Iron Harbor Open Market – On Deck

On Deck – Eurozone provides a first-draft summary of the recent trends in European data:

- A broad set of activity indicators substantiates our view that the Eurozone is in the Initial Recovery Phase of the business cycle. Activity will continue to improve, but the recovery will be slow and uneven.
- Underlying price trends will force the ECB to alter their risk assessment lower over the next 3 months and adjust monetary policy accordingly.
- Despite slow economic growth, we expect that European equity markets will outperform over the next 6-12 months. We also expect continued yield convergence across sovereign debt markets.

Gravelle Pierre, CFA
November, 2013

Iron Harbor: Prudent and Balanced

Bloomberg Global Macro: 94th-percentile vs peers

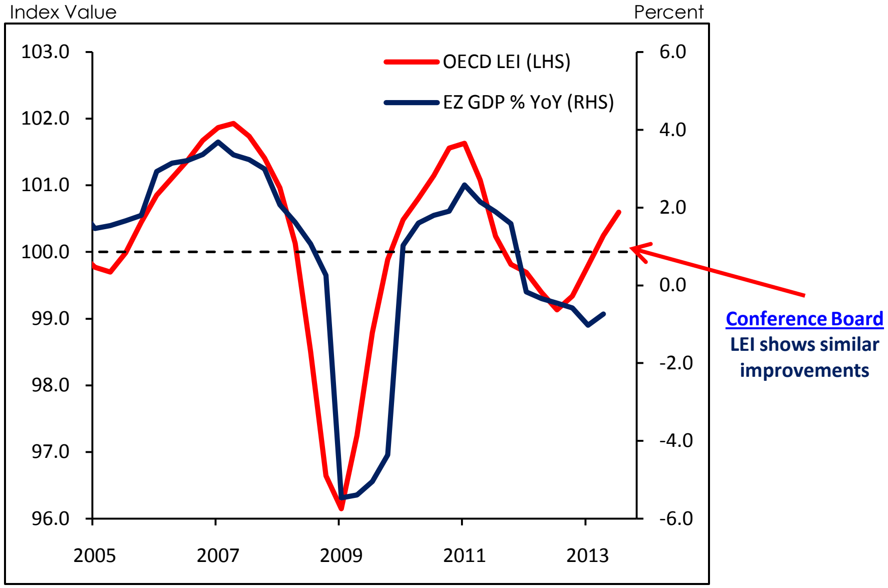
Year-To-Date Performance

Bloomberg Global Macro: 97th-percentile vs peers

Last 12 Months Performance

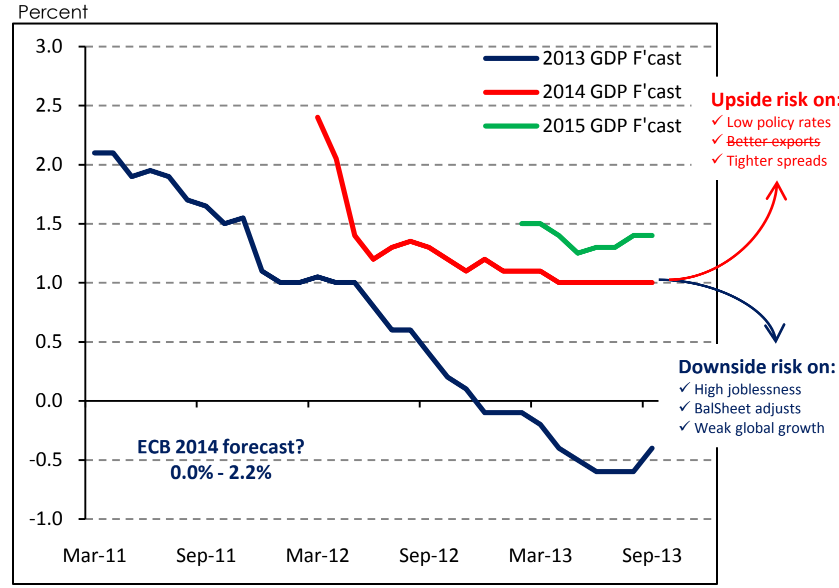
Figure 1. European Recovery? It's...Complicated.

