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Woodhall's Weekly

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A turning tide

- **Media over-reaction to our jobs report**
- **Miners start the charge**
- **World Bank raises global growth forecast**

Overview

On Thursday, some media commentators talked or wrote about a 'massive' loss of -22,600 jobs in the month of December. While the number is correct, the hyperbole isn't. As we have repeatedly written, the jobs report is based on a small sample of just over 20,000 households which must be magnified to estimate the impact on the employed workforce of nearly 12 million people.

The *Australian Bureau of Statistics* (ABS) is an excellent organisation that must balance cost against accuracy. The ABS warns us – at least those of us who take the time to read their publications – not to read too much into one month's number. Indeed, it tells us that December's result is much less than a fall of one standard deviation – which cannot be significant in any reasonable sphere of statistical inference. For the non-statisticians, the ABS is telling us that there is about a 20% chance that there could have been *an increase* in the population that just did not turn up in the people who happened to be sampled this month.

My main point is not to make a statistical point. Rather, I note that the ABS trend employment (its favoured measure) has been the *same* (to the nearest 10,000) for six consecutive months. Moreover, unemployment has been 5.8% in four of the last five months (the other was 5.7%). So rather than hurtle towards 6.25% as many forecast for 2014 – including the Commonwealth Treasury – unemployment deterioration has apparently stalled. Whether it can stay below 6% is not clear but there have been some glimmers of hope in other data including the previous week's retail sales data for December that was up +0.7%.

But not even the media could get a bad story about the big miners this week. True, the previous week was a bit of a disaster for iron ore companies but both BHP and RIO knocked the socks of production reports last week. With iron ore prices having risen in $A terms, all is looking well for some segments of the market going into reporting season. The Materials sector was up +4.1% for the week while the ASX 200 was broadly flat at -0.1%.

Financials took a bit of a beating at -2.1% but this is the story we have been on about since early last year. The banks' share prices are constrained by dividend compression and many analysts, in my opinion, were far too pessimistic on China.

The World Bank lifted its forecast for 2014 world growth from 3.0% last June to 3.2% now and faster in both 2015 and 2016. The US profit season has been a little mixed but the Fed's 'Beige' book has lifted its interpretation of US growth from 'modest to moderate' to now an unqualified 'moderate'. US retail sales belted in at +0.7% just to back up that view.

Market expectations

We started the year with our 2014 ASX forecasts for the e-o-y at 5,850; a low of 5,150; and a high of 6,150. We now have an automated system to monitor the progress of these forecasts on a daily basis.

Naturally, as the market shed 150 points to 5,212 our low forecast became closer and there is a natural lowering of an updated low – now down to 5,100 from 5,150. Our e-o-y and high are also off 50 points (we round these forecasts to the nearest 50 points – the actual changes happen to have been smaller).

We continue to see high yield sectors to be constrained by dividend compression with some modest growth in Resources and Industrials.

Market stats

Volatility (Chart 1) remains at normal levels and our fear index has even been on the low side. Our expected capital gains (Chart 4) seem to be settling down at just under +9% for the next 12 months.

We have the market a fraction cheap at -1.3% but the recent underpricing of Materials stocks was eroded in just three days. At +0.1% that sector is now fairly priced.

With Telcos overpriced by +2.5%, we have a forecast of -3.5% capital loss over the next 12 months.

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.

ASX forecasts - We have further supplemented our forecasting process for the ASX 200 by including not just a forecast of the peak (at some unspecified time during the year) but also the low. Thus, we now have an end point (e-o-y forecast) and a range for the whole year. Naturally, on a rising market the low is more likely to occur earlier in the year and the high nearer the end. Since we publish our forecasts to the nearest 50 points to reduce the sense of false accuracy a change of just a couple of points can kick the forecast over by 50 points at around the 25 and 75 marks.

Australian debt ceiling – Labor brought in a debt ceiling in mid 2018 of $75bn to self-impose some fiscal discipline during the onset of the GFC. Within seven months that ceiling was almost trebled to $200bn and it has since been raised to $300bn during Labor's term in office. Since before 2008 we had no debt ceiling that is equivalent to an infinite ceiling!!!

Black Friday – This term is used for the Friday after Thanksgiving in the US to denote the start of the shopping season for the holidays. Black refers to the accounts going back into the black from increased sales – it is certainly not a negative term!

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.

