

UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS



Monday, December 26th

Front Page Headline, Wall Street Journal – “Japan Approves Record Budget Despite Debt Woes. The Japanese cabinet approves a 90 trillion yen (\$1.15 trillion U.S.) budget blueprint which includes record-high spending and bond issuance for the next fiscal

MONDAY, DECEMBER 26TH

Christmas Holiday in Canada, Great Britain and the United States

year ending March 31, 2013. At a budget news conference, Japan’s Finance Minister announced: ‘I think that Japan’s budget-drafting processes and their reliance upon public debt have reached their limits. I implore the electorate to allow us to raise the consumption tax and overhaul the tax revenue structure, to prepare for a budget situation which will only become more difficult in the coming years amid a continuously aging society.’ The proposed budget requires parliamentary approval and underscores the challenges faced by Prime Minister Yoshihiko Noda’s administration. Both the credit rating agencies and the International Monetary Fund (IMF) cite raising the sales tax is essential and the government has vowed to prepare a detailed plan by the end of December to double this tax within five years. However, worried about hostile voters and a fragile economy, many of the ruling and opposition lawmakers remain opposed to the initiative.”

- Front Page Headline, Financial Times – “French Unemployment Rate at 12-Year High. France’s labour ministry reports the nation’s number of registered jobseekers increased by 29,900 in November to reach 2.85 million, up by 1.1% on the month and 5.2% higher than a year ago. Separately, according to International Labour Organization (ILO) compliant data from the INSEE national statistics office issued on December 1st. the unemployment rate in mainland France rose to 9.3% in the 3rd. quarter from 9.1% in the previous three months.”

- Front Page Headline, Financial Times – “U.K. Gilt Yields Decline on Economic Recession Fears. The yield on 10-year U.K. government bonds, or gilts, declined to 1.99% then closed at 2.03% on Friday, the lowest level since the 1890’s. Bond yields, which have an inverse relationship with bond prices, have declined steadily during 2011 due to rising fears of an economic downturn and the Bank of England’s recourse to quantitative easing. Jonathon Portes, director of the National Institute of Economic and Social Research, an economic think-tank, commented: “Our current historically low level of interest rates is – just as in Japan – a sign of economic failure, not success.”
- Front Page Headline, Globe and Mail – “Spain to Slide into Economic Recession: New Minister. In a press release, Spain’s new Economy Minister Luis de Guindos forecasts: ‘Spain will slide back into an (economic) recession early next year, with the current quarter and the first quarter of 2012 both registering negative GDP growth. During that time, I expect the Spanish economy (the euro zone’s fourth largest) to contract by 0.2% or 0.3%.’ Mr. de Guindos took office last week as part of the new conservative Popular Party government.”

TUESDAY, DECEMBER 27TH

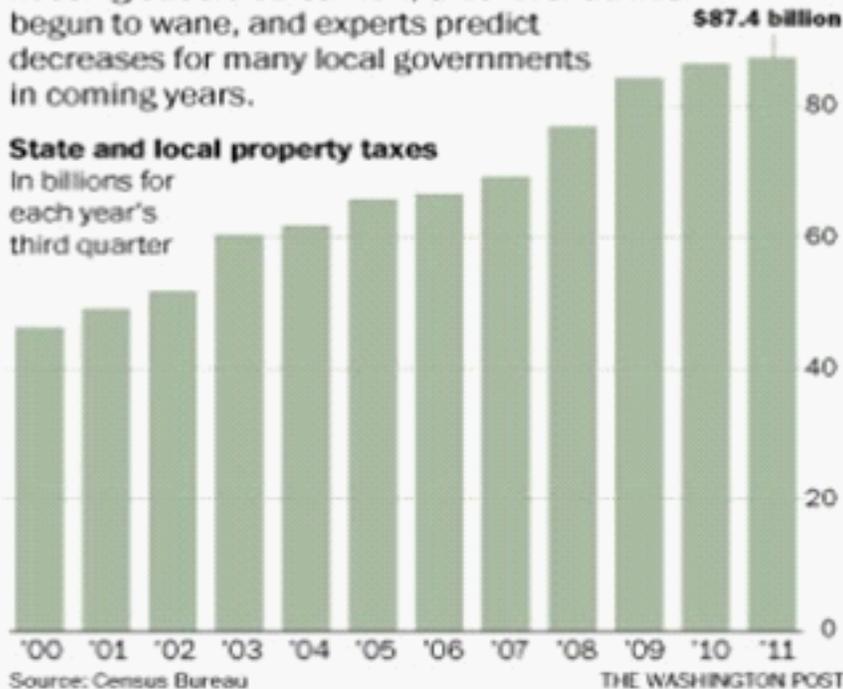
- Front Page Headline, Washington Post – “Falling Home Values Mean Budget Problems for Cities.”