1. Leading indicators signal 2H13 GDP gains



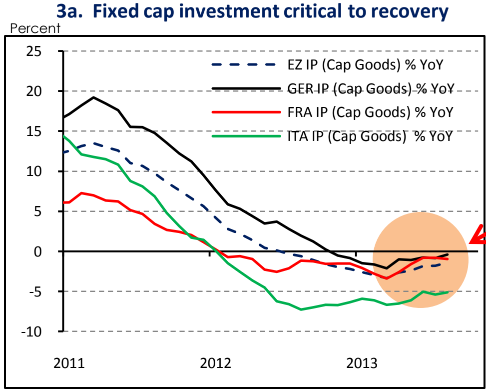
Source: OECD, Eurostat

2. Future growth expectations fairly steady

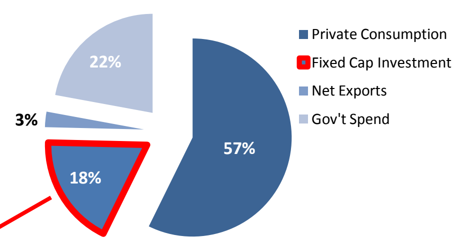


Source: Bloomberg

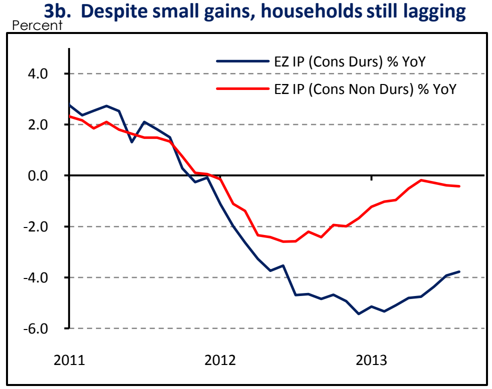
3a. Fixed cap investment critical to recovery



Eurostat



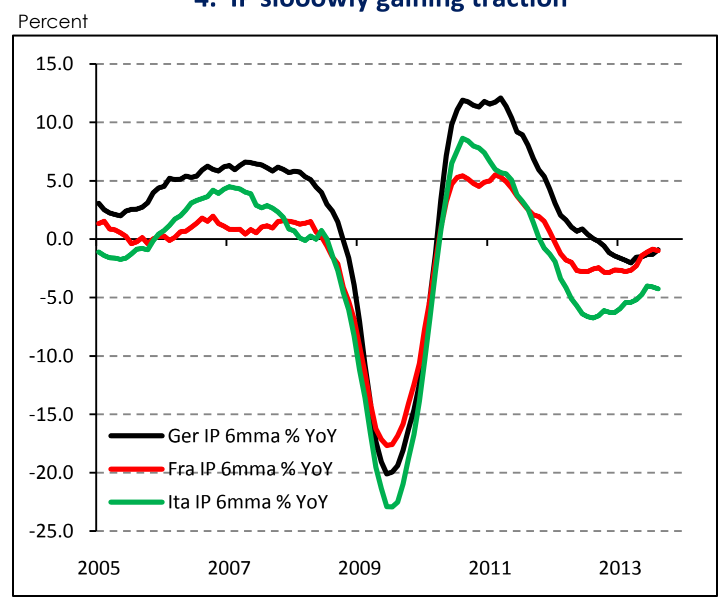
3b. Despite small gains, households still lagging



Eurostat

Fixed cap investment is important for both sustained economic growth and long-term corp profits. We closely watch capgoods production as a proxy for fixed cap investment. For the Eurozone to achieve 1% GDP in 2014, investment has to play a significant role given weak household fundamentals.

