

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



Monday, May 14th

Front Page Headline, Bloomberg News – “Gov. Brown Proposes \$8.3 billion (U.S.) in Spending Cuts to Close Wider Deficit. California Governor Jerry Brown, confronting a widening \$15.5 billion (U.S.) State deficit, proposes a four-day government work

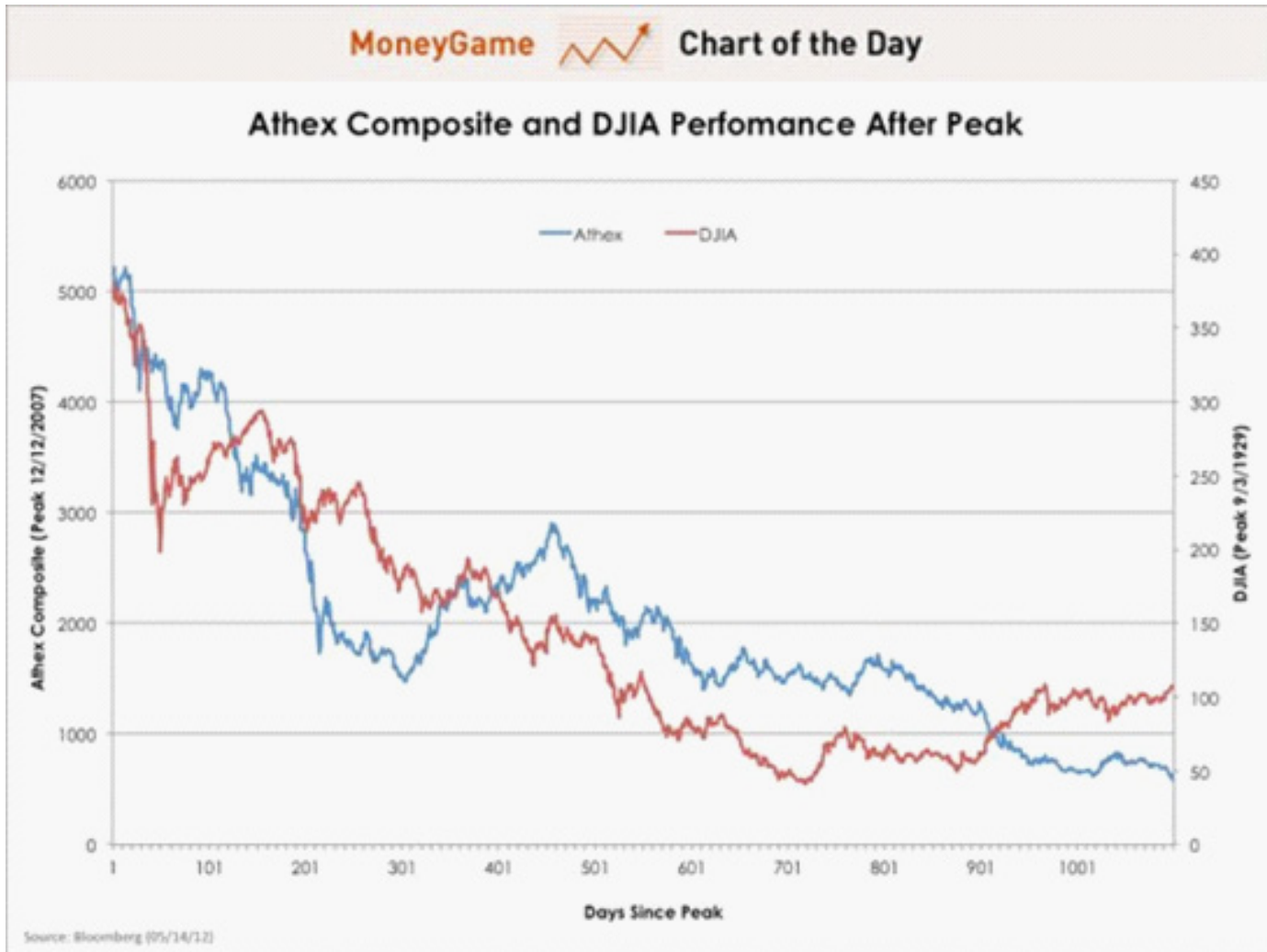
MONDAY, MAY 14TH

week to reduce payroll costs; as well as other spending cuts on welfare and medical care. A reduction to 38 hours in a four-day work week, from 40 hours in 5 days, would cut payroll costs by 5% for a savings of \$400 million (U.S.). Gov. Brown would also slice \$1.2 billion (U.S.) from health care for the poor, \$1.1 billion (U.S.) from welfare and in-home help for the elderly and disabled, and \$500 million (U.S.) from the court system. The California deficit grew after Gov. Brown overestimated tax revenue by \$4.3 billion (U.S.) when he proposed his budget last January. Simultaneously, some cost savings in the current year’s budget have been blocked by the federal government and the courts, while Democrats in the State Legislature resisted other spending reductions.”



California Governor Jerry Brown presents his revised State budget plan. Source: AP Photo

- Front Page Headline, Bloomberg News – “Moody’s Downgrades 26 Italian Banks. In a statement, Moody’s elaborated: ‘Italian banks are particularly vulnerable to adverse operating conditions, which are likely to cause further asset quality deterioration, earnings pressure and restricted market funding access. These risks are exacerbated by investor concerns over the sustainability of the Italian government’s debt burden, which has contributed to the difficult wholesale funding conditions faced by Italian banks.’ UniCredit, Italy’s biggest bank; along with Milan-based Intesa, the nation’s second largest bank, both had their long term debt ratings downgraded to A3 from A2.”
