

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



Monday, April 2nd

Front Page Headline, Globe and Mail – “Moody’s Positive on Canada’s Fiscal Outlook. Following last week’s federal budget, Moody’s vice president Steven Hess reports: ‘Canadian federal (government) debt is low and the trend is favourable. If

MONDAY, APRIL 2ND

realized, the improving deficit and debt trends in the budget are likely to keep the government’s borrowing costs low, a further credit-positive feature. The large provincial government sector (read Ontario) pushes Canada’s overall debt to gross domestic product (GDP) ratio from a relatively healthy 38.9% to approximately 70%.’ That’s in the middle of the range for advanced economies; better than the U.S. and Britain at 90%, but well back of Australia at 23%.”

- The Tempe, Arizona-based Institute for Supply Management’s manufacturing index rose to a reading of 53.4 in March following a level of 52.4 in February, citing gains in automobile production and business investment in new equipment; as well as gains in the level of employment
- Front Page Headline, Globe and Mail – “Breaking the Entitlement Addiction. In an op-ed, columnist Gwyn Morgan writes: ‘What do public-sector rioters who turned parts of Athens into charred ruins and the protesting students who have been paralyzing downtown Montreal have in common? The answer can be found in author Mark Steyn’s book, *After America, Get Ready for Armageddon*: The Greek rioters are the logical end point of the advanced social democratic state: not an oppressed under-class, but a spoiled over-class, rioting in defence of its privileges and insisting on more subsidy, more benefits. The Greek form of Armageddon arrived after decades of building a bloated public sector that devised ever more regulations, making founding and operating a business a bureaucratic nightmare. Private-sector

businesses collapsed or went underground. Tax evasion became a national art, reducing government revenues while deficit-fuelled government spending kept rising. The collapse, as it did in Greece, occurs when private-sector wealth creation is overwhelmed by public-sector wealth destruction. What does this have to do with the Montreal students protesting against postsecondary tuition increases? Two words: entitlement addiction. A great paradox of human nature is that the more people are given, the more they expect. They can become the spoiled over-class fighting to defend their privileges.”



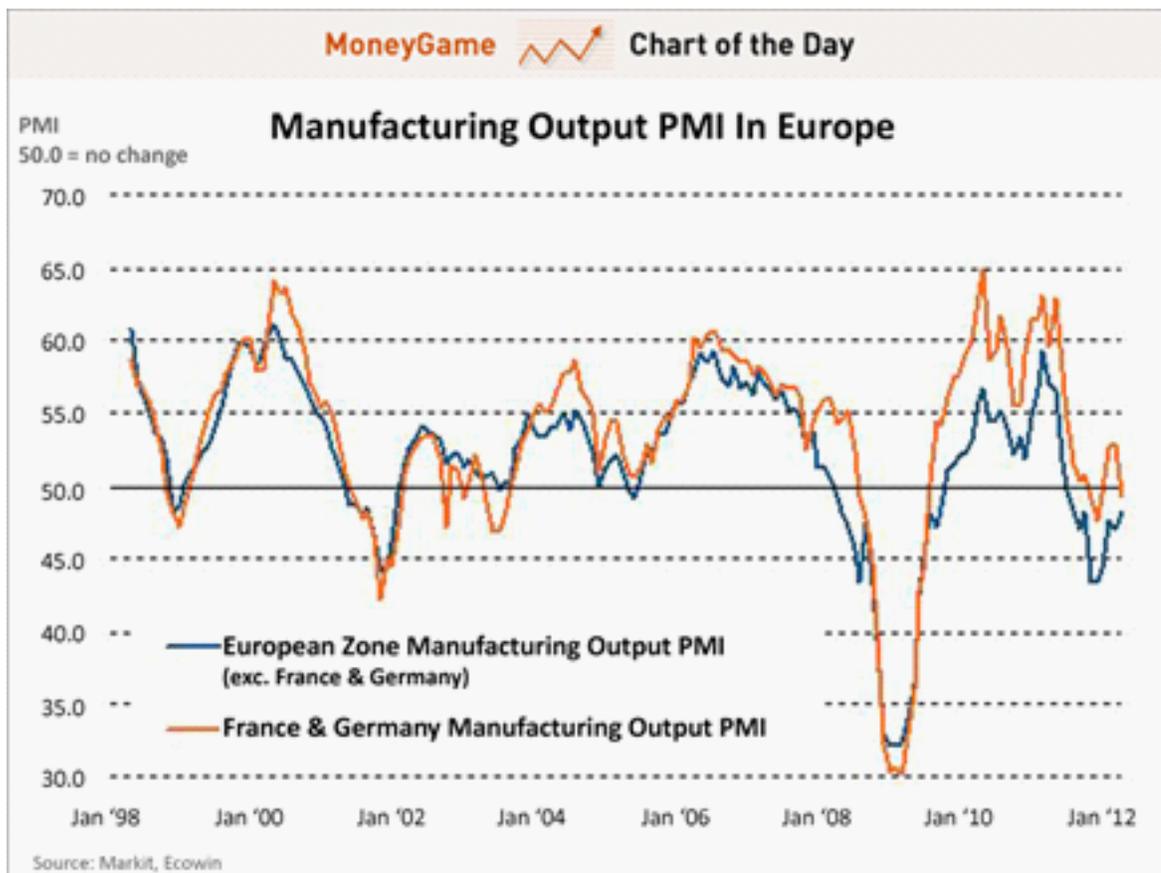
Quebec students in Montreal protest against planned tuition increases. Source: Paul Chiasson/Canadian Press