4. IP slooowly gaining traction

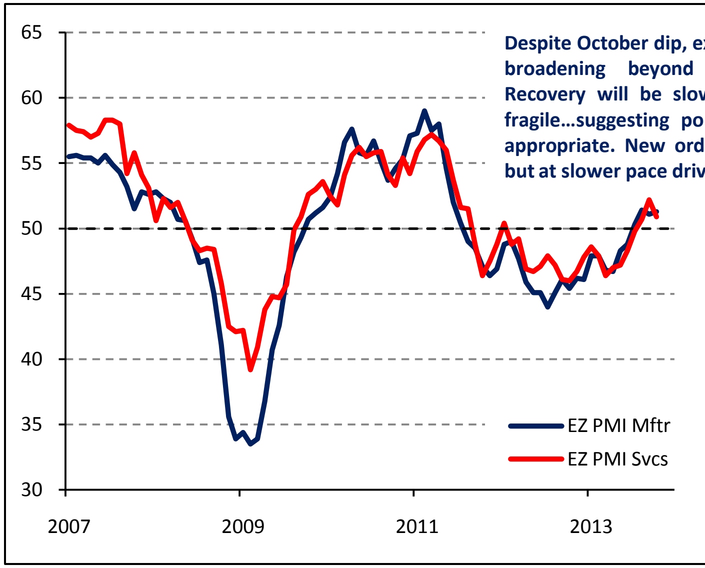


Source: Eurostat

Figure 2. Survey Data Show Biz Activity Stepping Higher

1. PMI taking the stairs, and stumbling higher

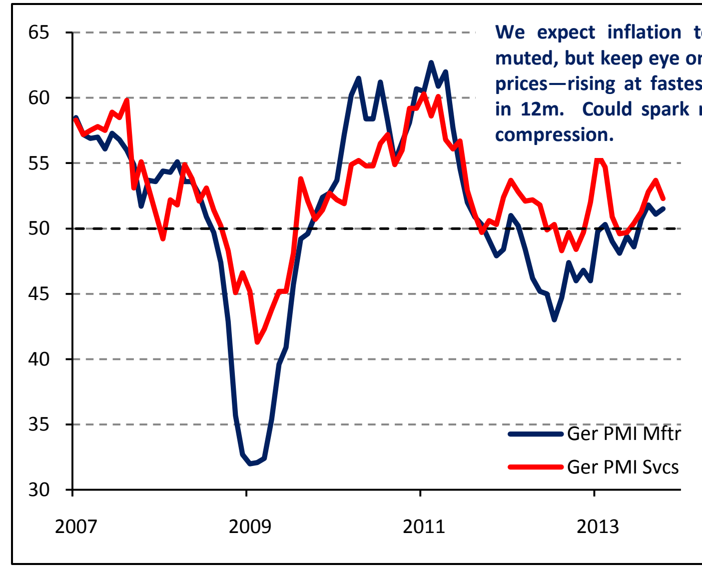
Index Value



Source: Markit

2. Germany still strong, but at slower rate in October

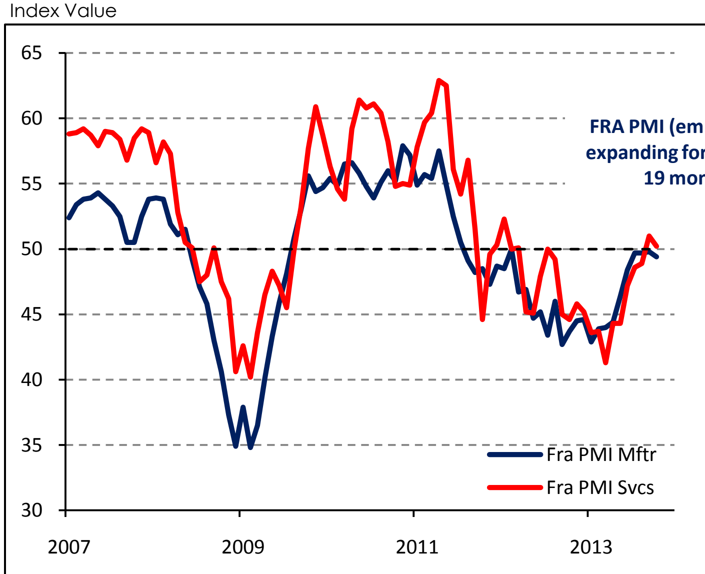