- The European Union’s statistics office, Eurostat, reports euro zone industrial production declined by 0.3% in March compared to February and fell by 2.2% on a year-over-year basis, the steepest fall since December 2009, citing an 8.5% drop in energy production
- Front Page Headline, Financial Times – “Greece Set for Further Coalition Talks. Greek President Karolos Papoulias is set to resume government coalition talks tomorrow with the country’s political leaders in another attempt to avoid a new general election after a Monday meeting ended without agreement. Antonis Samaras and Evangelos Venizelos, the conservative party and socialist party leaders, respectively; along with Fotis Kouvelis, the leader of a left-wing splinter group, held a fruitless one-hour discussion about how to escape the crisis, but agreed to meet again. According to the Greek constitution, President Papoulias



Greece's Athex performance from the 2007 peak v/s America's Dow Jones and its 1929 peak

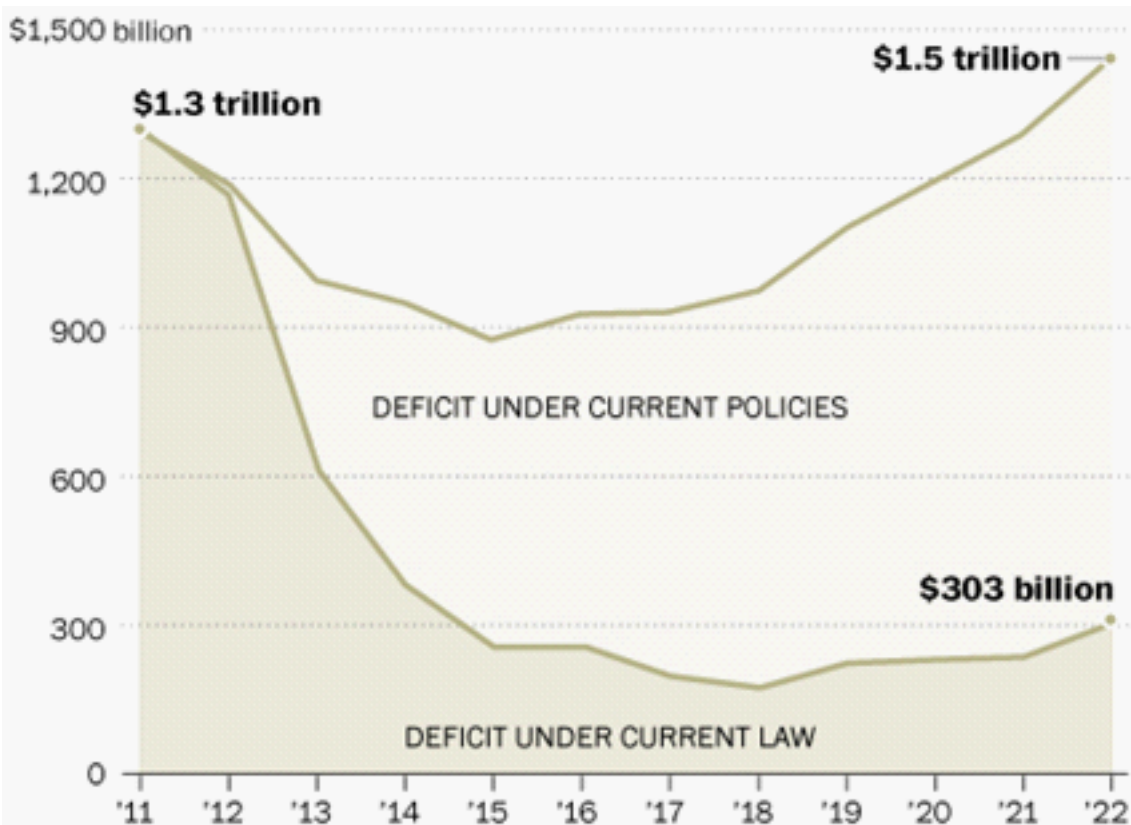
has another 48 hours to persuade politicians to join a national unity government, or face having to participate in another election. A poll by Kappa Research finds 78% of the Greek population want a new coalition government to do whatever it takes to keep their country in the euro; simultaneously, other polls reveal an overwhelming majority of Greeks reject the bailout and its attendant austerity measures, presenting an impossible dichotomy."

