PIRAEUS BANK

Global Economic & Market Monthly Review: Rising Volatility, US Recovery-European Stagnation

ECONOMIC ANALYSIS & RESEARCH DIVISION

Executive Summary

- USA: We estimate that real GDP growth accelerated during the third quarter of 2012 by 2.2% (quarterly annualized), compared to 1.3% in the second quarter.
- Eurozone: We estimate that real GDP contracted marginally (-0.1%) during the third quarter of 2012, as during the July-August period we recorded conflicting signs: very negative leading indicators and more upbeat hard data. Adopting the scenario of a gradual but uncertain resolution of the euro crisis, but taking into account the negative trend of leading indicators, we estimate that real GDP growth will decline marginally by 0.1% during the whole of 2013 as well.
- The Eurozone crisis and the necessary fiscal adjustment in the US are creating a drag on Emerging country and Japanese export demand. However, the decline in international food prices from the very high levels of 2011 gives the opportunity for monetary easing especially for the former. We note that in key emerging countries (BRIC's) inflationary pressures continue to outweigh industrial production growth, although this trend appears to be waning.
- Despite a very positive streak of macroeconomic surprises with equally positive announcements by central banks, risky securities came under pressure. Negative corporate sales announcements in the US are partially responsible since pressures were observed in commodities and in emerging market equities. It is likely that the combination of worsening corporate results, European uncertainty, concerns about the US election and the possibility of fiscal impasse in the US, combined with the very low level of market volatility (a lot of positive news having already been discounted), could lead to a period of rising uncertainty and volatility with a resulting reduction in risk appetite.
- This period is likely to be transient if a) the US finds a balance between economic slowdown and fiscal derailment and b) if the Eurozone does not diverge from its recent – admittedly slow and uncertain – path towards some kind of deeper integration.

October 2012

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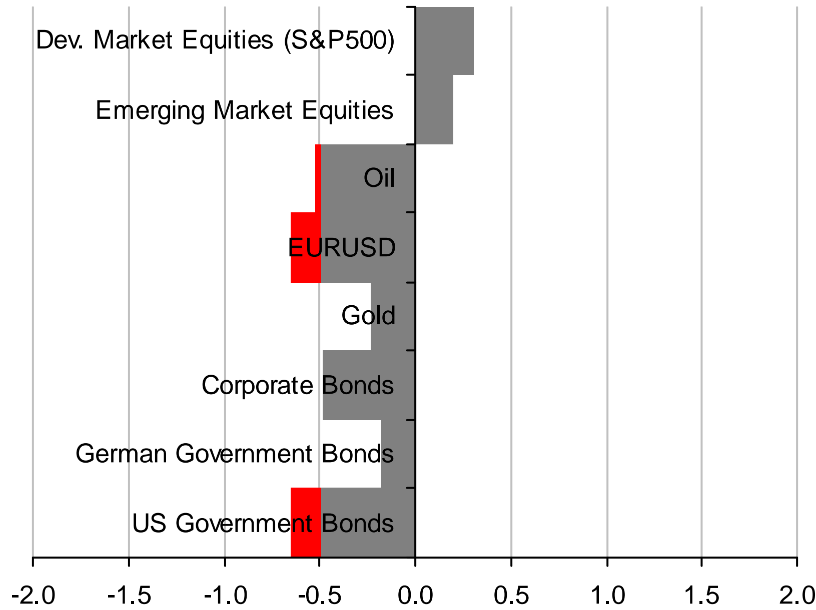
Global Market Risk-Return Scoring

(6-9 month horizon)

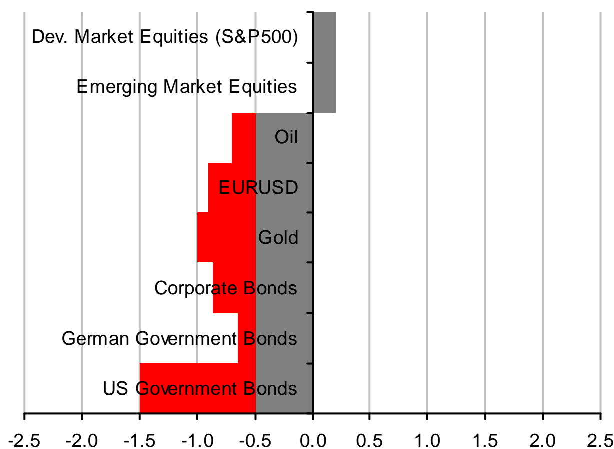


Scoring between -2.5 and 2.5, reflects an average estimate (50%) quantitative fundamental, & (50%) technical factors affecting individual markets.

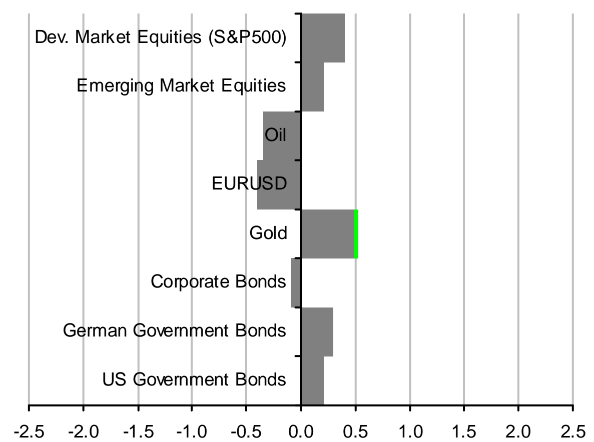
- *-0.49 to 0.49 neutral assessment*
- *0.5 to 1.49 positive assessment (-0.5 to -1.49 negative assessment)*
- *> 1.5 very positive assessment (<-1.5 very negative assessment)*

For long-term estimates (+9 months), more weight should be given to fundamental and quantitative factors, while for the medium term (3-6 months), more weight should be given to technical factors.

Fundamental & Quantitative Estimates



Technical Picture



Fundamental & Quantitative Estimates: Deviations from long-term average value measures (e.g. P/E for stocks, nominal growth for bonds, ppp for fx) as quantified by estimated "fair values" using for each the appropriate market & economic fundamentals. Technical Picture: Standardized display of figures such as MACD, RSI and other technical analysis measures

SPECIAL TOPIC: A FRAMEWORK OF TOOLS FOR THE PREDICTION AND ANALYSIS OF THE EURUSD EXCHANGE RATE

Introduction

- In this section we describe our evaluation model of the EURUSD exchange rate risk–return relationship. The first part presents the econometric and statistical methods used to estimate the "fair value" reflecting the fundamental view of the market. The second part presents the methods used to measure the trend, delineating the technical picture of the market.

