

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

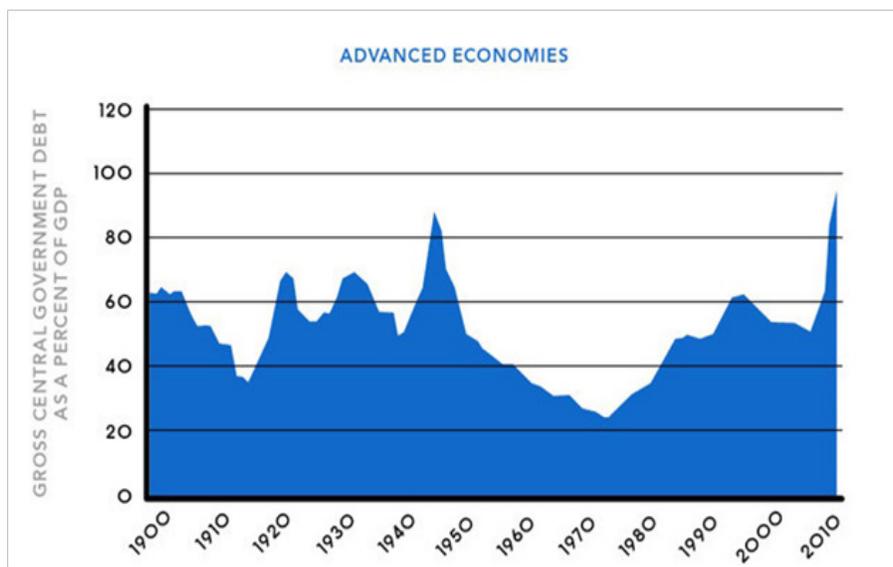


Monday, March 12th
Front Page Headline
Bloomberg News – “Financial
Repression Has Returned to
Stay.”

MONDAY, MARCH 12TH

- In a recent article, Carmen Reinhart (a senior fellow at the Peterson Institute for International Economics in Washington and co-author of ‘This Time Is Different: Eight Centuries of Financial Folly’) expounds: ‘As they have before in the aftermath of financial crises or wars, governments and central banks are increasingly resorting to a form of ‘taxation’ which helps liquidate the huge overhang of public and private debt and eases the burden of servicing that debt. Such policies, known as financial repression, usually involve a strong connection between the government, the central bank and the financial sector. At present, in the United States as in Europe, this means consistent negative real interest rates (yields less than the rate of inflation) that are equivalent to a tax on bondholders and more generally, savers.

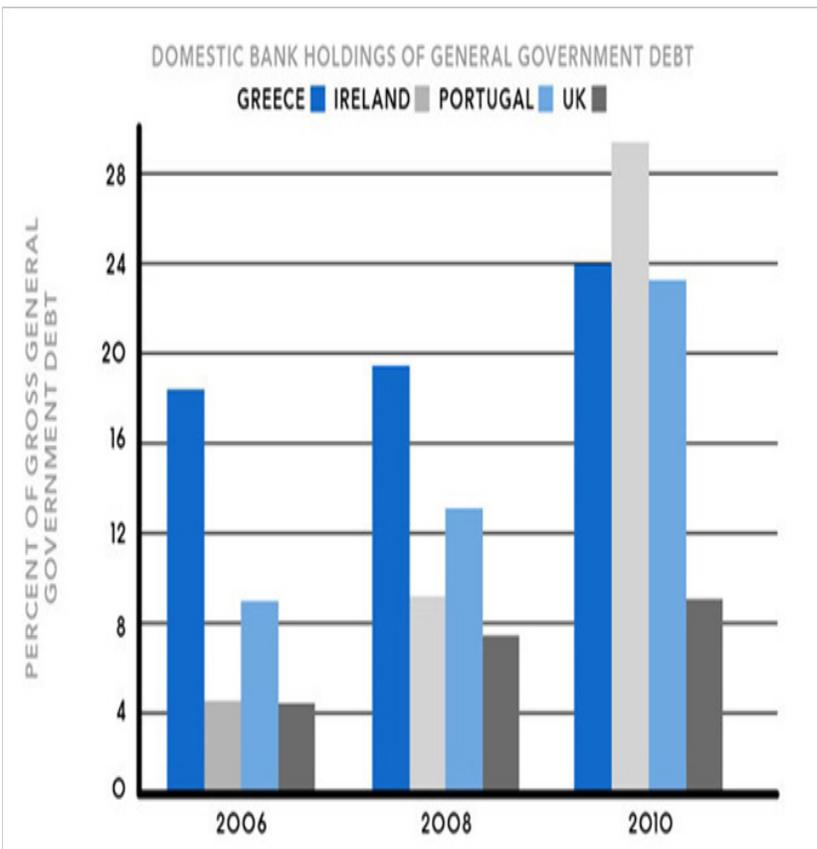
In the past, other measures also included directed lending to the government by captive domestic entities (such as banks or pension funds), explicit or implicit caps on interest rates, regulation of cross-border capital movements, and generally, a tighter coordination between governments and banks; either explicitly through public ownership of some institutions, or through heavy ‘moral suasion’ by officials. Central banks in both developed and developing countries are being subjected to complementary pressures. Increasingly, emerging markets may look to financial regulatory measures to keep international capital ‘out’ (especially given the expansive monetary policy stance pursued by the U.S. and Europe). Meanwhile, advanced economies have incentives to keep capital ‘in’ and create a domestic captive audience to absorb the financing for the high existing levels of public debt.



