

Dashboard

Macro Advisor Snapshot
Spring, 2013



Dashboard – US Inflation (Spring 2013)

Inflation is trending steadily lower in the US

- April core PCE at 1.05% is lowest ever recorded
- Other core inflation measures (CPI, PPI) also lower but more steady
- FOMC calls recent move temporary...alert to, but not alarmed by, lower inflation at this point

Inflation Expectations, however, have remained generally stable

- Household/economist/market expectations are well-anchored...
- ...at the same time Fed forecasts have inched lower.

Slower global growth and persistent output gaps will cap near-term rise in US real yields

- Sluggish Europe/China and US fiscal drag will restrain business confidence
- We expect downside payroll surprises in 3Q2013

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Iron Harbor Open Market - Dashboard

Collecting and processing the vast amount of relevant data that determine global trends is the great challenge of executing a global allocation (macro) strategy. In order to produce high quality returns, an investment team needs an established procedure for collecting data, converting it into information, and then forming investment themes based on that information.

Our economic database—Dashboard—consists of twenty countries and another twenty individual global economic data series. Dashboard is the foundation of our primary research effort and a key input in our investment process. Our senior markets analyst, **Eva Yun**, manages this process and has an important role in ensuring procedural consistency and discipline in idea generation.

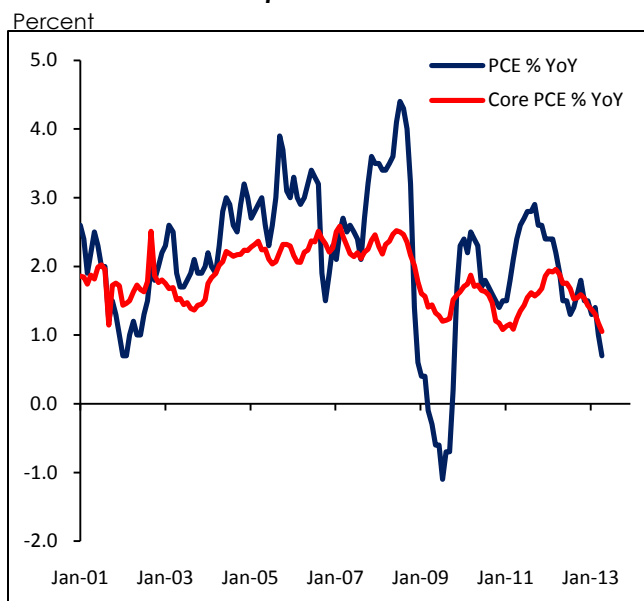
In Open Market–Dashboard, we will present regular snapshots of the trends on which we are focusing. This series will complement our other research efforts by providing investors with a short-form summary of themes and ideas that will impact global investment trends over time.

Gravelle Pierre, CFA



Figure 1. Inflation Measures

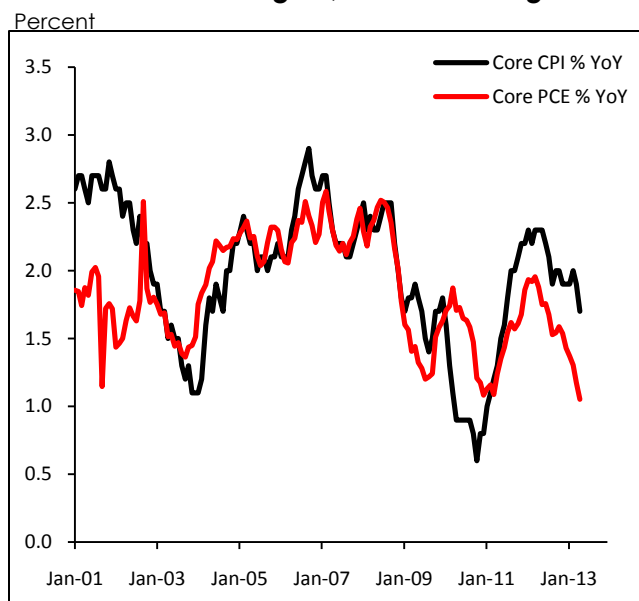
PCE at post-recession lows



Source: BEA

Notes: FOMC notes that headline and core PCE well below 2% goal, but due to temp factors (much lower gas prices big contributor). Other inflation measures/expectations remain more stable, still lower. FOMC says PCE requires "careful watching". Economy stronger now than in '09/'10 so FOMC less spooked by trend lower.