Fundamental – Quantitative Approach & Macroeconomic Model

- In order to estimate the "fair value" we use theoretical models with some transformations so as to include empirically useful ratios of internal value. In the case of FOREX markets, we use the basic monetary model of money demand for two countries (the asterisk denotes the variables of the foreign economy):

$$m(t)-p(t)=\boldsymbol{\alpha}+\boldsymbol{\beta}y(t)-\boldsymbol{\lambda}i(t)+u(t)$$

where m is the logarithm of money quantity, p is the price level, i is the interest rate and u represents other exogenous factors, with β and λ positive. Using the above equation together with Purchasing Power Parity:

$$p(t)=p^*(t)+s(t)$$

(where s denotes the nominal exchange rate in domestic currency units per 1 foreign currency unit) results in an equation for s:

$$s = m-m^* - \boldsymbol{\beta}\ (y-y^*) + \boldsymbol{\lambda}\ (i-i^*) + \boldsymbol{\omega}$$

According to this model, when we are at money market equilibrium (money demand = money supply), a relative increase in domestic money supply, $\Delta(m-m^*)>0$, causes depreciation in the domestic currency, a relative increase in domestic disposable income, $\Delta(y-y^*)>0$, causes appreciation, while a relative increase in the domestic interest rate, $\Delta(i-i^*)>0$, causes appreciation.

- We note that the monetary variables explain a large part of the variation in the exchange rate, when we compare the growth rates of M2 and of the ratio M2/M1 between the US and the Eurozone. The annual growth rates help in the estimation of exchange rate cyclicality, while the ratio M2/M1 helps in the estimation of the long-term trend. We observe that the increase in the ratio M2/M1 of the US compared to the Eurozone causes a negative contribution to the EURUSD long-term trend.

- In order to obtain a proxy for the difference in the growth rate between the US and the Eurozone, we use the difference between two leading indicators (German IFO Indicator and US ISM New Orders Indicator). For the interest rate difference, we use the difference in the ten-year yield between the two government bonds (German Bund and US Treasury). An increase in the German ten-year yield compared to the US causes downward pressure on the EURUSD exchange rate. For the other

variables, we use the difference in trade balance between the US and Germany, where an improvement in the US trade balance compared to Germany causes a decrease in the euro currency. We also include the five-year yield of the US Treasury which represents a measure of international liquidity conditions, where a reduction in US interest rates causes better liquidity conditions and consequently downward pressure on the US currency.

- We should note that the effect of a change in one variable can be measured, given the fact that the other explanatory variables stay unchanged ("ceteris paribus"). For example, when expectations about growth, monetary circulation, US interest rates and trade balance are established, then an exogenous increase in German interest rates causes a decrease in euro currency demand, leading to downward pressure on the EURUSD exchange rate, given the fact that the euro currency monetary supply also remains unchanged. Adjusting this example for the current crisis characteristics, an exogenous increase in German interest rates is probably related to the increase in the fiscal risk premium. We estimate the following equation:

$$F(t)=\underset{(12.2)}{0.96}-\underset{(-5.6)}{2.2}*DM2(t)-\underset{(-10)}{4.1}*DM2(t-10)-\underset{(-9.7)}{0.51}*D(m2-m1)(t)-\underset{(-6.9)}{0.11}*10ySpread(t)+$$

$$+\underset{(1.2)}{0.13}*IFO\text{-}ISM(t)-\underset{(-14.6)}{0.12}*US5y(t)-\underset{(-2.5)}{0.02}*\mathbf{TB}(3-12)$$

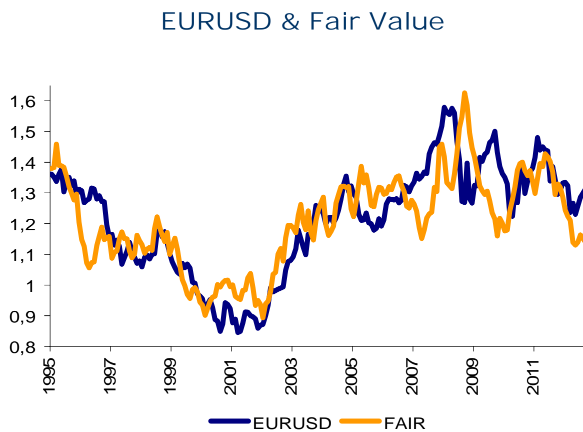
and

$$S(t)=F(t)+w(t)$$

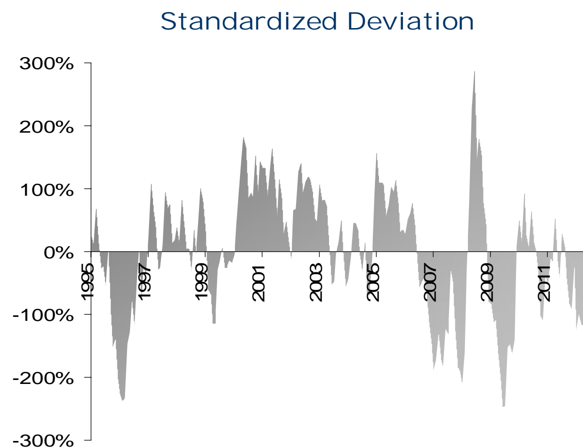
with the OLS (Ordinary Least Squares) method where:

1. F(t): the logarithm of the estimated exchange rate "fair value"
2. DM2%, DM2%(-10): the difference in the annual growth rate of M2 between the US and the Eurozone, together with its 10 month lag
3. D(m2-m1): the difference between the logarithms M2-M1 between the US and the Eurozone
4. 10YSpread : The difference in ten-year yield between the US Treasury and German Bund
5. IFO-ISM: the difference between the German Business Confidence IFO Indicator and the US ISM New Orders Indicator
6. US5Y: the five-year US Treasury yield
7. TB(3-12): the standardized difference between the average US and German trade balances from the 12-month average
8. s(t) : the logarithm of the exchange rate
9. w(t): the estimated deviation of the logarithm of the exchange rate from the "fair value"

- The correlation coefficient (R-squared=69%) and the statistical significance t coefficients (which are within the brackets) are judged to be satisfactory, although they are probably overestimated due to the high degree of correlation among the explanatory variables. Only the IFO-ISM variable does not seem to be statistically significant enough. The estimated deviation variable w(t) has an autocorrelation coefficient of 0.88 and is stationary I(0). In the left chart, we depict the actual and estimated EURUSD exchange rate, which is now estimated to be at 1.14. The actual exchange rate is now judged to be 1.6 standard deviations more expensive than what the macroeconomic fundamentals predict (right chart).



Source: Bloomberg,, Piraeus Bank Research



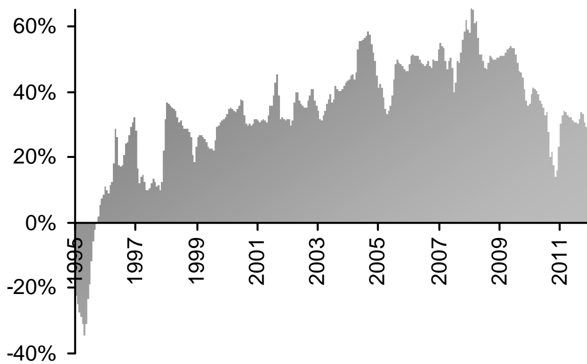
Source: Bloomberg, Piraeus Bank Research

Fundamentals – Quantitative Approach Market Models

- Apart from the usefulness of a model of macroeconomic equilibrium, the detection of other short- or medium-term factors that cause deviations from the "fair value" is extremely interesting and useful. For example, during the period 2003–2007, the USD came under pressure, as the strength of the developing economies and the decoupling scenario, together with large US fiscal deficits called into doubt the role of the USD as a reserve currency. The price of gold and the EURUSD exchange rate went up as these were possible successors to the USD. Hence models that included the price of gold as an explanatory variable were very useful in estimating the EURUSD exchange rate. This relationship has waned (as we can see in the left-hand chart on the next page), as the Eurozone crisis (as it is reflected in the increase in spreads against Germany) plays an important role as a fiscal risk premium.

