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Woodhall's Weekly

Greetings from Hoylake

- **GB positively bubbling**
- **Aus jobs really good**
- **US jobs don't impress me**

Overview

Having spent some or all of 55 of my 66 years in England, I feel I know my country. But I was blown away the day I landed with the positivity surrounding a Cycling Festival in London. Pro races scattered amongst rallies for mums, dads and children, grandparents and grandchildren. Economic news is being reported very positively; no whinging opposition leaders are getting any airtime or have ceased to exist; GB was leading the medal tally at the World Swimming Championships yesterday; and then there was that Thursday at Trent Bridge. GB is brimming with confidence. I can't recall GB being like that – at least since the 1966 World Cup victory.

But the Governor of the Bank of England did not raise rates on Thursday although put the economy on notice. Inflation is 0% but the economy is really starting to grow. A rate hike seems likely early in 2016. But the positivity seems to be interpreted as the economy can handle it.

In Australia, the jobs data were reported as problematic. But trend unemployment is unchanged at 6.1% and last October is still the peak for recent trend unemployment reads. Jobs growth was strong in both a trend and seasonally adjusted sense. The problem is (if, indeed, it is a problem), that the participation rate surged to a two and a half year high suggesting people are starting to look again for jobs with more enthusiasm. The RBA kept rates on hold.

Thankfully I have no access to Australian TV on my holiday with, I am sure, the opposition dominating the airwaves with negativity. Oh for a clear majority at home as Cameron now has in GB.

At home the big banks took a beating on ANZ's capital raising and profit downgrade. With the market down -3.9% on the week, Materials (-7.0%) and Financials (-5.7%) led the fall but no sector was spared. Discretionary performed the best at -1.2%.

The US nonfarm payrolls came in at an insipid +215,000 from a revised +231,000. Unemployment was constant at 5.3%. I can't see how the Fed would feel comfortable hiking rates in September with a number that is below both the 2013 and 2014 monthly averages. But they might feel pressured into starting in September with baby steps.

So is this fall a sign of worse to come? Again I doubt it. Once the capital raisings have been digested and somebody notices that iron ore prices are back of $56 perhaps our market can recover. The SPI futures point to a flat open.

For those interested, there are now 23 collected reports – LAST UPDATED ON 23rd JUNE – I have previously had published elsewhere that detail my thinking about my own personal portfolios over the

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WoodHall Investment Research

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 has fallen to 5,750. The new high forecast for the rest of 2015 rose to 5,950. Fair value is steady at 5,750. The index closed at 5,475 being -4.4% underpriced.

Our forecast for FY16 was for an end of 6,200, a high forecast (during FY16) of 6,500 and a low forecast of 5,300. The high forecast is now 6,350 and the end is 6,100.

So when will we break 6,000? The banks are central to the direction of our market and it is too early to say whether last week's falls were an over-reaction or not. There is nothing yet to suggest there is an outside chance 6,000 could happen this quarter (or at least in 2015).

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 2,220; the high forecast is at 2,270. And fair value is 2,140. The closing price was 2,078. Exuberance is about -2.9%.

Market stats

Our market volatility index (Chart 1) was back to normal but it shot out of the box on Friday. Our Fear Index (Chart 2) reached sub average levels before Friday, too, only to shoot out of the box. Our Disorder index (Chart 3) is just fine.

Our 12-month capital gains forecast (Chart 4) is steady at +7.6%. The market is underpriced at -4.4% (Chart 5). So that leaves the adjusted capital gains' forecast at +12.4%. The comparable 12-month adjusted capital gains forecast for the S&P 500 stands at +14.8%.

Resource stocks are particularly cheap (Chart 6). Healthcare is the highest priced but only at a very slim +0.6%.

The first tranche of my geared IOZ/IVV portfolio is up +17.6% from mid October 2014 and the second tranche is up +8.5% since December 2014. The complete new geared portfolio so far has an unrealised capital gain of +10.2% since I invested much more in the second tranche.

My Hybrid yield portfolio – including the impact of the March 5th 2015 rebalance – is up +8.9% against +1.3% for the ASX 200 since late June 2014. Including dividends, the figures are +15.3% and +6.0%, respectively. That corresponds to an outperformance of +9.3% in a little over a year.

Since my Hybrid portfolio does not contain any big banks, it only fell -1.6% compared to Financials at -5.7% or the market at -3.9%. My plan continues to be to rebalance my portfolio in early September after the reporting season has been digested.

There were no upgrades or downgrades in the target prices of my 12 Hybrid stocks. That was all done and dusted before reporting season began.

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!

CAIXIN (formerly HSBC) flash PMI – CAIXIN 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.

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.

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.

