



Woodhall's Weekly

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At last Aussie data impresses

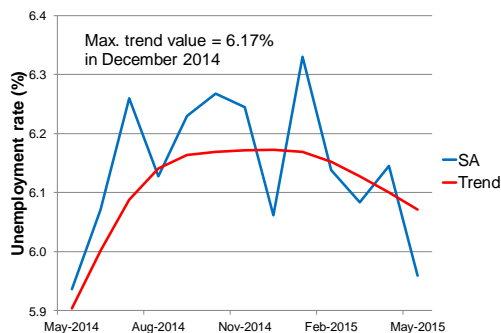
- **Aus unemployment back to under 6% and Business Confidence up**
- **Japan revises growth up to 3.9%**
- **Groundhog survives Montreal F1 Grand Prix**

Overview

While many analysts were (again) in panic mode last month over our unemployment data, we then pointed out that the ABS preferred trend estimate had fallen to 6.1%. Well the trend estimate has fallen further on a gentle downward trend to 6.07% in the latest read while the SA version is just under 6% at 5.97%. Of course the same analysts can't understand what is going on this month – they focus on the less reliable seasonally adjusted (SA) data because that gives them more to talk about.

There were +47,000 new jobs created in May of which +14,700 were full time and 27,300 were part time. Of course we reiterate that it is silly to add these two numbers together without correcting for the number of hours worked. Part-timers, on average, work about one quarter of those for a full-timer.

ABS unemployment rates: SA and Trend



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I don't usually include extra charts to save my time on my Saturday mornings but this one is so good – it's worth it. It shows trend unemployment peaked in December last year – and it shows the degree of sampling variation in the SA data. Of course, fortunes could be reversed at some point but the NAB Business Confidence survey came in at +7 from +3 which is the best since August last year.

The Budget is working and we are calling that unemployment has peaked! So should the RBA cut rates? It probably doesn't need to on the labour market front but that dollar of ours is not in the comfort zone. A cut in a few months is quite possible.

The Fed meets this coming week and Janet Yellen will speak afterwards. The June hike everyone was talking about is obviously off the table and September is now the call for most. We think that is too soon for the US. They are producing jobs but mainly at the low-wage end and so the consumer is not doing enough yet. 2016 for the first hike is still likely in our opinion but they may sneak a little one in before Christmas.

Japan revised its Q1 growth data up from +2.4% to a whopping +3.9% (both annualised). Perhaps those arrows have all left Abe's quiver and are flying in the right direction. Delaying the sales tax hike was a smart move by Abe.

Just as Germany looked to be making some concessions for Greece, the IMF walked away from the (lack of) negotiating table in disgust. I noticed

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the first photo of the new Greece Prime Minister without that smug grin on his face.

On the same front, S&P put the UK on negative watch because of its referendum on leaving the EU. Who would want to be part of that failed union? Sometimes people have to face up to divorce and move on. But who will get the house and kids is S&P's question?

After being the first major country to raise rates, New Zealand just cut by 25 bps. Having the highest rate in the street is not a great idea when your major export (dairy) is suffering.

China is still struggling with its trade data but it just slashed the import duty on luxury imports. China is always quick to move but now India has a higher growth rate than China!

But the best news of the week was on our Monday morning for those who enjoyed the movie Groundhog Day. At the Montreal F1 Grand Prix there are two very long fast straights and a groundhog was crossing the track at the end of a straight as the cars barrelled down on it at around 300k. Well the groundhog was seen scampering to safety on the grass. Hopefully, he (or she) lives on to fight another day.

We posted the slides from a presentation I gave at an Asset Allocation Conference yesterday (under the Investment Strategies tab). I haven't yet had a chance to write a narrative to go with it but interested people should get the idea by reading it in conjunction with the 'diary' on the same web page.

For those interested, there are now 22 collected reports – LAST UPDATED ON 27th 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.

