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Woodhall's Weekly

US jobs good – but not good enough

- **US employment misses expectations**
- **China announces a stimulus plan**
- **Is Australia in a property bubble?**

Overview

Overnight US non-farm payrolls came in at +192,000 against an expected extra 225,000 jobs. Unemployment held firm at 6.7% as more people were attracted to look for work. February's data was revised up to 197,000 from an initial estimate of 175,000.

Although the jobs data were fine, the S&P 500 slipped all night and some momentum stocks took a bath. We had the S&P 500 overpriced by a mild +1.8% going into the jobs report so the sell-off kept that market just a tad overpriced.

As we speculated (along with everyone else), China is embarking on a stimulus plan. It announced a package of rail, property and taxes on the back of a $US24bn bond issue. China announced 6,600km of new rail of which 1,000km is to be built this year – a distance of about Sydney to Melbourne.

The China manufacturing PMI started the month at 50.3 – up a notch from the previous month and above the 50.0 break-even level. It looks like China might have glided to a low and will now recover with its stimulus plan. Of course, the HSBC flash PMI will probably come out in a week or two below 50. The two indexes measure different things and shouldn't be compared. That won't stop some commentators missing the point.

On the announcement that the Australian household debt to disposable income statistic hit a new high of 177%, the bubble merchants came out in force. Property prices have increased strongly in recent times but this is how that market works. There are usually long spells of 4 – 10 years when inflation-adjusted prices go nowhere to be interspersed with short bursts of strong growth. Prices must be getting near the start of the next plateau so I agree with the Governor of the RBA that property doesn't look like a good investment at the moment. Of course, it could be a great decision to buy for those who want to live in the house for a decade or more to come.

Our Retail Sales growth came in at +0.2% after three strong months in a row. Of course the RBA did not change the official cash rate – currently at 2.5% – and seems unlikely to make any further cuts. The next-change-is-up movement is gaining momentum and that increase could start as early as this year – but 2015 is more likely. Either way, when the rate does start to go up there will likely be several increases in quick succession. 4% or more at the end of 2015 is not out of the question as 4% is near the low-end-of-normal when there is no economic crisis lurking nearby.

We also had a few more industrial closures announced last week: BP, Philip Morris and Boeing. But the jobs to be lost are small in comparison to the general increase in employment we have witnessed in recent times.

Market expectations

We started the year with our 2014 ASX forecasts for e-o-y at 5,850; a low of 5,150; and a high of 6,150.

Our forecast e-o-y on the ASX 200 is just above 5,700 and the predicted high during 2014 has settled at 6,000.

The gradual slide in out 12-months-ahead capital-gains forecasts for the ASX 200 in Quarter 1 was largely fuelled by deteriorating expectations in the Materials sector. The Energy sector forecasts have now joined that descent having lost over 6% points this year to date.

With the SPI futures down over 40 points for Monday, and no obvious positives particularly likely over the next week or two, we maintain our prediction of a softish Q2 followed by a stronger second half in 2014.

Market stats

Volatility (Chart 1) has fallen to 8.9% - well below the long-run average. Fear (Chart 2) nipped just above the range but ended the week right in the middle of normal.

The rolling 12-month unadjusted capital-gains' forecast dropped slightly over the week to land at +6.7% (Chart 4). But, allowing for mispricing at -0.3% (Chart 5), that capital-gains' target increases to +6.9%.

The Energy and Materials sectors' capital-gains forecasts continued to slip but iron ore prices did take a turn for the better and BHP's possible plan to split the company could add some positives for Materials.

While we have the market underpriced at -0.3%, Financials is overpriced moderately at +2.4% as yield hunters circle over the pack. Financials' yield is holding steady at 5.4%.

While Financials is the most over-priced sector, Energy and Staples, at -3.5%, are the cheapest. Materials would have been down there with Energy had it not been for a stellar week on the market – at +2.8% for the week – while the broader market increased +1.0% in line with most major overseas markets. Despite the beating last night, the S&P 500 was still up on the week.

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 2008 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!

China's shadow banking – In essence, the China government dictates what all banks must lend at and pay for deposits. As a result, if a potential borrower is deemed too risky at the prevailing rate, the banks refuse to lend (rather than increase borrowing rates as may happen here). The 'failed' borrower may then seek funding from the shadow banking system that is not so regulated.

It appears that any defaults in the shadow banking system would be covered by the Central Bank so there would not be the sort of contagion problems that arose in the US and Europe. However, a serious round of defaults in China would put a bit of a brake on growth.

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.

