UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE

THAT WAS THE WEEK THAT WAS

Monday, February 4th
Front Page Headline, Wall Street Journal – **"U.S. to Sue S&P over Sub-Prime Mortgage Bonds.**

Monday, February 4th

The U.S. Justice Department intends to sue Standard & Poor's Ratings Services, alleging the firm ignored its own standards to rate mortgage bonds which imploded during the financial crisis, costing investors billions of dollars in losses. The anticipated civil charges by U.S. Attorney General Eric Holder against one of the bond rating industry's three giants, will represent the first federal enforcement action against a credit rating firm over the crisis. Several state attorneys general are expected to join the civil action. According to informed sources, the two sides have been discussing a possible settlement for about four months, however, S&P reportedly balked over concerns that a settlement could sink the company."

U.S. Attorney General Eric Holder Photo: European Pressphoto Agency

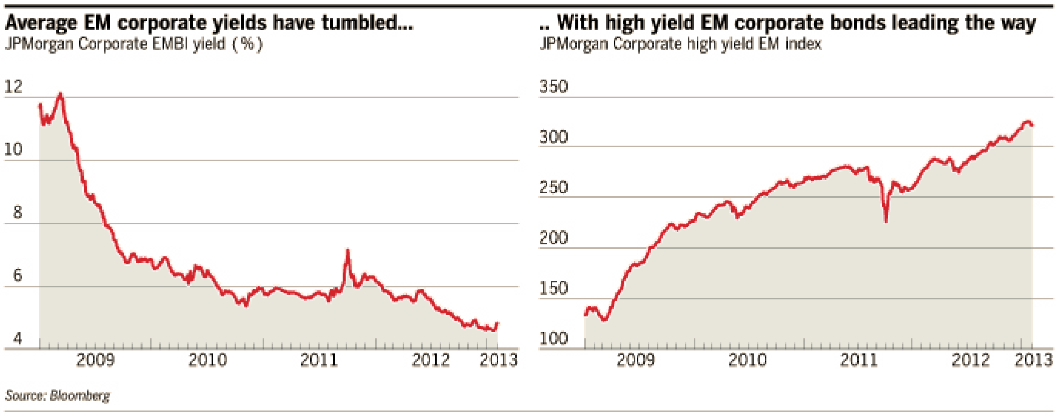
- Front Page Headline, Wall Street Journal – **"Low Interest Rates Force Corporations to Bolster Pensions.** Ford Motor Co. expects to spend $5 billion (U.S.) this year reinforcing its pension funds, almost as much as the auto maker spent in 2012 building plants, buying equipment and developing new cars. The company borrowed $1.2 billion (U.S.) in 2012 to contribute to its pension funds. The drain on corporate cash is a side effect of the U.S. Federal Reserve's monetary policy aimed at encouraging borrowing to stimulate the economy. Companies are required to calculate the present value of future pension liabilities by using a discounted interest rate based upon corporate bond yields. As those yields decline, corporate liabilities increase. Michael Moran, pension strategist at investment advisor Goldman Sachs Asset Management notes: 'Pension liabilities are one of the primary (financial) issues which U.S. companies are encountering at the present time."

- Front Page Headline, Financial Post – **"Canada's High Credit Ratings Entice Global Investors.** With the sovereign debt crisis in Europe and fiscal challenges in the U.S. casting a pall over global credits, investors flocked to Canada as a safe haven during 2012. Grant Berry, managing director and head of government finance at RBC Capital Markets commented: 'Money is coming to Canada and for good reason. Typically, when international markets buckle somewhat, that's when you see more investors come to Canada.' Investment banks helped raise $124.5 billion (CAD) for Canadian governments during 2012, as investors were enticed by Canada's 'AAA' sovereign debt credit rating. Jason Stewart, head of government finance at National Bank Financial noted: 'The number of 'AAA' and 'AA' credits globally was further reduced last year, making Canada stand out even more. If you look at where our bond yields were relative to U.S. levels and consider the credit quality and liquidity, that's why we saw a significant increase in terms of American investors and other foreign investors.' A key trend during 2012 was the issuance of ultra-long term bonds. For example, the Province of Nova Scotia has raised about $1.3 billion (CAD) since January 2012 with a bond issue maturing in 2062.