Source: Reinhart and Sbrancia – 22 Advanced Economies (2011)

Throughout history, debt-to-GDP ratios have been reduced in five ways: economic growth, substantive fiscal adjustment or austerity plans, explicit default or restructuring of private and/or public debt, a surprise burst in inflation and a steady dose of financial repression, which is accompanied by an equally steady dose of inflation. It is critical to note that the last two options – inflation and financial repression – are only viable for domestic currency debts (the euro area is a special hybrid case) ... Concerned about potential overheating, rising inflationary pressures and the related competitiveness issues, emerging-market economies may continue to welcome the changes in the regulatory landscape that keep financial flows at home. Indeed, this trend is already well under way. This concern means advanced and emerging-market economies are finding common cause in increased regulation and/or restrictions on international financial flows and more broadly, the return to more tightly regulated domestic financial environments. This scenario entails both a process of financial deglobalization (the reappearance of home bias in finance) and the re-emergence of more heavily regulated domestic financial markets.

- The Statistics Bureau reports Australian home mortgage approvals declined by 1.2% in January, the first drop in 10 months, as employment growth in the nation's mining-driven economy stagnates. Separately, the National Australia Bank's business confidence index declined to a reading of 1 in February, following a level of 4 in January, the lowest reading since September, 2011.
- Front Page Headline, Bloomberg News – "EU Urges Spain to Make Deeper Deficit Cuts. Ten days after Spain's Prime Minister Mariano Rajoy unilaterally raised the deficit target to 5.8% of GDP, European governments urge Spain to prune an additional 0.5% of gross domestic product out of the 2012 budget. Spain has already affirmed a target of reaching the EU's 3% limit of GDP in 2013. Luxembourg Prime Minister Jean-Claude Juncker informed reporters: "That pledge is far more important. That is the main figure that should be kept in mind."



Source: Kirkegaard and Reinhard – Domestic Bank Holdings (2011); IMF and World Economic Outlook

Elevated levels of public debt in the United States and elsewhere will probably be the most enduring legacy of the post 2007 financial crises. For the advanced economies, public debts hadn't neared these levels since the end of World War II."



Spain's Prime Minister Mariano Rajoy

Source: Jock Fistick/Bloomberg

- Front Page Headline, Daily Telegraph U.K. – "Global Liquidity Peak Spells Trouble for Second Half of 2012. The global liquidity cycle has already rolled over. Assuming that no new (stimulus) action is taken, world economic growth will peak within a couple of months and then fade in the second half of the year. Data collected by Simon Ward at Henderson Global Investors reveals that M1 money supply growth in the big G7 economies and leading E7 emerging powers buckled over the winter. Known as the six-month real narrow money gauge, M1 peaked at a 5.1% growth rate in November. It dropped to 3.6% in January and to 2.1% in February ... Mr. Ward commented: 'The speed of the decline is worrying. This (metric) acts with a six month lag time, so we can expect global growth to peak in May. There may be a sharp (economic) slowdown in the second half.' This may be a nasty surprise to the equity markets, hoping that America has reached 'escape velocity' and that Europe will suffer only a light