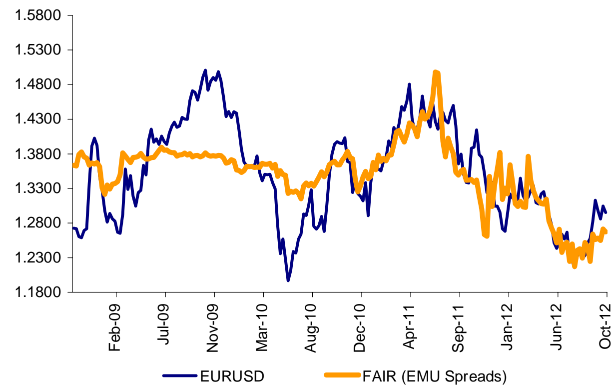
- Hence, in the current period, we continue to evaluate the influence of the price of gold, but we emphasize the Eurozone spreads. As we can see in the right-hand chart, since 2010 the actual EURUSD exchange rate tends to correct the deviations from the estimated fair value that includes the spreads (against the ten-year German Bund) as additional explanatory variable(s). According to this new updated model, the fair value of the EURUSD exchange rate is at 1.27, while the actual rate is at a higher level. As in the previous model, we divide by the standard deviation to obtain the value that we assign in the "Fundamentals & Quantitative" section of Global Asset Risk-Return Scoring section.

Rolling 30–Month Correlation EURUSD - Gold



Source: Bloomberg, Piraeus Bank Research

EURUSD & Fair Value (spreads)

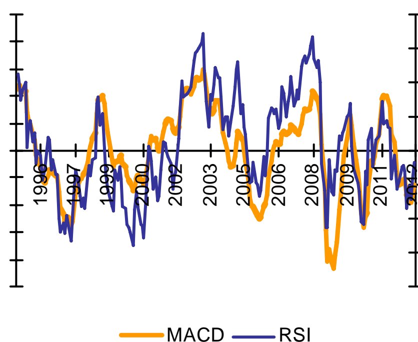


Source: Bloomberg, Datastream, Piraeus Bank Research

Technical Analysis

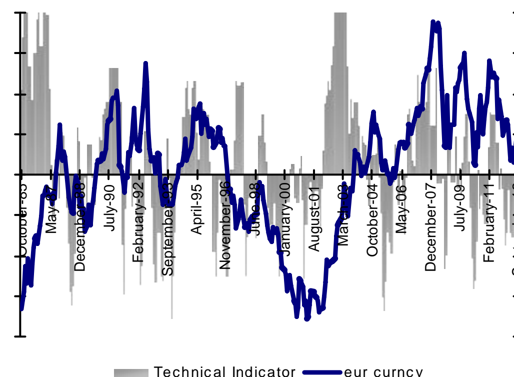
- In addition to the use of fundamental - quantitative analysis, technical analysis is also very useful for the detection of the trend or the potential trend of the market. We use two indices, the MACD (Moving Average Convergence - Divergence) and RSI (Relative Strength Index), which are extensively used by the majority of investment analysts. The former index (MACD) measures in essence the second derivative of a series, as it uses the difference between a short- and long-term moving average (usually 12 and 26 months) and then it uses the difference between the previous difference and its 9 month moving average. The second derivative is an indicator of whether a trend is positive or negative and if it is at its beginning or end. The latter index (RSI) measures whether a market is overbought (more than 70% of days posted increase) or oversold (less than 30% of days posted decrease). We monitor all the possible occurrences of these two indexes (i.e. MACD>0, MACD>some maximum value and 50<RSI<70) and we give a value that corresponds to the driving forces generated by the two indexes. These indicators are summed up and standardized, and then we estimate their average value. The obtained result is an indicator of the technical force of the exchange rate. In the right-hand chart, the actual exchange rate and technical force indicator are compared. Finally, we estimate the total exchange rate, using a weighted average of the estimated (standardized) deviations of the fundamental – quantitative and technical force methods. We use the same procedure for all markets that we monitor.

EURUSD, MACD & RSI



Source: Bloomberg, Piraeus Bank Research

EURUSD & Technical Indicator MA(3months)



Source: Bloomber, Piraeus Bank Research

Economic Developments

USA: Signs of faster recovery

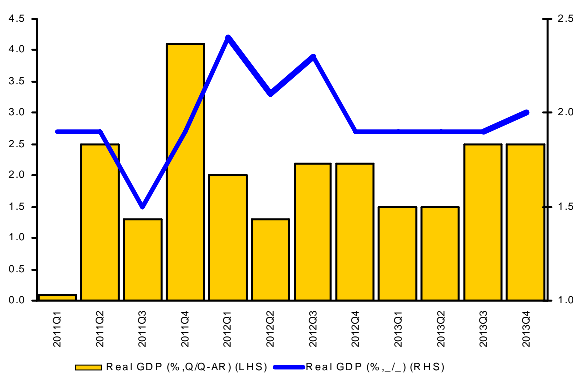
- The US economy accelerated during Q3, as we estimate that its real GDP grew by 2.2%, compared to 1.3% in Q2. We also estimate a similar GDP growth rate for Q4, leading to 2.2% overall for the current year.

- The very positive housing data, reduction in unemployment rate to lower than 8.0% and the increase in the consumer confidence indicator to the higher level since 2007, reflect the auspicious developments in the US economy.

- On the other hand, the crisis in the Eurozone, deceleration in big developing economies and, primarily, the expected fiscal consolidation measures (by the new US government) constitute the main threats. A possible post-election political agreement on debt ceiling rise will avoid strict austerity measures which would probably lead to a "fiscal cliff"

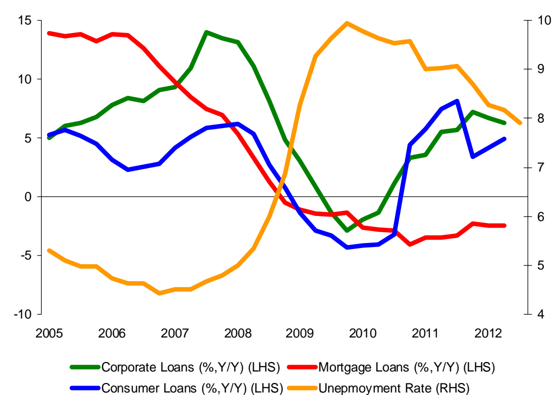
- Hence the most important concern is to find the optimum mixture of measures in order to promote gradual fiscal consolidation (i.e. avoid a "fiscal cliff") and simultaneously avoid worrying debt dynamic development, which would be an enormous threat for the global economy.