- Front Page Headline, Financial Times – **"Rajoy Allegation Lifts Spanish Bond Yields.** Spanish sovereign debt yields incurred their biggest one-day increase since September, as the controversy over slush fund payments to Spanish Prime Minister Mariano Rajoy and his party, unnerved fixed income investors. While Mr. Rajoy over the weekend denied the corruption scandal allegations, with Spain's opposition calling for him to resign as prime minister, the country's benchmark 10-year bond yield rose by 23 basis points to 5.44% (one basis point is 1/100 of 1%). At a joint Berlin news conference with German Chancellor Angela Merkel, Prime Minister Rajoy declared: 'I have the same desire, hope, strength and courage as when I arrived.' Chancellor Merkel confirmed: 'In its effort to end the five-year economic crisis, the Spanish government has the full trust of Berlin.' **Wakeup call for Chancellor Merkel: 'Put not your trust in princes, nor in any child of man, for there is no help in him. His breath goes forth and he returns to his earth; in that very day his thoughts perish.' Biblical Psalm 146: Verses 3-4."**

A fake internet image ridiculing Mr. Rajoy — Source: @daraconn2

- Front Page Headline, Financial Times – **"Emerging Market Companies Commit Original Sin on Debt.** A brisk trade in emerging market bonds has triggered fears that an emerging market debt bubble is inflating. Never before has the developing world enjoyed such low bond yields, at least in U.S. dollars. The risk is that some emerging economies and their companies may be borrowing too much denominated in foreign currencies. According to Dealogic, the volume of foreign currency bonds issued by emerging market companies and banks broke records in 2012, totaling more than $300 billion (U.S.). The pace of issuance to date in 2013 is almost twice that of last year. The International Monetary Fund is keeping a watchful eye on some smaller, poorer states to ensure they do not commit what has been termed the original sin of emerging markets. However, this time it may be companies, rather than governments, that are indulging."



Tuesday, February 5th

- Front Page Headline, Washington Post – **"U.S. President Obama Misses Budget Deadline for Third Consecutive Year.** Once again, Republicans are complaining about the fecklessness of President Barack Obama on fiscal matters as the White House misses the deadline for submitting a budget to Congress for the fiscal year ending September 2014. Although the Obama administration refuses to reveal a time frame for the budget release, congressional aides in both parties expect to see the budget in the latter half of March. Rudolph Penner, a budget expert at the Urban Institute commented: 'The 2014 budget will at least tell us ... whether President Obama really seriously wants a grand bargain, or whether it will be more marginal adjustments like last year. It will tell us a lot about precisely what the President wants to do over the next four years."

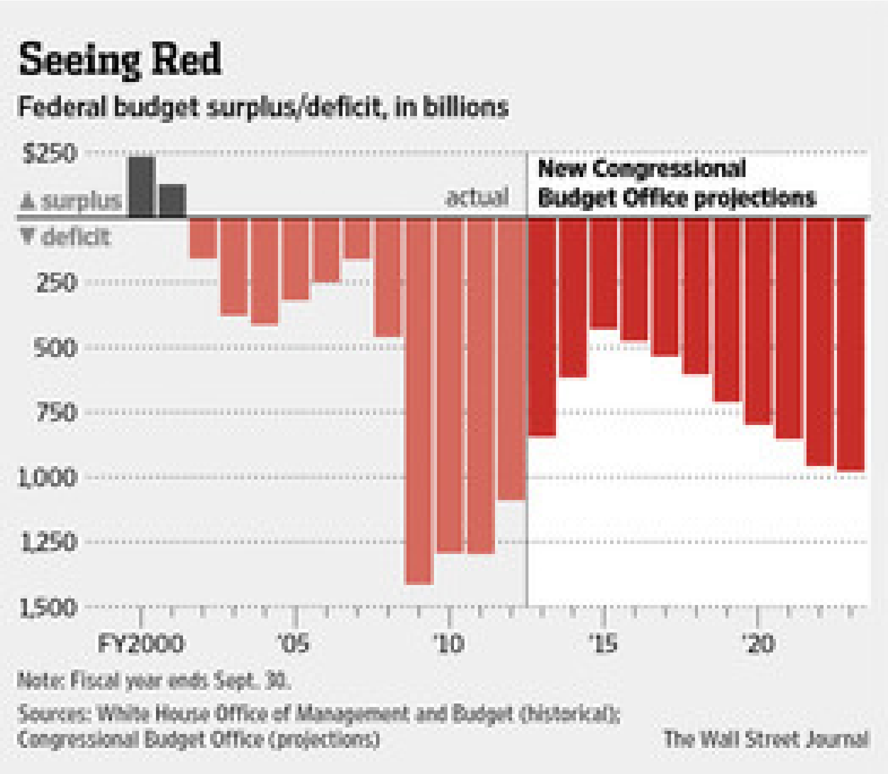
U.S. President Barack Obama — Source: Associated Press