- Front Page Headline, The Slog/Zero Hedge – “Uncertainty Persists as New Greek Sovereign Liabilities Surface. There are signs that Germany, the United States and the International Monetary Fund (IMF) retain their doubts about the latest Greek bailout ‘salvation.’ There are bank bonds, Hellenic Railway bonds, Urban Transportation bonds et al that are guaranteed by Greece. We also note that there are bonds tied to Inflation, Floating Rate Notes, Asset-Backed Securities and a whole mélange of other structured products possessing a Greek sovereign guarantee. What we all thought was (bailout) fact is now clearly fiction and default will now reveal a debt ‘acceleration’ that one could reasonably assume, in all kinds of these securitizations and in all kinds of currencies. This could emanate from the rating agencies placing Greece in ‘default,’ or arise from the Credit Default Swap (CDS) contracts being triggered depending upon each indenture; and we also note that a great many of these off balance sheet securitizations are governed by English law and not Greek law. One may also wish to consider the fallout to the (European) banking system, since the lead managers of all these issues could find themselves behind the eight ball, as various clauses trigger and as the holders of these securitizations line up at the judicial bench.”
 - Front Page Headline, Daily Telegraph U.K. – “Quantitative Easing, Austrians, Ron Paul and the Bank of England. In a recent op-ed, Assistant Editor Jeremy Warner writes: ‘The immediate financial crisis of a few months ago has abated somewhat, but in other respects, the outlook has been clouded further. The European Central Bank (ECB) has both reduced its (GDP) growth forecast and increased its inflation (rate) forecast ... Both of these factors will negatively impact (economic) growth, so ECB monetary policy is (left idling) in neutral. It’s a similar picture at the Bank of England where monetary policy is in a state of paralysis. However, that hasn’t stopped the National Association of Pension Funds (NAPF) from complaining bitterly about the ongoing damage quantitative easing (QE) is doing to U.K. pension funds. According to the NAPF, QE has added 90 billion pounds to (pension fund) deficits. Critics of QE do have a point, since it has succeeded in generating a bizarrely negative real rate of interest, which is plainly very bad for savers and has been occurring for some time now. The effect is to bring a net transfer of wealth from savers to borrowers or from the thrifty to the profligate. Morally, this is difficult to justify ... So, when people say that QE is unfair, yes it is, but that unfortunately, is the intention. Rather, as Paul Tucker, Deputy Governor of the Bank of England, cited to the Commons Treasury Select Committee last week, if the Monetary Policy Committee were to begin worrying about the effect of its policy on every interest group, it would never do anything. While I doubt that his audience had any idea what he was talking about when Ron Paul, U.S. (Republican) presidential candidate, declared that ‘we are all Austrians now,’ you have to be a true believer in that particular school of economics to think that doing nothing at all would actually have some merit. Would the world be any worse off without central banks? Well, they don’t seem to have done too well in recent years.”
- ### TUESDAY, MARCH 13TH
- The Commerce Department reports U.S. retail sales rose by 1.1% in February, following a 0.6% gain in January, citing broadly based sales at auto dealerships and clothing stores
 - In a statement released following a regularly scheduled meeting, the Federal Open Market Committee (FOMC) asserted: “The U.S. unemployment rate has declined notably in recent months, but remains elevated. Strains in global financial markets have eased, although they continue to pose significant downside risks to the economic outlook.” Separately, the Federal Reserve reported that 15 of the 19 largest U.S. banks could maintain adequate capital levels even in a severe recession, which assumes they keep paying dividends and buying back stock.
 - Front Page Headline, Globe and Mail – “Fitch Lifts Greece Out of Default Rating. As expected, Fitch Ratings affirmed: ‘Greece is no longer in default, but slow (structural) reforms, (economic) recession and political uncertainty could steer it back towards bankruptcy. The agency considers that significant and material default risk remains, in light of the still very high level of indebtedness ... and the profound economic challenges faced by Greece. We are assigning Greece a speculative ‘B’ (Low) rating.’ Despite the recent sovereign debt exchange, which enabled Greece to reduce its national debt by about 100 billion euros (\$130 billion U.S.), the new rating still places Greek government bonds in junk territory.
 - Front Page Headline, Globe and Mail – “China’s Rare-Earth Minerals Monopoly Challenged. As the risk of a global shortage of rare-earth minerals increases, the United States, Japan and the 27-country European Union file a complaint with the World Trade Organization (WTO) against China’s export restrictions and duties on metals, including 17 rare-earth minerals, which are used in the manufacture of electronics and high-tech products. The rare-earth minerals are valued for their indigenous properties of strength, magnetism and luminescence. China possesses about one-third of the planet’s rare earths, yet controls more than 90% of global production. In a televised Washington speech, U.S. President Obama stated: ‘American manufacturers require access to rare earth materials which China

