

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS



Monday, March 7th, 2011

Moody's Investors Service downgrades Greece's sovereign debt rating by three levels from Baa1 to B1 with a negative outlook, citing the government's difficulties with revenue collection and warning there

MONDAY, MARCH 7TH

is a risk that Athens might not meet the criteria for continued support from the European (EU) and the International Monetary Fund (IMF) beyond 2013, which may result in a voluntary restructuring of existing debt. Moody's warns: "the fiscal consolidation measures and structural reforms that are needed to stabilize the country's debt metrics remain very ambitious and are subject to significant implementation risks, despite the progress that has been made to date." In a strongly worded statement, Greece's Finance Ministry retorted: "the downgrade is completely unjustified because it does not reflect an objective and balanced assessment of the conditions Greece is presently facing. The downgrade underscores the misaligned incentives and the lack of accountability of credit rating agencies."

- A new report by the U.S. Government Accountability Office (GAO) recommends replacing the American one dollar bill with a coin similar to Canada's 'loonie,' citing the billions of dollars the U.S. would save by its implementation. Predictably, most Americans are skeptical of the proposal.
- As the crisis in Libya intensifies, according to the Financial Times, senior British military officers have advised U.K. Prime Minister Cameron to be wary of any involvement in a sustained military operation in Libya, because it would mean the U.K. would be unable to respond to any other security crisis which might erupt in the Middle East, i.e. in Bahrain or Oman, where the U.K. has much greater strategic interests

- Since Washington announced its freeze of Libyan assets last week, according to unnamed U.S. Treasury officials contacted by the Financial Times, American banks have uncovered \$32 billion (U.S.) of Libyan assets in the form of cash and securities, indirectly being held on behalf of foreign banks in what are termed sub-custody arrangements
- Figures reported by the Chicago Mercantile Exchange reveal that hedge funds and foreign exchange traders held short dollar positions totaling 281,088 contracts on March 1st. up from 200,564 contracts in the week ended February 22nd. See also, Winter Warning, September 22, 2008 – The Die Is Cast and The Flight to Folly
- In a Washington Post op-ed entitled America's Grim Budget Outlook, columnist Fareed Zakaria warns: "Look at the economic debate in Washington: We continue to avoid dealing with the large entitlement programs and the largest domestic giveaways, such as the tax deduction for mortgage interest. No tax increases, such as a value-added tax (VAT), or a gas tax, are even remotely possible. Instead, legislators make a show of cutting the budget by trumpeting the savings in the much smaller pie of discretionary spending, slashing education, infrastructure, science and other such programs. The net effect is that the United States will continue to massively subsidize consumption and starve investment. This is exactly the opposite of what history tells us produces long-term economic growth. The American economy is already far too focused on consumption and credit

... America's growth and prosperity over the past few decades have been consequences of major investments made in the 1950s and 1960's. Some of those are the interstate highway system; a public education system that was the envy of the world; massive funding for science and technology that produced the semi-conductor industry, large-scale computing, the Internet and the global positioning system. When we look back in 20 years, what investments will we point to that created the next generation of growth for the next generation of Americans?"

According to Bloomberg News, the Organization for Economic Cooperation and Development (OECD), in a survey of 28 advanced nations, only Chile and Mexico report a lower total tax burden than the United States. Measured against the size of the economy, U.S. federal tax revenue is at its lowest level since 1950. According to the White House, federal tax receipts in the current fiscal year are expected to equal 14.4% of gross domestic product (GDP). According to the Congressional Budget Office (CBO), that pales in comparison with the 40-year average of 18% of GDP. At present, Standard & Poor's (S&P) maintains a 'AAA' rating with a stable outlook on American sovereign debt (mostly U.S. Treasury notes and bonds) assuming the federal government will "soon reveal a credible plan to tighten fiscal policy ... which will require both expenditure and revenue measures." Harvard University economist Jeffrey Frankel, who advises the Federal Reserve Banks of Boston and New York agrees: "By the standard of U.S. history; by the standard of other countries; by the standard of where else are we going to get the money – increased tax revenues must be part of the solution." See also, Winter Warning February 15, 2011 – It's Still The Debt, Stupid