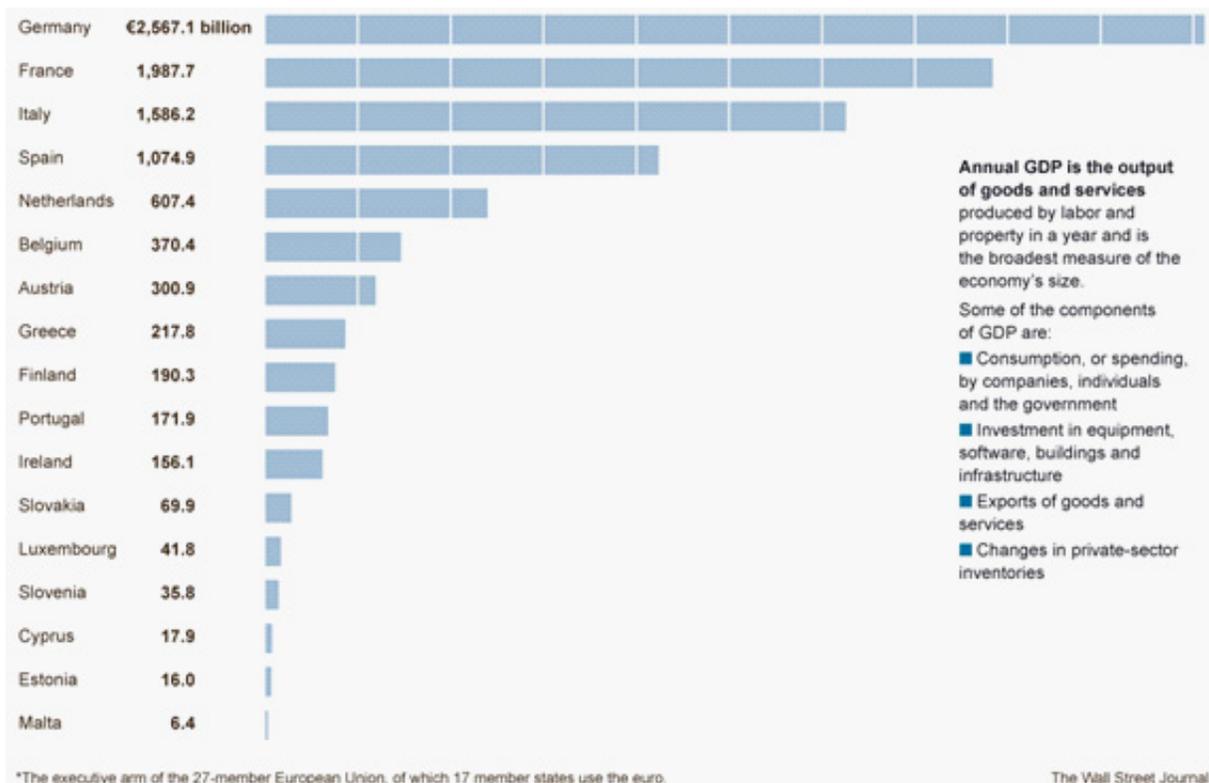
Average annual tuition in Quebec is \$2,519 (CAD), compared with \$6,640 (CAD) in Ontario. Tuition in Alberta, Saskatchewan, New Brunswick and Nova Scotia averages more than twice that of Quebec. Even after the modest \$325 (CAD) annual increases