produces. If China would simply let the market work on its own, we'd have no objections. However, their current policies are preventing that from happening and they go against the very (WTO) rules which China agreed to follow."

- Front Page Headline, National Post – "Russian Trade 'Priority.' But Why? The (Canadian) federal government is planning a trade mission to Moscow and St. Petersburg in June, to be led by International Trade Minister Edward Fast. According to a statement issued by Mr. Fast's department, the world's biggest country has been identified as a 'priority market' with significant potential benefits. Bilateral trade between the two countries reached \$2.5 billion (CAD) in 2009, less than 1% of Canada's total international trade ... Most of Russia's economic growth is happening around the oil and gas sector, the country's most important foreign exchange earner ... In fact, much of Canada's exports to Russia consists of oil and gas extraction technology, mining equipment and agricultural machinery. Chris Sands, a fellow at the Hudson Institute, a Washington, D.C.-based think-tank exhorted: 'Canada has a global reputation for sophisticated energy-extraction expertise and that's partly what the federal government is hoping to sell.' At Long Wave Analytics, we note that Vladimir the Terrible has recently been re-elected President of Russia – most likely for two 6-year terms – in what Mr. Sands agrees was 'one of the most sham elections on record.' Mr. Putin and his Russian oligarch / Stasi style police friends have well established reputations for theft (Google: Mikhail Borisovich Khodorkovsky) and for murder (Google: Sergei Magnitsky) along with several Russian journalists over the years. It is the height of naivety and ignorance for a Canadian Minister of International Trade, Mr. Edward Fast, to allow himself to be intimidated by Vladimir the Terrible and then legitimize his presidency and regime with a trade mission in June. This represents a huge embarrassment for Canada and an enormous insult to the Canadian electorate. Wakeup call for Mr. Fast and Canadian Prime Minister Stephen Harper: Western countries will rue the day they allowed Russia to join the World Trade Organization last year. Under Mr. Putin's direction, Russia's financial/economic and political systems cannot be trusted. The Kremlin leopard is not about to change his spots – and the Russian people know it.

WEDNESDAY, MARCH 14TH

- The Commerce Department reports the American current account deficit widened to \$124.1 billion (U.S.) in the 4th. quarter of 2011, the largest in three years. The deficit, which includes government revenues and transfers, rose by 15% from a revised \$107.6 billion (U.S.) shortfall in the 3rd. quarter. Separately, the Labor Department reports U.S. import prices rose by only 0.4%

in February, reflecting the biggest decline in food costs in three years.