TUESDAY, MAY 15TH

- The Federal Reserve Bank of New York reports its manufacturing index rose to a reading of 17.1 this month, following a level of 6.6 in April. This alternately named Empire State Index covers the State of New York, northern New Jersey and southern Connecticut.

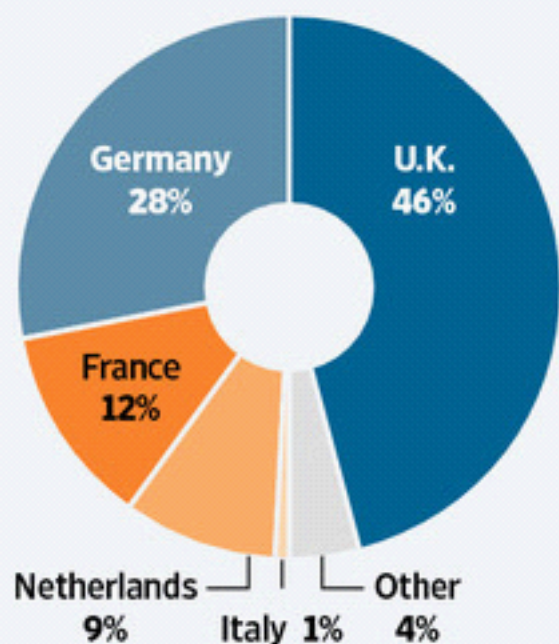
- Front Page Headline, Wall Street Journal – “Greek Coalition Talks Fail, New Elections Likely June 17th. Greece’s President Karolos Papoulias announces the failure of Greek political party leaders to form a coalition government, with new elections likely to be set for June 17th. In a transcript, Mr. Papoulias warned: ‘The situation facing Greece’s lenders is very difficult and the strength of the banks is very weak right now.’ Yesterday, depositors withdrew 700 million euros (\$898 million U.S.) from local banks. Economists have long warned that a run on domestic banks could develop if the population fears that a Greek exit from the euro is nigh and savings in bank accounts could be redenominated in a weak new national currency; namely the drachma. A bank run could become a self-fulfilling prophecy of a euro exit, if it reached a scale which forces Greek authorities to freeze bank accounts and print drachmas, in order to keep the financial system alive.”

