5 December 2015

Woodhall's Weekly

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Yellen gets green light from jobs data

- **Fed hike all but certain**
- **Draghi delivers but doesn't over-deliver**
- **China to join SDR basket**

Overview

We lost another -1.0% pts on the ASX 200 over the week after the stellar 100 pts gain on Tuesday. But the big number was due after our market close – and it was big.

The nonfarm payrolls number came in at a strong +211,000 new jobs with the previous month's +271,000 revised upwards to +298,000. The unemployment rate is stable at 5.0%. 211k is the Goldilocks number. Too big and it would have suggested that the Fed was behind the curve. Too small and markets would have taken it badly. The S&P 500 rose about +2% on the day in anticipation of a rate hike on December 16th!

Lots of commodities data also rose last night but WTI oil and iron ore price futures each dipped below $40 at some point. OPEC rolled its policies over last night – no cut in supply to support prices. Gold hit a five year low earlier in the week but jumped over $30 last night.

Mario Draghi announced QE will be extended by six months in Europe to March 2017 and cut 10 bps off its rate to -0.3%. The market was unhappy because 'Draghi always over-delivers' didn't come off this time. He delivered on expectations but he can move again if he so wishes.

The IMF announced the Yuan/Renminbi will join the Special Drawing Rights basket of currencies early next year. This implies increasing oversight on financial reform in China and more active trading. But the main point is symbolic. China has now been acknowledged as a financial power. China also announced a 30 minute time out next year any time the market goes up or down by 5%.

The China PMI number came in at 49.6 – a slight miss – but no one worried.

We got two very good pieces of data at home. GDP came in at +0.9% for the quarter (+2.5% for the year) and Retail Sales came in at +0.5% for the month. The RBA kept rates on hold and many are now predicting no changes next year – then a hike.

The RBA kept its easing bias but it will need to interpret the reaction to the much-anticipated Fed hike on the 16th first.

The new Fed question is how many rate hikes will the Fed make next year. Most think two or three. But the answer is that it is almost certain that they will be few and steady. That's why the market responded so positively to the jobs data.

It looks like we will build on the very positive US lead on Monday – and more. The unknowns are now largely known. The massacre in California could have ramifications but the main market push looks good for a late Santa rally.

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WOODHALL INVESTMENT RESEARCH

I was set for that rally to start last week and Tuesday felt great – but what is a few days between friends?

This NEWSLETTER could be late next week. I have been invited to Will Bewley's second birthday party next Saturday morning and wild horses couldn't keep me away from it – especially as my other two grandkids and both my kids and partners will also be there.

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 end of the year is now getting too close to worry about updated forecasts, particularly as we don't have any reasonable basis for predicting how quickly the current -3.7% mispricing will be eroded. Fair value has slipped to 5,350 and the index closed at 5,152.

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 updated high forecast is 5,750 and the new end is for 5,550.

But if the mispricing is eroded quickly – and it also overshoots – the ASX 200 could get to 5,650 with a correction being predicted sometime soon!

Similarly, it is too close to the end of the year to update our January 1st 2015 forecasts for the S&P 500. Fair value is 2,110.

Our prediction for mid 2016 on the S&P 500 is 2,230 with a possible high of 2,300!

Market stats

Our market volatility index (Chart 1) is elevated a little at 17.4%. Our Fear Index (Chart 2) is also a little high at 15.5%. The VIX has come back to normal levels at 14.9%. Our Disorder index (Chart 3) is at the low end of the normal zone. With a good day on Monday, conditions this week might be stable enough to consider trading – but one could get caught up in the rush to pull the trigger.

Our 12-month capital gains forecast (Chart 4) has risen to +9.1%. The market is underpriced at -3.7% (Chart 5). So that leaves the adjusted 12-month capital gains' forecast at +13.1%. The comparable 12-month adjusted capital gains forecast for the S&P 500 stands at +13.0%.

Only IT is over-priced on the ASX 200 (Chart 6) but not enough to worry anyone.

The forecast dividend yield for the ASX 200 stands at 4.9% with Financials at 5.8% (plus franking credits) and Property at 5.0%. There is growing evidence that the high-yield sectors are getting back to outperforming the other sectors after a poor start in 2015 for relative performance.

The IOZ:IVV Update

I did not trade on this strategy last week. I think it is likely that I will not add any further funds to either ETF in the foreseeable future. The charts show that some of these recent buys of IOZ (for the ASX 200) are already in the money.