to be phased in over five years, Quebec universities would still be the biggest bargain in the country. Quebec students would be paying only 17% of the cost; the other 83% would come from taxpayers, who spend their time working rather than protesting.”

- The China Federation of Logistics and Purchasing reports its Purchasing Managers’ index rose to a reading of 53.1 in March following a level of 51 in February, citing an increase in new orders and marked the fourth consecutive month of expansion for manufacturing activity. In a statement, Zhang Liqun, a researcher at the government think tank Development Research Centre, warned: “Future economic growth will still experience a slowdown.”
- The Markit euro zone manufacturing Purchasing Managers’ Index (PMI) declined to a reading of 47.7 in March from a level of 49 in February, remaining below the 50 mark – which divides economic growth from contraction – since August 2011. Chris Williamson, a data provider at Markit, commented: “Euro zone manufacturers suffered a miserable March. Ongoing steep (factory production) downturns in the periphery are now being accompanied by signs of renewed (economic) weakness in countries such as Germany and France.”

- Front Page Headline, Wall Street Journal - “Spain Faces Risks in Budget Overhaul. In a WSJ interview in Madrid, Spain’s Finance Minister Luis de Guindos stated: ‘Spain’s high-risk budget overhaul, necessary to get the country’s finances under control, could damage our economy and our standing in the financial markets. We have no margin for error. From a budget perspective, the government is facing a lose-lose situation. If we don’t make enough adjustments, the (fixed income) markets will penalize us. However, if we go too far, the (bond) market could also penalize us due to concerns about economic growth.’ The concern is the austerity measures may force Spain’s economy into a downward spiral that makes debt reduction increasingly difficult. Spain’s 10-year bonds currently trade at a 5.30% yield basis, about 350 basis points higher than the comparable German benchmark issue.”
- Eurostat reports the number of unemployed in the 17 countries that use the euro increased by 162,000 to 17.134 million in February, pushing the unemployment rate to 10.8% of the work force





- Front Page Headline, National Post – “CFTC Sues Royal Bank of Canada Alleging Wash Sales Scheme. The U.S. Commodity Futures Trading Commission accuses the Royal Bank of Canada (RBC) of hundreds of millions of dollars of illegal stock futures trades in order to gain Canadian tax credits. The allegations were contained in a complaint filed in U.S. District Court in New York. ‘The CFTC alleges that RBC willfully concealed and made false statements in a wash sales scheme between 2007 and 2010, where the bank traded futures contracts with its own subsidiaries under non-arms-length terms.’ In a statement, CFTC Enforcement Director David Meister postulated: ‘A fundamental purpose of the futures markets is to provide an arm’s-length mechanism for market participants to discover prices and shift risks associated with products traded in those markets. RBC not only designed and executed a wash sale scheme that undermined that purpose, (but also,) it went a step further and misled the exchange into believing that its conduct was lawful.’ In a statement, RBC has denied the claims as ‘absurd. Before we made a single trade, we proactively contacted the exchange to seek its guidance. RBC’s trading was permissible in 2005 and it is permissible today under the CFTC’s published guidance. The block trades referred to by the CFTC were entered into by independent RBC legal entities with the intent to establish genuine, bona fide positions, based upon the CFTC’s long-standing regulatory guidance. All the trades were properly disclosed and documented and given that the regulator never raised any con-

cerns at the time, it is absurd to now claim that these trades were either fictitious or ‘wash sales.’ We will rigorously defend our position against the charges.”