- Front Page Headline, Bloomberg News – **"U.S. Attorney General Holder Cites Egregious Conduct by McGraw Hill / S&P.** The U.S. Justice Department is seeking as much as $5 billion (U.S.) in penalties from McGraw Hill and its Standard and Poor's unit as punishment for its inflated credit ratings, that U.S. Attorney General Eric Holder said were central to the worst financial crisis since the Great Depression. At a news conference in Washington, Mr. Holder, flanked by state attorneys general who also filed suit against the New York-based company, said S&P made false representations, concealed facts and manipulated ratings criteria and credit models for profit. The Justice Department complaint, filed yesterday in Los Angeles, accuses McGraw Hill and S&P of three types of fraud in the first federal case against a ratings agency for credit gradings related to the financial crisis. Attorneys general for 13 states and the District of Columbia filed suits against the company. Three states – Illinois, Connecticut and Mississippi – had previously filed suits."

- Front Page Headline, Bloomberg News – **"U.S. President Obama Urges Congress to Delay Automatic Spending Cuts.** In a White House press conference, President Obama urged Congress 'to postpone sequester spending cuts scheduled to begin March 1st. in order to avoid real and lasting (negative) impacts on U.S. economic growth. Deep, indiscriminate cuts to areas like education and training, energy and national security will cost us jobs and slow down our (economic) recovery. This doesn't have to happen. Lawmakers should act on a short-term package of spending cuts and changes to the tax code that would increase revenue, such as limiting tax breaks, to replace part of the $1.2 trillion (U.S.) in across-the –board reductions.' In a statement, House Speaker John Boehner (R.- Ohio) commented: 'We believe there is a better way to reduce the deficit, because Americans do not support sacrificing real spending cuts for additional tax increases."

- The Tempe, Arizona-based Institute for Supply Management (ISM) reports its non-manufacturing index declined slightly to a reading of 55.2 in January, following a level of 55.2 in December

- Front Page Headline, Wall Street Journal – **"CBO Projects Total U.S. Federal Debt Will Reach 77% of GDP by 2020.** The Congressional Budget Office – the non-partisan U.S. agency that advises Congress on budget and economic matters – projects that if Congress leaves current laws unchanged, U.S. debt will be 77% of gross domestic product (GDP) by the end of the decade, and it will be even higher if across-the-board spending cuts are diluted, or various expiring tax breaks are extended. CBO Director Douglas Elmendorf emphasized the risk of failing to stabilize the debt: 'At this level of debt relative to GDP, our country would be incurring costs and bearing risks of a sort that we have not experienced in our history, except for a few years at the end of the Second World War. At the same time, bringing debt down relative to GDP requires reductions in services which we are getting from the government, or higher taxes paid to the government."