Index Value



Source: Markit

3. France on the fence

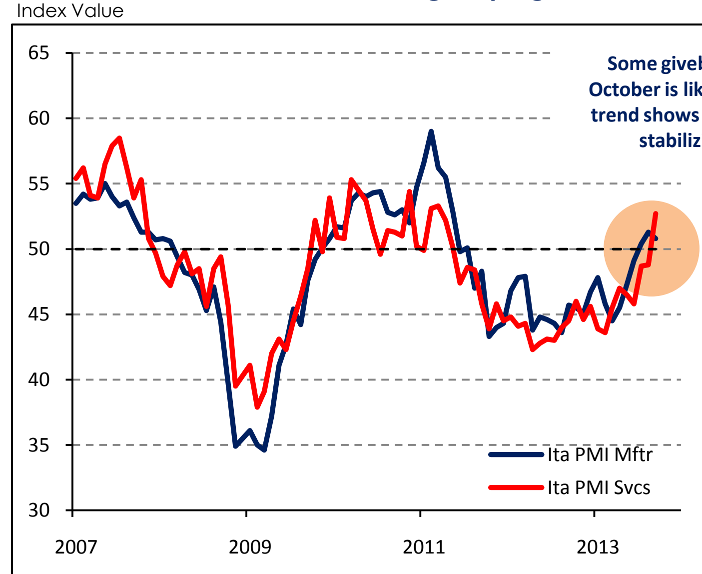
Index Value



Source: Markit

4. New orders driving Italy higher

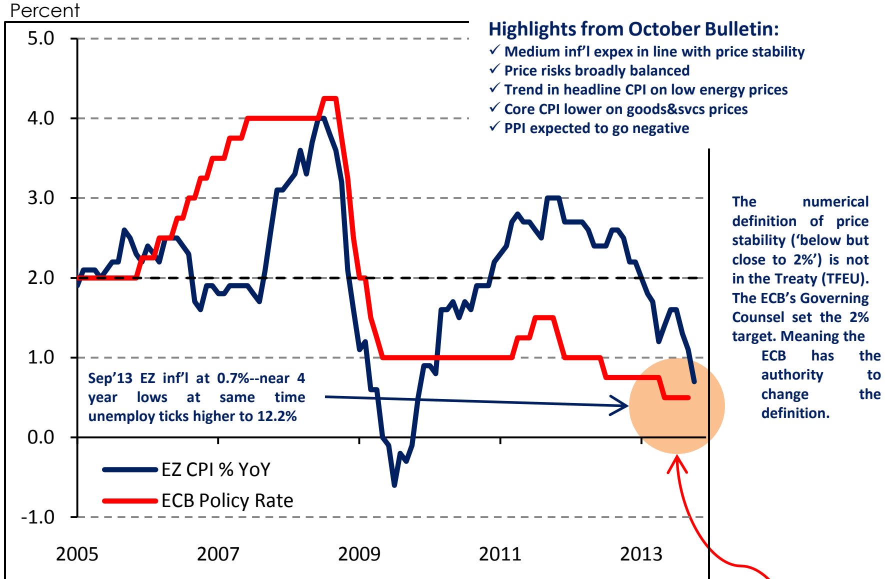
Index Value



Source: Markit

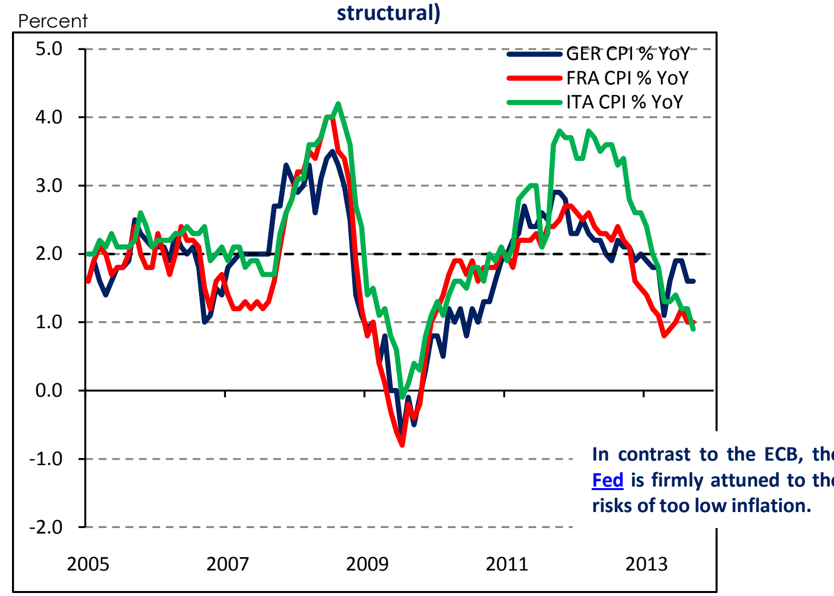
Figure 3. ECB: Inflation Risks Are "Broadly Balanced" (???)