- Front Page Headline, New York Times – "Goldman Sachs Employee Criticizes Firm. In an op-ed, Greg Smith, an executive director at Goldman Sachs, cites the reasons he is tendering his resignation at the Wall Street firm after almost 12 years of employment. 'To put the problem in its simplest terms, the interests of the client continue to be sidelined in the way the firm operates and thinks about making money ... It might sound surprising to a skeptical public, but culture was always a vital part of Goldman Sachs' success. It revolved around teamwork, integrity, a spirit of humility and always doing right by our clients. The culture was the secret sauce that made this place great and allowed us to earn our clients' trust for 143 years. It wasn't just about making money; this alone will not sustain a firm for so long. It had something to do with pride and the belief in the organization. I am sad to say that I look around today and see virtually no trace of the culture that made me love working for this firm for many years. I no longer have the pride, or the belief.'" Nice to see Goldman still 'doing God's work!' See Economic Winter, For the Love of Money, February 15, 2010.
- Front Page Headline. Daily Telegraph U.K. – "Fitch Lowers Britain's 'AAA' Credit Rating Outlook to Negative. The revision of the rating outlook to Negative from Stable reflects the very limited fiscal space to absorb further adverse economic shocks in light of such elevated debt levels and a potentially weaker than currently forecast economic recovery. In light of the considerable uncertainty around the economic and fiscal outlook, including the risks posed to economic recovery by ongoing financial tensions in the euro zone and against the backdrop of a still large structural budget deficit and high and rising government debt, the Negative Outlook indicates a slightly greater than 50% chance of a rating downgrade over a two year horizon. The triggers that would likely prompt a rating downgrade are as follows:
 - Discretionary fiscal easing which resulted in government debt peaking later and higher than currently forecast;
 - Averse shocks that implied higher levels of government borrowing and debt than currently projected;
 - A material downward revision of the assessment of the U.K.'s medium-term economic growth potential.

Conversely, economic and fiscal performance in line with Fitch's baseline expectations with general government gross debt peaking at around 94% in 2014-15 would result in the stabilization of the rating Outlook. In the absence of adverse shocks, Fitch doesn't expect to resolve the Negative Outlook until 2014."

- Front Page Headline, The Privateer – “The Real Danger Lies Here. On March 1st, Bloomberg reported that the central bank of Israel is beginning a ‘pilot program’ to invest a portion of its foreign currencies in U.S. equities. The initial investment is for 2% of reserves to be shoveled into the New York Stock Exchange. This amount is planned to rise to 10% of reserves. The report continues to state that Israel is not alone. Several other major central banks have been putting a gradually increasing proportion of their reserves into the world’s stock markets since 2010. As an example of this, the Swiss central bank recently announced that at the end of the third calendar quarter of 2011, it had 9% of its reserves in various equity markets ... Central banks in the U.S. and everywhere else are desperate to prop up the valuations of the paper for which they are seen to be responsible, as lenders of last resort. This means that they cannot allow any of the paper markets to fall. It also means that they are moving directly into stock markets all over the world. Their goal is to repeal the boom and bust cycle. The problem is that they are trying so hard to recreate the (global economic) boom that they are piling up the fuel for the bust to end them all.”

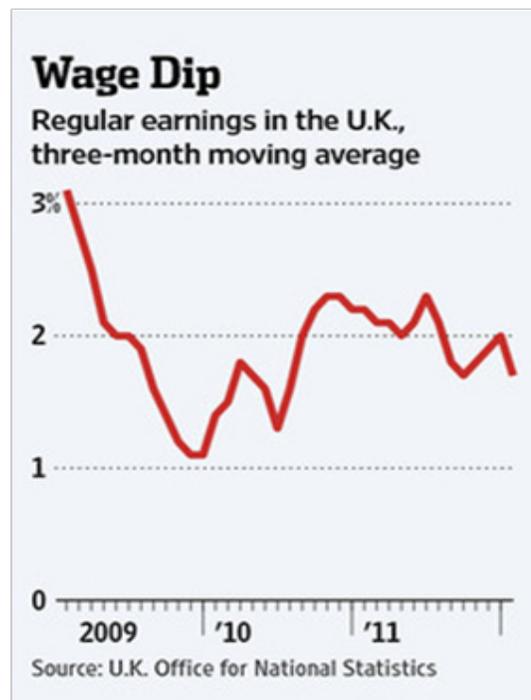


A pedestrian passes a London shop which is going out of business. Source: Associated Press

Rising unemployment is keeping a lid on salary increases with regular pay (excluding bonuses) rising 1.7% in the three months to January on an annual basis, 0.3% lower than the previous three month period. According to the Wall Street journal, muted wage growth is a sign the Bank of England has plenty of room to maintain its accommodative monetary policy, but with wages rising at less than half the rate of inflation, the likelihood of a quick recovery in consumer spending remains remote.