- In an interview with James West, publisher of the Midas Letter, investment managers Rick Rule and Eric Sprott provide their insight with respect to the current global economic picture. Mr. Rule states: “I’m personally not particularly concerned with Greece because it’s such a small part of the world’s gross domestic product (GDP). The nervousness that I have is that Greece is analogous to other somewhat larger economies like the United States and that, from my point of view, is problematic. Strangely, (since) you see strength in the U.S. dollar, it looks like the fact that the U.S. dollar is the most liquid lie in the world, makes it a preferable lie. That’s very difficult for me to imagine continuing forward.” Mr. Sprott elaborates: “Whether it’s a zero interest rate policy, quantitative easings, the long-term refinance operations, or unlimited swaps from G6 central banks; all of those things are telling us that the (global economic) system is out of control. People are losing confidence, whether it’s in Greek banks, Icelandic banks, Portuguese banks, or sovereign (credits). So, every day and almost now literally every week or two, there’s some new program, or some new meeting or (policy) to try to keep things together. I use the same analogy that Rick does except I would (point out) what I call a Minsky moment: (suffice to say) he was an economist who said that when

you keep expanding your economies by increasing debt, there comes a point when your economy can't deal with the debt. So, we're going to have to write it off. As Rick has always said, I'm sure that's the case in many countries, not just Greece."

TUESDAY, APRIL 3RD

- According to researcher Autodata Corp. U.S. sales of cars and light trucks rose by 13% in March, also the best quarterly pace since 2008, citing pent-up demand from buyers going to dealerships seeking more fuel efficient models. Deliveries accelerated to a 14.4 million seasonally adjusted annual rate from 13.1 million in the same period a year ago.
- Federal Open Market Committee (FOMC) minutes of its March 13th. meeting reveal a reluctance to increase monetary accommodation unless the U.S. economic expansion falters, or inflation rises at a rate slower than its 2% target
- The Commerce Department reports U.S. factory orders increased by 1.3% in February, following a revised decline of 1.1% in January, citing higher demand for business equipment. Joel Naroff, President of Naroff Economic Advisors Inc. in Holland Pa. commented: "The economy has leaned on the manufacturing sector for much of the economic growth during the entire recovery (period). There appears to be no reason to believe that will change anytime soon."
- Front Page Headline, Globe and Mail – "Spain's Rapid Descent Into Crisis Raises Spectre of Troika Bailout. During his presentation in parliament of Madrid's budget plan for 2012, Spanish budget minister Cristobal Montoro warned: 'Spain is in a critical (economic) situation. Spain plans to raise 186.1 billion euros of gross debt this year, which translates into a net debt increase of 36.8 billion euros.' Spain's financing costs have been rising lately. For most of 2011, Spain's bond yields were well below Italy's, but now the situation has reversed. The yield on Italy's 10-year bonds has declined to about 5%, while Spain's are about 5.5% and rising. Spain's climbing debt and jobless rates, combined with its weak banking system and the overhang from an out-of-control construction spree that came to a sudden halt in 2008 – leaving tens of thousands of apartments without owners or tenants – are reminders that the European debt crisis is far from over. Spain, the euro zone's fourth largest economy, is back in recession and some economists and politicians fear it will require a bailout from the so-named troika: the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund."

- Front Page Headline, Wall Street Journal – "China's Central Banker Sees Risk of Global Recession. In a panel discussion at the Boao Forum in the southern island province of Hainan, China's central bank governor Zhou Xiaochuan warned: 'There are new elements that could bring the global economy back into recession. We agree very much that to overcome a very serious financial crisis, the U.S. needs to inject liquidity. We understand that quantitative easing is one possible choice, but it is very difficult to control the flow of liquidity. While it is hoped that money injected into the U.S. economy will stay there, inevitably, some emerging economies will suffer too much capital inflow. Unlike other central banks, the Federal Reserve has a global impact when it acts because the dollar is the world's main reserve currency. So, the U.S. must have more responsibility to consider not just the U.S. economy, but the global economy.'
- Front Page Headline, Bloomberg News – "Tidal Wave of Foreclosed Homes About to Flood U.S. Market. Following a year-long probe into foreclosure practices that kept them off the market, as many as 1.25 million of America's most decrepit homes are headed for auction. According to Moody's Analytics Inc. sales of repossessed properties will probably increase by 25% this year from one million in 2011. According to Realty Trac Inc. prices for these homes could decline by as much as 10%, because they deteriorated as they were held in reserve during investigations by state officials, which were resolved in February. At that time, 43% of foreclosures had been delinquent for two or more years, compared with 21% in 2010, according to Lender Processing Services Inc. in Jacksonville, Florida. Todd Sherer, a manager of distressed mortgage investments for Dalton Investments LLC in Los Angeles, commented: 'The longer a foreclosed home is in the mill, the bigger the losses.'