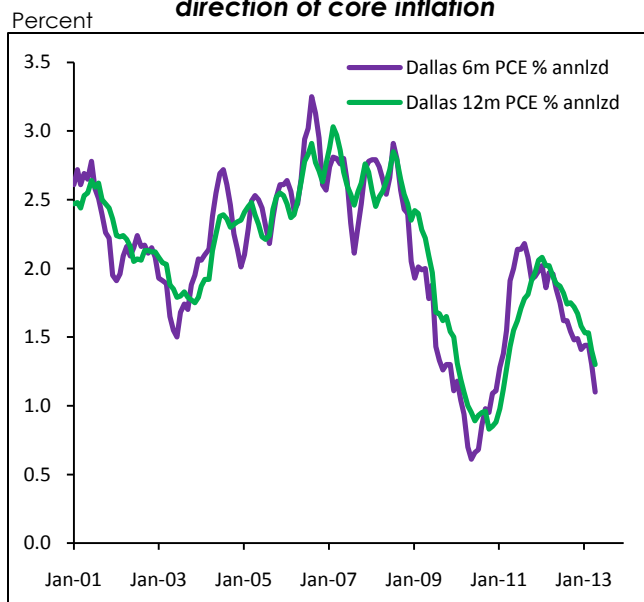
CPI 'anchored' higher, but also drifting lower



Source: BEA, BLS

Notes: Consumers focus on CPI (measures "out of pocket" spending). Higher CPI suggests household expectations anchored and less deflation risk. Flatter Phillips curve and less excess capacity means: 1) Fed more confident inflation bounded on downside and 2) Fed can be slower to hike on the upturn. Watch for PCE 'quirks'.

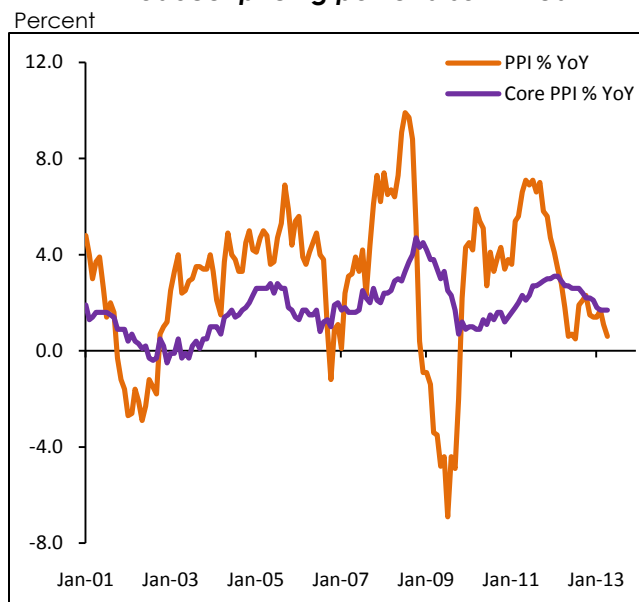
Dallas trimmed provides another look at direction of core inflation



Source: Dallas FRB

Notes: [Dallas](#) "trims out" biggest PCE movers on top/bottom. Energy goods/svcs big contributor to lower prints...guesses based on DOE price data shows gas prices flat (s/a) for May.