Real GDP



Source: Bloomberg, Datastream, Piraeus Bank Research

Unemployment Rate & Credit Expansion



Source: Bloomberg, Datastream, Piraeus Bank Research

- We estimate that the real GDP growth rate will decelerate to 1.5% during the first half of 2013, due to fiscal measures, but it will accelerate to 2.5% during the second half of the year, when the Eurozone crisis will probably be resolved or mitigated, leading to 1.9% growth overall next year.

- We also estimate that the inflation rate will be lower than 2.0% during the next year, a serious geopolitical event pushes international energy prices to a high level. Likewise, the core inflation rate will also be lower than 2.0%, as the capacity utilization rate is expected to remain at a relatively low level, while the unemployment rate will be at a relatively high level (7.5% - 7.9%).

- A rise in residential activity will help the labour market. On the other hand, business investment will remain relatively subdued, due to the high degree of uncertainty that stems from the Eurozone crisis.

US Economy: Macroeconomic Outlook

	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4	2011	2012	2013
	Q/Q-AR(%)								Y/Y(%)		
Real GDP	2.0	1.3	2.2	2.2	1.5	1.5	2.5	2.5	1.8	2.2	1.9
Personal Outlays	2.5	1.5	2.5	2.5	1.5	1.5	2.5	2.5	2.5	2.0	2.0
Public Consumption and Investment	-3.0	-0.7	1.0	1.0	-2.0	-2.0	-2.0	-2.0	-3.1	-1.5	-1.1
Private Fixed Investment	9.9	4.5	5	5	5	7	10	10	6.5	8.5	6.5
Exports	4.4	5.3	1.0	3.0	3.0	3.0	9.0	9.0	6.7	3.5	4.5
Imports	3.1	2.9	3.0	3.0	3.0	3.0	7.0	7.0	4.9	3.3	4.4
Change in Business Inventories Contribution	-0.4	-0.5	1	-0.5	-1	-0.5	1	0.5			
Inflation Rate	2.8	1.9	1.7	1.9	1.5	1.7	1.7	1.7	3.1	2.1	1.7
Unemployment Rate	8.3	8.2	8.1	7.9	8.0	7.9	7.8	7.7	8.9	8.1	7.9
Fed-Policy rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
10Y Treasury Yield	2.21	1.65	1.64	1.60	1.70	1.70	1.70	2.10	1.88	1.60	2.10
EUR/USD Exchange Rate	1.33	1.27	1.29	1.26	1.31	1.24	1.20	1.19	1.29	1.26	1.19

The Eurozone: Pressures Remain

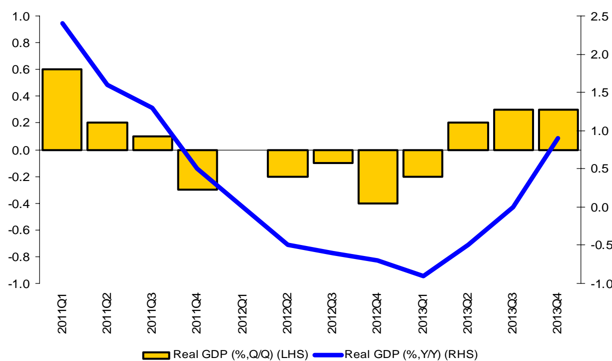
- Real GDP is estimated to have shrunk by 0.1% during Q3 as there was a big discrepancy in the data published. Economic activity data, such as retail sales, industrial and construction production, posted increases and the trade surplus broadened.

- On the other hand, all the leading indicators, such as the economic climate indicator, business and consumer confidence indicators and PMI indicators declined sharply. Hence, we estimate that real GDP will shrink by 0.4% during Q4, leading to -0.5% overall for the current year.

- Eurozone financial and economic fragmentation has intensified. The crisis has reached a capital flight phase. Cross border private capital is being repatriated from the periphery to the core at a pace typically associated with a currency crisis.

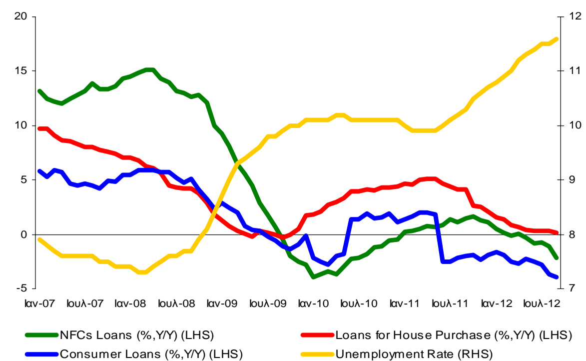
- Concerns over a possible breakup have led to severe fragmentation between financial markets in the core and the periphery. Banks, corporations and even households are left to cope with uncovered exposures to the most vulnerable countries in the euro area periphery.

Real GDP



Source: Bloomberg, Datastream, Piraeus Bank Research

Credit Expansion & Unemployment



Source: Bloomberg, Datastream, Piraeus Bank Research

- Severe fragmentation saps the foundations of the union. At the same time, deleveraging pressures raise the risk of a vicious cycle of an asphyxiating credit crunch and deep economic recession. Moreover, slow effective decision-making processes by political leaders constitute another impediment, as elections in Germany and Italy will take place in 2013.

- On the other hand, the establishment and operation of the ESM (European Stability Mechanism), OMT (Outright Monetary Transactions Program) and SSM (Single Supervisory Mechanism for the Banking System) are positive steps towards resolution of the crisis, but more things need to be done, such as a pan-European FDIC (Federal Deposit Insurance Corporation).

- We estimate that real GDP contraction will continue during the first quarter of 2013. Recovery will start from the second quarter, as the operational benefits of the ESM, OMT and SSM will probably help the real economy, leading to -0.1% growth overall next year.

- Subdued domestic demand will lead to an inflation rate of lower than 2.0% and an unemployment rate of higher than 11.5%. Hence, the ECB will lower its policy rate to 0.50% and will continue its ample liquidity operations in order to moderate pressures on the banking system.

