanted. It is a recovery beset by tensions and strain, which could even sow the seeds of the next crisis. We could see rising social and political instability within nations – even war.”
- The U.K. Markit/CIPS purchasing managers’ index (PMI) rose to a new high reading of 62 in January, following an upwardly revised level of 58.7 in December, citing British manufacturing is growing at the fastest pace in 19 years
- Pfizer Inc. announces the closing of its research center in Kent, England, laying off 2,400 employees. Vince Cable, U.K. Secretary of State for Business, Innovation and Skills, commented: “The decision is extremely disappointing. The company has been clear that this decision was part of its global program of change and not based upon a judgment of the U.K. as a location for pharmaceutical research.”

- According to the U.S. Census quarterly report, America’s home ownership rate declined to 66.5% in the 4th. quarter of 2010 from 66.9% in the 3rd. quarter – down from the 2004 peak of 69.2% and the lowest level since 1998
- The Tempe, Arizona-based Institute for Supply Management (ISM) reports its U.S. factory index rose to a reading of 60.8 in January, following a level of 58.5 in December
- The Commerce Department reports U.S. construction spending declined by 2.5% in December, bringing the value of all projects down to an annual level of \$787.9 billion (U.S.) – the lowest since July, 2000 – citing budget-constrained state and local governments restricting funding for public works, such as highways
- General Motors and Chrysler Group report U.S. vehicle sales increased by 23% in January, while Ford Motor sales rose by 9%. In Canada, General Motors and Ford Motor sales increased by 24% and Chrysler sales rose by 14%.
- The International Labour Organization (ILO) reports on a global basis 78 million young people were unemployed in 2010, excluding an estimated 1.7 million who have quit searching for a job. ILO director-general Juan Somavia commented: “The weak (economic) recovery in decent work reinforces a persistent inability in the world economy to secure a future for all youth. This undermines families, social cohesion and the credibility of policies.”

WEDNESDAY, FEBRUARY 2ND

- Automatic Data Processing (ADP) reports private sector employment rose by 187,000 jobs, following a gain of 247,000 jobs in December, citing “(hiring) strength was evident in all major industries and sizes of business”
- The U.S. Treasury Department announces its quarterly plans to auction \$72 billion of notes and bonds next week: \$32 billion of 3-year notes on February 8th. and \$24 billion of 10-year bonds on February 9th. and \$16 billion of 30-year bonds on February 10th. Mary Miller, the Treasury Department’s assistant secretary for financial markets commented: “While these estimates are subject to change, the Treasury intends to keep its note and bond sales at stable levels in the coming months.”
- Brazil’s industrial output fell by 0.7% in December, after a decline of 0.2% in November

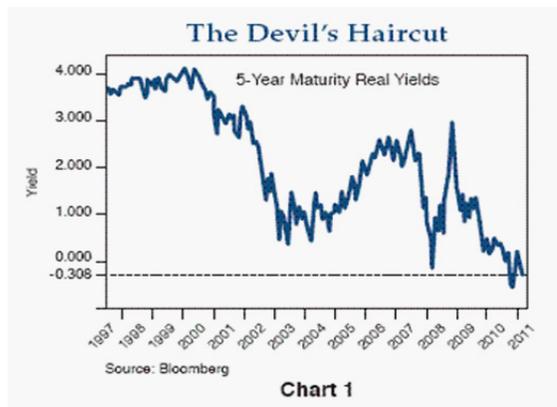
- Moody's Investors Service downgrades the local currency deposit ratings of five Egyptian banks, citing "our reassessment of the country's capacity to support its banking system, following the lowering of the government's ratings (on Monday); as well as a concern that the current political uncertainty, if unresolved, could negatively impact foreign direct investment flows into the country and disrupt economic activity, thereby weakening the performance of the main economic sectors"
- Marko Mrsnik, Standard and Poors (S&P) credit analyst, affirms Spain's 'AA' sovereign debt rating with a negative outlook, citing: "It reflects the benefits of what we view as a modern and relatively diversified economy, as well as our opinion of the government's continuing resolve to deal with the outstanding challenges, as reflected in a significant acceleration in both budgetary consolidation and the structural reform effort since 2010. The negative outlook reflects the possibility of a downgrade if Spain's fiscal position deteriorates materially, in our opinion, from the government's budgetary targets for 2011 and 2012." See also, Winter Warning, April 27, 2009 – Weak Sisters in the Euro Zone
- Standard and Poors (S&P) downgrades Ireland's sovereign debt to 'A' (Low) from 'A' warning that another downgrade could materialize as soon as April. S&P estimates that the indebtedness of Ireland's domestic banking groups, excluding the international financial services sector, in excess of 170% of the country's gross domestic product (GDP). As a result, S&P asserts that Ireland's banks are currently dependent "almost entirely" on the European Central Bank (ECB) to refinance their current maturing debts. Frank Gill, an S&P analyst commented: "I expect the Irish government's (debt) rating to remain in the investment grade category after our current assessment of the country's current economic prospects. Much hinges on the Irish economy and what happens to the unemployment rate. Were the labour market to deteriorate further, an increase in the level of delinquencies in the domestic banks' mortgage books could result in higher new capital requirements than we presently assume. The emergence of a European sovereign debt restructuring framework that could reduce the perceived adverse political and financial cost of a sovereign debt restructuring, could also lead us to reconsider our view of Ireland's creditworthiness." See also, Winter Warning, April 13, 2009 – No Man is an Island, Entire of Itself
- According to the New York Times, since the U.S. Securities and Exchange Commission (SEC) began producing audited statements in 2004, the Government Accountability Office (GAO) has faulted its reporting almost every year. Last November, the GAO stated that the SEC's books were in such disarray that the agency had failed at some of its most fundamental tasks: accurately tracking income from fines, filing fees and the disgorgement of ill-gotten profits. The GAO concluded: "A reasonable possibility exists that a material misstatement of the SEC's financial statements would not be prevented, or detected and corrected on a timely basis." SEC Chairwoman Mary Schapiro is pleading that she desperately needs additional monies in order to increase the commission's regulatory power; however, along with the rest of the U.S. federal government, the SEC is operating without an increase in its budget, which was \$1.1 billion (U.S.) in 2010.