Source: Justin Sullivan / Getty Images

According to a March 15th. report by the Federal Reserve Bank of Cleveland, homes stockpiled for less than a year sell for about 35% below the value set by lenders. At two years, the loss is closer to 60%. A surge of cheap foreclosures may erode prices in the broader real estate market, even as the economy expands and residential building increases, according to Karl Case, one of the creators of the S&P/Case-Shiller home price index.”

WEDNESDAY, APRIL 4TH

- Payrolls processor Automatic Data Processing Inc. (ADP) reports private sector employment increased by 209,000 in March, following an upwardly revised gain of 230,000 in February, previously reported as 216,000. Joel Prakken, Chairman of Macroeconomic Advisors which compiles the statistics for ADP, commented: “The March report is consistent with other (economic) indicators suggesting some firming of labor market conditions; such as the downward trend in unemployment claims and upturns in the components of consumer sentiment and confidence, influenced by perceptions about the availability of jobs.”
- Front Page Headline, Bloomberg News – “Prime Minister Rajoy Declares Spain in Extreme Difficulty. At a meeting of his Peoples Party in Malaga, Spanish Prime Minister Mariano Rajoy exclaimed: ‘Spain is facing an economic situation of extreme difficulty. I repeat, of extreme difficulty and anyone who doesn’t understand that is fooling themselves.’ Mr. Rajoy raised the threat of an international bailout for the second time this week, as he sought to defend the deepest austerity measures in at least three decades. ‘While no one likes the budget presented last week, the alternative is infinitely worse.’ Concurrently, Spain auctioned 2.59 billion euros (\$3.4 billion U.S.) of 5-year bonds, maturing in October 2016, at an average yield of 4.319% – up 94 basis points from the March auction – and which subsequently traded to a 4.48% yield basis in the secondary market. Peter Chatwell, a London-based fixed income strategist at Credit Agricole investment bank commented: ‘It’s back to reality now. The auction shows the recent 3-year liquidity injection by the European Central Bank (ECB) has been exhausted and so demand for Spanish paper is becoming increasingly price sensitive.’
- The Tempe, Arizona-based Institute for Supply Management’s non-manufacturing index declined to a reading of 56 from a one-year high level of 57.3 in February, citing slowing sales at restaurants and retailers

- Front Page Headline, Globe and Mail - “Yahoo Inc. Announces 2,000 Employee Layoffs. Computer search engine Yahoo initiates a broad corporate reorganization plan. Chief Executive Officer Scott Thompson elaborated: ‘Today’s actions are an important next step toward a bold, new Yahoo – smaller, more nimble, more profitable and better equipped to innovate as fast as our customers and our industry require. Our goal is to return to our core purpose – putting our users and advertisers first – and we are moving aggressively to achieve that goal.’ The cuts represent 14% of the company’s 14,100 staff work force.
- In its annual review of Canadian merchandise trade, Statistics Canada reports the value of U.S. bound exports grew by more than 10% in 2011 to \$330.1 billion (CAD), citing sharply higher crude oil sales. While the U.S. portion of exports was 73.7% last year – down sharply from 87.7% in 2002 – exports to Britain and China grew by 400% over the past decade. The two countries have overtaken Japan to become the number two and number three destinations for Canadian exports.
- The European Central Bank (ECB) holds its benchmark lending rate at a record low 1%, as ECB President Mario Draghi informed a press conference: “Downside risks to the economic outlook prevail ... the increase in Spanish and Italian financing costs are a warning shot to Madrid and Rome. These governments must execute their austerity reforms to reassure the rattled (bond) markets.” Separately, Olli Rehn, the European Union’s economic and financial affairs commissioner, warns: “European political leaders should be ready to provide a further bailout for Portugal. Some kind of bridge (financing) needs to be built before Portugal can return to the bond market next year.”