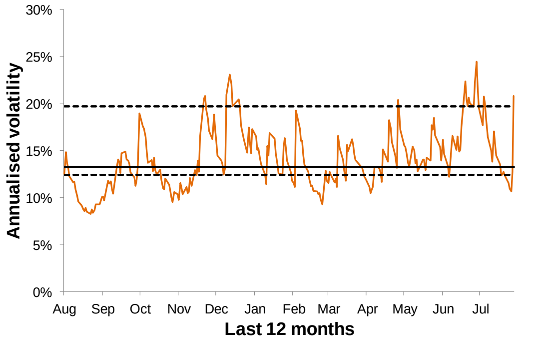
PMI – This acronym stands for Purchasing Managers Index. There is one for most countries and separate statistics for manufacturing and services. Manufacturing typically gets more attention. The statistics are published in the first few days of each month – with China on the 1st. A reading less than 50 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 was the name given to the exit strategy from QE3. It is not a tightening monetary policy – just an increasingly less accommodative stimulus.

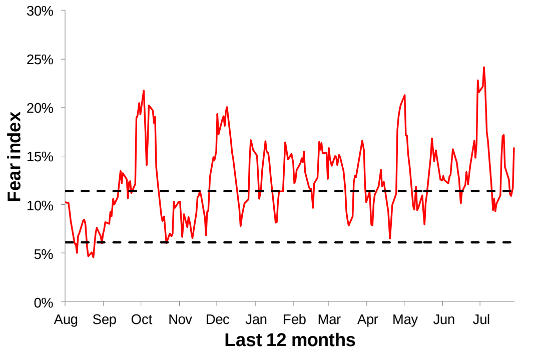
US non-farm payrolls data – are usually published on the first Friday of each month. They are generally considered to be the most reliable indicators for employment and unemployment in the US. Roughly speaking, a 200,000 increase in jobs is considered strong – particularly in the context of the tapering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

Chart 1: Market volatility



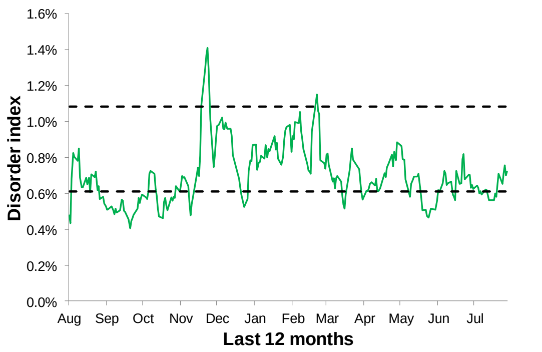
Notes: The solid black line depicts the average volatility since January 2010; the lower dotted line depicts the average volatility pre the GFC; the higher dotted line depicts the average level of volatility during the GFC - up to December 2009. The brown line is a daily estimate of the ASX 200 index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

Chart 2: Fear index



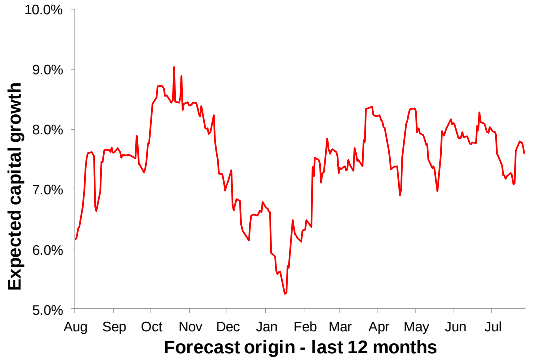
Notes: The fear index is a measure of 'excess' volatility denoting behaviour outside the open/close values each day. The two dotted lines depict the band in which the fear index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate complacency. Extended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



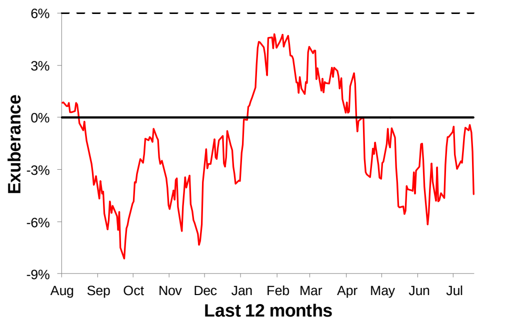
Notes: The disorder index measures the degree to which the 11 sectors' daily returns move in harmony. The two dotted lines depict the band in which the disorder index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate belief that there is little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



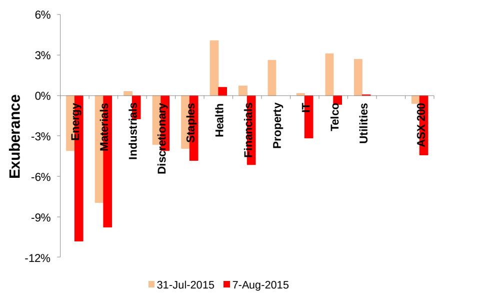
Notes: Each business day we update our estimates for capital gains on the ASX 200 for the following 12 months. For example, the left-most estimate on the vertical axis is a forecast for the 12 months concluding today. The right hand estimate is for the 12 months from today.

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