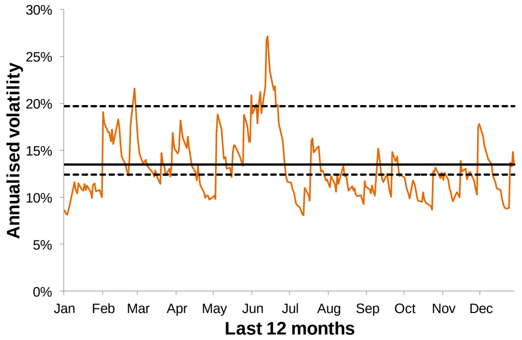
PMI – This acronym stands for Purchasing Managers Index. There is one for most countries and separate statistics for manufacturing and services. Manufacturing typically gets more attention. The statistics are published in the first few days of each month – with China on the 1st. A reading less than 50 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.

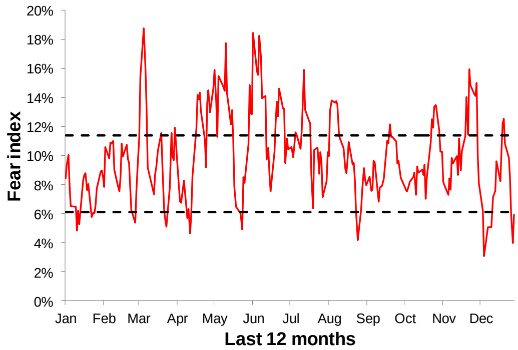
US non-farm payrolls data – are usually published on the first Friday of each month. They are generally considered to be the most reliable indicators for employment and unemployment in the US. Roughly speaking, a 200,000 increase in jobs is considered strong – particularly in the context of the tapering discussions.

Chart 1: Market volatility



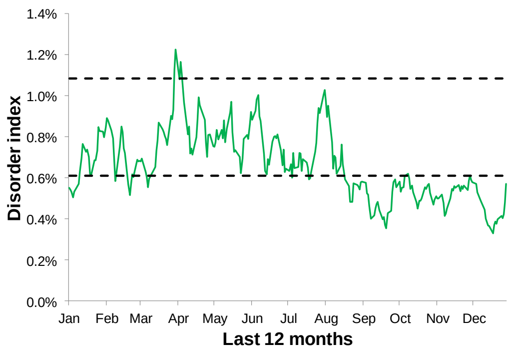
Notes: The solid black line depicts the average volatility since January 2010; the lower dotted line depicts the average volatility pre the GFC; the higher dotted line depicts the average level of volatility during the GFC - up to December 2009. The brown line is a daily estimate of the ASX 200 index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

Chart 2: Fear index



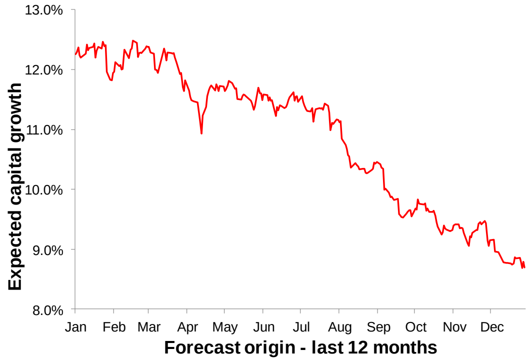
Notes: The fear index is a measure of 'excess' volatility denoting behaviour outside the open/close values each day. The two dotted lines depict the band in which the fear index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate complacency. Extended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



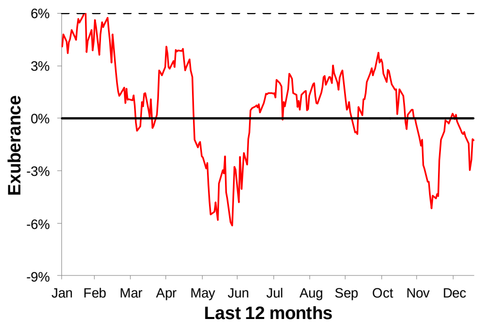
Notes: The disorder index measures the degree to which the 11 sectors' daily returns move in harmony. The two dotted lines depict the band in which the disorder index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate belief that there is little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



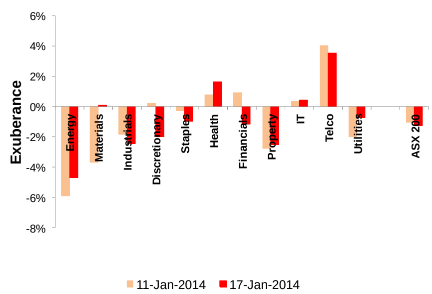
Notes: Each business day we update our estimates for capital gains on the ASX 200 for the following 12 months. For example, the left-most estimate on the vertical axis is a forecast for the 12 months concluding today. The right hand estimate is for the 12 months from today.

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