Woodhall's Weekly

Ron Bewley PhD, FASSA

Confidence follows the Budget

- **Banks still unloved**
- **Iron ore less loved**
- **FOMC pushes rate hikes back**

Overview

The ANZ-Roy Morgan weekly consumer confidence read jumped +3.6% but that got trumped by the Westpac-Melbourne Institute confidence index that jumped +6.4% to give the best read since before the 2014 budget. Problem solved! Even the LNP fought back to level peg with Labor in the polls.

There does seem to be a renewed optimism on TV and that must flow through to some consumer spending and, hopefully, business investment. But the Financials sector fell another -2.5% over the week making that fall -5.9% for the m-t-d.

The broader market fell -1.2% over the week but it did stage a bit of a rally on Thursday. It frittered away the lead from Wall Street on Friday after yet another new high on the S&P 500. That's not surprising given the upcoming Memorial Day long weekend in the US. Our SPI is down -9 points but I think there is a little latent energy hidden in our index.

The price of iron ore fell about $4 on the week to $58 / tonne. S&P came out with a forecast of $50 for the average price for the rest of 2015. The S32 spin-off from BHP sparked a lot of interest but it will be a while before that market settles.

The FOMC minutes removed any mention of a June rate hike and Janet Yellen made it clear in her Friday speech that it might take years before the Fed Fund rate returns to normalised levels – although she does think rates will start to rise this year.

I called that the market had a great future on Switzer TV Tuesday night. I put out a preliminary forecast for FY16 for the ASX 200 to finish at around 6,350. Two other guests and I agreed that banks were a buy. Peter got excited by my renewed positivity and called be an 'excited crazy professor' in his write-up on his website. I kind of liked that.

So my call stands. The S&P 500 is close to an all time high but it is not over priced! Our market has no sectors significantly overpriced, two (Staples and Financials) are quite underpriced and the rest are around par (Chart 6). The ASX 200 is underpriced by -2.6% so, with consumers at last happy again, bring it on.

Of course I don't think (nor do I want) the market to shoot out of the blocks but it won't be long before we have a '6 handle' on our index.

For those interested, there are now 21 collected reports – LAST UPDATED ON 2nd MAY – I have previously had published elsewhere that detail my thinking about my own personal portfolios over the last year – my "Woodhall Diary". Check out the Investment Strategy tab for the reports and updates.

Woodhall Investment Research Pty Ltd. (ABN 17 141 486 160); www.woodhall.com.au

WoodHall Investment Research

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 slipped again over the week to 6,000. The new high during the rest of 2015 slipped back to 6,250. Fair value is steady at 5,800. The index closed at 5,665 being -2.6% underpriced.

With only about five weeks to go, our current e-o-FY15 forecast depends so much on how quickly the -2.6% underpricing is eroded it is no longer worthy of comment. The June 2014 forecast for FY15 was for a 5,900 end. So 6,000 is pretty much off the table in the next five weeks

Our position held since September 2013 is that 6,000 on the index is unlikely to stick until the second half of 2015. We currently estimate that the market could jump to as high as 6,150 without signalling a correction!

We are still thinking 6,000 may stick for good – or at least for a reasonable time – from early 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 updated e-o-y stands at 2,270; the high forecast is at 2,360. And fair value is now 2,130. The latest closing price was 2,126. Exuberance is close to zero so there is plenty of room for upside.

Market stats

Our market volatility index (Chart 1) has fallen back to the long-term average. Our Fear Index (Chart 2) is just inside the top of the normal zone. Our Disorder index (Chart 3) is at the low end of the zone. These conditions are right for a rally from here.

Our 12-month capital gains forecast slipped a fraction (Chart 4) from +7.9% last week to +7.5% largely on the back of the Energy forecast falling from a very high level after the oil-price recovery. The market is underpriced at -2.6% (Chart 5). So that leaves the adjusted capital gains' forecast at a very healthy +10.2%. The comparable 12-month adjusted capital gains forecast for the S&P 500 stands at +10.4%.

Industrials (+3.0%) and Property (+2.0%) (Chart 6) are a little overpriced while Staples (-5.1%) and Financials (-4.3%) are quite cheap.

The first tranche of my geared IOZ/IVV portfolio is up +17.9% from mid October 2014 and the second tranche is up 8.8% since December 2014. The complete new geared portfolio so far has an unrealised capital gain of +10.5% since I invested much more in the second tranche.

My Hybrid yield portfolio – including the impact of the March 5th 2015 rebalance – is up +13.0% against +4.8% for the ASX 200 since late June 2014. Including dividends, the figures are +18.8% and +9.4% respectively. Barring any disasters it looks like I might get close to a +10% outperformance on that portfolio for FY15!

One of the 12 Hybrid stocks had its target price from consensus broker forecasts lifted a little last week. Two were fractionally down and nine were unchanged.

I still have a little cash to deploy but I haven't yet made up my mind. It is most likely it go to one of my big banks' holdings (CBA or WBC). We'll see how next week pans out.

