

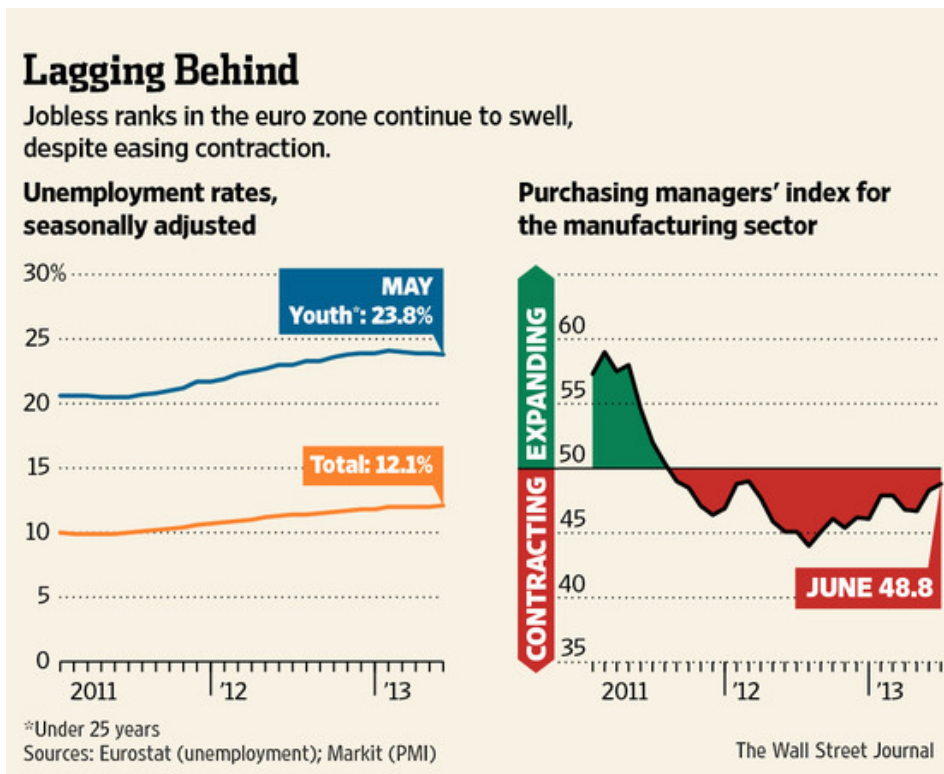
UNDERSTANDING THE LONGWAVE ECONOMIC AND FINANCIAL CYCLE
THAT WAS THE WEEK THAT WAS



Monday, July 1st
Front Page Headline, Wall Street Journal – “Record Euro Zone Unemployment Likely to Increase Further.”

Monday, July 1st Canada Day

Eurostat reports the unemployment rate across the 17 countries in the European Monetary Union (EMU) rose to a record 12.1% in May from 12.0% in April. Anna Zabrodzka, an economist at Moody’s Analytics, commented: ‘A contracting economy and major fiscal consolidation across the region have been the main drivers of rising euro zone unemployment. Despite signs of improvement, this year will be challenging for the euro zone’s economy. Unemployment will continue to increase even further because the labour market follows the business cycle with a lag.’



- The Institute for Supply Management (ISM) reports its U.S. manufacturing index rose to a reading of 50.9 in June from a level of 49.0 in May. The ISM index is compiled from a survey of executives who order raw materials and a variety of supplies for their companies. Thomas Simons, an economist at Jeffries & Co., noted: “The ISM index is averaging a 50.2% reading over the past three months which indicates the manufacturing sector is stuck in neutral.”
- The Commerce Department reports U.S. construction spending rose by 0.5% to a seasonally adjusted annual rate of \$874.9 billion (U.S.) in May, from a downwardly revised gain of 1% in April, previously reported as an increase of 0.4%.
- The National Bureau of Statistics and China Federation of Statistics and Purchasing reports its purchasing managers’ index (PMI) declined to a reading of 50.1 in June – the lowest reading in four months – from a level of 50.8 in May. Separately, HSBC Holdings Plc and Markit Economics report their private PMI declined to a reading of 48.2, the lowest level since September 2012. In a note to clients, Lu Ting, an economist at Bank of America Corp. in Hong Kong observed: “The lower official PMI could heighten concerns that the liquidity squeeze in June will negatively impact GDP growth.”