- The Labor Department reports the U.S. consumer price index (CPI) remained unchanged in April restrained by a decline in fuel prices, while the core rate – which excludes food and energy – rose by 0.2%. Separately, the Commerce Department reports U.S. retail sales rose by 0.1% in April, following a gain of 0.7% in March.
- Front Page Headline, Wall Street Journal – “Boehner Draws Line in the Sand on Statutory Debt Limit. In a speech to the Peter G. Peterson Foundation in Washington, U.S. House of Representatives Speaker John Boehner (R., Ohio) warned: ‘Any increase in the federal government’s statutory debt limit – likely to hit the \$16.394 trillion (U.S.) debt ceiling close to the fiscal 2012 year end of September 30th. – must be accompanied by spending cuts and other budget savings of greater value.’” In response to Mr. Boehner’s remarks, White House spokesman Jay Carney stated: ‘We cannot hold the full faith and credit of the United States Government hostage to one party’s political agenda.’” As a signatory to lobbyist Grover Norquist’s Taxpayer Protection Pledge, Speaker Boehner has ruled out tax increases as part of any potential agreement to reduce the federal deficit. See the U.S. Fiscal Cliff Chart below.
- Front Page Headline, Wall Street Journal – “More Real Estate Loans Default in Europe. European commercial real estate markets are struggling with a sharp increase in problem mortgages. A growing number of landlords, hit with falling rents and lower occupancies, are defaulting on loans, not only in the most troubled economies of Europe, but also, in major centers like London and Frankfurt. According to CBRE Group Inc. property values are down nearly 20% since their 2007 peak across Europe. Billions of euros of commercial mortgages are coming due, but capital is scarce for refinancing. Problems are especially acute for some 80 billion-plus euros in mortgages that were converted into commercial mortgage-backed securities, or CMBS. The properties are concentrated in the U.K. and Germany. They face a wave of defaults, as both borrowers and lenders begin to realize that restructurings of European commercial mortgage securities are more complicated than their counterparts in the U.S. According to Moody’s Investors Service, at the end of the 1st. quarter 17.8% of European CMBS issues faced the need for a possible restructuring and had been transferred to special servicers, up from 14.6% six months earlier. More issues are expected to default through 2013 as a growing number reach maturity, which would push the rate higher still. Special servicers represent bondholders in overseeing issue restructurings.



Troubled Debt

European CMBS loans in special servicing, needing possible modification



Source: Moody's Investors Service
The Wall Street Journal

- Statistics Canada reports the nation's factory shipments rose by 1.9% in March – in terms of both value and volume – for the biggest gain in six months; citing increased demand from the U.S. benefitting Canadian producers of everything from cars to aerospace products
- Front Page Headline, Wall Street Journal – “Greece Sets Interim Government for New Elections. Senior Judge Panagiotis Pikrammenos led the nomination for an interim government stating his administration would have ‘the sole purpose of leading the country to elections,’ widely expected to be June 17th. He named the finance ministry’s chief economic advisor, George Zannias, to the post of temporary Finance Minister. The election campaign will take place against a background of rising financial market turmoil in Europe and great uncertainty in Greece regarding the country’s destiny. Greek bank officials reported depositors were continuing to withdraw large amounts of money from their bank accounts yesterday, although the outflow eased from Monday’s peak of nearly 700 million euros. German officials and European Union (EU) authorities reiterated today that Greece needs wrenching economic overhauls to stay inside the European Monetary Union (EMU). Jose Manuel Barroso, President of the European Commission (EC), noted: ‘Greek voters face an historic choice because the ultimate resolve to stay in the euro area must come from Greece.’ German Finance Minister Wolfgang Schauble added: ‘Undeniably, Greece belongs to Europe, but whether every European state is also a member of the currency union ... that is the question which the Greek people are addressing in these days and weeks.’”



Greek Council of State President Panagiotis Pikrammenos
Source: Agence France Presse/Getty Images

WEDNESDAY, MAY 16TH

- The Commerce Department reports U.S. housing starts rose by 2.6% to a 717,000 unit annual pace in April, following a revised 699,000 unit pace in March. Separately, the Federal Reserve reports U.S. industrial production rose by 1.1 in April, the most since December 2010.
- The Mortgage Bankers Association reports the U.S. mortgage delinquency rate – home mortgage payments at least one month in arrears – declined to 7.4% in the 1st. quarter from 7.58% in the 4th. quarter of 2011

- Front Page Headline, Wall Street Journal – “Portugal’s Unemployment Rate Rises to 14.9%. The National Statistics Agency reports the Portuguese unemployment rate rose to 14.9% in the 1st. quarter from 14% in the 4th. quarter of 2011. The rapidly rising unemployment rate is a source for concern among Portugal’s

officials overseeing the country's 78 billion euro (\$99.29 billion U.S.) bailout program. The government had previously estimated the unemployment rate for all of 2012 at 13.6%, up from 12.7% in 2011, but has since revised its forecast to 14.5%."