THURSDAY, MARCH 15TH

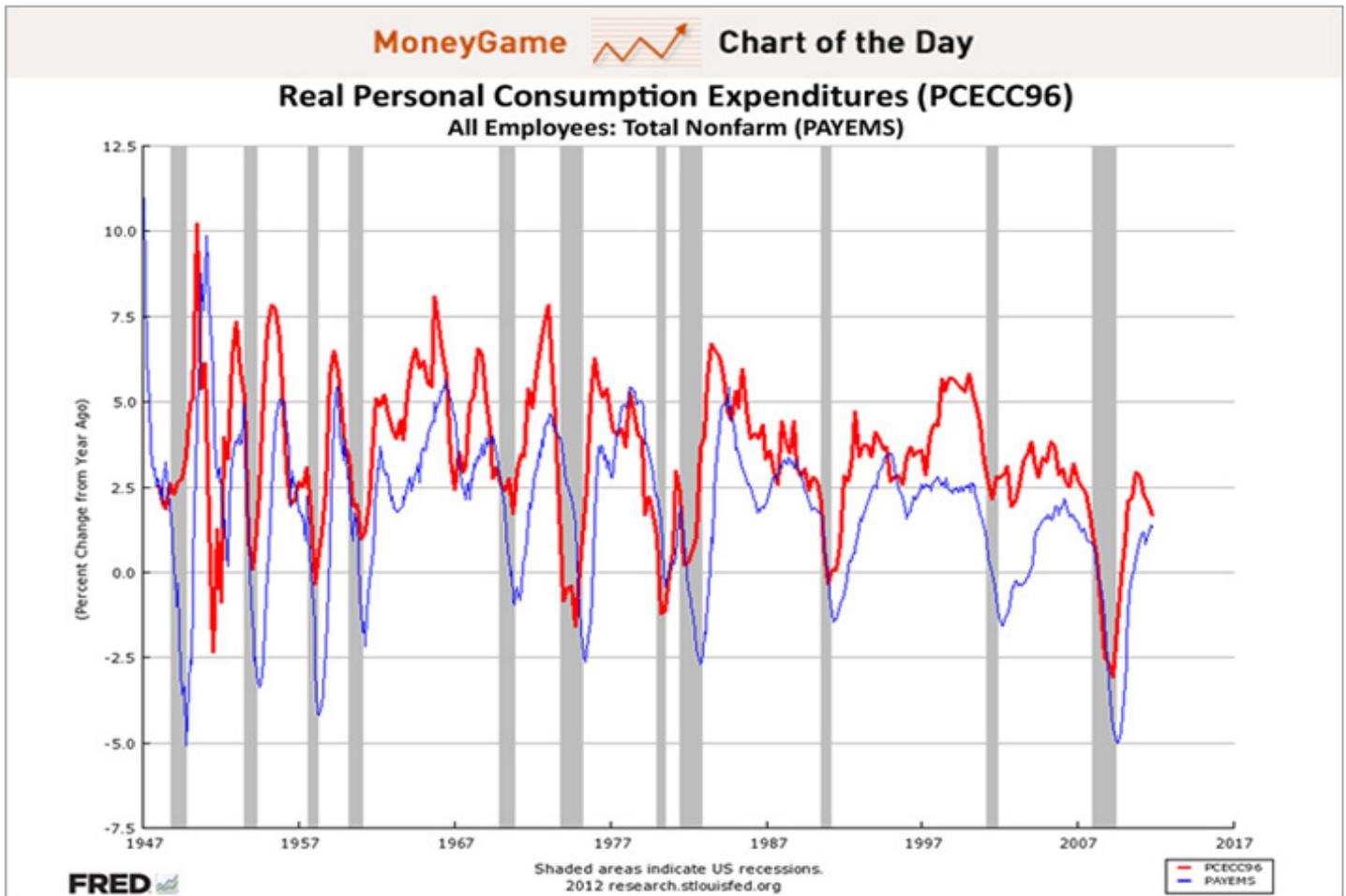
- Irvine, California-based Realty Trac Inc. reports U.S. foreclosure filings declined by 8% in February – the smallest year-over drop since October, 2010 – as a total of 206,900 homes received notices of default, auction or repossession
- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 14,000 to 351,000 in the week ended March 10th. while continuing claims fell by 81,000 to 3.34 million in the week ended March 3rd. Those people who have exhausted their traditional benefits but are now receiving emergency or extended benefits under federal programs declined by about 73,900 to 3.33 million in the week ended February 25th.
- The National Statistics Office reports U.K. public sector employment declined by 37,000 in the 4th. quarter of 2011 and by 270,000 on an annual basis.