Wednesday, February 6th

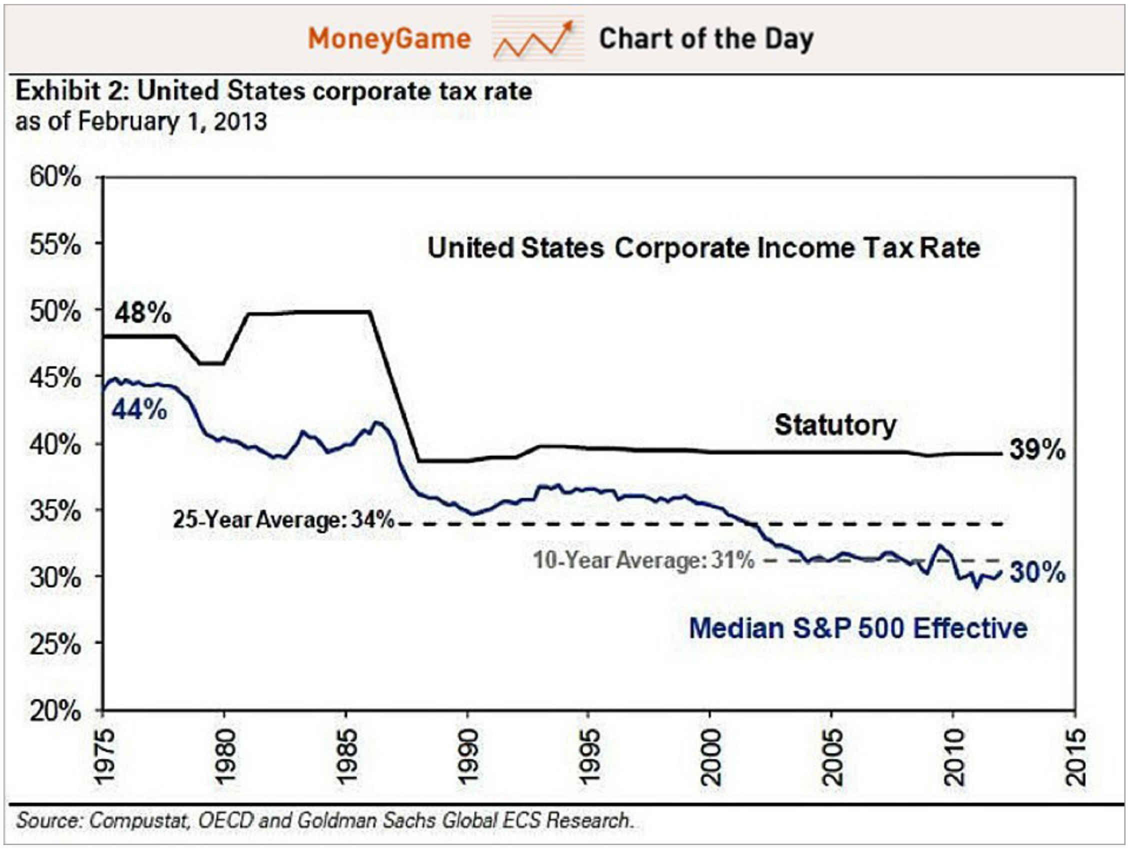
- Front Page Headline, Wall Street Journal – **"Government Spending Must Be Tackled: Boehner.** The chances of avoiding approximately $85 billion (U.S.) in government (sequester) spending cuts scheduled to begin March 1st. are dwindling, as House Republicans stand firm against Democratic calls to replace the spending cuts with tax increases. In rejecting U.S. President Obama's call yesterday to postpone the spending cuts, House Speaker John Boehner (R., Ohio) commented: 'Personally, I don't like the spending cuts, which equate to taking a meat axe to our government and will weaken our national defense. However, at some point Washington must deal with its spending problem. President Obama doesn't believe we have a spending problem because he genuinely believes that government spending creates economic growth.' The signs that Congress is preparing a last-minute plan to avoid the sequester cuts are few at the moment. Moreover, there are neither back-channel conversations between Democratic and Republican leaders on avoiding the spending cuts, nor has House Majority Leader Eric Cantor (R.,Va.) outlined a floor schedule for next week which omits any votes to suspend or replace the mandatory spending cuts. Mr. Cantor and House Minority Whip Steny Hoyer (D., Md.) debated the sequester cuts on the House floor today. Mr. Hoyer complained: 'We're not going to escape the (automatic) sequester unless there's legislation that you bring to this floor and you have the authority to do that. I don't think it ought to happen because I think the sequester cuts are going to be bad for the country.' Mr. Cantor countered: 'Democrats are constantly saying let's just raise more taxes."