- Front Page Headline, Financial Times – "Rajoy Warns Bond Markets May Prove Inaccessible to Spain. Speaking in parliament, Spain's Prime Minister Mariano Rajoy warned: 'We must reduce the public deficit because there is a serious risk that we will not be able to borrow, unless at astronomical prices ... All these (austerity) measures are to get us out of the hole in which we find ourselves.' The yield on Spanish 10-year bonds briefly breached 6.50% today, for the first time since November 2011, moving towards yield levels which previously prompted bailout packages for Greece, Portugal and Ireland. Indeed, the yield spread on Spanish 10-year bonds over comparable German bunds, briefly climbed above 500 basis points."
- Front Page Headline, Daily Telegraph U.K. – "QE 3 Remains on the Table: U.S. Federal Reserve. Minutes of the central bank's April 24-25 meetings disclosed that 'several members' thought additional Fed support could be required if the (economic) recovery lost momentum, or if the risks to the economy became great enough. The minutes did identify some threats to the U.S. economy, notably: the European sovereign debt crisis and the risks that spending cuts and tax increases – which could take effect at year end, if Congress can't reach a budget agreement – could slow GDP growth by 4%."
- Front Page Headline, Washington Post – "U.S. President Barack Obama Warns Republicans Against Debt Ceiling Fight. President Obama warns Congressional leaders that he would not tolerate a replay of the bitter debt ceiling fight of last summer which nearly placed the United States in default and led to the nation's first sovereign debt credit rating downgrade. During a White house luncheon with leaders of the House and Senate, President Obama called the political gridlock of last year 'unacceptable' and emphasized that he expects a 'serious bipartisan approach' to tackling the budget and budget deficit this year."

THURSDAY, MAY 17TH

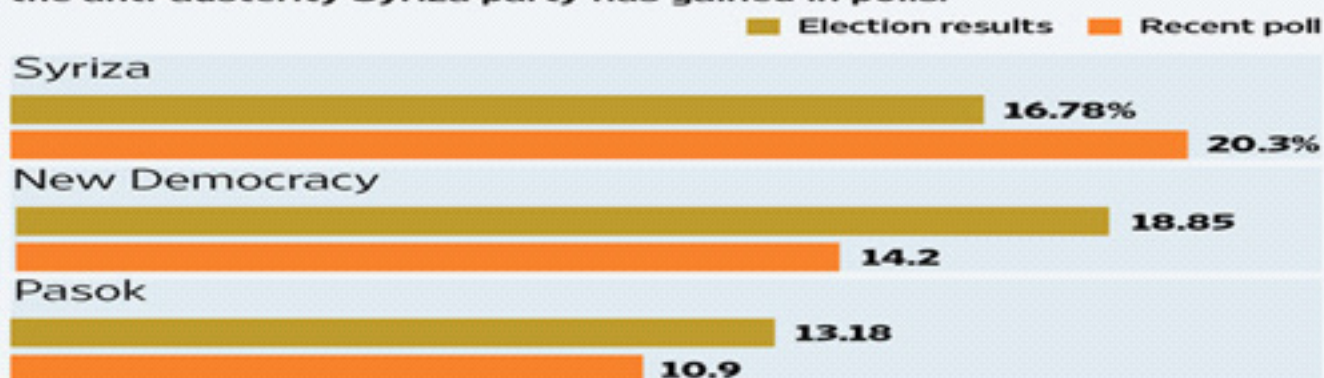
- The Philadelphia Federal Reserve reports its Business Outlook Survey Diffusion Index declined to a reading of minus 5.8 in May, following a level of plus 8.5 in April. The survey covers eastern Pennsylvania, southern New Jersey and Delaware.