Eurozone Economy: Macroeconomic Outlook

	2012Q1	2012Q2	2012Q3	2012Q4	2013Q1	2013Q2	2013Q3	2013Q4	2011	2012	2013
	Q/Q(%)								Y/Y(%)		
Real GDP	0.0	-0.2	-0.1	-0.4	-0.2	0.2	0.3	0.3	1.5	-0.5	-0.1
Private Consumption	-0.2	-0.4	0.1	-0.3	-0.1	0.1	0.3	0.3	0.1	-0.9	-0.1
Public Consumption	0.1	0.0	-0.2	-0.2	0.2	-0.2	-0.2	-0.2	-0.1	-0.1	-0.3
Investment	-1.2	-1.5	-0.5	-1.5	-0.5	0.5	1.5	1.5	1.5	-3.5	-1.1
Exports	0.7	1.3	1	1	0.5	1.5	1.5	1.5	6.5	3.5	4.5
Imports	-0.3	0.6	-0.5	-0.5	-0.5	1	1.5	1.5	4.5	-0.5	1.5
Change in Business Inventories Contribution	-0.1	0	0.1	-0.3	-0.1	0.1	0.2	0.1			
Inflation rate	2.7	2.5	2.6	2.4	2.2	1.8	1.8	1.8	2.7	2.6	1.9
Unemployment Rate	10.9	11.3	11.4	11.5	11.6	11.6	11.5	11.4	10.3	11.3	11.5
ECB-Policy rate	1.00	1.00	0.75	0.75	0.50	0.50	0.50	0.50	1.00	0.75	0.50
10Y Bund	1.79	1.59	1.44	1.30	1.35	1.50	1.75	1.88	1.85	1.30	1.88

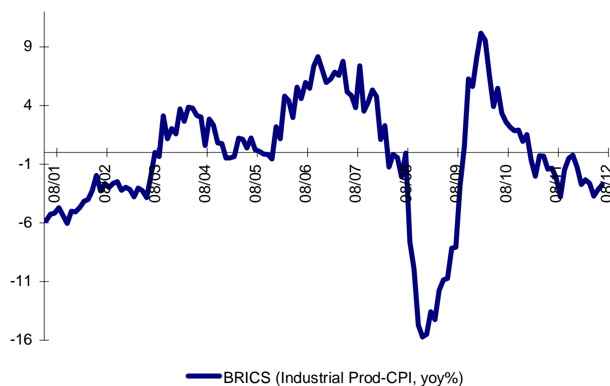
China, Japan and India

- The Eurozone crisis and necessary US fiscal consolidation have resulted in lower demand for exports from the big developing economies and Japan. But, lower international food prices have reduced inflationary pressures, allowing for the relaxation of monetary policy tools.

- Japan posted a recovery during 2012, as a normal consequence of the restoration of production and trade activity and reconstruction works undertaken, after the vast natural disasters in 2011. We estimate real GDP growth rate to be at 2% for the current year, but it will fall to 1% during the next year, as the aforementioned positive effect will decline. Moreover, fiscal consolidation is necessary also for Japan, as its public debt to GDP ratio has soared, resulting in lower domestic demand.

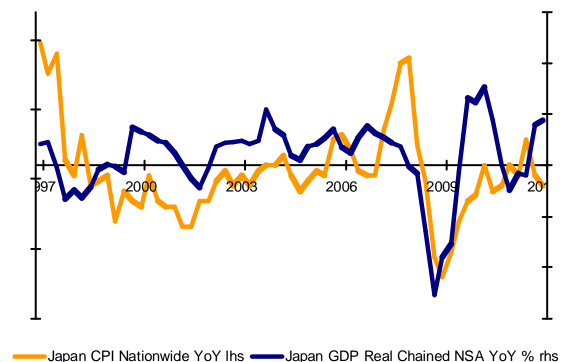
- The real GDP growth rate and inflation rate fell during 2012 in China. Hence, relaxation of monetary policy tools will stimulate domestic demand in order to counterbalance lower external demand. The gradual change (from exports to domestic demand) in the structure of GDP growth constitutes the most important concern for Chinese authorities. We estimate that the real GDP growth rate will accelerate slightly to 8.0% during 2013 from 7.5% in 2012 and 9.1% in 2011.

BRICS: Industrial Production – CPI yoy%



Source: Bloomberg, Piraeus Bank Research

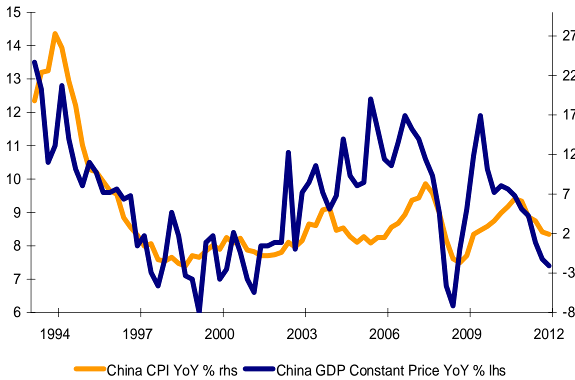
Japan: Growth & Inflation



Source: Bloomberg, Piraeus Bank Research

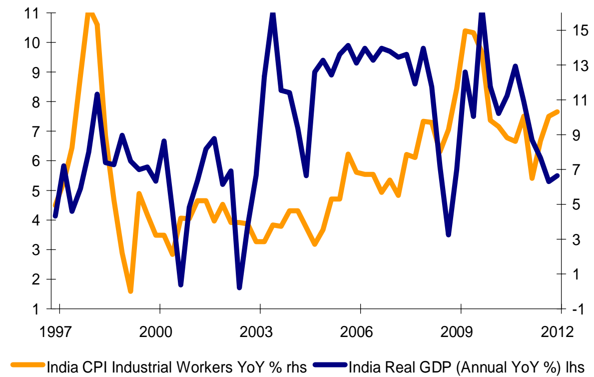
- Likewise, the real GDP growth rate declined in India. But, the big concern was the fact that the inflation rate did not follow the same trend. Inflationary pressures escalated, due to INR depreciation. Hence monetary policy flexibility is very limited. Furthermore, the high fiscal deficit to GDP ratio and considerable current account deficit to GDP ratio reduce this flexibility still further. We estimate that stabilization of the INR exchange rate will provide the opportunity for some monetary policy relaxation and consequently a small acceleration in real GDP growth rate of 6% during 2013 from 5.5% in 2012 and 6.9% in 2011.

China: Growth & Inflation



Source: Bloomberg, Piraeus Bank Research

India: Growth & Inflation



Source: Bloomberg, Piraeus Bank Research

Markets: Signs of Medium-Term Fatigue

- Given the recent significant improvements in the investment climate, it is important to revisit the broader context within which markets have until recently operated. In the aftermath of the 2007 crisis, the global economy and markets remain in a demand deficit environment, where the dynamics of private deleveraging in developed economies have transformed in an attempt to address the excessive accumulation of government debt, while emerging economic slowdown is seen, alongside inability to introduce necessary political and productivity reforms. In this context, amidst heightened fiscal concerns, the identity crisis of the euro also remains a major source of uncertainty. Given the nature of these problems, economic policy decisions remain at the forefront, overshadowing the usual processes of the free market economy and thereby preserving unusually high investment risk.

- As mentioned previously, there has recently been a very fortunate concurrence of favourable economic policy decisions from four main central banks (FED, ECB, BoJ, BoC) and positive macroeconomic surprises in both developed and developing economies. So, "normally" the combination of expectations of higher liquidity (from central banks) and strong economic data would have caused a further improvement in the investment climate, probably with a parallel surge in inflationary expectations. This reflationary model was verified last month only by the rise in government bond yields (+16 & 11 bps for 10-year yields in the US and Germany). In contrast the picture of risky values was mainly negative with only a few exceptions: Most equity markets came under pressure (S&P500 -2.2%, Nasdaq -5%, MSCI Emerging -0.8%) with the exception of most European ones (Eurostoxx50 1.5%), markets in China (HSCEI Index 8.2%) and Greece (ASE 20%). These upward movements are explained mostly by idiosyncratic factors in the aftermath of the recent ECB policy announcements and by political developments in Greece. These reasons also led to a significant reduction in bond yields of the European periphery: by 247 bps in Greece and by 25 and 37 bps in Italy and Spain respectively, along with a EURUSD rally of 0.90%. The rise in Chinese equities can probably be characterized as idiosyncratic / technical as well because neither commodities (-2.2%) nor the price of copper (-5.1%) was consistent with expectations of stronger economic growth in this country. In addition, the significant decline in the price of gold (-4%) was also not in line with a reflationary environment.