House Speaker John Boehner Source: Associated Press

- Front Page Headline, Daily Telegraph U.K. – **"RBS Fined 390 Million Pounds for Rigging LIBOR Rate.** Evidence discovered by investigators reveals how staff at the Royal Bank of Scotland conspired with traders at rival banks including UBS, to manipulate the London Inter-bank Offered Rate for profit between 2006 and 2010. E-mails published by the U.S. Department of Justice, the Commodities Future Trading Commission (CFTC) and the Financial Services Authority revealed traders boasting about their ability to profit from rigging interest rates."

An RBS employee crosses the bank's foyer in Edinburgh. Source: Getty Images

- Front Page Headline, Business Insider – **"U.S. Companies Haven't Paid the Statutory Tax Rate for at Least 45 Years: OECD.** According to the Organization for Economic Cooperation and Development, the U.S. statutory corporate tax rate is 39%. This represents a combination of the 35% federal statutory tax rate and a weighted average of state marginal income tax rates. However, due to a complicated tax code riddled with breaks, subsidies and loopholes, the actual tax rate paid is much lower. David Kostin, a research analyst at Goldman Sachs, explains: 'Statutory (tax) rates do not reflect the effective taxes paid by large-cap American firms. For the last 45 years, the median S&P 500 firm has paid an effective tax rate averaging more than 5 percentage points below the statutory rate. Despite statutory (tax) rates hovering near 39% for the last 25 years, effective tax rates have been gradually declining (see chart below). At 30%, the current S&P 500 median effective tax rate is almost 10 percentage points below the statutory level and close to the global statutory average. The aggregate tax rate has averaged 33% over the past 10 years and was 26% for 2012 ... Indeed, less than 10% of U.S. companies pay at least the statutory (tax) rate of 39%. The tax preferences which create the gap between effective and statutory (tax) rates will likely receive scrutiny from policymakers as they attempt to reform the tax code. By closing the gap between effective and mandated tax rates, the (federal) government could raise revenues while lowering the statutory (tax) rate, thus presenting the change as a tax cut. Democratic leaders, including President Obama and House Minority Leader Nancy Pelosi, have specifically mentioned targeting corporate tax strategies which create this gap."



Thursday, February 7th

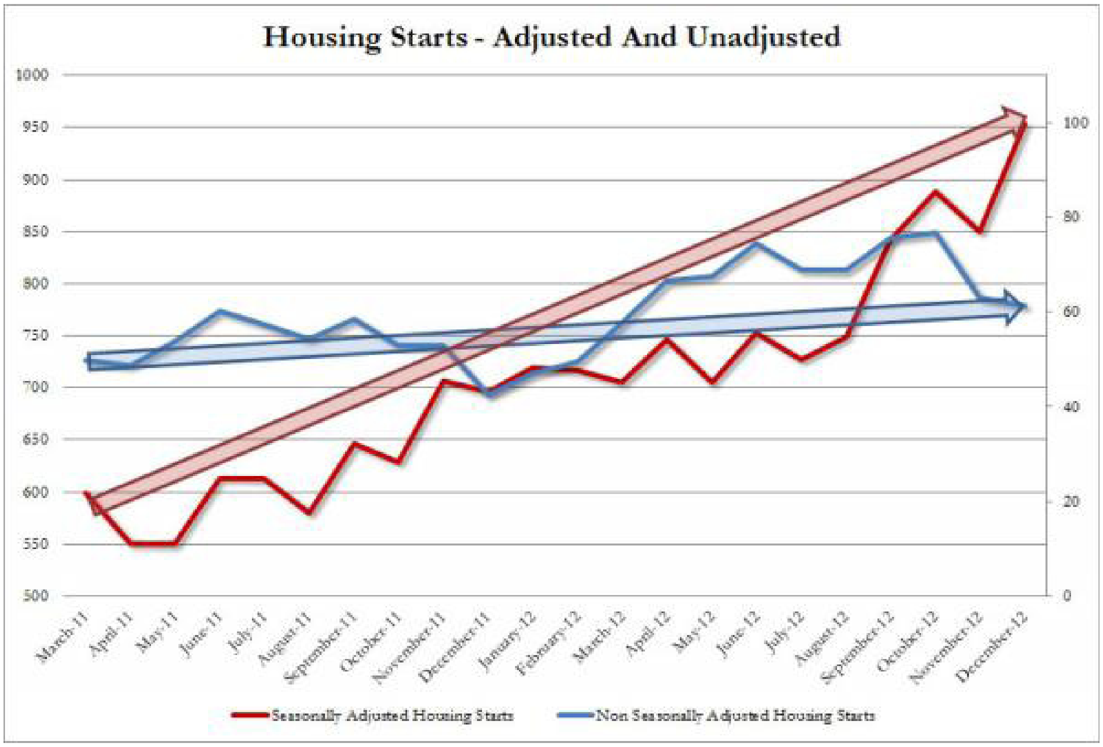
- Several U.S. retailers report mixed sales results for January, as consumers faced lower take-home pay packets resulting from higher payroll taxes; while cold weather increased the purchases of winter clothing. For example, Costco Wholesale Corp. reported January same store (outlets open for at least a year) sales rose by 4%.