- The Canada Pension Plan Investment Board (CPPIB) reports the CPP investment portfolio earned a 6.6% rate of return for the fiscal year ended March 31st. citing mostly from capital gains in the fund's private equity portfolio. The CPPIB also noted the pension fund's asset base has now reached a record \$161.6 billion (CAD).
- Front Page Headline, Globe and Mail – "Bank of Canada Fears Weak Global Economic Growth. In a quarterly recap of its latest economic research data, a team of five researchers at the Bank of Canada issues a veiled warning: 'Fiscal consolidation in the United States and Europe, flexible (foreign) exchange rates and structural (economic) policies (in order) to stimulate domestic demand in the emerging market economies of Asia; as well as (systematic) structural reforms in Europe and Japan, could lead to balanced gross domestic product growth and an orderly resolution of global imbalances over the medium term. However, continued delays and/or uncoordinated implementation (of policies) may result in severe negative consequences which could lead to even weaker (economic) growth in global output and near-term deflationary pressures.' At Longwave Analytics, we have long been forecasting that excessive levels of global debt: from sovereign to state and local governments and from financial institutions to households would negatively impact global economic growth during the current Kondratieff winter economic cycle. We have forecast declining stock market indices; witness the Dow Jones Industrial Average (DJIA) and rising unemployment rates, witness Greece, Spain and Portugal. Moreover, the euro zone debt problems, notwithstanding, we have yet to witness the full, negative economic impact of excessive debt in the U.K and the U.S. If the Bank of Canada is now becoming concerned about the prospect of weak global economic growth, why has Bank of Canada Governor Mark Carney been hinting over recent weeks that he may raise Canada's Bank Rate from its current level of 1%? Could it be that the Governor's visionary expectations are rather limited to the short term, but subject to revision when the winds of change finally become obvious to investors and the markets?"
- The Labor Department reports U.S. initial claims for state unemployment benefits were unchanged at a revised seasonally adjusted 370,000 in the week ended May 12th. while continuing claims rose by 18,000 to 3.27 million in the week ended May 5th. The number of Americans who have exhausted their traditional benefits, but are now receiving extended or emergency benefits under federal programs, declined by 22,150 to 2.67 million in the week ended April 28th.

- Front Page Headline, Wall Street Journal – “BOE Cuts Economic Growth Forecast. The Bank of England announces that it now expects the U.K. economy to grow at an annual rate of 2.6% in the first quarter of 2014, the end of its forecast period, compared with 3% when it last released forecasts in February.”
- Front Page Headline, Wall Street Journal – “Greek Left-Wing Leader Throws Down Gauntlet on Debt. In an interview with the Wall Street Journal, Alexis Tsipris – leader of Greece’s radical left-wing party Syriza – bluntly states: ‘A financial collapse in Greece would drag down the rest of the euro zone. Europe must consider a more growth oriented (economic) policy to arrest Greece’s spiraling recession and address the growing humanitarian crisis facing the country. Our first choice is to convince our European partners that, in their own interest, financing must not be stopped. If we can’t convince them – because we don’t have the intention to take unilateral action – but if they proceed with unilateral action on their side, in other words they cut off our funding; then we will be forced to stop paying our creditors.’ According to recent opinion polls, Syriza is poised to win the most votes in repeated elections expected in mid-June, bettering its surprise second place finish in an inconclusive May 6th. vote that left no party or coalition with enough seats in parliament to form a government. With Mr. Tsipris poised to win the pole position in the coming vote, it heightens the risk that Greece will soon face a showdown with European creditors over the contentious austerity program that Athens must adhere to in order to receive additional financial assistance. Meanwhile, Fitch Ratings downgraded its sovereign debt credit rating for Greece two levels further into junk territory, pointing to the increased risk that Greece may leave the euro zone.”
- Front Page Headline, National Post – “Moody’s Downgrades 16 Spanish banks. Moody’s Investors Service meets out a sweeping downgrade of 16 Spanish banks, including Banco Santander – Europe’s largest bank – citing a weak economy and the government’s reduced ability to support troubled lenders. While all the banks’ long term debt ratings were downgraded by at least one level, some endured three level cuts. Awash in bad mortgages after a real estate boom collapsed, Spain’s banks are at the heart of the euro zone debt crisis because markets fear that a state bailout would put a severe strain on the country’s already stretched public finances. Spain relapsed into a recession in the 1st. quarter and likely faces a prolonged economic slump, as the government tries to shrink its budget deficit by slashing spending. In a statement, Moody’s elaborated: ‘Amid the ongoing euro area debt crisis, the Spanish government’s rising budget deficit and the renewed recession, sovereign creditworthiness has declined. This decline is a driver of today’s bank rating downgrades.’”
- Front Page Headline, Daily Telegraph U.K. – “Euro Zone Crisis Increases Pensions Black Hole by 30 Billion Pounds within Two Weeks. According to actuary John Ball, Director of U.K. Pensions at Towers Watson, total deficits in FTSE 350 companies’ pension funds are estimated to have increased from 62 billion pounds at the end of April to 92 billion pounds by May 16th. ‘The lower gilt and corporate bond yields go, the bigger pension liabilities in company accounts will look.’”