Property taxes leveling off

Because of the lag time in assessments, among other factors, property tax revenue often takes years to catch up with the current economy. That means many municipalities saw tax revenue rise even after the housing bubble burst. Now, that revenue has begun to wane, and experts predict decreases for many local governments in coming years.

State and local property taxes

In billions for each year's third quarter



The City of Baltimore, Md. for example, collected \$815 million (U.S.) in property taxes during the most recent fiscal year, according to Bill Voorhees, Baltimore's director of revenue and tax analysis. Next year the figure is predicted to shrink to \$803.5 million (U.S.) and to \$729.4 million (U.S.) by 2015. Only in 2016 do City officials anticipate property tax revenues to increase again. Noting that Baltimore already faces a budget deficit in excess of \$50 million (U.S.) next year, Mr. Voorhees remarked: 'To be honest, I don't see any quick fixes over the next four or five years. Obviously, it means we have much lower property tax revenues than we had in the past. It's creating gaps in our budget ... It's a very large problem.'

- Front Page Headline, Daily Telegraph U.K. – "Treasury Outlines Plans for Euro Failure. The U.K. Treasury is drafting contingency plans for the possible disintegration of the euro that include capital controls. The preparations are being made only for a worst-case scenario and would complement similar capital controls across Europe, imposed to reduce the economic chaos of euro disintegration and to ease the transition to new currencies.

U.K. officials fear that if one member state left the euro, investors in both that country and other vulnerable euro zone nations would transfer their funds to safe havens abroad. Capital flight to countries such as Britain would strengthen sterling, dealing a blow to the government's plans to rebalance the economy towards exports."

- Front Page Headline, Daily Telegraph U.K. – "Brazil Overtakes Britain as World's Sixth Largest Economy. According to the Centre for Economics and Business Research (CEBR), the resource-rich Brazilian economy has grown on exports to China, unhampered by the 2008 financial crisis that has tempered economic growth in the U.K. CEBR chief executive Douglas McWilliams commented: 'Brazil has beaten the European countries at soccer for a long time, but beating them at economic is a new phenomenon. Our world economic league table shows how the economic map is changing, with Asian countries and commodity producing economies climbing up the league, while we in Europe fall back. However, over the next ten years, Britain is expected to fare better than France, which is currently the

world's fifth largest economy behind the U.S. at number one, China, Japan and Germany.”