Tuesday, July 2nd

- Front Page Headline, Daily Telegraph U.K. – **“It May Take 20 Years to Fix British Economy.”** In a speech to an audience of civil servants at Civil Service Live in west London, Cabinet Secretary Sir Jeremy Heywood warned: ‘The austerity measures instituted by the Coalition Government did not extend nearly far enough and there is still a very long way to go. This is not a 2-year project or a 5-year project. This is a 10-year project: a 20-year generational battle to bolster the economy in ways that we have not seen for many, many decades ... We were reminded only last week that the economy as a whole remains about 4% below the size it was in 2008. Those are really daunting numbers which just show the size of the challenge; there is no alternative. All the civil servants in the room will be well aware that the last three or four years have been tough. There have been years of austerity, years of pay freezes and of pay restraint. Every part of government has been told by ministers – and rightly so – to hunt out waste and tackle inefficiencies. However, despite all of these efforts we have made over the last three years ... our debt to GDP ratio is still rising and debt interest payments are rising. There is still an enormous amount of work to reduce our deficit to a balanced level ... Austerity measures will likely continue until 2017 and possibly longer.’



U.K. Cabinet Secretary Sir Jeremy Heywood

Source: REX / Daily Telegraph

- The Commerce Department reports U.S. factory orders rose by 2.1% in May, citing higher orders for motor vehicles, heavy machinery and computers. Bricklin Dwyer, an economist at BNP Paribas in New York commented: “We’re expecting a second half gross domestic product growth story (to unfold), which should promote more (business) investment. At this point, GDP growth is pretty stagnant.”
- Front Page Headline, Globe and Mail – **“U.S. Auto Industry’s Sales Accelerate.** General Motors, Ford Motor and Chrysler Group all gained market share in the first half of the year for the first time in two decades as demand in June for brawny pickup trucks drove the American auto industry to its strongest month since late 2007. Overall, U.S. auto industry sales in June rose by 9% to 1.4 million vehicles and finished the month with the strongest annual sales pace – at 15.96 million vehicles – since November 2007.”
- Front Page Headline, Daily Telegraph U.K. – **“France’s Triumphant ‘Joan of Arc’ Vows to Restore Franc.** Marine Le Pen is spoiling for a fight. If she wins the next election, Mrs. Le Pen vows to destroy the existing order of Europe and force the dissolution of the European Monetary Union (EMU). It is no longer an implausible prospect. In an interview with the Daily Telegraph, Mrs. Pen stated: ‘Upon setting foot in the Elysee Palace, my first order of business will be to announce a referendum on European Union (EU) membership, rendez vous one year later. I will negotiate over the points upon which there can be no compromise. If the result is inadequate, I will call for withdrawal. We cannot be seduced. The euro ceases to exist the moment that France leaves and that is our incredible strength. What are they going to do, send in tanks? Europe is just a great bluff. On one side there is the immense power of sovereign peoples and on the other side there are a few technocrats.’ In a recent by-election, Mrs. Pen’s Front National Party secured 46% of the vote, trouncing the ruling Socialists in their own bastion of Villeneuve-sur-Lot. For the first time, the Front National is running level with the two governing parties of post-war France; Socialists and Gaullistes. All parties are near 21% in the national polls, although the Front alone has the wind in its sails. Yet it is the detail in the Villeneuve vote that has shocked the political class. The Front scored highest in the most Socialist cantons, a sign that it may be breaking out of its right-wing enclaves to become the mass movement of the white working class. The French media have begun to talk of ‘Left-LePenism’ as Mrs. Pen outflanks the Socialists with attacks on banks and cross-border capitalism. Meanwhile, Anna Rosso-Roig – a candidate for the Communist Party in the 2012 elections – has just defected to the Le Pen camp. The Socialists had thought the rising star of Marine Le Pen would work to their advantage, splitting the Right. However, now they discern a deadly threat.