THURSDAY, FEBRUARY 3RD

- Florida Governor Rick Scott outlines his plans to close the State's \$3.6 billion (U.S.) budget deficit and create 700,000 private sector jobs within the next seven years, by cutting government spending, reducing property and corporate income taxes; as well as restructuring the State government. Among the Republican Governor's proposals is a goal of cutting \$1.4 billion (U.S.) annually from the budget by requiring State employees to contribute to the State's public pension system for the first time and by channeling new employees into 401(K)-style (pension) plans that don't guarantee set benefits upon retirement. Undoubtedly, Governor Scott faces significant opposition to his plans from unions and environmentalists; as well as skepticism from some within his own party. Governor Scott, take note that the State of Illinois recently raised the rates of personal and corporate income taxes.
- New York City Mayor Michael Bloomberg proposes eliminating an annual \$12,000 (U.S.) bonus payment to future police and fire retirees, as part of an overall plan to create a new tier of less generous benefits for future employees. Last month, Mayor Bloomberg broadly outlined his plans to reduce the City's pension costs which have skyrocketed to \$7 billion (U.S.) this year, compared to \$1.5 billion (U.S.) in 2001. Union officials accused the Mayor of trying to inflict damage to the work force's hard-fought pension system and unfairly burden workers with the City's fiscal problems. Harry Nespoli, chairman of the Municipal Labor Committee (an organization comprised of City unions), commented: "We're going to fight Mayor Bloomberg all the way. He's looking to destroy the pension system of City workers. It's a dictatorship."

- In his most recent Investment Outlook Newsletter entitled Devil's Bargain, Pimco Managing Director Bill Gross warns: "America desperately requires a rebalancing of priorities. After readjusting the compensation scales via regulation and/or free market sense, America needs to anoint a new set of Mensans who can create something more than a cash machine and make this country competitive again in the global marketplace. We need to find a new economic Keynes, or at least elect a chastened Congress, that can take our structurally unemployed and give them a chance to be productive workers again. We must have a President whose idea of "centrist" policy is not to hand out presents to the right and the left; then altruistically, proclaim the benefits of bipartisanship. We need a President who does more than propose "Win The Future" at annual State of the Union addresses without policy follow-up. America requires more than a makeover or a facelift. It needs a heart transplant, absent the contagious antibodies of money and finance filtering through the system. It needs a Congress that cannot be bought or sold by lobbyists on K Street, whose pockets in turn are stuffed with corporate and special interest group payola. Are record corporate profits a fair price for America's soul? A devil's bargain more than likely.