EU economic and financial affairs commissioner Olli Rehn, Source: American Foreign Press

- Front Page Headline, Wall Street Journal – “Russian Capital Flight Continues. The Russian central bank reports domestic capital outflows totaled \$35.1 billion (U.S.) in the 1st. quarter, nearly double the \$19.8 billion (U.S.) tallied in the same period a year ago. While the central bank didn’t release a monthly breakdown, using figures reported earlier for January and February, analysts estimated the capital outflow for March at about \$12.5 billion (U.S.). Alexander Morozov, chief economist at HSBC in Moscow warned: ‘The capital outflows are emanating from domestic business people sending their money out of the country, which they aren’t likely to reverse this year.’
- Front Page Headline, Financial Times – “China to Allow More Foreign Investment. The China Securities Regulatory Commission announces that international fund managers will be allowed to invest a combined total of \$80 billion (U.S.) in China’s onshore capital markets – up from the previous limit of \$30 billion (U.S.) in an expansion of the so-termed qualified foreign institutional investor (QFII) quota. Beijing also increased the total amount of renminbi that foreign investors can raise in Hong Kong for investment on the mainland, from 30 renminbi (\$3.2 billion U.S.) to 70 billion renminbi. Concurrently, China’s Premier Wen Jiabao endorsed bolder financial reforms when he declared that the government intended to “smash the monopoly” of the country’s big state-owned banks, for whom “profits come too easily.” Premier Jiabao’s comments appeared aimed at advancing reforms that would remove the current cap on deposit rates and a floor

on lending rates that guarantee banks a healthy profit margin. The reform is also a necessary step towards full convertibility. Separately, at a conference in southern China, Dai Xianglong, China’s former central bank governor, and the person now responsible for managing the country’s largest pension fund, commented: “China should accelerate renminbi convertibility on the capital account to make it become a currency that can be used for the purpose of investment.”

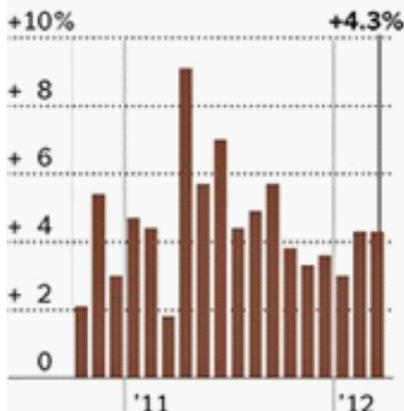
THURSDAY, APRIL 5TH

- The Labor Department reports U.S. initial jobless claims for state unemployment benefits declined by 6,000 to 357,000 in the week ended March 31st. while continuing claims fell by 16,000 to 3.338 million in the week ended March 24th. The number of people who have exhausted their traditional benefits and are now receiving emergency or extended benefits under federal programs increased by about 17,000 to 3.26 million in the week ended March 17th.
- Same store sales (outlets open for at least a year) at 20 U.S. retailers tracked by Thomson Reuters rose by an average of 4.3% in March, citing an 8.5% increase at apparel stores

Retail Sales for March

THOMSON REUTERS RETAIL COMPOSITE INDEX

Year-to-year change based on monthly sales at stores open at least a year.



SALES

Results are for the five weeks that ended March 31, except as noted, compared with the period a year earlier.

COMPANIES	TOTAL SALES, IN BILLIONS	CHANGE	CHANGE IN SAME-STORE SALES
<i>Wal-Mart releases its sales figures quarterly</i>			
Costco* 5 weeks to April 1	\$9.1	+ 10 %	+ 6 %
Target	6.4	+ 7.9	+ 7.3
Macy's	2.4	+ 6.9	+ 7.3
TJX*	2.3	+ 14	+ 10
Kohl's	1.8	+ 5.3	+ 3.6
Gap*	1.5	+ 10	+ 8
Nordstrom	1.0	+ 14.7	+ 8.6
Ross Stores*	1.0	+ 15	+ 10
Limited Brands*	0.8	- 2.5	+ 8