- Although the delay of the Spanish government in seeking formal assistance, which would trigger the ECB bond buying scheme (OMT), is a significant potential risk, markets are proving to be more patient than usual. This may be because Spain has taken fiscal austerity measures,, but is also because Germany seems to be tacitly encouraging Spain not to ask for assistance (which, of course, is a fundamental contradiction and a long-term risk). So, judging from the reaction of European bonds and the euro, it is not European risk that is driving international markets in this phase. As we will try to substantiate in what will follow, it is likely that the combination of worsening corporate results, concerns about the election and the possibility of financial impasse in the US and protracted European uncertainty, combined with the very low level of volatility (which points to complacency), could be leading to a period of rising fluctuations and a reduction in the appetite for investment risk. This period is likely to be transient if a) the US finds a balance between economic growth and fiscal prudence and b) if the Eurozone does not display signs of derailment from an – admittedly slow and uncertain – course towards some kind of economic integration. Finally, the risk of policy exit for the FED remains, particularly in the eventuality of significant positive surprises in the data at the beginning of the bond purchase program.

Equity markets

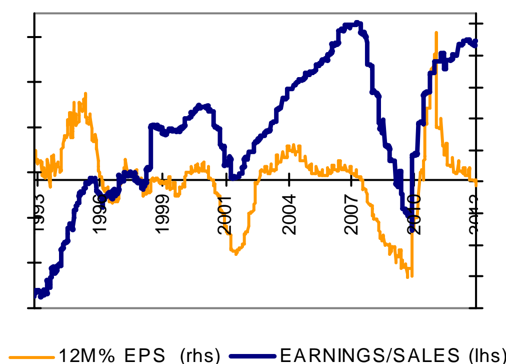
- A parameter that is having a major effect on equity markets is corporate earnings announcements for the third quarter of 2012. With 244 of the 500 companies in the S&P500 having reported, 71% appear to have surprised positively on profitability (weighted average surprise +4.6%) but 61% produced negative surprises relative to sales (weighted average surprise -0.49%). As analyzed in the previous month, negative surprises in sales are related to the dynamics of consumption, and ultimately to the sustainability of positive profitability rates and therefore are market negative. As shown on the first chart, the ratio of profits to sales is close to all-time highs (9.3%), so significant negative surprises in sales could be foreshadowing an even stronger correction of profitability. Equity valuations in the US with a P / E ratio of 14.5 remain reasonable but not cheap.

- Although cyclical macroeconomic signs have begun to change to positive as far as their impact on equity markets is concerned, structural uncertainty remains high and the ensuing institutional (i.e. artificial FED) support is not a positive long-term factor in itself. We believe that although institutional support is able to provide support in times of pressure, it cannot stand out as a differentiating factor for a long-term increase in risky assets' exposure. A straightforward negative factor for equity markets are worries about the budget stalemate in the US (fiscal cliff). Given the upward summer movement and the recent reluctance to continue given the favourable combination of data and stimuli, equities are likely to start to be affected by this combination of electoral and fiscal uncertainty and thus to enter a period of rising volatility. Indeed, equity volatility (VIX index) not only remains at very low levels, but also displays signs of stabilization that could lead to an upward movement in the next 1-3 months.

- During that period, if economic data continue to surprise positively and the two US parties come to some sort of agreement in relation to the fiscal impasse then, in the longer term, prospects of American (and international) equity markets could evolve to positive.

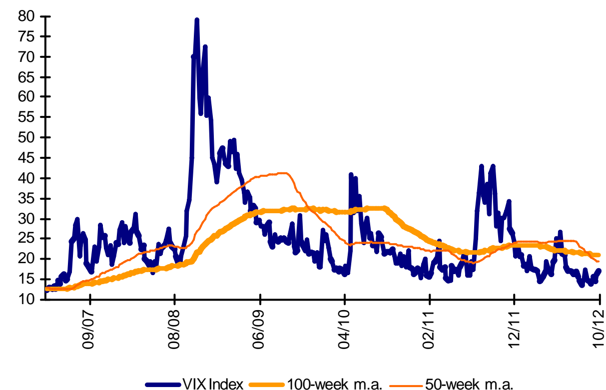
- *We note a further deterioration in the technical picture for US equity markets (to neutral with a positive predisposition) with a constant rating of fundamental / quantitative factors (which remain neutral with a positive disposition, as positive economic data offset the negative corporate results). The overall picture remains neutral.*

S&P500, Earnings Growth vs Earnings/Sales



Source: Bloomberg, Piraeus Bank Research

VIX Index

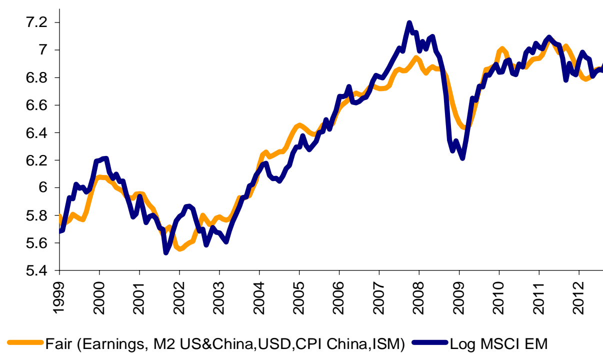


Source: Bloomberg, Piraeus Bank Research

- In emerging equity markets we have observed over the last 6 months a convergence towards our fair valuation measures (in the first chart- using monetary and real growth indicators as well as profitability), while valuations in terms of a P / E at 12.6 are considered fair to cheap. So, despite the fact that company profitability remains in a medium-term bearish trend, the rate of contraction has decreased, while the markets have almost discounted this falling trend. On the macroeconomic front we note stabilization tendencies in the industrial production of the BRICs countries, but inflation pressures in India and Russia continue to cause concern. Overall we observe that the recent downward trend of the difference between manufacturing and inflation rates remains dominant although weakened, posing another negative factor against a sustainable emerging equity market rally. A possible milestone for emerging markets is the change in leadership of the Chinese Communist Party in early November. This could lead to economic stimulus announcements that are expected to benefit the whole of the emerging (and possibly developed) equity market universe. *Technically, emerging markets continue to show signs of stabilization and the picture has changed to neutral with a positive predisposition (from very negative 6 months ago). The fundamental picture is also neutral (with a positive predisposition). The overall picture has also improved but remains neutral with a positive disposition.*