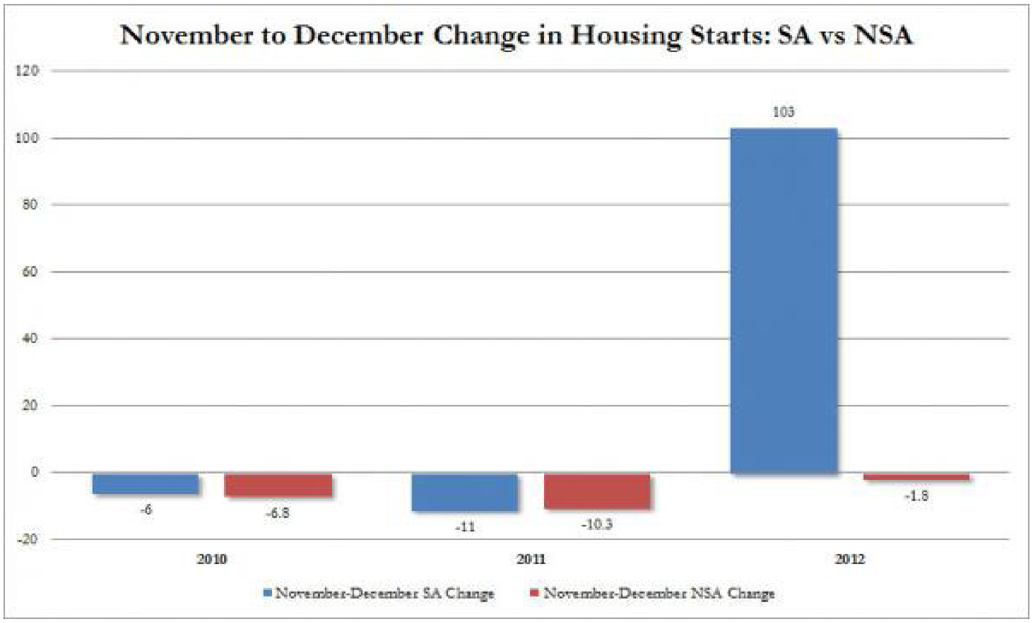
- Front Page Headline, New York Times – **"Ireland Reaches Agreement with ECB to Ease Huge Debt Load.** Following 18 months of negotiations with the ECB, the Irish Government reaches an agreement enabling it to lighten its staggering debt burden of bailout loans made to its biggest banks 4 years ago. The agreement will enable Ireland to swap 28 billion euros ($38 billion U.S.) of high interest promissory notes, which were used to bail out Anglo Irish Bank in 2009, for long term government debt. Although specific details of the agreement were not disclosed, it appears to be another important milestone in Ireland's slow emergence from a banking and real estate crisis which had cut living standards, worsened unemployment and left cities scarred by half-finished building projects. The agreement could also be an important step for the euro zone, illustrating that it is possible for a member to survive the painful financial adjustments imposed to recover from the crisis without leaving the European Monetary Union."

- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 5,000 to a seasonally adjusted 366,000 in the week ended February 2nd. while continuing claims rose by 8,000 to 3.22 million in the week ended February 26th.