Marine Le Pen, Leader of the Front National Party

Source: EPA

- Front Page Headline, Globe and Mail – **“U.S. Federal Reserve Adopts Basel III Capital Rules.** The American central bank voted in favour of the long-awaited U.S. version of the global rules which require banks to use more equity capital to fund their operations; making them more robust following the 2007-2009 credit meltdown. While it provides some flexibility to benefit the housing recovery and smaller banks, the Fed announced it would write four new rules in the coming months to address concerns about the risk the eight largest U.S. banks pose to the financial system. Allison Breault, a lawyer at Cleary, Gottlieb, Steen and Hamilton in Brussels noted: ‘The headline here is that American community banks are receiving significant relief. However, the largest banking organizations are going to be subject to even more strict requirements than they had originally anticipated.’”
- Front Page Headline, Globe and Mail – **“EU Issues Greece Three-Day Ultimatum.** Unhappy with the limited progress which Greece has made in reforming its public sector, the country has been given three days to reassure the European Union and the International Monetary Fund (IMF) that it can comply with the conditions attached to its international bailout, in order to receive the next tranche of financial aid. Athens, which has about 2.2 billion euros of bonds maturing in August, needs the current talks to conclude successfully. If they fail, the IMF might have to withdraw from the 240 billion euro bailout in order to avoid violating its own rules, which require a borrower to be financed a year in advance.”

Wednesday, July 3rd

- The Commerce Department reports America’s trade deficit widened by 12.1% to \$ 45 billion (U.S.) in May, citing a near record level of imports at \$232.1 billion (U.S.), as consumer demand increased for foreign produced products such as cellular phones, automobiles and fuel.
- Roseland, New Jersey-based ADP Research Institute reports U.S. private sector payrolls increased by 188,000 workers in June, following a gain of 134,000 in May.
- The Labor Department reports U.S. initial claims for state unemployment benefits declined by 5,000 to 343,000 in the week ended June 29th. – from an upwardly revised 348,000 in the week ended June 22nd. – while continuing claims declined by about 60,000 to 2.93 million in the week ended June 22nd. Those people who have exhausted their traditional benefits and are now receiving emergency or extended benefits from state and federal programs declined by 39,300 to 1.67 million in the week ended June 15th.
- Markit Economics and the Chartered Institute of Purchasing and Supply report the U.K. services industry index rose to a reading of 56.9 in June from a level of 54.9 in May. Alan Monks, an economist at JP Morgan Chase in London noted: “The breadth of the improvement in the U.K. data is striking. While it’s too early to identify the demand drivers ... the output data suggest this strength will continue into the 3rd. quarter.”
- Front Page Headline, Globe and Mail – **“Political Turmoil Threatens Europe’s Fragile Economies.** Political instability in Portugal, combined with troubles in Greece and Italy, are raising the prospect of an austerity backlash, rather than the gaping budget deficits which have been the hallmark of the sovereign debt crisis in the 17-member European Monetary Union (EMU). The resignations of both the finance and foreign ministers in the centre-right government of Prime Minister Pedro Passos Coelho has plunged Portugal into political chaos, helping to drive down European stock prices and send the country’s 10-year sovereign bond yield north of 10%. The fear among investors and European political leaders is that Portugal’s coalition government will collapse, putting its austerity programs into disarray. A political vacuum in Portugal would send voters back to the polls two years ahead of schedule, possibly electing an anti-austerity government bent on undermining reforms and spending cuts agreed upon in 2011, when the European Union (EU) and International Monetary Fund (IMF) sponsored a 78 billion euro (\$107 billion U.S.) Portuguese bailout package. All this transpires even as several of the worst-hit euro zone countries are seeing tentative, though encouraging, signs that their job-killing recessions are bottoming out. Any upset to that trend could plunge the region back into crisis mode as the global economic recovery struggles to unfold. Retail sales in the 17-country EMU rose by 1% and industrial production in some of those countries is either rising or contracting less sharply. Brenda Kelly, a market strategist with IG Group in London observed: ‘Political upheaval in Egypt and an austerity backlash within the Portuguese government – both of which threaten to re-ignite the euro zone crisis – have led to a strongly negative (market) sentiment today. For now, it seems that we must accept (the probability of) a summer of market volatility.’”
- Statistics Canada reports the country’s trade deficit shrank by almost 70% in May, solely because imports declined twice as fast as exports, reflecting challenges for the economy. Canada’s 17th. consecutive trade deficit fell to \$303 million (CAD) in May from an upwardly revised \$951 million (CAD) in April. The figures indicate that exporters are still struggling to cope with uncertain foreign markets while lower imports reflect a flat domestic economy.