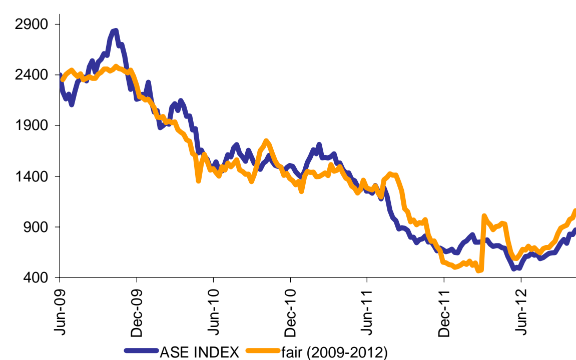
- The Greek stock market (along with the bond market) retains its upward trajectory given the positive announcements / rumours in relation to an agreement with the troika and the friendlier international environment. So, as the market remains, in the longer term, over-sold and overly negative realizations are becoming less likely, the short-term (or even the medium-term) trend could remain upward (particularly after breaking above the 800 level in terms of the General Index). But the investment risk is still too high for the average investor, as fundamentals (macroeconomic and corporate) have yet to show signs of stabilization that would indicate a sustainable change of the long-term dominant negative trend. In addition to this, in the short term the market is becoming over-bought.

MSCI Emerging Market Index & Fair Value



Source: Bloomberg, Piraeus Bank Research

ASE vs Fair (10y GGB yield, EURUSD, S&P500)



Source: Bloomberg, Piraeus Bank Research

Bond Markets

- Downward pressures were observed in both the US and German bond markets. The pressure in Germany can only be explained by the further reduction in the risk premium in relation to the European crisis. The economic data flow, falling rate of monetary growth (M3) and IFO, along with the pressure on the price of oil (inflation-negative) would encourage lower bond yields. In the US the rise in yields is explained by the upward trend in inflation and capacity utilization and by the fall in oil prices (growth-positive). Bonds continue to enjoy the protection of the FED, so even in the event of a rise in economic growth, recent policy announcements imply that the upside in government bonds' yields should be limited. This "insurance" cancels a possible future dollar-positive factor (interest rates), so for the rest of the world, a lack of pressures on individual currencies – in the face of US growth – is deflationary on the margin, providing protection to local bond markets. This mechanism provides a low-volatility bond market environment under two conditions: a) inflationary expectations remain tame and b) the US fiscal bond market risk-premium does not explode.

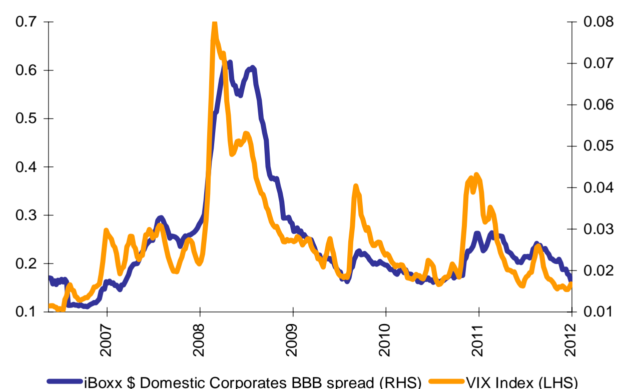
- As far as the first risk is concerned, inflationary expectations, even though these have retreated from the post QE3 announcement highs, retain a medium-term upward trend, still remaining within the long-term fluctuation band which is associated with monetary stability, b) in connection to the US fiscal risk–premium: it seems that it does not exist! When in August 2011, the S & P downgraded US government debt from AAA, yields on US Treasuries came under pressure due to increased demand for safe havens ... This is also reflected in the negative correlation between US bond yields and the corresponding cds. Of course, this relationship is not sustainable in the long term and could change in the event that the US fails to take necessary measures.

- Yields continue to include a substantial risk premium (they remain very low), making bonds expensive. *The technical picture in the US has developed to neutral and to slightly positive in Germany. Overall we maintain a negative view of government bonds, although in the next 1-3 months,, a rise in volatility could lead to a period of strengthening.* Corporate spreads (IBOXX BBB $ index) fell further last month and they have started to trade below longer-term averages and fair value measures (based on profitability and equity volatility measures). *These factors render corporate bonds fair to expensive with respect to sovereigns from a fundamental standpoint. The technical picture has deteriorated to neutral (with a negative predisposition). The overall picture is downgraded to neutral (compared to sovereigns) with marginally negative predisposition.*

US 10-year Treasury Yield

Source: Bloomberg, Piraeus Bank Research

Corporate Spreads vs. Equity Volatility



Source: Bloomberg, Piraeus Bank Research

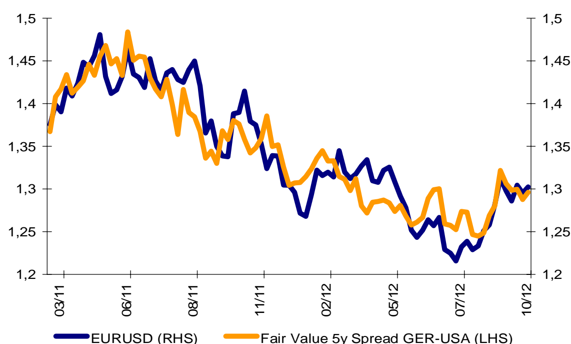
Forex

- The EURUSD cross remained on an upward trajectory last month, despite the fact that US economic data appeared more positive. The market remains under the influence of the ECB OMT announcements, as is evident from the continuing decline of the regional European spreads. Despite the apparent reluctance of the Spanish government to request an official support mechanism, markets continue to treat the euro (and other European securities) under the assumption that such a development is directly possible. These expectations provide support to the exchange rate, but as time goes by – and negative news continues to be released (Moody's downgrade of the autonomous regions, deviations from fiscal targets) – the patience of the market is likely to be exhausted and so a formal Spanish request could come only after considerable market pressure. Apart from the support that contributes to the improvement of the overall European sentiment, we are witnessing a decline in the difference between monetary (M2) growth rates between the US and the Eurozone and a rising Eurozone trade surplus with the US. These forces would lead to a substantial increase in the fair value of the EURUSD, if they were not partly cancelled out by the upward trend in US bond yields (USD positive).

- Overall, the medium-term picture remains marginally positive but easily reversible given the political uncertainties. In the 1.2950 area, the cross remains fairly valued in relation to the difference between German and US yields but relatively expensive compared to the Eurozone country bond spreads against Germany (a fair value around 1.27). *In the long term, the cross remains significantly overvalued but less so than in the past.* As mentioned in earlier publications, ECB intervention provides significant protection around 1.20 and *the overall technical picture has improved to neutral (with a negative predisposition). We maintain our overall negative position.*

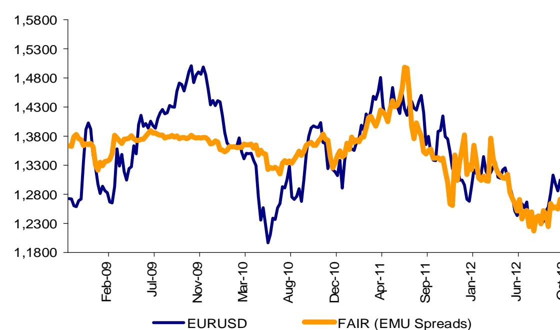
- For the next 3-4 months, we expect trading in the 1.2030 - 1.3450 range. We expect significant short-term support in the 1.2750 area and resistance around 1.3175. An upward break could come as a result of changes in the political climate with developments towards deeper integration and / or faster European recovery, while a downward move would result from faster recovery in the US, significant delays of Spain (and Italy perhaps) in entering some sort of rescue mechanism and general political weakness to leverage on the ECB initiatives. We maintain our 12-month target of 1.19.