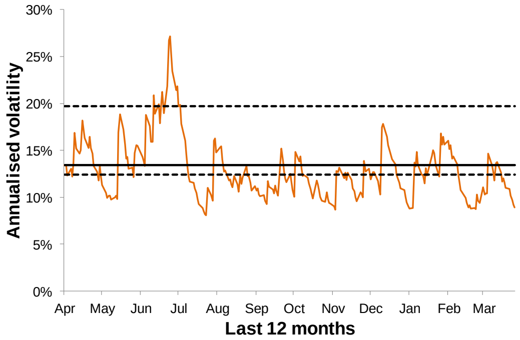
PMI – This acronym stands for Purchasing Managers Index. There is one for most countries and separate statistics for manufacturing and services. Manufacturing typically gets more attention. The statistics are published in the first few days of each month – with China on the 1st. A reading less than 50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

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.

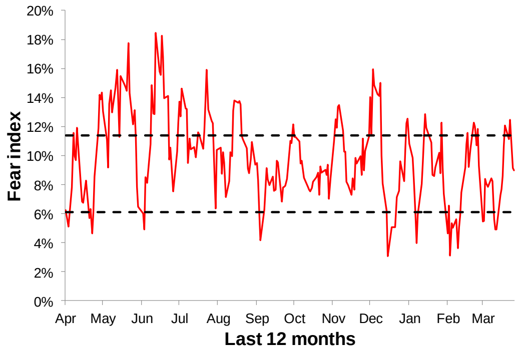
US non-farm payrolls data – are usually published on the first Friday of each month. They are generally considered to be the most reliable indicators for employment and unemployment in the US. Roughly speaking, a 200,000 increase in jobs is considered strong – particularly in the context of the tapering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

Chart 1: Market volatility



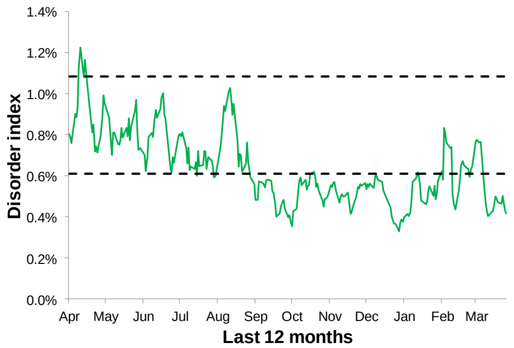
Notes: The solid black line depicts the average volatility since January 2010; the lower dotted line depicts the average volatility pre the GFC; the higher dotted line depicts the average level of volatility during the GFC - up to December 2009. The brown line is a daily estimate of the ASX 200 index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

Chart 2: Fear index



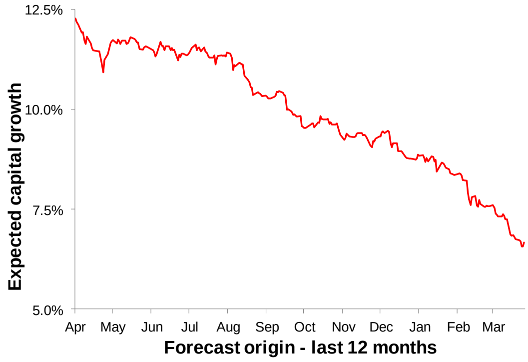
Notes: The fear index is a measure of 'excess' volatility denoting behaviour outside the open/close values each day. The two dotted lines depict the band in which the fear index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate complacency. Extended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



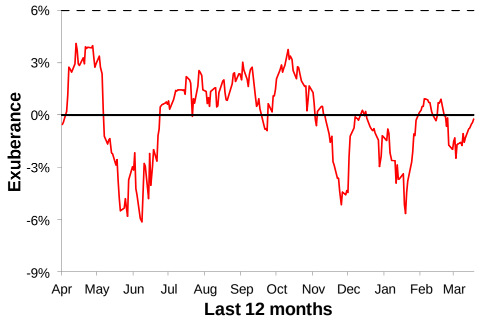
Notes: The disorder index measures the degree to which the 11 sectors' daily returns move in harmony. The two dotted lines depict the band in which the disorder index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate belief that there is little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



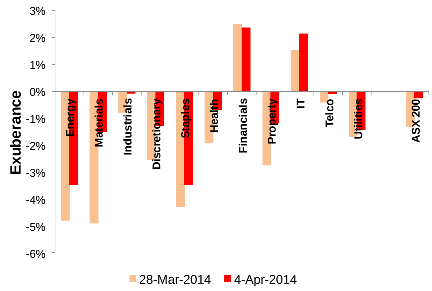
Notes: Each business day we update our estimates for capital gains on the ASX 200 for the following 12 months. For example, the left-most estimate on the vertical axis is a forecast for the 12 months concluding today. The right hand estimate is for the 12 months from today.

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