Anger Over Austerity

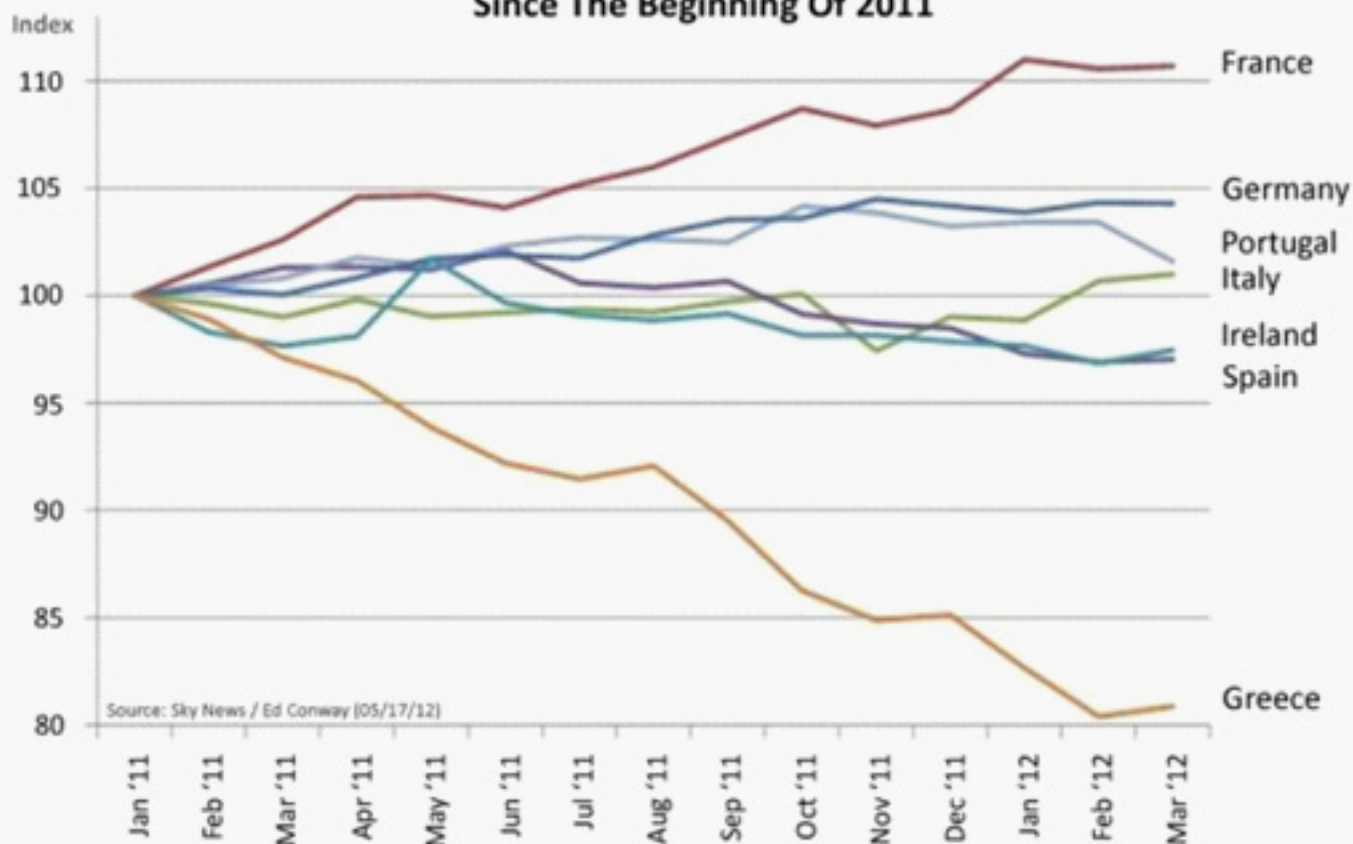
Greece’s two mainstream parties, New Democracy and Pasok, have continued to lose popular support since the May 6 elections, while the anti-austerity Syriza party has gained in polls.