*Company disclosed some figures only to the nearest round number

- Canada's Ivey purchasing managers' index declined to a reading of 63.5 in March on a seasonally adjusted basis, citing weak employment gains and a drop in inventories. Separately, Statistics Canada reports the country's employers added 82,300 jobs in March, while the unemployment rate fell to 7.2% from 7.4% in February.
- The Chicago-based job placement firm Challenger, Gray & Christmas Inc. reports planned U.S. firings declined by 8.8% in March on a year-over-year basis to a 10-month low of 37,880. Planned job cuts at government and non-profit agencies dropped by 86% in the 1st. quarter compared with the same period a year ago.
- The National Institute for Economic and Social Research (NIESR) reports the U.K. gross domestic product (GDP) rose by only 0.1% in the 1st. quarter, after stagnating in the previous three months ended in February
- The Economy Ministry in Berlin reports German industrial output declined by 1.3% in February, citing the extremely cold weather kept workers off construction sites
- The Office for National Statistics reports U.K. manufacturing output declined by 1% in February, following a revised drop of 0.3% in January, previously reported as an increase of 0.1%
- Statistics Canada reports the value of the nation's building permits rose by 7.5% in February, as construction permits in the non-residential sector soared by 36.2% while building permits in the residential sector fell by 5.3%, including both single family and multi-family units

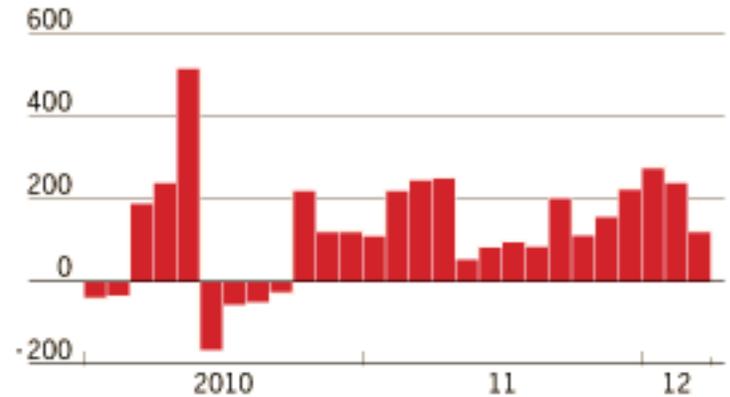
FRIDAY, APRIL 6TH

Good Friday Holiday in Canada and the United States

- The Labor Department reports U.S. non-farm payrolls increased by 120,000 in March, following an upwardly revised gain of 240,000 jobs in February, previously reported as 227,000. January payroll gains were downwardly revised to 275,000, previously reported as 284,000. Separately, the unemployment rate declined marginally to 8.2% in March from 8.3% in February. Tony Crescenzi, a strategist at Pacific Investment Management Corp. (PIMCO) commented: "We see a lack of sustainability in terms of strong job growth. This is still not strong enough to create escape velocity, which is to say an economy strong enough to make it on its own without additional monetary stimulus from the Federal Reserve."

US employment

Monthly change in non-farm payrolls (000s)



Source: Thomson Reuters Datastream

- Front Page Headline, King World News – “There’s an Ominous Something Out There Waiting to Materialize: Richard Russell. The author of the Dow Theory Letters writes: ‘My guess is that this is the big money that has been holding off as long as it decently can and then dumping their positions just before the (market) close. I don’t think that the big money likes this (stock) market and I think they have been slowly exiting this (stock) market as quietly as they can. The big money tends to look out six months to a year or so, and there is something out there that they see, but don’t like. Is it a rise in the (prevailing level) of interest rates? Is it the (increasing) power of the Chinese Yuan? Is it a (further) collapse in real estate values? Whatever it is, it’s time to plan for the worst. Honestly, I don’t know what it is, but I’m convinced there’s an ominous something out there waiting to materialize. The big money, the institutional money, doesn’t want to be in this (stock) market when it materializes.’”