- Front Page Headline, The Privateer – “The Real Danger Lies Here (2). While the non-official segment of the investment world has for some time been concerned with a return of its capital, the world’s central banks remain concerned with a rate of return on its capital. The official ‘haircut’ in Greek sovereign debt has shaken the official investment world badly. The Fed’s latest report on foreign central bank holdings of U.S. Treasury debt acknowledges what most have long known. China is accelerating its move out of U.S. Treasuries. Over the last half of 2011, Chinese central bank holdings of U.S. Treasuries declined by an official \$150 billion (U.S.), or by 12%. According to the latest Fed figures, China’s holdings of U.S. Treasuries declined by \$100 billion (U.S.) in December 2011 alone. The trading range of U.S. Treasuries looks positively terrifying. Foreign ‘demand’ for U.S. debt (Treasuries) is declining and will continue to decline. What is not declining is the rate at which the amount of U.S. debt is increasing.”

FRIDAY, MARCH 16TH

- In a preliminary report for March, the University of Michigan/ Thomson Reuters index of U.S. consumer confidence declined to a reading of 74.3 from a level of 75.3 in February, citing higher gasoline prices as a major concern. Paul Dales, a senior economist at London-based Capital Economics commented: “U.S. households are balking at higher gasoline prices ... more than offsetting the continuing rally in equity prices.”
- The Labor Department reports the U.S. consumer price index rose by 0.4% in February, citing 80% of the increase was due to higher gas prices. Benjamin Reitzes, an economist at BMO Capital Markets in Toronto commented: “There are worries from the energy prices perspective, but ... most people realize the increase will probably be transitory.”



Source: Business Insider Money Game

- According to the Business Insider, the Economic Cycle Research Institute (ECRI) currently maintains a bearish outlook for the U.S. economy. ECRI co-founder Lakshman Achuthan provided a deeper look at exactly how WCRI makes its predictions, relating that it focusses on year-over-year (economic) indicators for output, employment, income and sales and the consumer confidence index. Mr. Achuthan elaborated: "In particular, the relationship between year-over-year consumption and employment is perhaps the clearest signal that the U.S. is heading back into a recession. People must understand the sequence. I think the hope is that job growth will increase consumption in the coming months; but in point of fact, (economic) growth follows consumption ... There are many instances where job growth precedes a recession." In the above chart of these two indicators, it is clear that in the past, U.S. (economic) recoveries have virtually relied upon consumption growth ... and currently, that consumption growth is slowing down.
- Front Page Headline, Globe and Mail – "An Architect of Putin's Rise Refutes His Creation. In a Moscow interview with Globe reporter Mark MacKinnon, political consultant Gleb Pavlovsky relates that he used to be proud of what he created. Long considered the Karl Rove of the Kremlin, he saw himself as helping deliver Russia from its chaotic 1990s to what he called 'managed democracy' – a political system designed to avoid political upheaval and restrict the choices Russian voters could make. Mr. Pavlovsky and a group of other top political consultants created a cult of personality around Vladimir Putin – who 12 years ago seemed to embody the stability Russians were craving after the tumult of the Boris Yeltsin era – and then helped the Kremlin take control of the media and sideline the political opposition. Initially, it was known as the Putin Project. It's a system he is now fighting to bring down. Mr. Pavlovsky elaborates: 'It's like those who work on designing a weapon. These weapons can end up in the wrong hands, or be used the wrong way. Are you responsible because you made the weapon? The system was supposed to be temporary ... but the further it went the more human passion came into play. I should have read more Plato. Putin was a reasonable man in the beginning. I thought he was smart enough not to make the mistakes he's making now. Eventually, Mr. Putin stopped listening to me, depending more on advice from an inner circle of allies. After 12 years in power, those elites are now billionaires, with much to lose – and fear – if Mr. Putin were to be replaced as the country's ultimate authority. I believe that these men, many of whom share Mr. Putin's background in the security services (former KGB), convinced Mr. Putin he needed to return to the Kremlin after a four-year term in the theoretically subordinate post of prime minister. Throughout Mr. Putin's first eight years in the Kremlin, I was seen as the mastermind of a scorched earth strategy that left the fledgling politician with no