- Front Page Headline, Wall Street Journal – **“Egyptian Military Ousts President Morsi.** In a terse televised statement, Defense Secretary General Abdel Fattah Al Sisi – joined by important Muslim, Coptic and opposition leaders – not only, announced the ouster of President Morsi, but also, the appointment of Adly Mansour – Chief Justice of Egypt’s Supreme Constitutional Court – to lead a technocratic, empowered government inclusive of all political factions. General Al Sisi also suspended the Egyptian constitution and charged the Court with addressing the draft law for new parliamentary elections.”



Anti-Morsi protestors set off fireworks in Tahrir Square, Cairo.

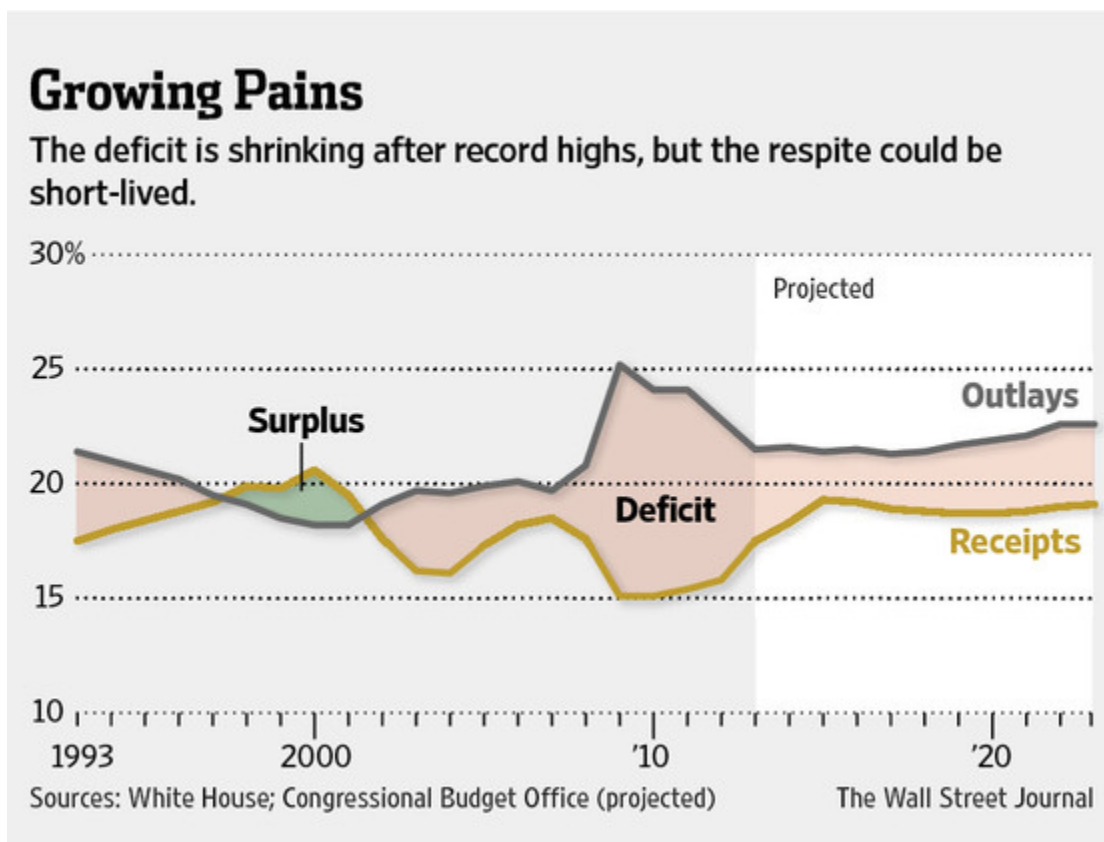
Source: Reuters



Egyptian General Al Sisi

Source: AFP / Getty Images

- Front Page Headline, Wall Street Journal – **“Next Debt Ceiling Fight Could Unfold This Fall.** Sometime between September and November, U.S. Democrats and Republicans are expected to again debate one of Washington’s least pleasant topics: whether to raise the federal government’s statutory debt limit. Bipartisan efforts earlier this year to broker a budget deal and raise the debt ceiling faltered amid political gridlock over taxes, spending and entitlements. However, Washington is always capable of delaying these negotiations to a later time.



Thursday, July 4th Independence Day Holiday in the United States

- Front Page Headline, Daily Telegraph U.K. – **“Carney and Draghi Extend Easy Monetary Policies.** In a coordinated effort to reassure global markets, newly-appointed Bank of England Governor Mark Carney and European Central Bank Governor Mario Draghi announced their easy monetary policies would remain in place for an extended period of time. In his BOE Monetary Policy Committee announcement, Governor Carney emphasized: ‘Investors are not warranted in thinking that the prevailing level of interest rates would begin rising from the end of 2104.’ ECB President Draghi soon echoed: ‘Interest rates will be at current or lower levels for an extended period of time.’
- Front Page Headline, Wall Street Journal – **“IMF Fears Risks of Policy Slippage in Italy.** In its annual Article IV report, the International Monetary Fund warns: ‘Any policy slippage in Rome could further tighten credit conditions and renew doubts about Italy’s 2 trillion euro (\$2.6 trillion U.S.) sovereign debt load.’ The IMF has long urged Italy to shift fiscal burdens away from highly taxed labour and business to wealth and consumption, a proposal that has renewed focus during a long recession, when Italy’s households are dipping into their savings to offset dwindling income. Another IMF proposal was to increase the inheritance tax in the name of fairness and efficiency. Aasim Husain, deputy director of the IMF’s European department, observed: ‘Tax debates should hang on what levies are most (GDP) growth friendly.’”

- Front Page Headline, Financial Post – “**Pension Fund Deficits Reach the Danger Zone: DBRS.** Based upon the 2012 financial results of 461 defined benefit pension plans in Canada, Japan, Europe and the United States, the Dominion Bond Rating Service concludes: ‘For the first time since DBRS began evaluating the health of pension funds a decade ago, the aggregate pension deficit is now in the danger zone with a 78.3% funded status; or below the 80% level which we deem to be a minimum funding threshold. Also, a mere 41% of these pension funds remain in good shape, down from 45% in 2011.’”