Sources: VPRC poll of 804 people conducted May 10–14; Greek Interior Ministry
The Wall Street Journal

MoneyGame  **Chart of the Day**

The Relative Level Of Deposits In Various Countries' Banking Systems Since The Beginning Of 2011



FRIDAY, MAY 18TH

- Front Page Headline, Wall Street Journal - "Spain's Regions Contribute to Wider Deficit. In a press release, Spain's Budget Ministry reports it has revised its budget deficit estimate for 2011 to 8.9% of gross domestic product (GDP), previously reported as 8.5%; largely due more red ink reported by the four regional governments of Madrid, Valencia, Andalusia and Castille-Leon. However, the Ministry stated it is maintaining its budget deficit target of 5.3% of GDP for 2012. Spain's regions control almost half the nation's spending, including socially sensitive areas such as education and health care, while recording a long history of budget overruns. These regions are now grappling with plummeting tax revenue in a weak economy, after the collapse of a tax-rich housing boom. Increasingly, they have encountered difficulties obtaining financing from international capital markets, and more recently, even from local banks." See also, Economic

Winter, The Ongoing Saga of the European Sovereign Debt Crisis – The Pain in Spain Is Far From on the Wane, May 18, 2012.

- Front Page Headline, Wall Street Journal – "Greek Euro Exit Plans Discussed: EU Officials. The European Union is preparing for Greece's possible exit from the euro zone, ahead of a crucial round of Greek elections expected in mid-June, which are rapidly transforming into a referendum on Greece's membership in the European Monetary Union (EMU). Euro zone officials are planning to contain any resulting fallout with the preparation of emergency scenarios by staff at the European Commission (EC), the European Central Bank (ECB) and in national finance ministries. The euro zone's financial firewall may need boosting in order to reassure markets that neither Spain, nor Italy would be permitted to default on their debt during any market panic which might follow an eventual Greek exit. The bloc's bailout fund – the European Financial Stability Facility (EFSF) – has

unused lending capacity of 500 billion euros (\$635 billion U.S.), only enough to finance Spain and Italy for a few months. In remarks to a Belgian newspaper, EU Trade Commissioner Karel de Gucht related: 'The EC and the ECB are working on emergency scenarios if Greece does not make it.' Asked whether the German finance ministry was drafting emergency measures, a spokeswoman cited comments by Finance Minister Wolfgang Schauble: 'Our citizens expect us to be prepared for every eventuality.'



George Zannias, Greek Temporary Finance Minister Source: Agence France Presse/Getty Images

- Statistics Canada reports the nation's consumer price index (CPI) rose by 0.1% in April and by 2% on a year-over-year basis, citing higher prices for transportation, food and fuel
- Front Page Headline, Financial Times – "China Linked to Economic Espionage. In its annual report on the Chinese military, the U.S. Pentagon concludes: 'Chinese actors are the world's most active and persistent perpetrators of economic espionage. We believe China will continue to be an aggressive and capable collector of sensitive U.S. technological information, including that owned by defense-related companies, and represents a growing and persistent threat to U.S. national security.' The Pentagon report is the latest in a series of blunt warnings from the Obama administration about the growing risks to U.S. interests from Chinese espionage, including from cyber-attacks. A November 2011 report prepared by U.S. intelligence agencies concluded: "Concerted cyber espionage by China and Russia pose significant and growing threats to American economic power and national security." See Economic Winter, China's Renminbi: The World's Next Reserve Currency? China's Corporate Espionage, April 9, 2012.

CLOSING LEVELS FOR FRIDAY MAY 18TH.

WEEKLY CHANGE

| | | |
|--------------------------------------|--------------------|---------------------|
| Dow Jones Industrial Average | 12,369.38 | – 451.22 points |
| Spot Gold Bullion (July) | \$1,591.90 (U.S.) | + \$7.90 per oz. |
| S&P / TSX Composite | 11,280.64 | – 414.03 points |
| 10-Year U.S. Treasury Yield | 1.72% | – 13 basis points |
| Canadian Dollar | 97.96 cents (U.S.) | – 2.01cents |
| U.S Dollar Index Future (Spot Price) | 81.089 cents | + 0.788 cent |
| WTI Crude Oil (July) | 91.48 (U.S.) | – \$4.65 per barrel |

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