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 rose back to 5,950 over the week – above where it started on Jan 1! The new high forecast for the rest of 2015 remains at 6,150. Fair value is still steady at 5,800. The index closed at 5,545 being -4.1% underpriced.

With two weeks to go our June 2014 forecast for FY15 of 5,900 is highly unlikely but that is only 100

points above fair value – and anything is possible at the end of the financial year – up or down – as fund managers and investors square their books.

'Our position held since September 2013 is that 6,000 on the index is unlikely to stick until the second half of 2015'. But we currently estimate that the market could jump to as high as 6,150 without signalling a correction! An orderly Greek resolution might do it. But if it takes a couple of weeks into FY16 to get back to 5,900, I wouldn't be unhappy.

We are still thinking 6,000 may stick for good – or at least for a reasonable time – from Q3. Our provisional June 30, 2016 (end of FY16) forecast is 6,300.

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 2,260; the high forecast is at 2,340. And fair value is 2,130. The latest closing price was 2,094. Exuberance about -1% so there is plenty of room for upside.

Market stats

Our market volatility index (Chart 1) is still quite high – but not too bad now. Our Fear Index (Chart 2) is rapidly on its way back to the normal zone. Our Disorder index (Chart 3) is just fine. With a SPI futures lead of -6, buying opportunities may abound this coming week.

Our 12-month capital gains forecast gained (Chart 4) inched up to +8.1%. The market is underpriced at -4.1% (Chart 5). So that leaves the adjusted capital gains' forecast at +12.6%. The comparable 12-month adjusted capital gains forecast for the S&P 500 stands at +13%.

All sectors are underpriced (Chart 6). The Financials' yield stands at 5.5% with an adjusted capital gain of +9.2% on top! The other three high-yield sectors have yields that are clustered between 4.9% and 5.1%.

The first tranche of my geared IOZ/IVV portfolio is up +17.4% from mid October 2014 and the second tranche is up 8.4% since December 2014. The complete new geared portfolio so far has an unrealised capital gain of +10.1% since I invested much more in the second tranche. (see the conference presentation for charts, etc)

My Hybrid yield portfolio – including the impact of the March 5th 2015 rebalance – is up +10.7% against +2.6% for the ASX 200 since late June

2014. Including dividends, the figures are +16.6% and +7.2% respectively. Interestingly, since the March 5th rebalance, the portfolio has outperformed the ASX 200 by over 4% suggesting that the yield play is still on – we just had a little bubble take a prick.

Three of the 12 Hybrid stocks had their target prices from consensus broker forecasts lifted a little last week. Five were down and four were unchanged. But none of the changes are big.

Importantly, the results in my conference paper suggest to me that rebalancing every three months is not worth the effort but every 6 months is much better than once a year. I'll be ready to move again at the start of September – just after reporting season. But I'll keep you updated as more performance data comes in.

The big banks are looking very, very cheap with the sector underpriced at -5.3% and, at 5.5%, the yield for the sector is very attractive. Westpac's reshuffle at the top looks very, very interesting!

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 – HSBC 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

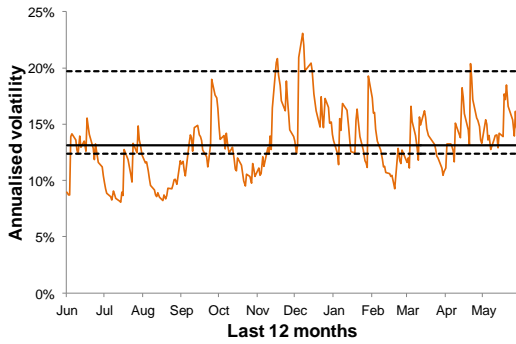
reading less than 50 means the sector is decreasing in its growth rate – so If China growth slows from 8% to 7%, its PMI should be below 50. If the US speeds up from 2% to 2.5%, its PMI should be above 50.

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.

