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Woodhall's Weekly

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Where has all of the good news gone?

It was hard to find any good news this last week. On the previous Friday in the US – after our markets had closed – there was a disappointing retail sales read for the US and materials stocks and commodities prices dropped sharply. China added fuel to the fire on Monday with GDP growth of 7.7% which beat China's official target rate but disappointed analysts who expected 7.9% - reigniting the China slow-down story.

The Boston bombings compounded the poor sentiment and the gold price plunged 14% in two days – making it a 30% fall from the top – a bear market. Then the IMF dropped its world growth forecast for 2013 from 3.5% in January to 3.3% - just above the 2012 figure of 3.2%.

But during all of this mayhem, Spain sold more 10 year debt than it anticipated at the lowest yield since September 2010. Iron ore prices stayed within a dollar or two of $140 a ton all week.

Unsurprisingly, therefore, the S&P 500 had its worst week of the year (-2.1%) but the ASX 200 only sustained a loss of -1.6%. Volatility (Chart 1) was elevated but not nearly as high as when Cyprus was on the front page earlier in the year. Fear (Chart 2) only rested on the upper bound of the normal range but disorder (Chart 3) jumped out of the box. Heightened disorder was larger due to the savage beating resource-linked stocks took on Thursday followed by a big retracement on Friday while defensives largely just defended during the week.

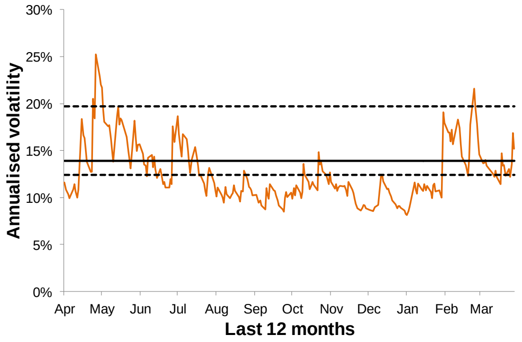
Even though there was a gallant recovery on Friday, Materials lost -7.0% on the week and Energy lost -6.5%. Telcos gained +3.2%, Property +2.2% and Staples gained +1.9%. Exuberance (Chart 5) is just about at fair price (-0.05%) for the ASX 200 but all three resource-linked sectors (Energy, Materials, Industrials) are cheap (Chart 6) by our measure.

It seems that some of the investors who came off the side-lines full of cash and into the market turned tail this week but expected dividend yields are still uncharacteristically low for the four main high-yield sectors: Financials (5.4%), Property (5.2%), Telcos (5.7%) and Utilities (5.4%). We suspect that these sectors must be near the top of their capital growth for a little while as any further yield compression might not sufficiently reward investors for the equity risk they are taking.

Our Capital Growth forecast for the next 12 months on the ASX 200 (Chart 4) slipped a little over the week to +11.8% from just above 12%. Surprisingly most of the stocks in my own portfolio were upgraded in their consensus recommendations at the end of the week. Presumably these recommendations are based on being oversold rather on than on raising target prices at this point.

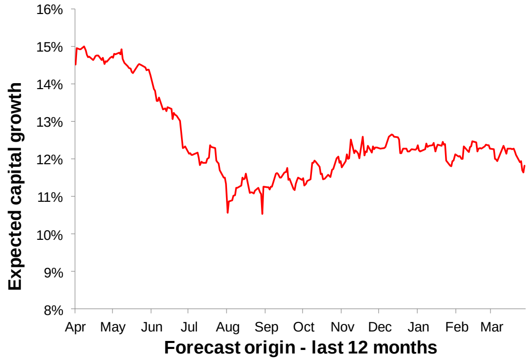
Our index has a small positive lead going into Monday but the outcome might depend on the as-yet-to-be-apprehended terrorist from Boston. Providing nothing more goes awry there, Materials stocks – in particular, the big ones – look like buying opportunities. China did release a particularly strong PMI number – but for services, not manufacturing. Perhaps accumulating rather than jumping in head first is the way to go until more unfolds.

