4 April 2015

Woodhall's Weekly

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Mixed bag of data

- **US jobs a massive miss**
- **China PMI above 50 again**
- **Iron ore prices take another hit**

Overview

Analysts were expecting about +248,000 jobs to have been created in March but the US nonfarm payrolls came in at only +126,000 – about 70,000 short of the most pessimistic forecaster! The cold weather was possibly part of the reason but not all of it.

On the bright side, the US nemployment rate was steady at 5.5% and the hourly average wage rate was up from +0.1% to +0.3%. Explain that one if you can!

The Boston Federal Reserve put out a research report during the week announcing some survey results. They found that there has been a growing trend toward so-called 'informal work' – that is babysitting, dog-walking and the like. This type of work supplements both part-time and full-time work and tends not to be picked up in labour statistics or their tax office. Perhaps life in the US is better than the data have been telling us (if you happen to love animals and babies)

With Wall Street closed for Good Friday, the markets have not yet had a chance to react to the Good Friday morning jobs data. Australia and much of Europe will be closed for Easter Monday and so our Tuesday night could be interesting if we watch Wall Street open.

Given Yellen's stance on data watching, surely she now has to wait a couple of more months – even if the coming jobs data are good – just to be sure. So, as we have been writing for some time, we think June is off the table and so now is September. Before the jobs data, the last week of November was being priced in by markets for the first hike. It looks like 2016 to us now.

That puts pressure on the RBA to act sooner than later to keep the dollar under control. Tuesday looks like a cut and the markets had it priced in at a 70% chance before the US jobs data.

The China PMI number came in above expectations at 50.1 from 49.9 the month before. Nothing to write home about – but better than being sub 50 again! Nevertheless iron ore price tumbled at the end of the week.

The UK, coming up to its general elections, reported a strong +0.6% growth for the quarter and consumer confidence was the highest in 12 months. Perhaps the Tories will get back in after all.

So Tuesday here will be a busy day. An RBA decision at 2:30pm and a late night open on Wall Street. I think I have nothing to do but sit and wait.

For those interested, there are now 19 collected reports I have previously had published elsewhere that detail my thinking about my own portfolios over

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the last year – my “Diary”. I feel (from occasional emails) that there is a demand for this sort of info.

I will update this file on my portfolios as I write and I am preparing some more factual information about what I hold and why. Check out the Investment Strategy tab for the reports and updates.

Market expectations

Our start-of-year 2015 forecasts for the ASX 200 were for an e-o-y of 5,900, a high of 6,200 and a low of 5,200. The updated e-o-y forecast stands at 6,200; up from last week. The new high stayed at 6,500. Fair value is up at 5,800. The index closed at 5,899 being +2.0% overpriced.

With just less than three months to go, our current e-o-FY15 forecast is 6,000 from the original June 2014 forecast of 5,900. Our ‘high’ FY15 forecast has slipped back a little to 6,150 over the week. All in all, the market continues to look better than we previously thought – and that is based on broker forecasts as always.

Our position held since September 2013 is that 6,000 on the index is unlikely to stick until the second half of 2015. But now we (obviously) think that we have a chance of some fleeting visits above 6,000 sooner than we then thought! We are back to thinking 6,000 may stick for good – or at least for a reasonable time – from Q3.

Our January 1st 2015 forecasts for the S&P 500 were: e-o-y 2,240; high 2,360; low 1,970. Fair value was 2,080. Our current e-o-y inched up to 2,300; the high is at 2,350. And fair value is 2,100. The latest closing price was 2,061. Exuberance is -1.5% so there is plenty of room for upside – but probably markets not want take the bait in Tuesday night!

Our SPI futures’ index is down -9 points for Tuesday’s open – but that is a pretty meaningless number given everything else that is going on.

Market stats

Our market volatility index (Chart 1) continues to be a little bouncy at just above the long-run average. Our Fear Index (Chart 2) fell back to the middle of the normal range and then jumped above it again at the end of last week. Our Disorder index (Chart 3) is in the zone.

Our capital gains forecast has jumped up (Chart 4) to +8.3%. The market is now overpriced at +2.0% (Chart 5). So that leaves the adjusted capital gains’ forecast at a handy +6.1%. The comparable adjusted gains’ forecast for the S&P 500 stands at +10.9%.

Only Health (+7.1%) and Financials (+7.6%) are now above the +6% ‘magic’ overpricing level

The expected dividend yields on the High Yield stocks remain clustered at just below 5%. Perhaps this is the new level consistent with the recent easing bias from the RBA,

The first tranche of my geared IOZ/IVV portfolio is up +20.9% from mid October 2014 and the second tranche is up 11.6% since December 2014. The complete new geared portfolio so far has an unrealised capital gain of +13.4%.

My Hybrid yield portfolio – including the impact of the March 5th 2015 rebalance – is up 13.1% against 9.2% for the ASX 200. Including dividends, the figures are 18.5% and 13.2% respectively.

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.

High-Yield Sectors: by this, we mean Financials, Property, Telcos and Utilities.