WORST AND BEST FUNDED CANADIAN PENSION PLANS

WORST-FUNDED DEFINED-BENEFIT PLANS, BY FUNDING DEFICIT

IN US\$ MILLIONS

Ontario Power Generation	\$3,332
Air Canada	\$3,193
Hydro-Quebec	\$2,759
Bombardier Inc.	\$2,551
Imperial Oil Limited	\$2,222
BCE	\$1,815
Resolute Forest Products	\$1,549
Hydro One Inc.	\$1,515
TELUS Corporation	\$1,364
Suncor Energy Inc.	\$1,294
Saskatchewan Power	\$1,109
Bank of Nova Scotia	\$1,071
Thomson Reuters Corporation	\$984
Canadian Pacific Railway	\$884
Manulife Financial Corporation	\$822
Canadian National Railway Company	\$524
ATCO Ltd.	\$520
Royal Bank of Canada	\$509
Canadian Utilities Limited	\$488
Bell Aliant Regional Communications Inc.	\$466

BEST-FUNDED DEFINED-BENEFIT PLANS, BY FUNDING DEFICIT

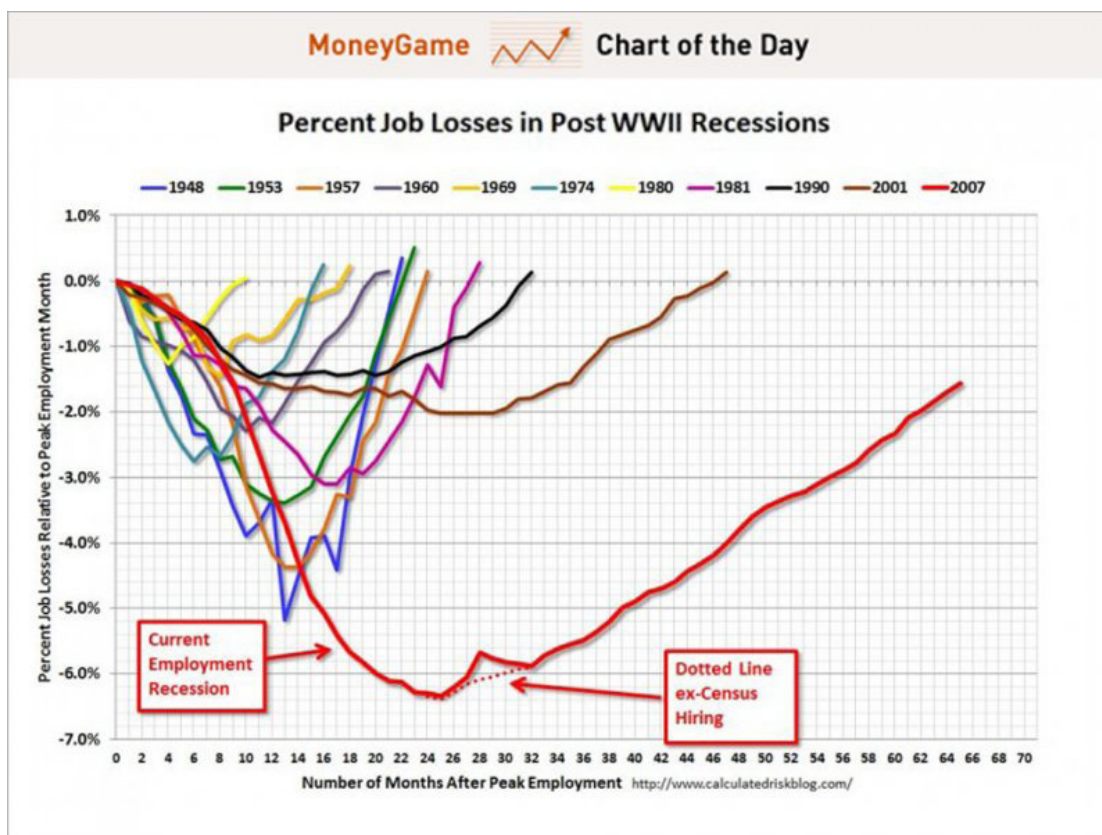
IN US\$ MILLIONS

Pembina Pipeline Corporation	\$22
Toromont Industries Ltd.	\$27
Norbord Inc.	\$30
Husky Energy Inc.	\$33
Superior Plus Income Fund	\$33
Nordion Incorporated	\$34
Shoppers Drug Mart Corporation	\$34
Newfoundland Power Inc.	\$44
SNC-Lavalin Group	\$58
ENMAX Corporation	\$68
Laurentian Bank of Canada	\$70
Empire Company Limited	\$70
National Bank of Canada	\$83
Canfor Corporation	\$102
Agrium	\$107
Finning International Inc.	\$109
Metro Inc.	\$111
Talisman Energy Inc.	\$111
Nexen Inc.	\$116
Barrick Gold Corporation	\$121

- Front Page Headline, Financial Times – **“EU Threatens to Suspend Data Sharing With U.S.** The European Union has threatened to suspend two data sharing agreements with the United States, in an escalation of transatlantic tensions over claims that America’s intelligence agencies have been spying on European citizens and embassies. In a letter addressed to Janet Napolitano, secretary of Homeland Security, and David Cohen, undersecretary of the Department of the Treasury, Cecilia Malmstrom, the EU’s home affairs commissioner, stated: ‘We are experiencing a delicate moment in our relations with the U.S., our strongest ally. Mutual trust and confidence have been seriously eroded and I expect the U.S. to do all that it can to restore them. Should you fail to demonstrate the benefits of the terrorist financing tracking program and passenger name record instruments for our citizens and the fact that they have been implemented in full compliance with the law ... I will be obliged to reconsider if the conditions for their implementation are still met.’ According to officials in Berlin, Germany will conduct its own bilateral negotiations with the U.S. to seek ‘clarification’ of the extent of U.S. surveillance, in addition to the EU-U.S. talks agreed upon by Washington. Hans-Peter Friedrich, Germany’s interior minister, will fly to Washington next week to hear at first hand the U.S. response to German reports of European embassies and EU offices being monitored. Mr. Friedrich will follow a mission of high-level officials from Germany’s own intelligence services and his ministry, who are departing at the weekend.”

Friday, July 5th

- The Labor Department reports U.S. non-farm payrolls increased by 195,000 in June, following an upwardly revised similar gain in May, while the official unemployment rate remained unchanged at 7.6%. Retailers, health care, the services industry and leisure and hospitality businesses led the gains in June.



- The Economy Ministry in Berlin reports German factory orders – adjusted for seasonal swings and inflation – declined by 1.3% in May, following a revised decline of 2.2% in April. Carsten Brzeski, an economist at ING in Brussels observed: “The German manufacturing industry still faces challenges to its return to full strength. While reasonably-filled order books should ensure a gradual increase in industrial production, the medium term outlook is not exactly looking rosy.”
- Statistics Canada reports the country’s employment level declined by 400 in June, following May’s upward surge of 95,000 while the official unemployment rate remained unchanged at 7.1%. Separately, London, Ontario-based Western University Business School reported the nation’s Ivey purchasing managers’ index declined to a reading of 55.3 in June – on a seasonally adjusted basis – following a level of 63.1 in May.

CLOSING LEVELS FOR FRIDAY, July 5th		WEEKLY CHANGE
Dow Jones Industrial Average	15,135.84	+ 226.24 points
Spot Gold Bullion (August)	\$1,212.70 (U.S.)	– \$11.00 per oz.
S&P / TSX Composite	12,134.91	+ 5.80 points
10 - Year U.S. Treasury Yield	2.74%	+ 25 basis points
Canadian Dollar	95.54 cents (U.S.)	+ 0.46 cent
U.S. Dollar Index Future (Spot Price)	84.449	+ 1.272 cents
WTI Crude Oil (August)	\$103.22 (U.S.)	+ \$6.66 per barrel

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