TUESDAY, MARCH 8TH

- The National Federation of Independent Business' U.S. confidence index rose to a reading of 94.5 in February – the highest level since December 2007 – citing increased hiring and sales expectations
- The National Association of Realtors reports U.S. existing home sales increased by 22% in January from October 2010, the biggest 3-month gain since the expiration of the home buyer tax credit in the spring of last year, citing buyer reaction to lower house prices

- Canada Mortgage and Housing Corp. reports the nation's seasonally adjusted annual rate of housing starts increased to 181,900 units in February from 170,600 units in January, citing greater activity in multi-family starts in Ontario and the prairie provinces
- The Alberta Court of Appeal rules against the federal government's proposal to create a national securities regulator, citing the legislation is unconstitutional and the federal government should negotiate a new regulatory regime rather than impose it on the provinces: "The proposed securities legislation would enter an area of regulation long occupied by the provinces, and long considered to be clearly within provincial jurisdiction. It is inconsistent with numerous prior decisions of the highest court delineating the division of power over specific industries. The proposed legislation would, if enacted, be unconstitutional." While the Quebec Court of Appeal has yet to release its decision, the Supreme Court of Canada has scheduled a hearing on the subject for April, and is expected to release its decision before the end of the year.
- According to preliminary numbers from the Congressional Budget Office (CBO), the U.S. Government recorded a deficit of \$223 billion in February, its largest monthly deficit in history – \$1.54 trillion (U.S.) annualized on a 5-month basis – illustrating just how absurdly, U.S. federal government spending has exploded. Simultaneously, according to the Daily Treasury Statement, the U.S. Treasury drew down its cash balance by \$81.6 billion (U.S.) in the first four days of March, leaving the federal government with a credit balance of only \$108.9 billion (U.S.).

WEDNESDAY, MARCH 9TH

- The Office for National Statistics reports the U.K. trade deficit narrowed to 7.06 billion pounds (\$11.4 billion U.S.) in January from a record 9.69 billion pounds in December, citing a record increase in exports and a decline in aircraft imports
- Greece's Statistical Authority reports the country's unemployment rate rose to 14.8% in December, up from 13.9% in November, citing a heavy toll taken by painful austerity measures. GSEE, Greece's largest labour union, decried: "We urge the government to take immediate steps to implement a different mix of economic policies ... away from policies that create unemployment, poverty and deprivation."