1. ECB in no hurry to ease policy rates



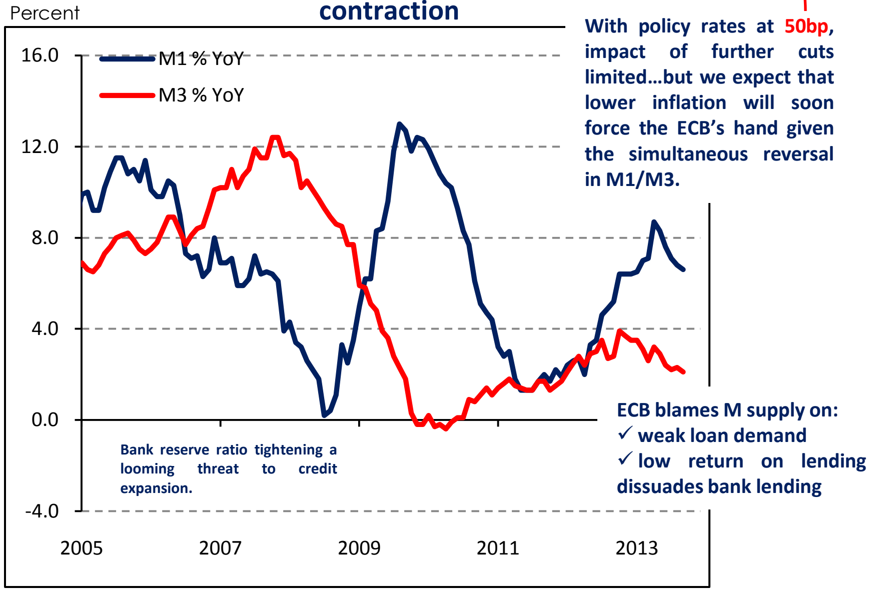
Source: Eurostat, Bloomberg

2. Excess capacity will keep prices low (it's not a mystery, it's structural)



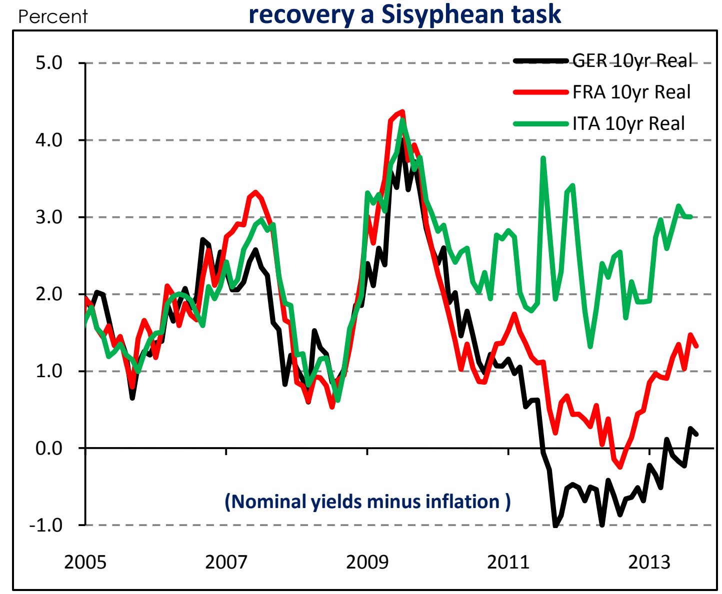
