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26 October 2013

# Woodhall's Weekly

## Lofty levels for ASX 200

- **The ASX 200 crossed the 5,400 level – but Financials are precariously overpriced!**
- **Delayed US nonfarm payroll data pushed back expectations for the start of tapering**
- **Big licks for miners and mining services companies**

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### Overview

The market crossed 5,400 but it was only moderately over-priced by our measure. However, the Financials sector exuberance crossed the 'magic' 6% level suggesting a possible correction or prolonged sideways movement. Importantly, that sector's expected dividend yield is down to 5.2% which looks unsustainably low. That 5.2% is just shy of the 5.1% in May when stock prices fell sharply to get the yield up to 6.0%! Importantly, the three other high-yield sectors (Property, Telcos and Utilities) have not been sucked into this exuberance.

The US government is back at work after the partial shutdown and the cost to the country of the Congressional squabble is being counted. But we do now know consumer confidence was brought down by the debacle. The delayed payrolls data – which should have been released on the first Friday of the month – disappointed this week and so the markets rallied! At 148,000 jobs, the data were too weak to allow tapering to start any time soon – hence the rally. The unemployment rate did fall to 7.2% from 7.3% but that got little attention.

With upbeat AGMs from the likes of Bradken (Mining Services) and BHP, together with a strong flash PMI read for China manufacturing, helped propel many stock prices upwards in the related sectors. BHP was around $31 at its mid-year lows and is now over $37. Similarly RIO's price has lifted from about $51 to nearly $64.

With BHP predicting a 75% increase in the demand for commodities over the next 15 years at its AGM, mining services stocks rallied too. Take Bradken – about $4.20 to $6.65 in a few months – and Emeco – about 17c to around 36c over the same period – but then fell to 33.5c on Friday afternoon! Iron ore prices remain solid in the low $130s after calls from big houses for $80 during Q3 and/or Q4 made as recently as a few months.

At home, the CPI came in at 0.7% - a little stronger than expected and putting paid to any more rate cuts. The Aussie climbed above 97c for a day. With Yellen likely for Fed Chairman, weak US jobs data, and moderate Australian inflation data, a dollar below 90c – as many predicted recently – seems way off target.

### Market expectations

With CBA's yield down to 5.0% after the share price climbed above $76, further capital gains seem unlikely but the other three big banks report in a couple of weeks. Telstra's share price seems more in line with dividend expectations but these high yield sectors have to be a constraint on the ASX 200 going in to 2014.





WOODHALL INVESTMENT RESEARCH

We have the market overpriced by +2.8% and our baseline e-o-y forecast solid at 5,300 – below last night's close.

As we wrote in the February edition of *Professional Planner* 5,400 was not out of question for the e-o-y if long-run mispricing was eroded. The market could climb to just under 5,600 by the e-o-y without triggering a correction – but our FY '14 forecast is still for 5,500 – unless, of course, company guidance starts to upgrade outlook statements.

There is room for more growth in Energy, Materials and Mining Services than there is in the high yield sectors. We see momentum continuing in resource stocks by rebalancing from high yield. If this happens, our e-o-y forecast will be on the low side. But remember the consensus forecast by top brokers at the start of 2013 reported in the AFR was only about 4,700 – or a projected 0% growth for the year! At least we started 2013 with a forecast of 5,150 which drifted up to 5,300 by mid-year – and then stabilised.

## Market Stats

Materials led the charge this week with a gain of +3.0% but, since it started the week as underpriced, Materials is now only just overpriced at +0.5% (Chart 6). Financials gave it a go with a gain of +1.7% but now that sector is overpriced by +7.1% and dividend yield has dropped to 5.2%. The other high-yield sectors have yields of 5.6% - 5.7% and so are better yield plays. The adjusted capital-gains forecast for Financials is -1.2%.

The overall market rose a creditable +1.2% that is just ahead of the S&P 500 and just behind the DAX and the FTSE. The ASX 200 is moderately overpriced at +2.8% (Chart 5) and has some wiggle room before it hits the 6% line that marks a possible correction or prolonged sideways movement.