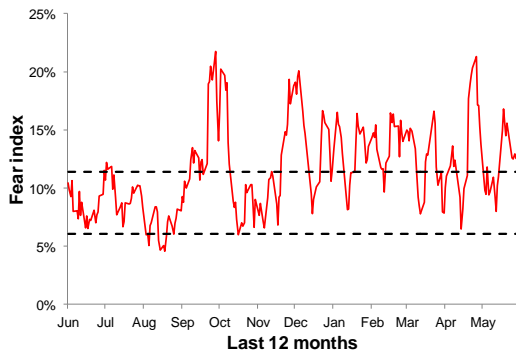
US non-farm payrolls data – are usually published on the first Friday of each month. They are generally considered to be the most reliable indicators for employment and unemployment in the US. Roughly speaking, a 200,000 increase in jobs is considered strong – particularly in the context of the tapering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

Chart 1: Market volatility



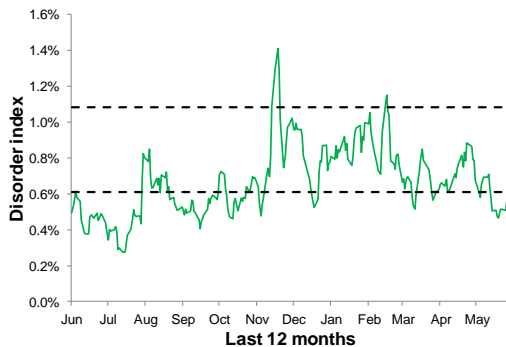
Notes: The solid black line depicts the average volatility since January 2010; the lower dotted line depicts the average volatility pre the GFC; the higher dotted line depicts the average level of volatility during the GFC - up to December 2009. The brown line is a daily estimate of the ASX 200 index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

Chart 2: Fear index



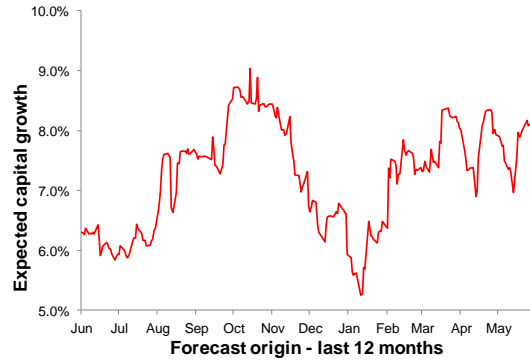
Notes: The fear index is a measure of 'excess' volatility denoting behaviour outside the open/close values each day. The two dotted lines depict the band in which the fear index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate complacency. Extended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



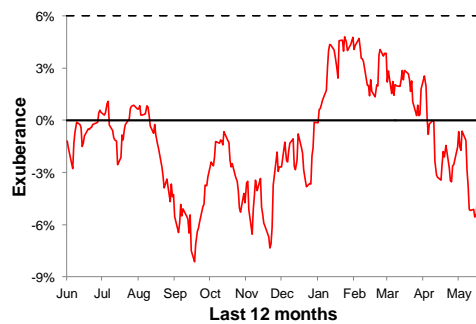
Notes: The disorder index measures the degree to which the 11 sectors' daily returns move in harmony. The two dotted lines depict the band in which the disorder index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate belief that there is little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



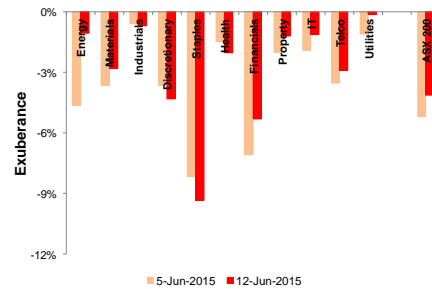
Notes: Each business day we update our estimates for capital gains on the ASX 200 for the following 12 months. For example, the left-most estimate on the vertical axis is a forecast for the 12 months concluding today. The right hand estimate is for the 12 months from today.

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