serious rivals.' The media was pried out of the hands of the powerful oligarchs who had wielded so much influence under Mr. Yeltsin and like other key companies and industries, were effectively re-nationalized. Those who opposed Mr. Putin were marginalized, forced into exile, or – as in the case of tycoon Mikhail Khodorkovsky, who ignored Mr. Putin's warnings to stay out of politics – jailed. Something resembling law and order was restored and the country rebounded economically, during Mr. Putin's early years in office. Most Russians applauded, rewarding Mr. Putin with 70% approval ratings. Mr. Pavlovsky continues: 'Things started unravel in 2008, when Mr. Putin was required to step down after serving the maximum two consecutive terms (a total of 8 years) as president. Mr. Putin installed his long-time aide Dmitry Medvedev in the Kremlin, who returned the favour by appointing his former boss as prime minister. However, Mr. Putin never accepted that he was now only the second-most powerful man in the country. Apparently, I crossed the line when I published an essay in 2008, calling for the Kremlin to allow a wider variety of voices on television. The TV news had become a drama with only one character. I received the first in a series of personal reprimands from Mr. Putin, who made it clear that he was not interested in seeing Russia enter another period of political glasnost. Dismissed last year after I publically stated that it would be better for the country if Mr. Medvedev were to serve another term as president. I believe Mr. Medvedev wanted to run for re-election, but was coerced into standing aside.' Mr. Putin, who won an eyebrow-raising 63% of the March 4 vote (with many polling stations issuing ballots containing only one name), argues his return to the Kremlin was planned years ago. He has promised to appoint Mr. Medvedev as his prime minister after his May inauguration. Mr. Pavlovsky, who advised tycoon Mikhail Prokhorov during the presidential campaign (he finished a distant third), was later than many in realizing that the Putin Project had gone awry. Marat Gellman, another top political consultant, who served as deputy head of the main national television station during Mr. Putin's initial run for office in 2000, walked away after Mr. Putin was re-elected in 2004. Mr. Gellman commented: 'Tasked in the early days of the Putin Project with creating the president-to-be's public persona of a tough and sober-minded man of the people, I realized in 2004 that the Kremlin elites just didn't want to win the election, they wanted guarantees that no one else could. Mr. Khodorkovsky was jailed in the run-up to the campaign and remains in a Siberian prison. This so-called 'sovereign democracy' had lost all sense of shame. What happened was against my views – not only mine – but others' as well. We thought society could develop differently. I remain amazed that Mr. Putin ended up as Russia's most powerful man, given the seemingly random way that he was selected to succeed Mr. Yeltsin in 1999. It absolutely could have been someone else. There were maybe five candidates.' Ironically, Mr. Putin's biggest sup-

porter was oligarch Boris Berezovsky, now in exile and one of Mr. Putin's loudest critics. Like Mr. Pavlovsky, Mr. Gellman is actively advising the opposition to Mr. Putin. While neither man expects anything as dramatic as a revolution in the short term, both believe that the system they helped construct is now collapsing from within. Mr. Pavlovsky concludes: 'Nobody believes that Mr. Putin's coming term in office will last six more years. We are expecting some crisis. Sooner or later, there will be either a coup, or new elections. Putin is no longer the person who can decide alone what happens next.' At Long Wave Analytics, not wishing to be counted among the gullible, we remain skeptical.

| CLOSING LEVELS FOR FRIDAY, MARCH 16TH | | WEEKLY CHANGE |
|---------------------------------------|---------------------|---------------------|
| Dow Jones Industrial Average | 13,232.62 | + 310.60 points |
| Spot Gold Bullion (April) | \$1,655.80 (U.S.) | - \$55.70 per oz. |
| S&P / TSX Composite | 12,496.96 | - 6.66 points |
| 10-Year U.S. Treasury Yield | 2.29% | + 26 basis points |
| Canadian Dollar | 100.86 cents (U.S.) | - 0.06 cent |
| U.S. Dollar Index Future | 79.781 cents | - 0.283 cent |
| WTI Crude Oil (April) | \$107.06 (U.S.) | - \$0.34 per barrel |

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