After slipping in recent weeks, the 12-month capital-gains forecast (Chart 4) recovered some ground to finish up at +9.8% but that gets adjusted down to +6.9% when exuberance is accounted for.

Volatility (Chart 1) has settled right down at low levels and the Fear index (Chart 2) and Disorder (Chart 3) are in the zone. The SPI futures index is indicating a +33 start at the open on Monday to get it back above 5,400. So, in theory, a rally can be sustained a little longer but we are worried about Financials and that is 40% of the index. Volumes were strong on the ASX 200 on Friday.

Presumably investors are chasing the dividends that will soon be announced for ANZ, NAB and WBC – and CBA is getting carried along for the ride. Special dividends might be expected but when investors realise they will be getting less than 5% (plus franking credits) if prices increase much more, they might then feel duped.

## US economy

The non-farm payroll data needs to come in at above 200,000 to get analysts even slightly excited. The September data, delayed by the partial government shutdown, was released on October 22nd. It came in at a disappointing 148,000 but the unemployment rate did fall a notch to 7.2%.

The August nonfarms were revised upwards from 169,000 to 193,000 which is almost a reasonable outcome.

Given that next month's release will be affected by the shutdown, it will be December before we get the next meaningful indicator about the state of the US economy.

An unemployment rate of 6.5% was being targeted as a minimum rate for the QE3 programme to be ended. Bernanke has said that not all unemployment rates are the same – implying that rates can fall because some people give up looking for work. Nevertheless, the unemployment rate has been falling steadily and a '6 handle' might not be that far away.

## China economy

The preliminary HSBC PMI read on China manufacturing surprised to the upside with a print of 50.9 against an expected 50.4 and a previous month of 50.2. This latest value was the highest in seven months and suggests the manufacturing sector is accelerating. The official PMI – corresponding to larger firms – is due out on the 1st of the month.

Also during the week Fitch, the ratings' agency downgraded its 2014 GDP growth forecast to 7.0% from 7.5%. BHP, at its AGM, matched the 7.0% forecast but was upbeat about it. They also said they see a 75% increase in the demand for commodities over the next 15 years.

Money markets spiked mid-week when there was talk of credit problems in China but markets seemed to forget – or at least downplay credit issues – when the production data came in.

## Glossary

**Abenomics –** Japan's Prime Minister Shinzo Abe came to power early in 2013 and has brought a new economic style to managing that economy.

**FOMC –** The Federal Open Market Committee determines monetary policy in the United States. It can be thought of as being similar to our Reserve Bank board.

**GOP –** stands for Grand Old Party which is an alternative name for the US Republican Party.

**HSBC flash PMI –** HSPC publishes an alternative to the official PMI for China. It is based on a survey of predominantly small to medium sized firms – unlike the official version. The number on the 1st of the month gets much less attention than the official but the preliminary, or 'flash', reading gets attention as a read a week or two before the official numbers.

**Long-run mispricing –** This measure is based on analysing trends over more than a century of data. The average period of over- or under-pricing is about 18 months. That is, we do not expect the market to rapidly approach its fair value.

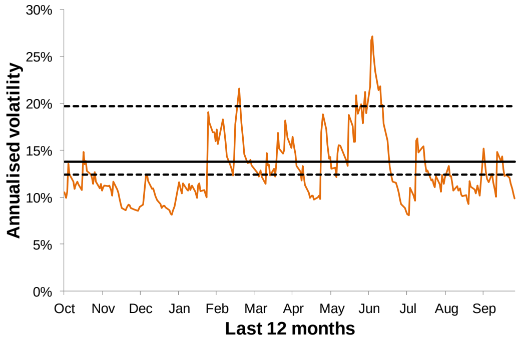
**Short-run mispricing –** This exuberance measure is our mispricing statistic reported in Chart 5. It is based on 12-month-ahead forecasts of the ASX 200. Please see the notes under Chart 5.

**PMI –** This acronym stands for Purchasing Managers Index. There is one for most countries and separate statistics for manufacturing and services. Manufacturing typically gets more attention. The statistics are published in the first few days of each month – with China on the 1st. A reading less than 50 means the sector is decreasing in its growth rate – so If China growth slows from 8% to 7%, its PMI should be below 50. If the US speeds up from 2% to 2.5%, its PMI should be above 50.