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.

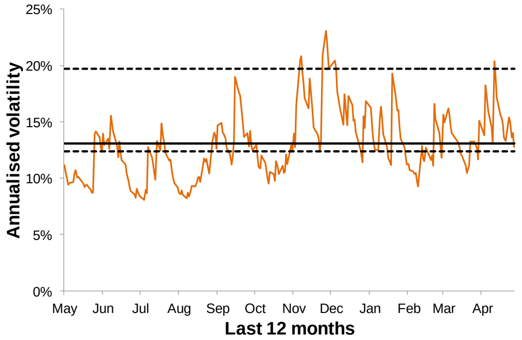
PMI – This acronym stands for Purchasing Managers Index. There is one for most countries and separate statistics for manufacturing and services. Manufacturing typically gets more attention. The statistics are published in the first few days of each month – with China on the 1st. A reading less than 50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

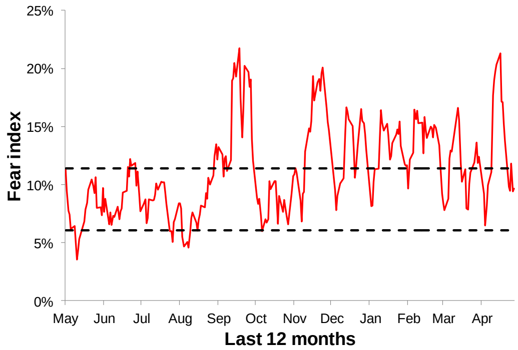
US non-farm payrolls data – are usually published on the first Friday of each month. They are generally considered to be the most reliable indicators for employment and unemployment in the US. Roughly speaking, a 200,000 increase in jobs is considered strong – particularly in the context of the tapering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

Chart 1: Market volatility



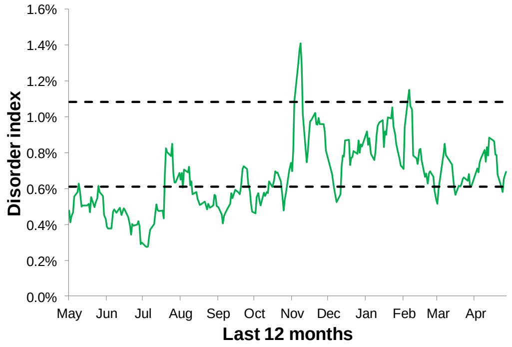
Notes: The solid black line depicts the average volatility since January 2010; the lower dotted line depicts the average volatility pre the GFC; the higher dotted line depicts the average level of volatility during the GFC - up to December 2009. The brown line is a daily estimate of the ASX 200 index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

Chart 2: Fear index



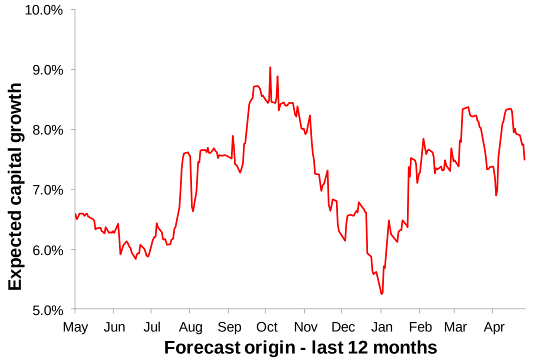
Notes: The fear index is a measure of 'excess' volatility denoting behaviour outside the open/close values each day. The two dotted lines depict the band in which the fear index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate complacency. Extended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



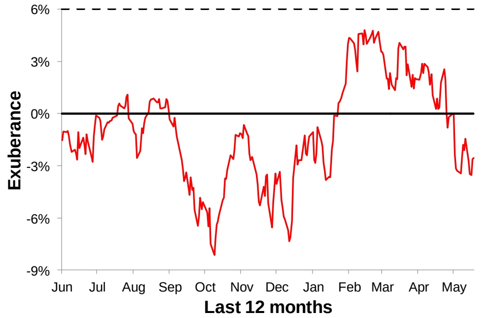
Notes: The disorder index measures the degree to which the 11 sectors' daily returns move in harmony. The two dotted lines depict the band in which the disorder index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate belief that there is little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



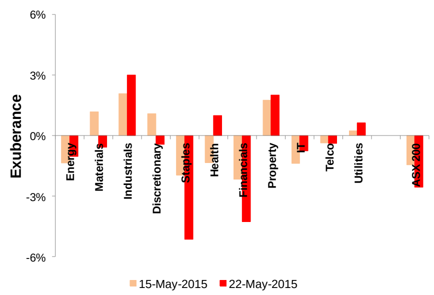
Notes: Each business day we update our estimates for capital gains on the ASX 200 for the following 12 months. For example, the left-most estimate on the vertical axis is a forecast for the 12 months concluding today. The right hand estimate is for the 12 months from today.

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