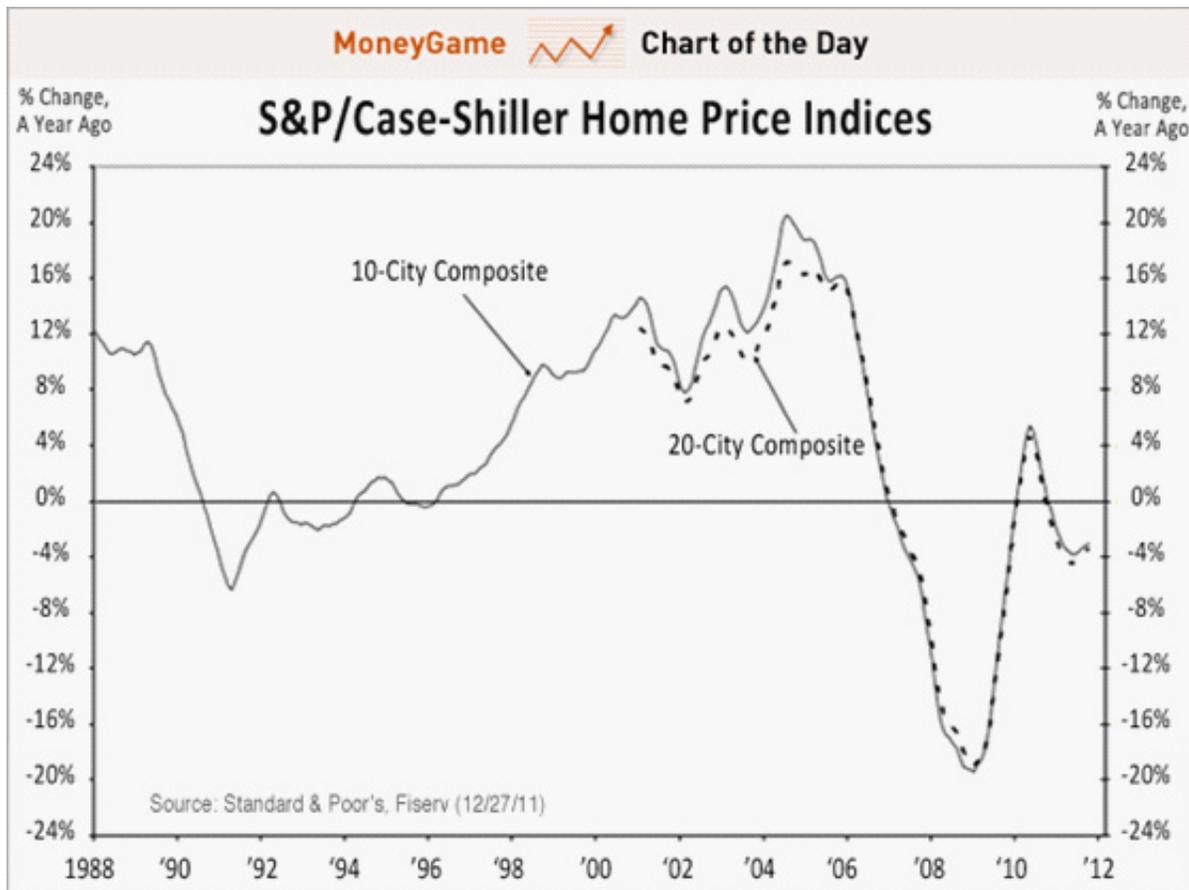


Source: Getty Images

- The S&P/Case Shiller index of property values in 20 U.S. cities declined by 3.4% in October on a year-over-year basis, indicating the American housing market continues to be negatively impacted by foreclosures. In an interview on Bloomberg Radio, Karl Case, co-creator of the index commented: “It’s a picture of

a market that’s attempting to return to equilibrium. Housing conditions vary widely across the country ... it’s quite segmented. Huge inventories (of foreclosures) exist that we’ve never really had before.”

- Front Page Headline, Bloomberg News – “Sears to Shutter Stores as Holiday Sales Decline. Sears Holdings Corp. announces the closure of 120 Kmart and Sears retail stores, generating \$140 million (U.S.) to \$170 million (U.S.) from sales of inventory and the leasing or sales of the locations. The Hoffman Estates, Illinois-based company will record total non-cash charges of \$2.4 billion (U.S.) in the 4th. quarter, related to a valuation allowance and goodwill impairment. In a press release, Sears’ Chief Executive Officer Lou D’Ambrosio elaborated: “Given our performance and the difficult economic environment, especially for big-ticket items, we intend to implement a series of actions to reduce on-going expenses, adjust our asset base and accelerate the transformation of our business model.”
- The New York- based Conference Board reports its U.S. consumer confidence index rose to a reading of 64.5 in December from a level of 55.2 in November



- The ESEE retail federation reports: “Greek retailers endured a Christmas gloom that chipped away any optimism they had before the holidays. Despite widespread price discounts, clothing and footwear sales dropped by 40%, electrical goods by 30% and sales in the food and beverages sector fell by 15%.” Greeks have been suffering wage and pension cuts, rising inflation and a recession now in its 4th. year, which in turn has slashed living standards and forced them to reduce spending.
- Front Page Headline, Agency France-Press – “U.S. to Reach Statutory Debt Limit in Early January. The U.S. Department of the Treasury reports the federal government is expected to arrive within \$100 billion (U.S.) of the \$15.2 trillion (U.S.) statutory debt limit by the end of December, leading to an imminent request for a \$1.2 trillion (U.S.) increase by President Obama, which would likely carry the government beyond the general elections in November, 2012.
- Front Page Headline, Daily Telegraph U.K. – “Nervous Banks Place 411 Billion Euros with ECB. Having borrowed 489 billion euros for a term of three years from the ECB a week ago, the same banks seem to be depositing 411 billion euros back with the European Central Bank for safety reasons. Banks will also be searching for ‘safe havens’ in an attempt to reduce their risk profile for year-end accounts.”
- The Ministry of Economy, Trade and Industry reports Japan’s industrial production declined by 2.6% in November, citing widespread floods in Thailand – a major production center for Japanese manufacturers – together with the continuing strong yen and a slowdown in economies abroad. The automobile, information and communications electronic-equipment sectors were among those most severely affected.