EURUSD vs 5y German-US Bond Spread



Source: Bloomberg, Piraeus Bank Research

EURUSD vs Intra-Eurozone Bond Spreads

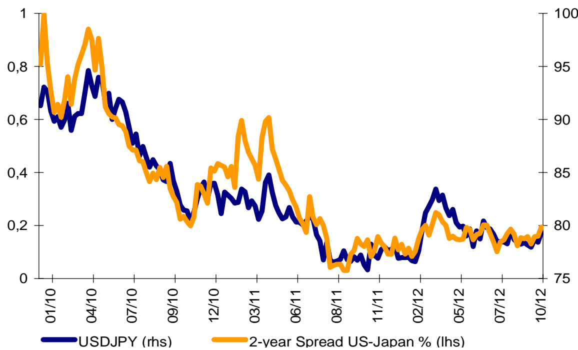


Source: Bloomberg, Piraeus Bank Research

- The Japanese yen came under pressure against the US dollar with the USDJPY cross rising by approximately 2.5%. The economic data in Japan surprised negatively, not only with respect to the US, but in absolute terms as well (trade balance, industrial production machinery orders), leading to a significant widening of the US-Japanese spreads (17 & 8 bps in 10-year and 2-year respectively). The recent break of the exchange rate over 79 is consistent with the emerging cyclical dominance of the US economy and the policies of central banks. On an annual view, we maintain our target of 82.50. In the short term inability to break the 80 area, is likely, especially if our expectations for a rise in market volatility is verified. On the downside a move below 78 would imply even sharper corrections and it is not our primary expected scenario. In general, a stabilization of the cross over 80 would signal a change of the long-term USDJPY trend from downward to upward.

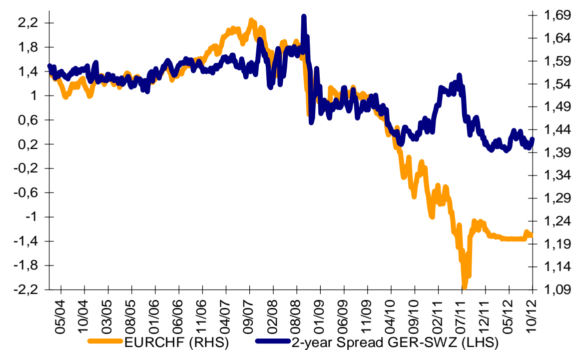
- As the safe haven demand for Swiss francs linked to the Eurozone crisis remains subdued, the EURCHF, at 1.21 retains marginally its upward trend (after trading close to 1.2185). Last month economic data (retail sales, industrial production and trade surplus) surprised positively in Switzerland with inflation being now marginally lower than 0 (-0.3%). Although signs such as the PMI manufacturing index at 43.6 are telling of the pressures still being exerted on the economy, in the future, signs of a stronger sustainable recovery (and inflation) could eliminate any speculation of a rise in the 1.20 floor in the EURCHF rate. Given though that the franc remains significantly overvalued relative to the euro, we would need a very significant shift in the Swiss-EZ growth differential for inflationary forces to appear that would force the SNB to review its policy of artificial franc weakening.

USDJPY vs 2y US-Japan Bond Spread



Source: Bloomberg, Piraeus Bank Research

EURCHF vs 2y German-Swiss Bond Spread



Source: Bloomberg, Piraeus Bank Research

Commodities

- Commodities came under pressure, despite positive economic data and central bank announcements (especially precious and cyclical metals) which would have been expected to rally in the positive growth / inflation environment that would be consistent with the recent news flow. As with equity markets, part of the pressure could be associated with uncertainty about the US elections and the perceived fiscal impasse there. Moreover, as we mentioned last month, China is expected to emerge as an important factor, given the change of leadership in early November and expectations about a policy stimulus package. Given the concerns about Chinese growth that have recently been incorporated into the markets, a medium-term positive surprise is likely. *Overall, commodities remain relatively expensive given the dynamics of the global economy (mainly precious metals and oil). The overvaluation remains but its size has decreased given recent pressures and the positive economic surprises. The overall picture remains negative.*

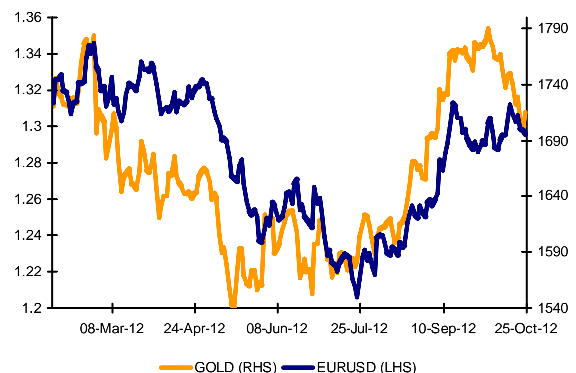
- The price of oil (crude) came under pressure, falling by approximately 7% in the past month. Indications of increased production and reserves were stronger than the increase in demand, while, despite the positive economic signs, concerns about global growth caused downward pressure on prices. Although an announcement of a Chinese stimulus could have a positive effect, broader global economic dynamics, but mainly *the increase in production would suggest a much lower price of around $80*. Recently, the topic of long-term production growth in North America has started to spread, affecting the estimates of analysts and markets. *The technical picture of the oil price remains negative as does our overall view.*

- The price of gold fell (-4%) in the past month along with other commodities. In the absence of negative developments on the Eurozone front, this correction is a relative paradox, as the combination of excess liquidity and better economic data would 'normally' lead to an upward move in the price of gold. Moreover, worries about deficits in the US do not justify pressure on gold, quite the contrary. One explanation has to do with the fact that the gold price has already discounted a lot of positive factors and is now entering a period of rationalization. Perhaps, the recent marginal increase in real ten-year US yields was the excuse for some profit taking. This recent correction has closed the gap with respect to the recent co-movement with EURUSD. *The technical picture remains positive but has worsened.* Renewed pressures on the euro, with a parallel stabilization of the US economy, remains a potential risk for the gold price as *it continues to overshoot according to a series of fundamentals* (budget deficits, money supply, inflation, interest rates, dollar). Technically the inability to stabilize over the 1800 area is a negative development. To maintain the positive medium-term picture, it is necessary to retain support over the 1665 area. *We continue to maintain a neutral point of view.*

Crude Oil Price

Source: Bloomberg, Piraeus Bank Research

Gold & EURUSD



Source: Bloomberg, Piraeus Bank Research

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