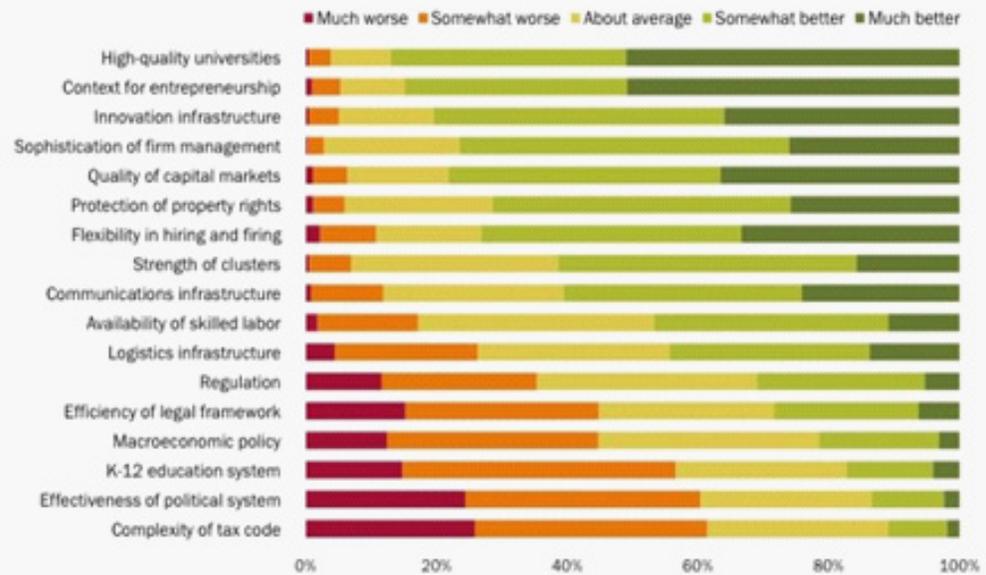


Richard Russell

Source: Casey Research via You Tube

At Long Wave Analytics, we are very much inclined to agree with Mr. Russell: Is it a renewed, but more damaging round of Washington political gridlock? Is it another sovereign debt credit rating downgrade for U.S. Treasuries? Is it a Congressional battle erupting over another increase of the statutory debt ceiling? Is it the inexorable increase in the national debt to unmanageable levels? Or, is it all of the above?

FIGURE 9: HOW DOES THE U.S. COMPARE TO OTHER ADVANCED ECONOMIES TODAY?



Note: Elements are ordered by the difference between the percentage of respondents answering "somewhat better" or "much better" and the percentage answering "somewhat worse" or "much worse." This difference determines horizontal placement in Figure 11.

FIGURE 10: IS THE U.S. FALLING BEHIND, KEEPING PACE, OR PULLING AHEAD?



Note: Elements are ordered by the difference between the percentage of respondents answering "pulling ahead" and the percentage answering "falling behind." This difference determines vertical placement in Figure 11.

- Front Page Headline, Business Insider – “U.S. Falling Severely Behind in Terms of International Competitiveness: HBS. A Harvard Business School study released in January, reveals of the Harvard alumni recently polled who are personally involved in a corporate relocation decision, 57% responded that the decision ‘involved the possibility of moving existing (business) activities out of the United States. Only 9% of respondents were considering moving existing (business) activities from another country into the U.S.’ The study’s author, HBS Professor Michael Porter concluded: ‘A U.S.- based respondent was three times as likely to be considering moving business activity out of the U.S. than a non-U.S. respondent was likely to be considering moving a business activity into the U.S.’” See Harvard Business School bar charts outlined above:

CLOSING LEVELS FOR FRIDAY, APRIL 6TH.

WEEKLY CHANGE

Dow Jones Industrial Average	13,060.14	– 151.90 points
Spot Gold Bullion (June)	\$1,630.10 (U.S.)	– \$41.80 per oz.
S&P / TSX Composite	12,103.11	– 289.07 points
10-Year U.S. Treasury Yield	2.06%	– 15 basis points
Canadian Dollar	100.29 cents (U.S.)	+ 0.04 cent
U.S. Dollar Index Future (Spot Price)	79.839 cents	+ 0.89 cent
WTI Crude Oil (May)	\$103.31 (U.S.)	+ \$0.29 per barrel

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