WEDNESDAY, DECEMBER 28TH



A statue of George Washington is pictured inside the U.S. Capitol Building. Source: Jewel Samad/AFP/Getty Images

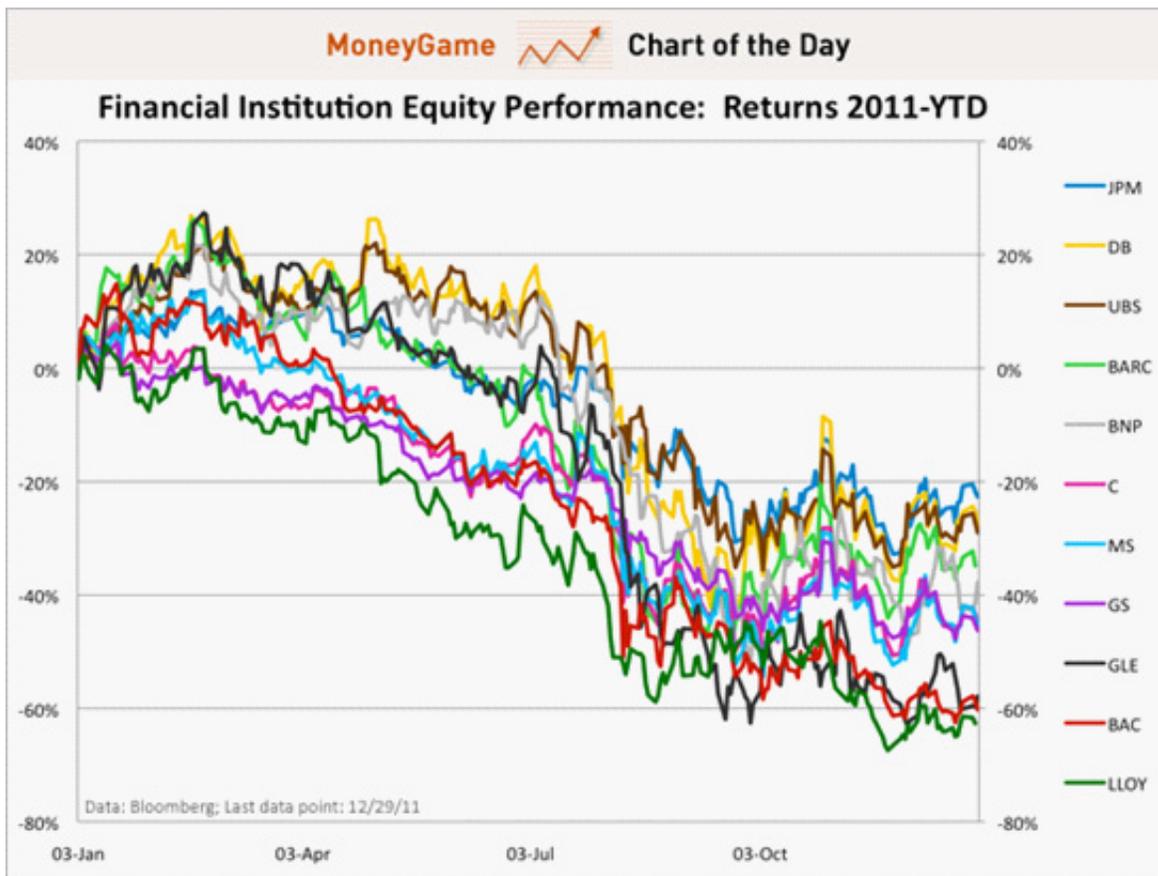
- Front Page Headline, Wall Street Journal – “U.S. Warns Iran on Strait of Hormuz. Tensions between Iran and America increase as the U.S. Navy warns it will prevent any attempt to close the Strait of Hormuz, as Iranian officials have threatened in response to the imposition of Western sanctions on its oil exports. A significant supply of the world’s energy – about 15 million barrels of oil daily – passes through the Strait, a narrow passage which connects the Persian Gulf to the Gulf of Oman. During the past week, several Iranian officials have commented on Iran’s capability and willingness to blockade the Strait if the West embargoes Iranian oil ... Within the next few weeks, U.S. President Obama is expected to sign new legislation prohibiting any business dealings with Iran’s central bank, through which Tehran executes most of its oil sales.

almost certain recession over the coming months for the region as a whole. Tim Congdon at International Monetary Research commented: ‘The message of these numbers is that the euro zone faces a bleak 2012, with inflation falling rapidly. There is a desperate need to restore growth to the banking system and boost the quantity of money.’