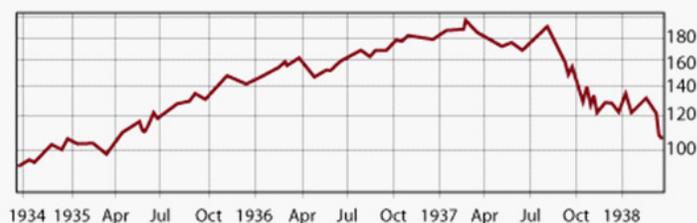
- According to new data from the U.S. Census Bureau, the population of Cleveland, Ohio has declined by 17% over the last decade to about 397,000 people. Cleveland was once America's fifth largest city with its population peaking at 915,000 in 1950.
- According the Center on Budget and Policy Priorities, Texas is one of 39 American states which have projected budget deficits for their 2012 fiscal years. The Lone Star State is facing a \$25 billion (U.S.) budget shortfall over the next two fiscal years, which state authorities plan to partially cover with \$10 billion (U.S.) of spending cuts in many areas, including education. Mark Williams, President of the Austin Independent School Board emphasizes: "We are cutting into the bone." Meria Carstarphen, a school superintendent in the same district laments: "This is almost unthinkable, that we in Texas, would be in a situation like this." In Texas, education is particularly vulnerable. It accounts for 55% of state spending compared to 25% for health care and 10% for public safety. Despite a statewide body of five million students, approximately 100,000 jobs are expected to be cut from public education. Scott Hochberg, Chairman of the Texas House Appropriations Subcommittee on Education warned: "In my position, I can suggest rearranging the deck chairs; but these are deck chairs on the Titanic."
- In a new staff study, the International Monetary Fund (IMF) warns: "The diagnosis and repair of financial institutions and overall asset restructuring are much less advanced than they should be at this stage. Confidence in financial systems is still highly dependent upon explicit and implicit central bank and government support. Governments have done little to force the write downs of bad assets, or use public money to remove them from banks' balance sheets. The expectation of future central bank support has increased moral hazard in the system by underwriting risky bank activity – a danger increased by greater concentration within the financial services sector." The staff study does not necessarily represent the views of IMF management; however its conclusions are likely to influence the IMF's advice in future financial crises.
- In a UK Telegraph op-ed entitled "EU Paralysis Drives Fresh Bond Rout", International Business Editor Ambrose Evans-Pritchard, cites political paralysis in Brussels and monetary tightening by the European Central Bank (ECB) has set off a fresh spasm of the euro zone bond crisis, pushing yield spreads on Portuguese, Irish and Greek bonds to post-EMU records. This week Portugal had to pay almost 6% to raise 2-year funds and the yield on 10-year bonds briefly surged to 7.8%, after the Chinese rating agency Dagong downgraded the country's sovereign debt rating to BBB (High). Portuguese Treasury Secretary Carlos Costa Pina warned: "These levels of interest rates are

not sustainable over time. An EU-IMF bailout is not justified. Portugal doesn't need external help, rather she needs urgent measures by the European Union to restore market confidence." David Owen from Jeffries Fixed Income commented: "The European Central Bank is playing (a game of) brinkmanship with European Union leaders, pressuring them to (devise) a grand solution to the debt crisis at (economic) summits this month. It is a dangerous game."

- Today, the reporting cast of CNBC is "celebrating" the two-year anniversary of the Dow Jones Industrial Average (DJIA) "bull run" from its March low of 2009. Comparably, as the chart below indicates, the Dow actually doubled from September, 1934 to October, 1936; then it topped out in March, 1937 and by March, 1938 lost all the gains it had gleaned in the previous three years. By 1939, U.S. Treasury Secretary Henry Morgenthau admitted to Congress: "We are spending more money than we have ever spent before and it does not work ... After eight years of this administration, we have just as much unemployment as when we started ... and an enormous debt, to boot." See also, Winter Warning, January 26, 2011 – The Economic and Financial Outlook for 2011.

If the Past is Prologue...

The Dow's performance, Sept. 1934–March 1938



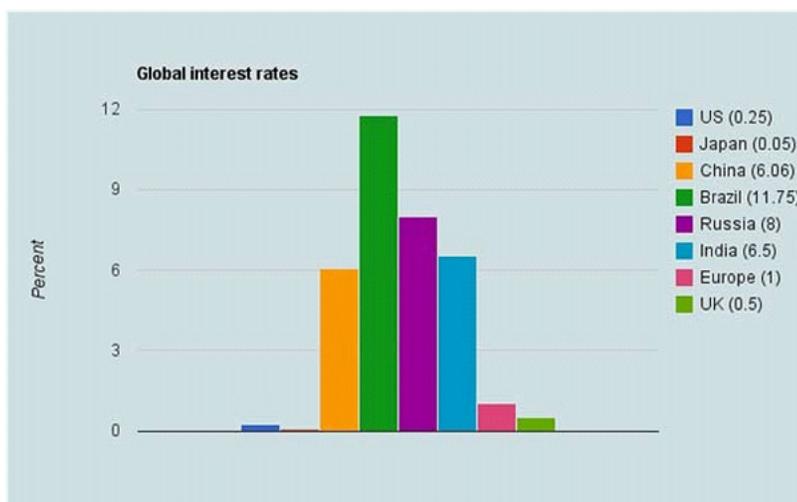
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THURSDAY, MARCH 10TH

- Moody's Investors Service downgrades Spain's sovereign debt rating to Aa2 from Aa1 with a negative outlook, citing: "fears that the restructuring of the nation's banks (cajas) will cost more than currently estimated by the government, which could further increase the public debt ratio. We also remain concerned about the government's ability to structurally improve its public finances given the limits of central government control over the regional governments' finances and expectations of 'only moderate' economic growth in the short-to-medium term."