Source: Eurostat

3. The biggest threat to the Eurozone recovery: credit contraction



Source: ECB

4. High real rates in struggling economies makes recovery a Sisyphean task



Source: Bloomberg, Iron Harbor

Figure 4. Households Feeling Better—But Tough Miles Ahead

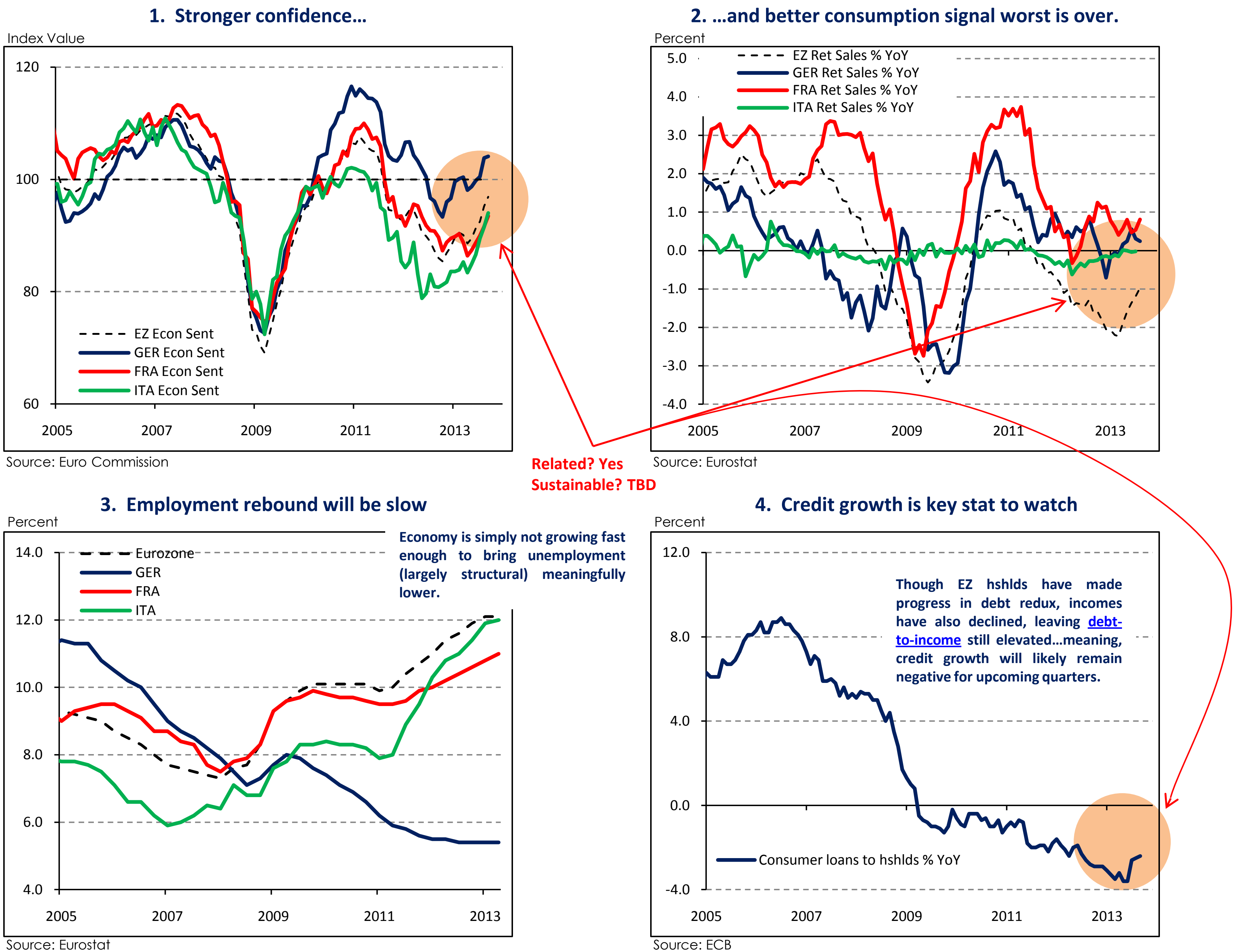


Figure 5. Eurozone Export Growth Is Shrinking

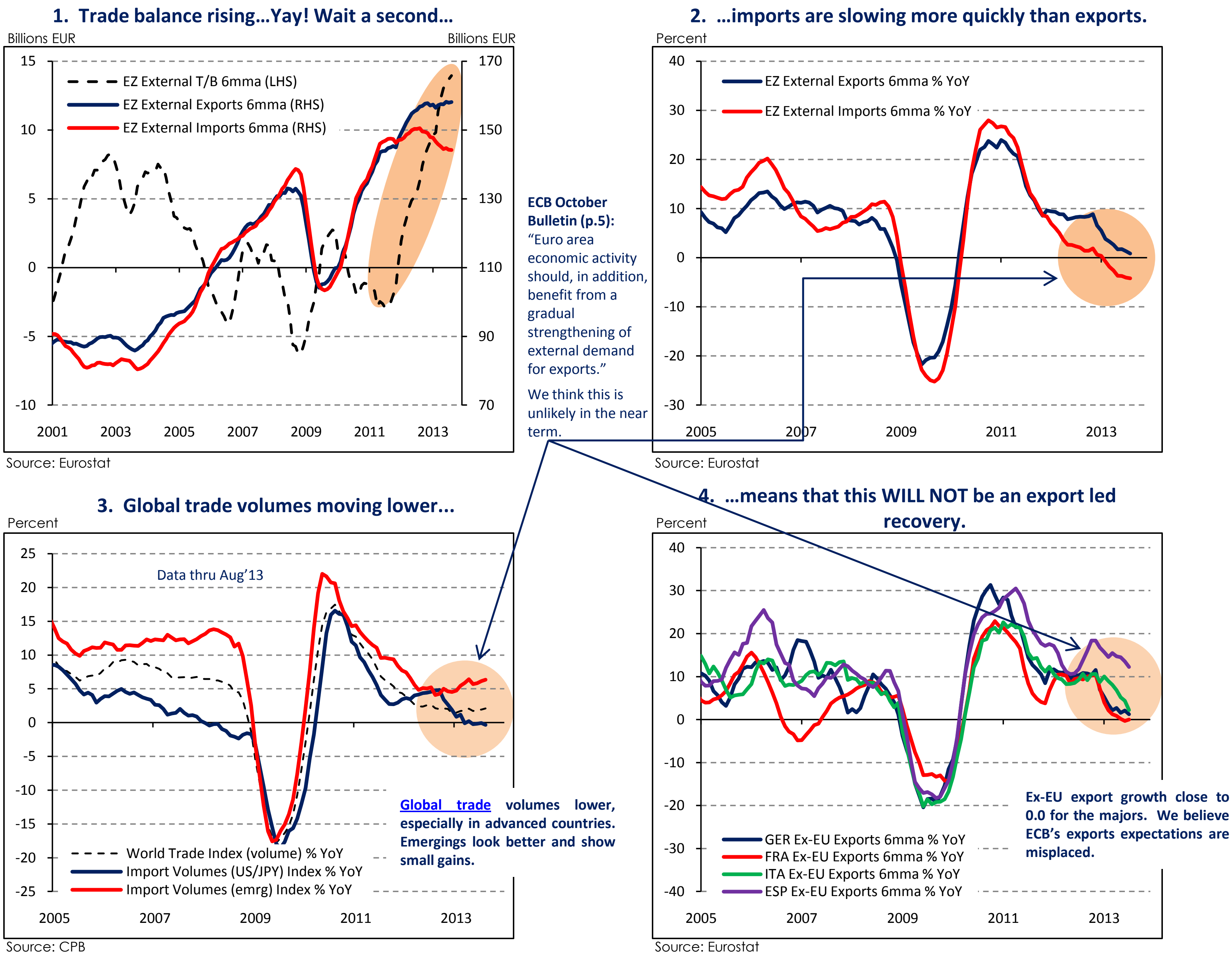
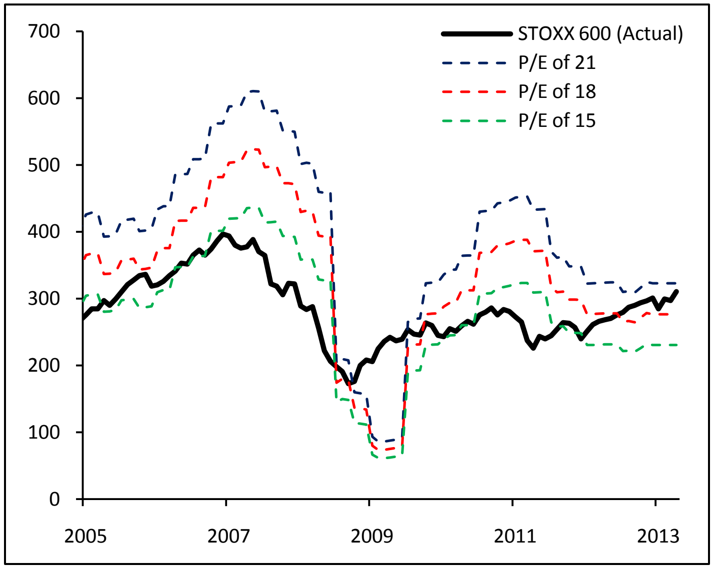