- Lloyds Banking Group – 61.22%
- BNP Paribas – 36.29%
- Bank of America – 59.45%
- Barclay’s – 33.31%
- Societe Generale – 58.49%
- UBS – 28.42%
- Goldman Sachs – 45.89%
- Deutsche Bank – 27.01%
- Morgan Stanley – 44.22%
- JP Morgan – 21.28%
- Citibank – 43.63 %

THURSDAY, DECEMBER 29TH

- Front Page Headline, Daily Telegraph U.K. – “Euro Zone Credit Crunch Fears on M3 Money Supply Contraction. Europe is at a mounting risk of a fresh credit crunch, after the euro zone broadly-defined money supply (M3) contracted for the second consecutive month in November. Credit to households and businesses has been flat for months and is now shrinking; signaling an



- The National Association of Realtors reports U.S. pending home sales rose by 7.3% in November, following a 10.5% gain in October, citing increased demand fuelled by continuing record low mortgage rates and declining home prices
- The Labor Department reports U.S. initial claims for state unemployment benefits increased by 15,000 to a seasonally adjusted 381,000 in the week ended December 24th. while continuing claims rose by 34,000 to 3.6 million in the week ended December 17th. The number of people who have exhausted their traditional benefits but are now receiving emergency or extended benefits under federal programs declined by about 7,800 to 3.5 million in the week ended December 10th.
- The Federal Statistics Office reports German consumer prices rose by 0.7% in December and 2.3% on a year-over-year basis, citing an increase in holiday-related travel and accommodation costs overshadowing modest declines in energy and fuel prices
- Front Page Headline, Bloomberg News – “Italy Auctions 7 Billion Euros of Bonds. The Italian Treasury auctions 2.5 billion euros of 2-year bonds and 2.5 billion euros of 10-year bonds at a yield basis of 5.62% and 6.98%, respectively. The Treasury also auctioned about \$2 billion euros of bonds maturing in 2018, for a total of 7.05 billion euros (\$9 billion U.S.). While the yield

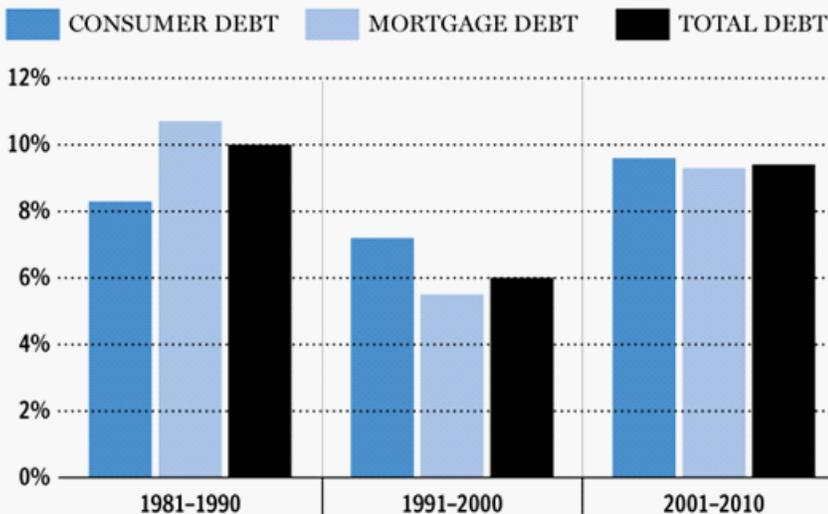
on the 10-year bonds was 58 basis points lower than an auction of a month ago, the total size of the auction fell 1.5 billion euros short of expectations. In a press conference following the auctions, Italian Prime Minister Mario Monti remarked: ‘Auctions held yesterday and today went rather well, but the financial turbulence absolutely isn’t over. To reassure investors further, most of the work needs to be done in Europe because the European Financial Stability Facility (EFSF) needs significantly greater resources.’ During 2012, Italy must raise almost 450 billion euros in the fixed income markets to refinance maturing treasury bills and bond issues.