Producer pricing power also limited



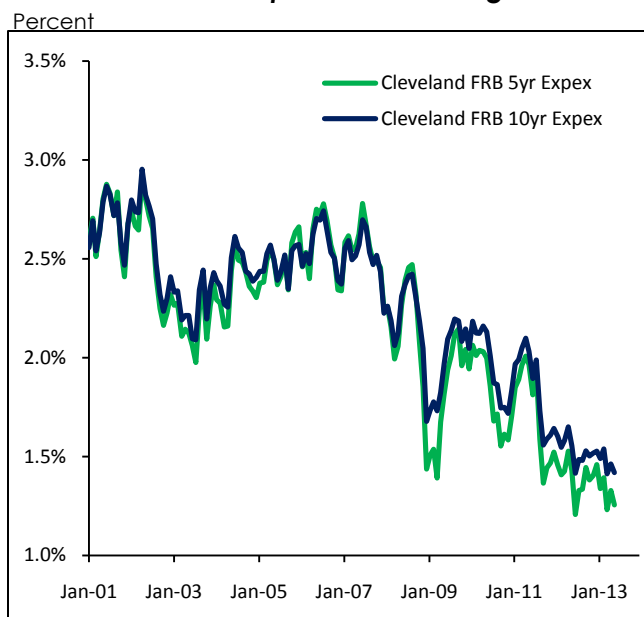
Source: BLS

Notes: Prices received for producer final goods show similar slow-down, but with core better behaved. Until better job growth, US companies will find it hard to raise prices without losing customers.



Figure 2. Inflation Expectations

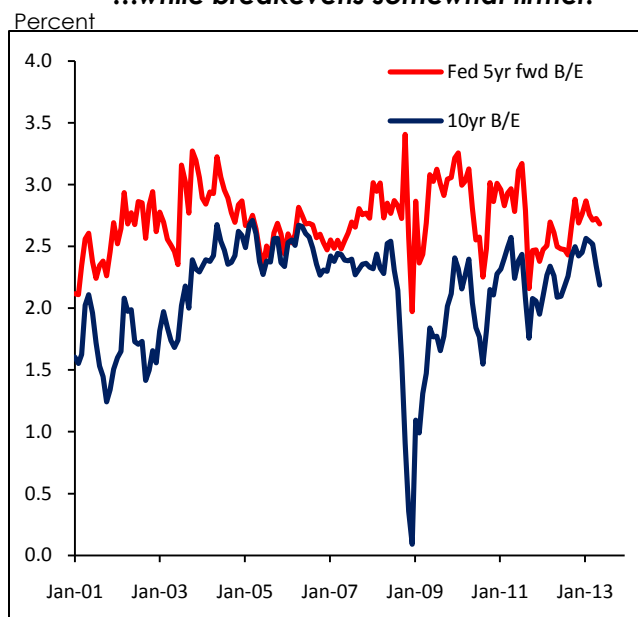
Cleveland expectations sinking lower...



Source: Cleveland FRB

Notes: [Cleveland model](#) based on two surveys (SPF & Blue Chip), nominal rates and inflation swaps. The model aims to account for the inflation risk premium not factored into breakevens (nominal – tips)...which means that breakeven rates are too high.

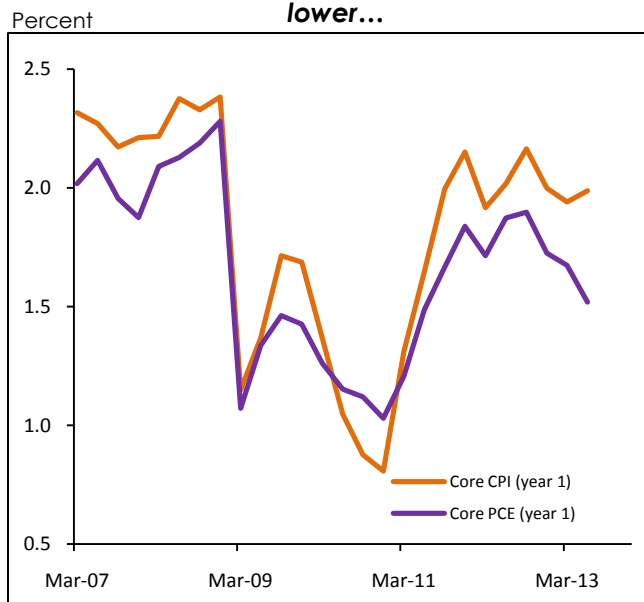
...while breakevens somewhat firmer.



Source: Bloomberg

Notes: Breakevens choppy but steady...suggests expectations are roughly anchored if inflation risk premium assumed stable. If inflation risk premium has increased ([as studies have shown](#)), then B/E 'stability' is suspect. Also, B/E based on TIPS which are based on CPI which is higher than PCE. Watch Fed language on expectations.