This metaphorical devil's bargain has its equivalent in the credit markets these days. Central bankers have lowered the cost of credit (interest rates) for 30 years now, legitimately following global disinflationary forces downward, but also, validating increased leverage via lower real interest rates. Today's rock-bottom (bond) yields, however, have less to do with disinflation than with providing fuel for an asset-backed economy that promotes unsustainable wealth creation and a false confidence in perpetual gains. Real 10-year interest rates fell from over 5% in the early 1980s to just under 1% in recent months. They have arguably been responsible for 3,000 – 4,000 Dow (Jones) points and 2 – 3% annual appreciation in bond (rates of return) over those three decades.

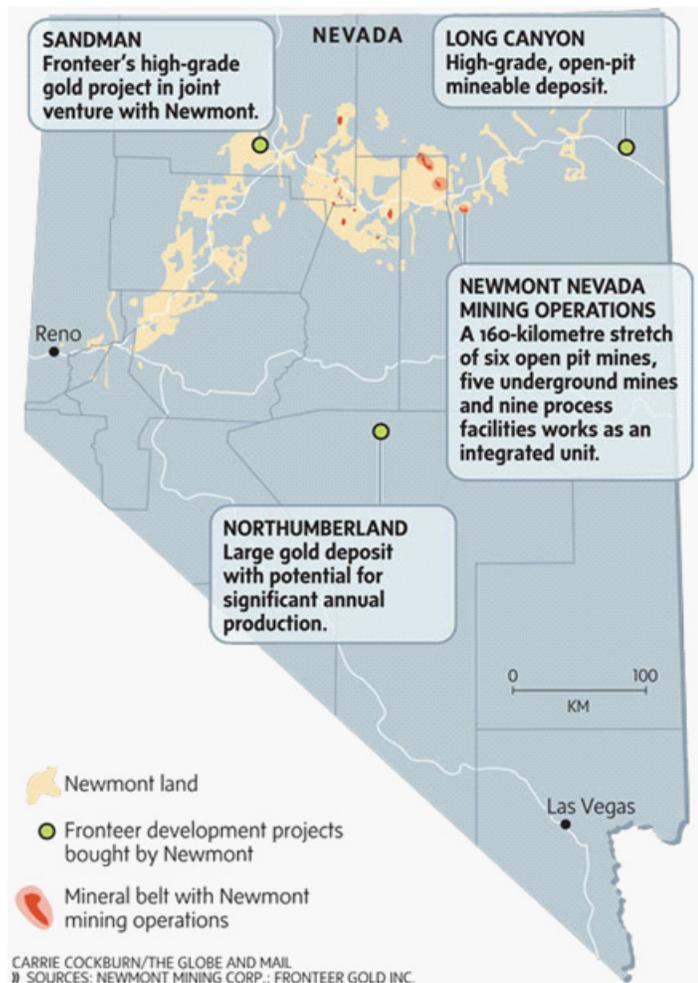


Ultimately, however, the devil gets his due or, at least the central bankers run out of mathematical room to lower real yields below common sense floors. Today's negative real yield on 5-year TIPS (Treasury Inflation Protected Securities) is perhaps, reflective of a market that has lost its fundamental value anchor. A century-long history of average 5-year real (Treasury) yields would indicate that bond investors in a 'AAA' 5-year Sovereign credit have demanded and received a real interest rate return of 1.5% instead of today's minus 0.1%. We are being short-changed, in other words, by 160 basis points from the outset, a "haircut" (see chart 1 above) that is but one of the four ways that governments attempt to escape from an over-levered national balance sheet. See also, Winter Warning, September 15, 2009 – Behold a Pale Horse and He Who Sat Upon Him Was Named Death, and Hell Followed With Him

- In a speech to the National Press Club in Washington, Federal Reserve Board Chairman Ben Bernanke issues a warning to Congressional Republicans who plan to use the debate over raising the federal debt ceiling to force spending cuts across the federal government: "If the debt limit is not raised for a time, the U.S. Treasury has various resources it can use to make payments on our national debt. But beyond a certain point it would not have those resources and the United States could conceivably – I think that this is very remote, but it is not something you want to play around with – be forced into a position of defaulting on its debt. If the (debt) ceiling isn't raised, a U.S. debt default would have catastrophic implications for the financial system, U.S. fiscal policy and the economy. I would very much urge Congress not to focus on the debt limit as being a bargaining chip in this discussion, but rather to address directly the spending and tax issues that we must deal with, in order to make progress on this fiscal situation." In the same speech, Mr. Bernanke was pleased to note that QE2, like QE1, was contributing to improving the outlook for equity prices.
Wake-up call for Mr. Bernanke: Since when has it been the Fed's mandate to interfere in the supposed free market equity system?
- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 42,000 to 415,000 in the week ended January 29th. while continuing claims fell by 84,000 to a seasonally adjusted 3.93 million in the week ended January 22nd.