**Savings ratio –** In Australia, the ratio of net savings to household disposable income defines the savings ratio. It does not include superannuation contributions.

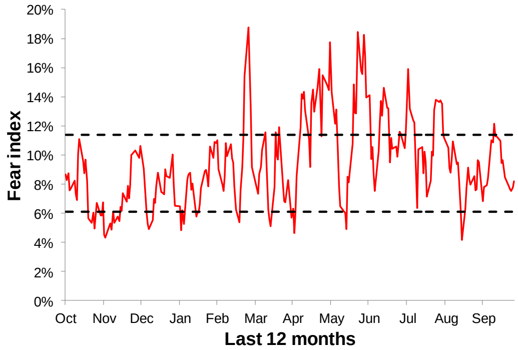
**Tapering –** It is the name given to the exit strategy from QE3. It is not a tightening monetary policy – just an increasingly less accommodative stimulus.

## Chart 1: Market volatility



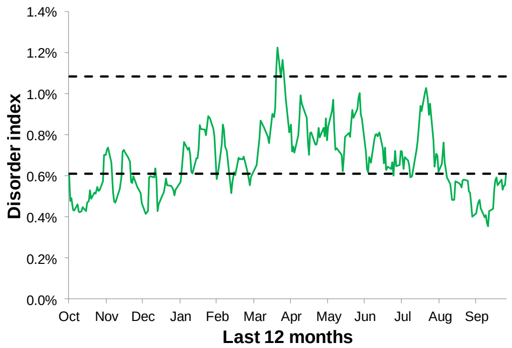

Notes: The solid black line depicts the average volatility since January 2010; the lower dotted line depicts the average volatility pre the GFC; the higher dotted line depicts the average level of volatility during the GFC - up to December 2009. The brown line is a daily estimate of the ASX 200 index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

## Chart 2: Fear index



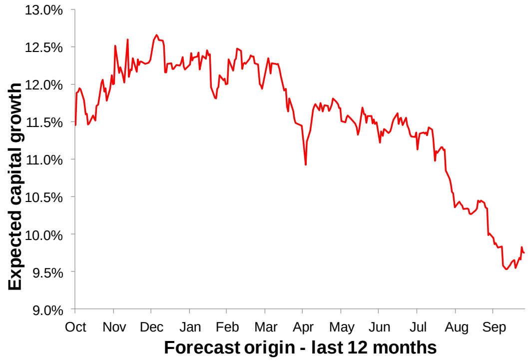

Notes: The fear index is a measure of 'excess' volatility denoting behaviour outside the open/close values each day. The two dotted lines depict the band in which the fear index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate complacency. Extended 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 3: Disorder index



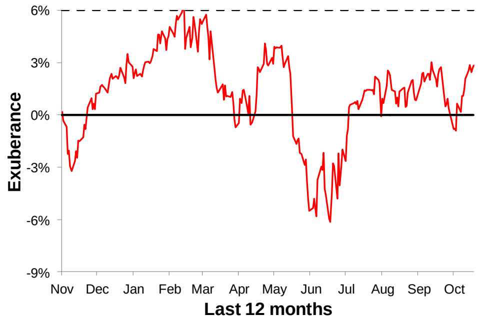

Notes: The disorder index measures the degree to which the 11 sectors' daily returns move in harmony. The two dotted lines depict the band in which the disorder index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate belief that there is little 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 4: 12-month-ahead capital gains forecasts



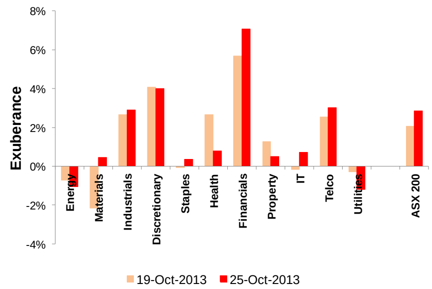

Notes: Each business day we update our estimates for capital gains on the ASX 200 for the following 12 months. For example, the left-most estimate on the vertical axis is a forecast for the 12 months concluding today. The right hand estimate is for the 12 months from today.

## Chart 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 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