Economists adjusting expectations lower...



Source: Philadelphia FRB

Notes: Survey of Professional Forecasters (SPF) provides economists' expectations...here we graph end-2013 expectations. Notably, SPF and FOMC forecasts for end-2013 and 2014 are close.

...in lockstep with the FOMC.

	Central Tendency			Range		
	2013	2014	2015	2013	2014	2015
PCE						
Mar '13	1.3 - 1.7	1.5 - 2.0	1.7 - 2.0	1.3 - 2.0	1.4 - 2.1	1.6 - 2.6
Dec '12	1.3 - 2.0	1.5 - 2.0	1.7 - 2.0	1.3 - 2.0	1.4 - 2.2	1.5 - 2.2
Sep '12	1.6 - 2.0	1.6 - 2.0	1.8 - 2.0	1.5 - 2.1	1.6 - 2.2	1.8 - 2.3
Jun '12	1.5 - 2.0	1.5 - 2.0	n/a	1.5 - 2.1	1.5 - 2.2	n/a
Apr '12	1.6 - 2.0	1.7 - 2.0	n/a	1.5 - 2.1	1.5 - 2.2	n/a
Jan '12	1.4 - 2.0	1.6 - 2.0	n/a	1.4 - 2.3	1.5 - 2.1	n/a
Core PCE						
Mar '13	1.5 - 1.6	1.7 - 2.0	1.8 - 2.1	1.5 - 2.0	1.5 - 2.1	1.7 - 2.6
Dec '12	1.6 - 1.9	1.6 - 2.0	1.8 - 2.0	1.5 - 2.0	1.5 - 2.0	1.7 - 2.2

Source: Federal Reserve – PCE Inflation forecasts

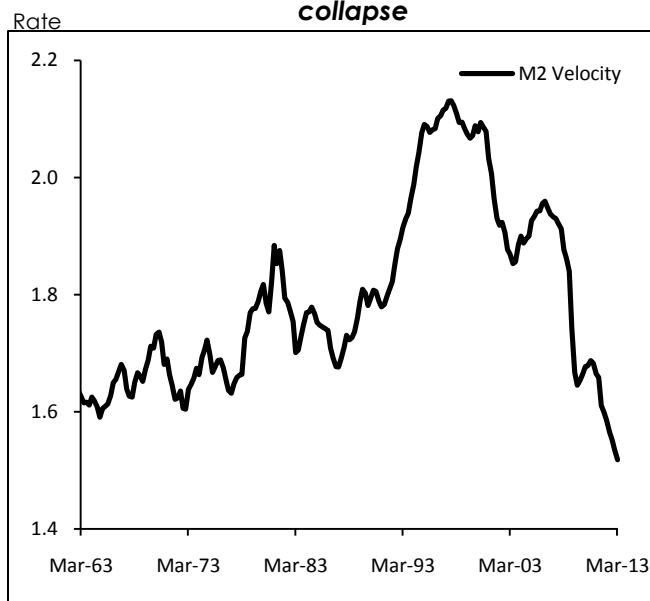
Notes: Fed forecasts for headline PCE rose thru most of 2012...then reversed reflecting fiscal drag? Will be interesting to see how slow Europe/China affects next estimates. Notably, [OECD annual inflation](#) at lowest since October 2009 (energy the big drag)...outside OECD, inflation picture more diverse.

Entrenched hawks skewing forecasts higher.



Figure 3. Inflation from another perspective

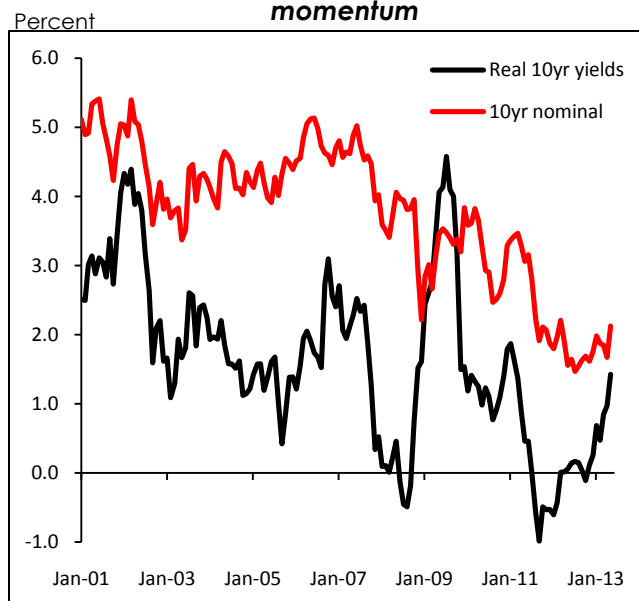
Upside inflation risk limited by velocity collapse