Returns on IOZ:IVV strategy

Tranche	Buying window	Rel. value of IOZ buys	Rel. value of IVV buys	Total
I	16/10/2014	100	100	14.0%
II	28/11/2014 - 15/1/2015	400	400	5.2%
III	26/8/2015 - 4/9/2015	200	200	1.7%
IV	4/11/2015 - 16/11/2015	500	0	0.2%
Total		1,200	700	5.4%
Internal rate of return (pa)				6.7%

NB The top five returns are not annualised. See notes in the Strategy Section for further explanation and charts.

Given the state of the markets over this period +6.7% pa for the strategy seems very healthy for now. However, the performance took a hammering last week – especially as our dollar is above 73c.

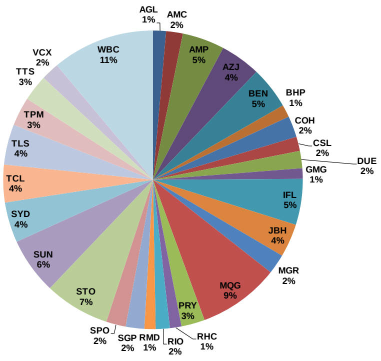
There is nothing in recent behaviour to suggest the underlying forecasts for the ASX 200 or the S&P 500 have been proven to be invalid. Indeed, the strategy is very much on track.

SMSF Share Portfolio

I rebalanced my SMSF on November 2, 2015. I combined my new Yield Conviction portfolio with a High Conviction portfolio in about equal proportions. The notion behind the strategy is to note that I believe the pure yield play is over. This 50:50 strategy is, in essence, an each-way bet until a clear view is established on which strategy is likely to be better going forward.

There are 29 stocks. My current holdings are given in the pie chart below.

Current holdings



The performance of my SMSF portfolio – including the impact of the March 5th 2015 and the November 2nd rebalances – against the ASX 200 since late June 2014 is shown in the table below. That corresponds to an outperformance of +6.4% (annualised) in nearly 18 months.

Annualised returns (since June 25th 2014)

	Portfolio	ASX 200	Alpha
Cap gains	2.2%	-3.3%	5.5%
Tot rets	7.8%	1.4%	6.4%

SPO fell around -40% on a profit downgrade during the week. However, there have not been any material changes in consensus recommendations. I think they have been tainted with the Dick Smith 'Private Equity IPO' brush. It has one of the best recs around at 1.75. I am not selling – at least not on the news to date.

These results could improve over the next couple of weeks as rights issues come into play for STO, TPM and TCL. I took STO and TPM up in full last week and I plan to take up TCL next week.

The table below summarises changes in stock prices over the week since the close on the previous Friday along with the changes to consensus recommendations for the component stocks.

Summary changes in stock statistics over week

	Improved	Deteriorated	Unch.
Stock price	10	19	0
Target price	6	4	19
Recommendation	12	10	7

Individual stock statistics

Sector	Stock	Percentage change over week: Price	Target Price	Consensus Rec.
Energy	SANTOS	5.0%	0.8%	11.0%
Materials	AMCOR	-3.1%	2.2%	-2.8%
	BHP BILLITON	-4.5%	-0.3%	-4.6%
	RIO TINTO	-4.0%	2.8%	0.2%
Industrials	SPOTLESS GROUP HOLDINGS	-43.3%	-3.6%	0.0%
	AURIZON HOLDINGS	-2.9%	0.0%	-4.9%
	SYDNEY AIRPORT	-4.1%	0.0%	0.2%
	TRANSURBAN GROUP	-5.4%	0.0%	0.1%
Discretionary	JB HI-FI	-8.2%	-0.9%	2.0%
	TATTS GROUP	2.1%	0.0%	-0.1%
Health	COCHLEAR	-0.7%	0.0%	0.0%
	CSL	-1.4%	2.6%	0.0%
	PRIMARY HEALTH CARE	-4.3%	-20.4%	-0.1%
	RAMSAY HEALTH CARE	-2.6%	0.0%	-2.2%
	RESMED CDI.	-3.8%	2.6%	0.2%
Financials	AMP	1.2%	0.0%	0.0%
	BENDIGO & ADELAIDE BANK	-0.3%	0.0%	0.1%
	IOOF HOLDINGS	1.7%	0.0%	0.0%
	MACQUARIE GROUP	0.4%	0.0%	0.0%
	SUNCORP GROUP	-0.4%	0.0%	0.0%
	WESTPAC BANKING	0.6%	0.0%	3.4%
Property	GOODMAN GROUP	-0.3%	0.0%	0.0%
	MIRVAC GROUP	-1.9%	0.0%	-8.1%
	STOCKLAND	0.5%	0.0%	6.8%
	VICINITY CENTRES	-0.7%	0.0%	-0.1%
Telcos	TELSTRA	0.2%	0.0%	1.8%
	TPG TELECOM	2.3%	0.0%	0.2%
Utilities	AGL ENERGY	0.6%	0.0%	-3.4%
	DUET GROUP	-0.4%	0.9%	2.6%

The cut to the target price of PRY is causing me some concern. I have it on watch. Nothing else is yet bothering me.