- China posts a trade deficit of \$7.3 billion (U.S.) in February – the biggest deficit in seven years – more than offsetting January’s \$6.5 billion (U.S.) trade surplus. Wei Yao, China economist at Societe Generale in Hong Kong, commented: “One thing we are more certain about (from the data) is that China’s trade surplus is most likely to decline at a faster rate than anyone expected this year. A much smaller trade surplus for China means the external pressure for yuan appreciation would be lessened.”
- The Commerce Department reports the U.S. trade deficit widened by 15.1% to \$46.3 billion (U.S.) in January from a revised \$40.3 billion in December. Aichi Amemiya of Nomura Securities commented: “The combination of acceleration in stockpiling activity to meet stronger domestic demand and (the) price effect from higher commodity prices led to the stronger-than-expected growth in imports.”
- Bloomberg’s U.S. consumer comfort index declines to a reading of minus 44.5 in the period to March 6th. from the prior week’s level of minus 39.7, citing surging gasoline prices and continuing high unemployment levels
- The Labor Department reports U.S. claims for state unemployment benefits increased by 26,000 to 397, 000 in the week ended March 5th. while continuing claims declined by 20,000 to 3.77 million in the week ended February 26th.
- Statistics Canada reports the nation’s trade surplus narrowed to \$116 million (CAD) in January from a downwardly revised \$1.7 billion (CAD) in December, previously reported as \$3 billion (CAD); citing higher imports of automobiles and energy products. Canada’s trade surplus with the United States, the country’s largest trading partner, narrowed to \$3.8 billion (CAD) in January from \$4.3 billion in December, due partially to the premium level of the Canadian dollar.
- AOL Inc. announces 900 job layoffs worldwide, nearly 20% of its work force, partly to eliminate overlap stemming from its recent purchase of the Huffington Post
- Canada’s National Energy Board issues a public certificate of convenience and necessity for the Mackenzie Valley natural gas pipeline, after approval was granted by the federal cabinet. The project’s energy consortium will ultimately decide whether or not to build the 1,196 kilometer pipeline, estimated to cost \$16 billion (CAD). The consortium consists of Imperial Oil Resources Ventures; the Mackenzie Valley Aboriginal Pipeline (partnership with Trans Canada Corp.); Shell Canada; Conoco Phillips Canada and Exxon Mobil Canada Properties.
- By a vote of 53 to 42, the Republican-controlled Wisconsin Assembly passes an amended bill stripping nearly all collective bargaining rights from the State’s public workers. Governor Scott Walker announced he will sign the bill as quickly as possible: “I applaud all members of the Assembly for attending, debating the legislation and participating in democracy. Their action will save jobs, protect taxpayers, reform government and help balance the budget ...we will continue to focus on ensuring Wisconsin has a business climate that allows the private sector to create 250,000 new jobs.”
- The Bank of England’s Monetary Policy Committee (MPC) leaves its benchmark administered interest rate unchanged at 0.50% for the 25th. consecutive month. The Bank also left its 200 billion pound limit unchanged for its quantitative easing program. See chart below for current central bank administered rates – Canada is 1%.

Source: U.K. Telegraph



- U.S. Education Secretary Arne Duncan reports an estimated 82% of U.S. schools could be labeled as 'failing' under the nation's No Child Left Behind Act this year. The Department of Education estimates the percentage of schools not meeting yearly targets for their school's proficiency in mathematics and literacy could increase from 37% to 82%; as states raise standards to satisfy the mandate of a 2002 law requiring them to set targets for student proficiency by 2014 – a standard now considered to be wildly optimistic.