Chart 1: Market volatility



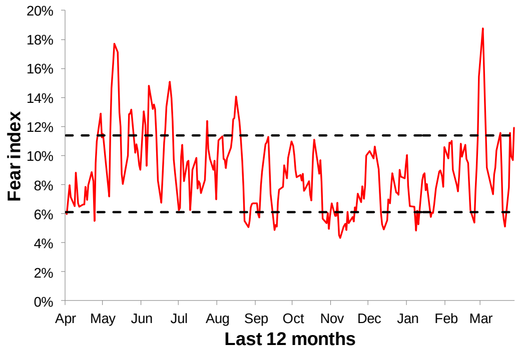
Notes: The solid black line depicts the average volatility since January 2010; the lower dotted line depicts the average volatility pre the GFC; the higher dotted line depicts the average level of volatility during the GFC - up to December 2009. The brown line is a daily estimate of the ASX 200 index volatility.

Chart 4: 12-month-ahead capital gains forecasts



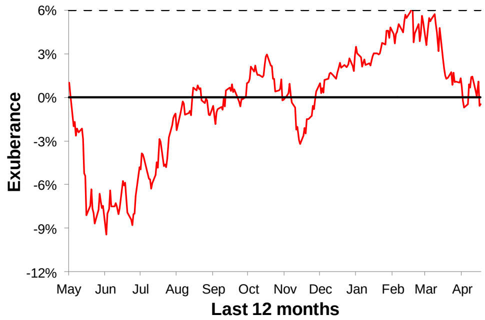
Notes: Each business day we update our estimates for capital gains on the ASX 200 for the following 12 months. For example, the left-most estimate on the vertical axis is a forecast for the 12 months concluding today. The right hand estimate is for the 12 months from today.

Chart 2: Fear index



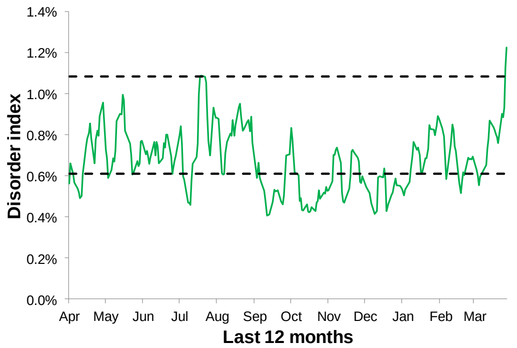
Notes: The fear index is a measure of 'excess' volatility denoting behaviour outside the open/close values each day. The two dotted lines depict the band in which the fear index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate complacency. Extended periods, or extreme values, of the index above the higher dotted line might indicate a propensity for the market to overreact in an irrational manner.

Chart 5: Market exuberance



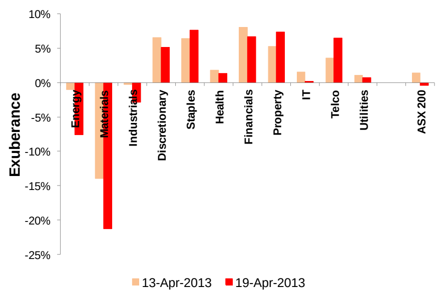
Notes: Exuberance is our measure of mispricing on the ASX 200. A value below the solid black line denotes the market is perceived to be cheap and above that line expensive. Experience suggests that exuberance above +6%, denoted by the dotted line, is an indicator of a potential correction of 6% to 10% - or for the market to move sideways for an extended period.

Chart 3: Disorder index



Notes: The disorder index measures the degree to which the 11 sectors' daily returns move in harmony. The two dotted lines depict the band in which the disorder index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate belief that there is little information to have different impacts on different sectors. Extended periods, or extreme values, of the index above the higher dotted line might indicate investors and traders are lurching from sector to sector in search of a new trend.

Chart 6: Sector exuberance



Notes: The estimates in this chart are based on the same notions as for Chart 5. More detailed information on mispricing is contained in our companion weekly publication in the same section of our website