The IOZ:IVV Strategy

I plan to use the Table in the 'IOZ:IVV Update' section to keep readers informed about the performance of my geared portfolio [an approximate equal mix of two ETFs: IOZ for the ASX 200 and IVV for an unhedged exposure to the S&P 500]. Since I have borrowed against my home, I will now limit my investments even if additional opportunities present themselves. I will await the sell signals in times to come.

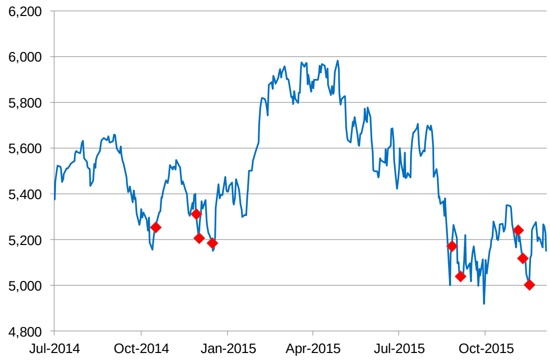
The basis of the strategy is to buy when the indexes (using ETFs) get very close to or cross the beginning of the year predicted low – and to sell when the indexes reach the predicted highs – as indicated in the 'Market Expectations' section. I do not use the weekly updated lows and highs for this purpose. These update statistics help me consider whether or not the strategy is going awry.

Since the IVV ETF is unhedged it benefits from $A depreciations and vice versa. I will switch to IHVV – the hedged version of the S&P 500 ETF – when I think the currency is more likely to appreciate. When I am unsure, I will blend IVV and IHVV.

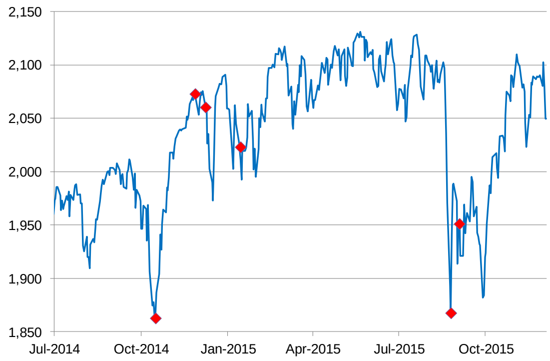
Please note that the irr is a single annualised return to summarise all of the buys of both ETFs and the current value.

The following charts show where I bought. Since the 'buy' signals are based on the S&P 500 (as I do not have credible exchange rate predictions) I show both the S&P 500 expressed in $US (unhedged) and $A (hedged).

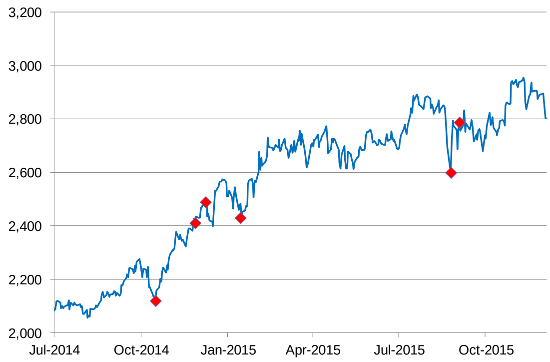
IOZ buy points on the ASX 200



IVV buy points on the S&P 500 ($US – hedged)



IVV buy points on the S&P 500 ($A – unhedged)



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.