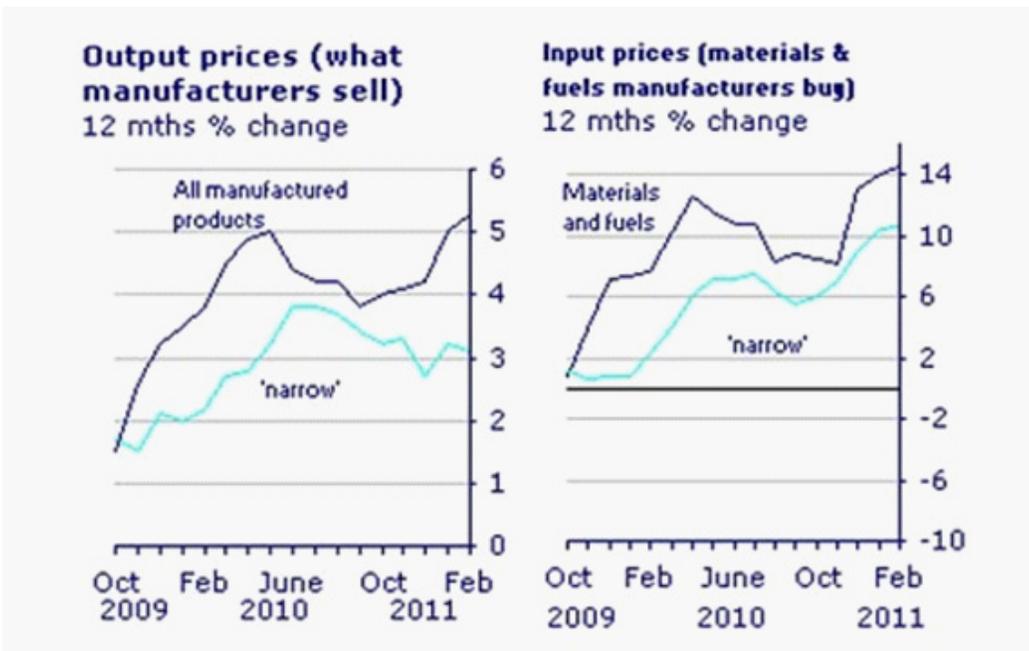
- The Thomson Reuters / University of Michigan preliminary index of U.S. consumer sentiment declined to a reading of 68.2 in March from a level of 77.5 in January
- Statistics Canada reports the nation's unemployment rate remained unchanged at 7.8% in February, as part-time employment rose but full-time employment declined; so the economy created only a net of 15,100 jobs. Doug Porter, deputy chief economist at BMO Nesbitt Burns, commented: "Underwhelming (news). If anything, the subdued nature of the report confirms that there is no need for policy makers to shift gears (and raise the Bank Rate), especially given the increasingly tumultuous global backdrop."

FRIDAY, MARCH 11TH

- The Commerce Department reports U.S. retail sales rose by 1% in February following a revised 0.7 increase in January, citing strong automobile sales and improved weather conditions
- Office for National Statistics data on U.K. producer prices from the manufacturing industry reveals input costs rose by a further 1.1% between January and February, causing the annual inflation rate to reach 5.3%, a 28-month high

CLOSING LEVELS FOR FRIDAY, MARCH 11TH.
WEEKLY CHANGE

Dow Jones Industrial Average	12,044.40	- 125.48 points
Spot Gold Bullion (April)	\$1,421.80 (U.S)	- \$8.40 per oz.
S&P / TSX Composite	13,674.25	- 578.52 points
10-Year U.S. Treasury Yield	3.41%	- 8 basis points
Canadian Dollar	102.77 cents (U.S.)	- 0.17 cent
U.S. Dollar Index Future (Spot Price)	76.734	+ 0.327



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