Figure 6. Stocks Will Do Well Despite Slow Growth

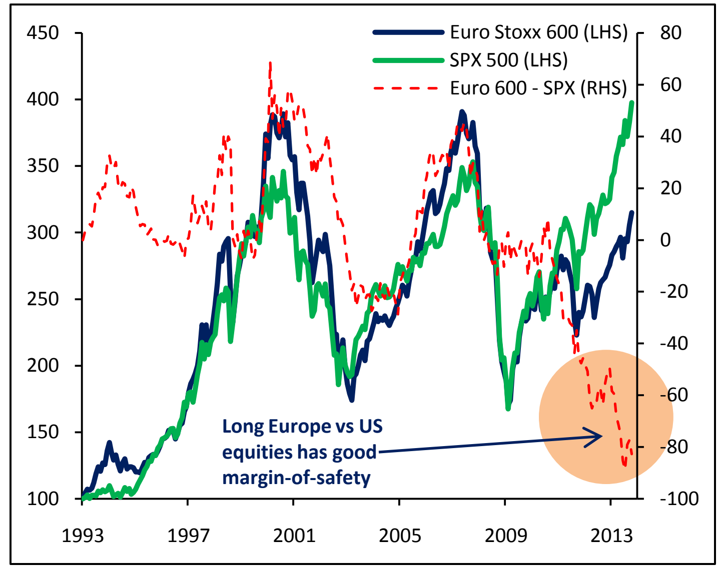
EZ rates have to move lower, which adds to case for stocks

1. Equities valuation steadily gaining…



Source: Bloomberg

2. …but relative performance is near 20 year lows.



Source: Bloomberg

3. A closer look at valuations

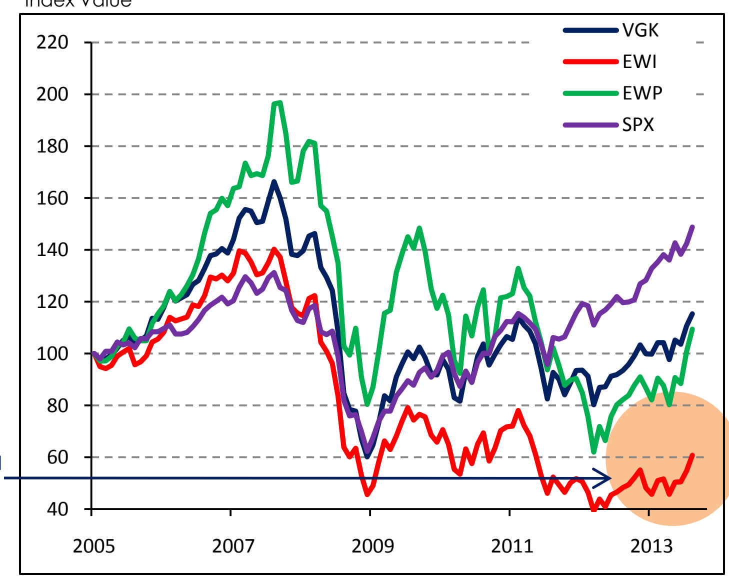
Index	Fwd P/E	Dividend Yield / 10Y Real	Current P/B
S&P 500	15.69	2.03 / 0.41	2.31
Stoxx 600	14.46	3.38 / 0.75	1.79
DAX (GER)	12.96	3.05 / 0.23	1.70
CAC40 (FRA)	13.83	3.26 / 0.54	1.45
IBEX 35 (ESP)	16.37	3.93 / 2.40*	1.45
FTSE MIB (ITA)	15.01	2.86 / 2.72	**0.97**
FTSE 100 (UK)	13.37	3.67 / -0.55	1.21

Source: Bloomberg. Linkers used where avail. * denotes nominal – CPI.

Italy trading at less than book!

Assuming political risk is priced…good margin-of safety!

4. Time for market to ‘kiss and make-up’ with Europe



Source: Bloomberg

Figure 7. Euro Capped on the Upside

1. Euro risk to downside on weak inflation

Mario Draghi's response to question on euro appreciation at Feb, 2013 ECB press conference:

"On the exchange rate, the first thing is that the appreciation is, in a sense, a sign of the return of confidence in the euro. But net of the return of confidence, exchange rates should reflect fundamentals and, by and large, both the nominal and the real effective exchange rates are at or around their long-term averages. However, as I said last time, the exchange rate is not a policy target, but it is important for growth and **price stability**, and we will certainly want to see **whether the appreciation is sustained** and will alter our risk assessment as far as price stability is concerned."

ECB staff inflation forecasts for 2014: inflation 1.3%, euro 1.33. Most recent headline inflation at 0.7% points to some type of ECB easing.

2. Euro near average level…overvalued based on PPP

Source: Bloomberg