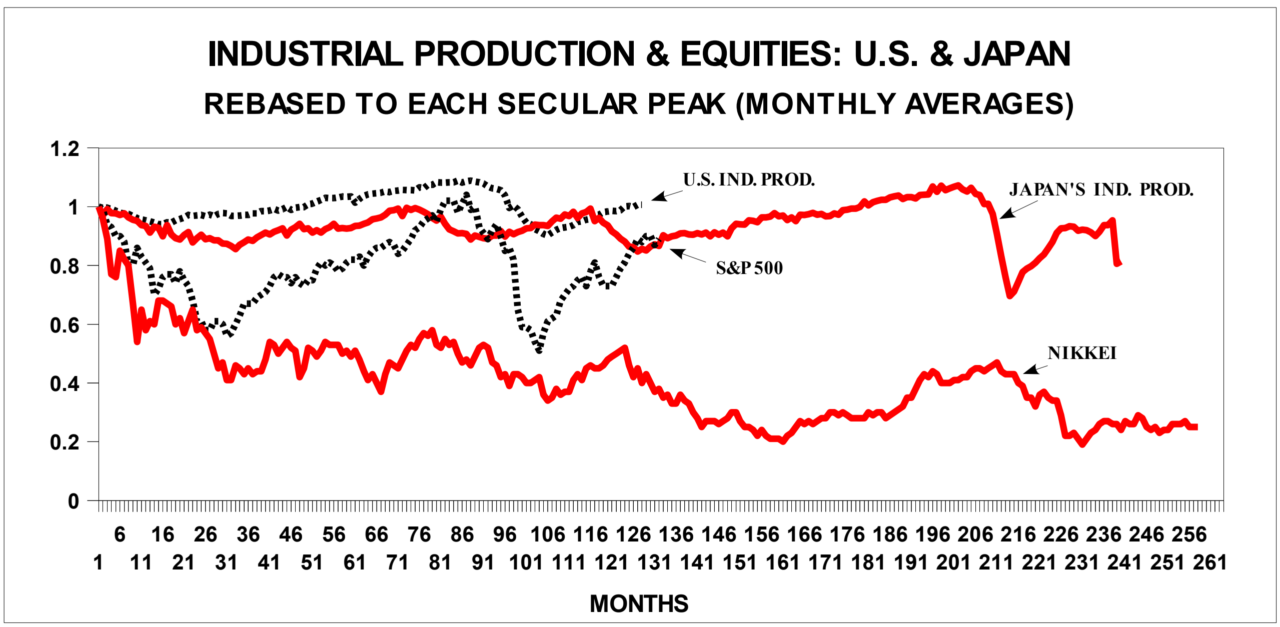
BUSINESS CYCLE DEVELOPMENTS

Unlike Credit Controls or wars, an exogenous shock can also be subtly imbedded in a secular growing economy, slipstreaming behind the organic growth and enhancing it for years, but all the while inserting its error within the economy. Two examples of this were the Subprime and the Euro Crises. Both times slow economic growth and market clearing price realities flushed them out.

Subprime issues started in the 1990's through relaxed underwriting standards, the repealing of Glass-Steagall and the Commodity Futures Modernization Act of 2000. A few saw through the Subprime flaw, that was dispersing its defects and misdirecting economic growth for years. However, when E*Trade sold their MBS's in late summer 2007 for 23 cents on the dollar it turned what was then an economic slowdown into a recession. This slow ticking policy error, once exposed, acted like an exogenous shock, similar to Credit Controls or wars.

The doom of a common currency, without a political connection, was predicted by a few savants, but the leveraging-up and growth allowed this policy error to slipstream along, concealing the pressures of the spendthrift south vs. the provident north. When the gearing and growth slowed it exposed an exogenous shock. Strong growth covers policy errors, but slow growth and free market clearing prices will flush them out.

That Euro Crisis, coupled with the July 29th GDP revision and the Budget Control Act of 2011, are all coinciding major exogenous shocks. To find out on July 29th that the past 13 quarters of GDP were revised down



an average of -1% each quarter is significant and underscores proof of the Japanization of the U.S. This revision vindicates the 2010 slowdown and the Japanization has been pointed out in the chart above and as early as August 12, 2004, but not without arguments. Two trading days later (August 2nd) the Budget Act included severe cuts to defense and healthcare, which had not been expected. Any industry that has 10% or more of its revenues coming from government programs has to be very concerned they don't get sacrificed on the altar of a balanced budget. It's no wonder the markets have shuddered -18%, as these are exogenous events, unpredictable by algorithmic means and operating from outside conditions or an ultimately exposed imbedded policy error.

Past exogenous shocks have caused recessions, but consumers and corporations are already taking steps to ameliorate an inventory digestion cycle or recession. One negative quarter is possible, but not two and slow growth is certain. Tradable rallies, similar to the five in Japan, will begin ahead of any resolution having to do with the budget or the euro. Every market downturn in the past 50 years that has not been accompanied by a recession has averaged -19% (+/- 6%) for eight months (+/- 4 mo.). Assuming April as the peak, then we've seen four months decline and 95% of the average correction. If there's no recession, then two of six **Market Trough Indicators** are needed and there's only one, to date. From the 2nd **MTI** to the bottom it's been -7% (+/- 7%) and 3 months (+/- 2 mo.). If a recession is expected, then five of the six **MTI's** must be signaling to re-enter equities.