- Statistics Canada reports the value of the nation's building permits issued by municipalities declined by 11.2% to $5.7 billion (CAD) in December, following a 14.5% drop in November, citing lower construction intentions in both the residential and commercial sectors. Every province, except Quebec, registered a drop in December, with Alberta, Manitoba and Ontario posting the largest declines.

- Front Page Headline, Le Metropole Café – **"The U.S. Housing Recovery Is a Complete Myth.** When one analyzes the critical variables underlying the housing market, it leaves no doubt that the market remains fundamentally damaged and overvalued, with a very high probability that the market has another serious decline ahead of it. Furthermore, housing stocks have completely dislocated from market fundamentals and investors who hold them risk a significant loss of capital once the equity market discounts the underlying fundamentals. The U.S. housing market recovery that is perceived by investors and the public at large is a product of deceptively reported housing statistics and hyperbolic media reporting. The entities which report housing market data (government agencies and housing market associations) take considerable liberties with adjusting the data, often utilizing data massaging techniques such as 'seasonable adjustments.' The government's housing starts report of January 17, 2013 illustrates this point. The headline reported 954,000 housing starts for December 2012 on a 'seasonally adjusted annualized' basis, a 36.9% increase over December 2011. That 36.9% increase is embedded with a plethora of statistical errors. If one looks at the non-seasonally adjusted number of housing starts for the month of December 2012, it came in at 61,500. **In point of fact, that was the lowest monthly non-adjusted number since March 2012.** The following are two charts prepared by Zerohedge, which graphically portray our point that the actual data, when stripped away from the statistical adjustments, show an entirely different picture.





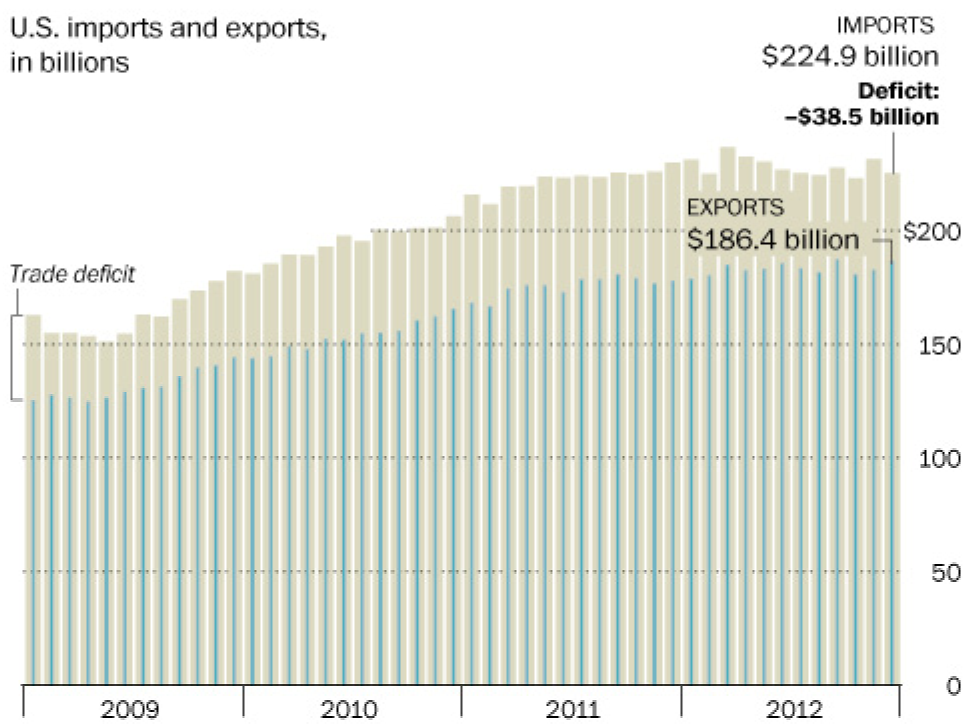
Friday, February 8th

- Front Page Headline, Globe and Mail – **"Twilight of an Energy Boom: Alberta's New Fiscal Challenge.** As it confronts an energy market that has turned dramatically against it in recent times, the hopes and dreams of the Province of Alberta are undergoing a hollowing out process. Alberta is rapidly tumbling back to the group of Canadian provinces experiencing severe fiscal challenges. The Alberta provincial government has just witnessed $6 billion (CAD) evaporate from its revenues as a result of declining natural resource income; equivalent to the province's annual education budget."