ISM - Institute of Supply Management produces a 'PMI-like' number for the US economy. Like the PMI, 50 is the cut off between improving and worsening expectations.

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.

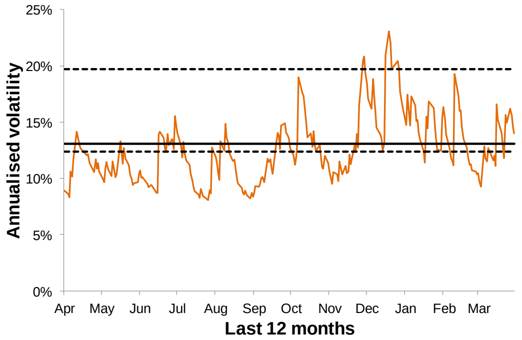
PMI – This acronym stands for Purchasing Managers Index. There is one for most countries and separate statistics for manufacturing and services. Manufacturing typically gets more attention. The statistics are published in the first few days of each month – with China on the 1st. A reading less than 50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

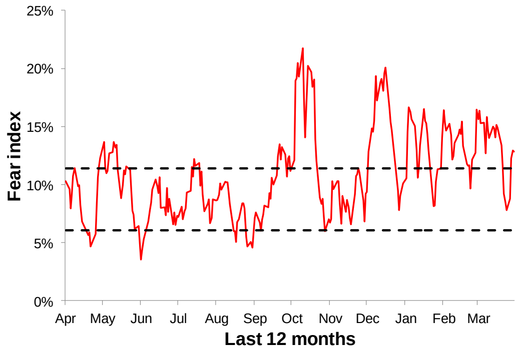
US non-farm payrolls data – are usually published on the first Friday of each month. They are generally considered to be the most reliable indicators for employment and unemployment in the US. Roughly speaking, a 200,000 increase in jobs is considered strong – particularly in the context of the tapering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

Chart 1: Market volatility



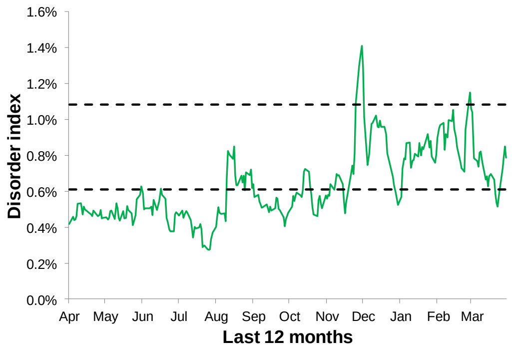
Notes: The solid black line depicts the average volatility since January 2010; the lower dotted line depicts the average volatility pre the GFC; the higher dotted line depicts the average level of volatility during the GFC - up to December 2009. The brown line is a daily estimate of the ASX 200 index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

Chart 2: Fear index



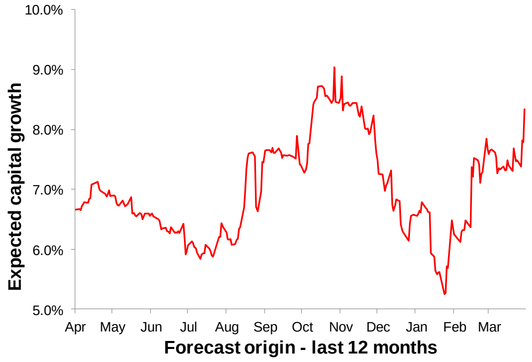
Notes: The fear index is a measure of 'excess' volatility denoting behaviour outside the open/close values each day. The two dotted lines depict the band in which the fear index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate complacency. Extended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



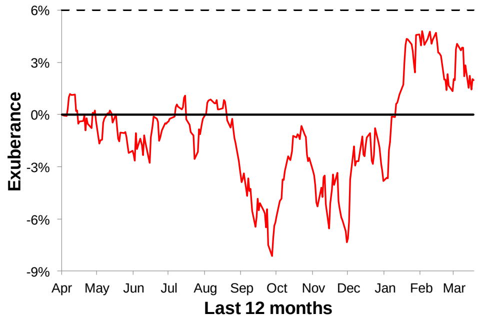
Notes: The disorder index measures the degree to which the 11 sectors' daily returns move in harmony. The two dotted lines depict the band in which the disorder index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate belief that there is little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



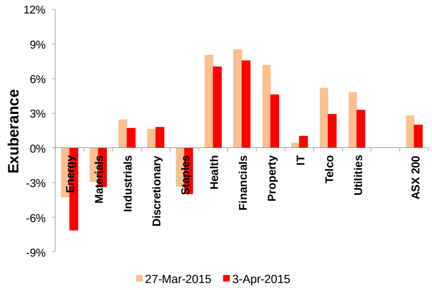
Notes: Each business day we update our estimates for capital gains on the ASX 200 for the following 12 months. For example, the left-most estimate on the vertical axis is a forecast for the 12 months concluding today. The right hand estimate is for the 12 months from today.

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