FRIDAY, DECEMBER 30TH

- The U.S. Department of Justice Antitrust Division announces Beverly Hills, California-based CDR Financial Services, together with its founder/owner David Rubin, plead guilty to bid-rigging and fraud conspiracies related to contracts for the investment of municipal bond proceeds and other related municipal finance contracts. Mr. Rubin – the sole shareholder of CDR – entered a guilty plea on his own behalf, as well as the firm’s behalf to one count of wire-fraud and two counts of conspiracy. Mr. Rubin faces a possible maximum of 20 years in prison on the wire-fraud conviction.

*HOW HOUSEHOLD
INDEBTEDNESS IS INCREASING*

**ANNUAL GROWTH RATES OF TOTAL HOUSE DEBT
COMPOUND AVERAGE**



SOURCE: CMHC, ADAPTED FROM STATISTICS CANADA

ANDREW BARR / NATIONAL POST

- Front Page Headline, Financial Times – “Foreign Central Banks Reduce Holdings of U.S. Treasurys. According to recent data from the U.S. Federal Reserve, holdings of U.S. Treasurys by foreign central banks have declined by \$69 billion (U.S.) in December
- In its annual Housing Observer report, Canada Mortgage and Housing Corp. (CMHC) warns: “It is important that Canadian consumers and stakeholders continue to be vigilant in monitoring both the magnitude, as well as the composition of household debt. While most Canadians could absorb some level of economic adversity, owing to the high quality of mortgage credit in Canada, the substantial equity position of most Canadian homeowners and households’ ability to adapt their discretionary spending. However, household financial vulnerability remains a serious issue which merits close attention going forward.”
- Front Page Headline, Daily Telegraph U.K. – “Standard Chartered Warns: Euro Zone Closer to Dissolution. Peter Sands, Chief Executive Officer of Standard Chartered – one of Britain’s ‘big five’ banks – warns: ‘We enter 2012 with a very difficult outlook for the euro zone and with an increasing possibility of countries actually leaving the euro zone. Nobody should un-

derestimate the (economic) significance of such an event, because it would be very difficult to manage the contagion risk, even it were only Greece. That would have ramifications all over the world ... because the simple math is the euro zone is a very large part of the global economy and if it is going slower, then economic trade would be slower around the world; also just from a confidence perspective. I think the probability of countries leaving the euro zone has increased because we have witnessed several successive plans announced to solve the (debt) problem of the euro zone which simply haven’t convinced the market. Ultimately, the current structure, shape and scope of the euro zone will only work if the (fixed income) market believes it’s worth supporting. We are in a path-dependent problem, wherein the solutions available at any one time are not necessarily available at the next step. So, I think that the solutions base has narrowed because we have missed opportunities.”

- Front Page Headline, Washington Post – “Federal Gravy Train for Greater D.C. Economy Nears End. In an op-ed, columnist Steven Pearlstein refers to a recent study by Stephen Fuller, a colleague at George Mason University and an authority on the D.C. area economy: ‘Since 2007, the District of Columbia’s economy has grown by about 14 per cent – at a time when the



national economic growth has been about 3 per cent – the result of rapid increases in spending by the federal government. Over the past decade, federal employment has increased by 50,000 ... More significantly, federal procurement spending grew by 166% to \$80 billion (U.S.). With less than 5% of the nation's population, the D.C. region captures 17% of the federal payroll and 21% of the procurement dollars, helping make greater Washington one of the wealthiest regions in the country.”

Closing Levels for Friday, December 30th.		Weekly Change	Annual Change
Dow Jones Industrial Average	12,217.56	– 76.44 points	+ 640.06 points
Spot Gold Bullion (February)	\$1,566.80 (U.S.)	– \$39.20 per oz.	+ \$145.40 per oz.
S&P / TSX Composite	11,955.09	+ 28.42 points	– 1,488.11 points
10-Year U.S. Treasury Yield	1.88%	– 14 basis points	– 141 basis points
Canadian Dollar	98.33 cents (U.S.)	+ 0.37 cent	– \$.023 cen
U.S. Dollar Index Future (Spot Price)	80.205 cents	+ 0.211 cent	+ \$1.215 cent
WTI Crude Oil (February)	\$98.83 (U.S.)	– \$0.85 per barrel	+ \$7.45 per barrel

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

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