An oil pumpjack sits unused in a field north of Edmonton. Source: Jason Franson / Globe and Mail

- Front Page Headline, Bloomberg News – **"China Surpasses U.S. as World's Largest Trading Nation.** Measured by the sum of exports and imports, China surpassed the U.S. to become the world's biggest trading nation in 2012, representing a milestone in the Asian nation's challenge to the American dominance in global commerce, which has been the case since the end of World War II in 1945. Last week, the U.S. Commerce Department reported American imports and exports totaled $3.82 trillion (U.S.) in 2012.In January, China's customs administration reported that country's total trade in 2012 amounted to $3.87 trillion (U.S.). China posted a $231.1 billion (U.S.) annual trade surplus while America registered a deficit of $727.9 billion (U.S.). In a telephone interview, Jim O'Neill, chairman of Goldman Sachs' Asset Management Division – and the economist who bound Brazil to Russia, India and China to form the BRIC investing strategy – commented: 'For many countries on a global basis, China is rapidly becoming the most important bilateral trading partner. At this kind of pace, by the end of the decade many European countries will be doing more individual trade with China than with bilateral partners in Europe."

- Front Page Headline, Washington Post – **"U.S. Trade Deficit Declined in 2012.** The Commerce Department reports the U.S. trade deficit declined in 2012 – for the first time in three years – citing record exports, combined with a drop in the cost of imported oil and reduced demand for foreign consumer goods. In a statement, Deputy Commerce Secretary Rebecca Blank noted: 'We're continuing to make historic progress, since a record $2.19 trillion (U.S.) in exports was achieved despite global economic headwinds which undercut trade in many countries."



- Statistics Canada reports the nation's employers cut 21,900 jobs in January, as both the public and private sectors posted layoffs. Meanwhile, the unemployment rate eased slightly to 7% from 7.1% in December – its lowest level since December 2008 – as fewer people were recorded looking for work. Citing the weakening outlook for the Canadian housing and export markets, Merrill Lynch economist Joshua Dennerlein noted: "I definitely think Canada is going to experience some economic softening during 2013."

- Front Page Headline, Globe and Mail – **"Venezuela Devalues Its Currency by Nearly Half.** The Venezuelan government announces it is devaluing the country's fixed exchange rate from 4.3 bolivars to the U.S. dollar to 6.3 bolivars to the American dollar. Under the government's strict currency exchange controls – in force since 2003 – people and businesses must apply to a government currency agency to receive U.S. dollars at the official rate to import goods, pay for travel or, cover other obligations. However, in black market street trading, U.S. dollars have recently been selling for more than 4 times the official exchange rate of 4.3 bolivars."

- The Canada Mortgage and Housing Corp. (CMHC) reports the nation's housing starts declined to 9,904 in January, compared with 13,038 in January 2012. The seasonally adjusted annualized rate of Canadian housing starts was 160,577 units in January; down from 197,118 in December which was revised from 197,976 reported previously. In a statement, Deputy Chief Economist Mathieu Laberge commented: "The trend in total housing starts has been moderating since September 2012 and in existing home sales since May 2012. Trends in the two market segments typically follow a similar pattern, with the new home market lagging behind the existing home market by a few months. The current trend is also in line with CMHC's 2013 outlook for housing starts."

CLOSING LEVELS FOR FRIDAY, February 8th		WEEKLY CHANGE
Dow Jones Industrial Average	13,992.97	– 16.82 points
Spot Gold Bullion (April)	$1,666.90 (U.S.)	– $2.50 per oz
S&P / TSX Composite	12,801.23	+ 32.40 points
10 - Year U.S. Treasury Yield	1.94%	– 8 basis points
Canadian Dollar	99.73 (U.S.)	– 0.63 cent
U.S. Dollar Index Future (Spot Price)	80.201 cents	+ 0.995 cent
WTI Crude Oil (April)	$95.72 (U.S.)	– $2.05 per barrel

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

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