Source: Bloomberg

Notes: Bank deposits are piling up with [nowhere to go](#)...and velocity has plunged. With so many inflation measures weak in addition to evidence that households are holding cash (CASH!) as a store of value, it is increasingly difficult to conceive of an environment of faster inflation (and much higher real US rates).

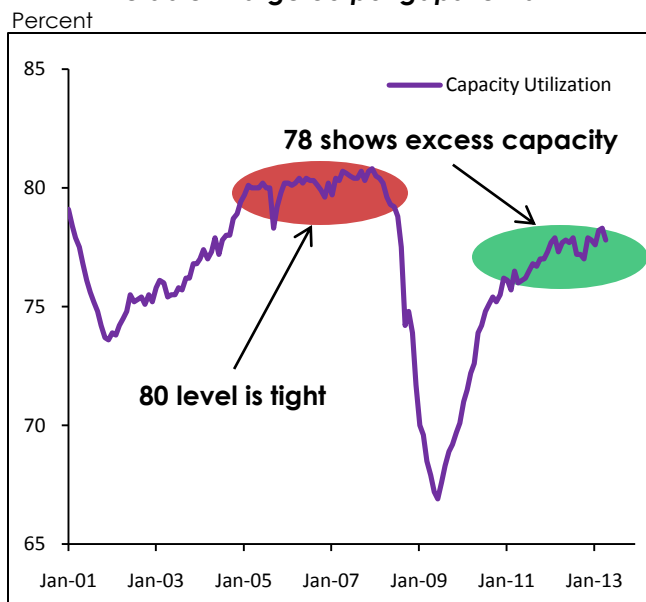
Higher real yields don't reflect underlying momentum



Source: Bloomberg

Notes: Real = nominal – headline PCE. Higher real rates are incongruous with weaker global growth profile and Fed-dependent US cyclical momentum.

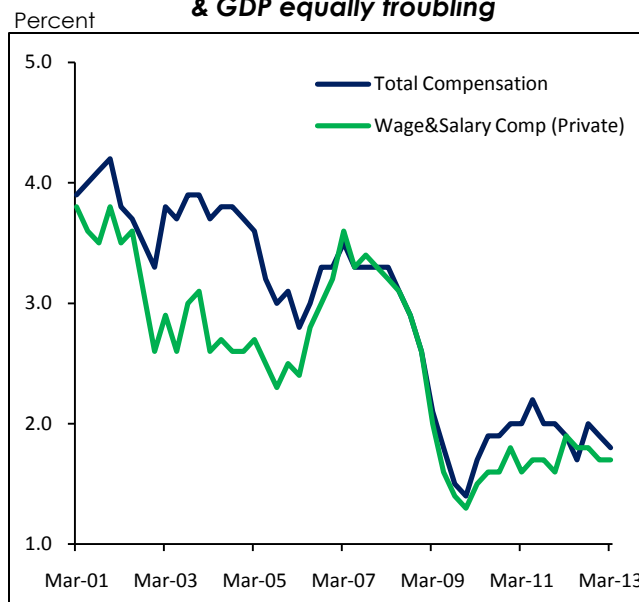
Persistent large output gaps remain



Source: Federal Reserve

Notes: Caput's reliability as inflation indicator may be less than it was in the 70's but can't be ignored as a measure of domestic economic slack.

Stagnant wages' impact on inflation & GDP equally troubling



Source: BLS

Notes: Little evidence suggesting labor cost as potential catalyst for inflationary cycle. Longer cycle (5-7yrs) wages will gradually increase as global excess labor disappears.

Iron Harbor Open Market-Dashboard

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