FRIDAY, FEBRUARY 4TH

- Statistics Canada reports the nation's employment level rose by 69,200 as the labour force increased by 106,400 in January, while the unemployment rate rose to 7.8% from 7.6% in December, as more people were actively looking for work
- Denver-based gold mining giant Newmont Mining Corp. acquires Fronteer Gold Inc. in a transaction valued at \$2.3 billion (CAD). Newmont is offering \$14.00 (CAD) per share, a 37% premium, for Vancouver-based Fronteer whose flagship asset is the Long Canyon development project located near Newmont's existing operations northeast of Reno, NV.



- Mark O'Dea, Fronteer Gold's President and CEO, commented: "People aside, if you've got the right projects you can raise money on them, you can generate momentum, you can generate interest and build value."
- U.S. House Republicans, led by House Budget Committee Chairman Paul Ryan (R-Wis.), pledge to cut more than \$32 billion (U.S.) from government agency budgets over the next few months. Independent budget analysts stated the figure represents an unprecedented rollback that would force some domestic government agencies to cut spending by as much as 20%. While Democrats immediately vowed to fight the proposal, calling it a short-sighted plan that would curtail many critical government services, a group of conservative Republicans is demanding even deeper spending cuts and vowing to offer a plan to eradicate \$100 billion (U.S.) from agency budgets when House leaders bring a spending bill to the floor of the House on February 14th. In a statement, Rep. Ryan commented: "Washington's spending spree is over. As House Republicans have pledged, the spending cuts will restore sanity to a broken budget process and return spending for domestic government agencies to pre-stimulus, pre-bailout levels."
- According to the Wall Street Journal, several State prosecutors are receiving assistance from an organized group of whistle blowers, amid a widening investigation into whether banks over-charged public pension funds by tens of millions of U.S. dollars for foreign exchange transactions. The whistle blowers, who are using Delaware shell companies to remain anonymous, are assisting with investigations into the issue by attorneys general in California, Virginia, Florida and Tennessee. The states are probing into whether certain American banks charged state pension funds the most expensive foreign exchange price during the day when a transaction occurred; rather than the rate the bank paid when the currencies were sold. John Galanek, chief operating officer of FX Transparency, commented: "Custodial banks, when left to execute standing-instruction trades as a principal, are not being policed (regulated)."
- The Labor Department reports U.S. non-farm payrolls increased by 36,000 in January, while the unemployment rate fell to 9% from 9.4% in December, citing the figures were affected by adverse "winter weather conditions and annual benchmark revisions"

	CLOSING LEVELS FOR FRIDAY, FEBRUARY 4TH.	WEEKLY CHANGE
Dow Jones Industrial Average	12,092.15	+ 268.45 points
Spot Gold Bullion (March)	\$1,349.10 (U.S.)	+ \$8.40 per ounce
S&P / TSX Composite	13,791.80	+ 354.20 points
10-year U.S. Treasury Yield	3.64%	+ 23 basis points
Canadian Dollar	101.24 cents (U.S.)	+ 0.56 cent

Ian A. Gordon, The Long Wave Analyst www.longwavegroup.com

Disclaimer : This information is made available by Long Wave Analytics Inc. for information purposes only. This information is not intended to be and should not to be construed as investment advice, and any recommendations that may be contained herein have not been based upon a consideration of the investment objectives, financial situation or particular needs of any specific reader. All readers must obtain expert investment advice before making an investment. Readers must understand that statements regarding future prospects may not be achieved. This information should not be construed as an offer to sell, or solicitation for, or an offer to buy, any securities. The opinions and conclusions contained herein are those of Long Wave Analytics Inc. as of the date hereof and are subject to change without notice. Long Wave Analytics Inc. has made every effort to ensure that the contents have been compiled or derived from sources believed reliable and contain information and opinions, which are accurate and complete. However, Long Wave Analytics Inc. makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any errors and omissions which may be contained herein, and accepts no liability whatsoever for any loss arising from any use of or reliance on this information. Long Wave Analytics Inc. is under no obligation to update or keep current the information contained herein. The information presented may not be discussed or reproduced without prior written consent. Long Wave Analytics Inc., its affiliates and/or their respective officers, directors or employees may from time to time acquire, hold or sell securities mentioned herein. In addition, the companies referred to herein may pay a fee to Long Wave Analytics Inc. to be listed on www.longwavegroup.com. Copyright © Longwave Group 2010. All Rights Reserved.

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