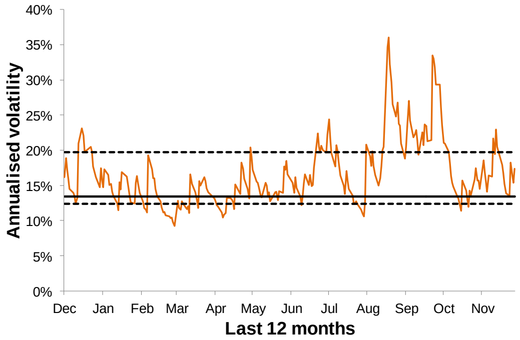
PMI – This acronym stands for Purchasing Managers Index. There is one for most countries and separate statistics for manufacturing and services. Manufacturing typically gets more attention. The statistics are published in the first few days of each month – with China on the 1st. A reading less than 50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

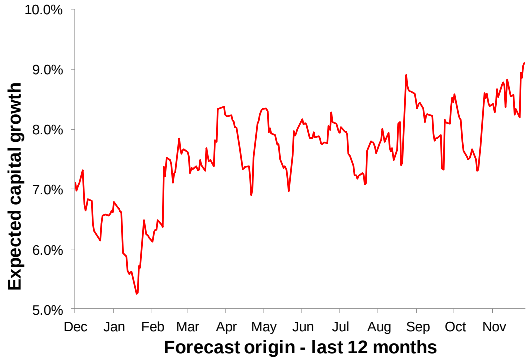
US non-farm payrolls data – are usually published on the first Friday of each month. They are generally considered to be the most reliable indicators for employment and unemployment in the US. Roughly speaking, a 200,000 increase in jobs is considered strong – particularly in the context of the tapering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

Chart 1: Market volatility



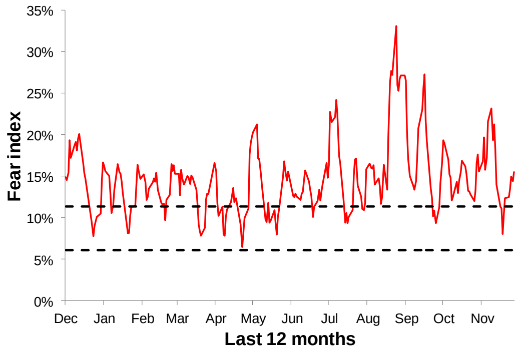
Notes: The solid black line depicts the average volatility since January 2010; the lower dotted line depicts the average volatility pre the GFC; the higher dotted line depicts the average level of volatility during the GFC - up to December 2009. The brown line is a daily estimate of the ASX 200 index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

Chart 4: 12-month-ahead capital gains forecasts



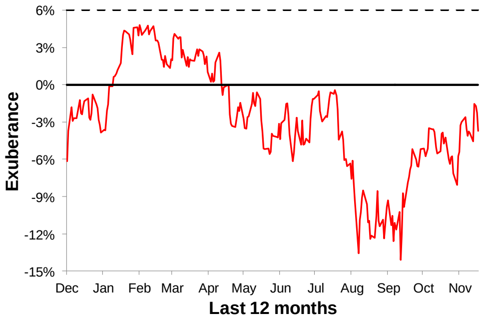
Notes: Each business day we update our estimates for capital gains on the ASX 200 for the following 12 months. For example, the left-most estimate on the vertical axis is a forecast for the 12 months concluding today. The right hand estimate is for the 12 months from today.

Chart 2: Fear index



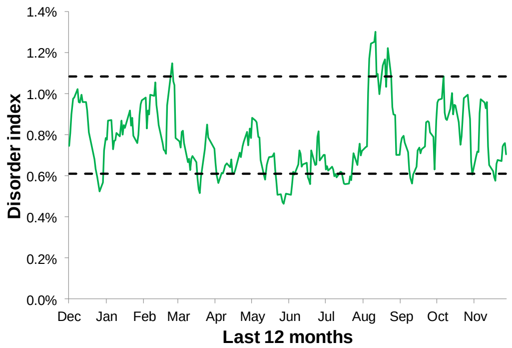
Notes: The fear index is a measure of 'excess' volatility denoting behaviour outside the open/close values each day. The two dotted lines depict the band in which the fear index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate complacency. Extended 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 5: Market exuberance



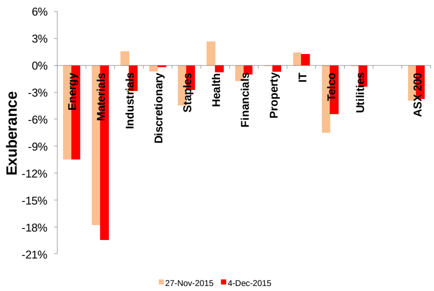
Notes: Exuberance is our measure of mispricing on the ASX 200. A value below the solid black line denotes the market is perceived to be cheap and above that line expensive. Experience suggests that exuberance above +6%, denoted by the dotted line, is an indicator of a potential correction of 6% to 10% - or for the market to move sideways for an extended period.

Chart 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 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