16 April 2016

Woodhall's Weekly

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Aussie employment data a bit of a worry

- **Mixed messages in Labour force data**
- **All eyes on Doha**
- **China data please**

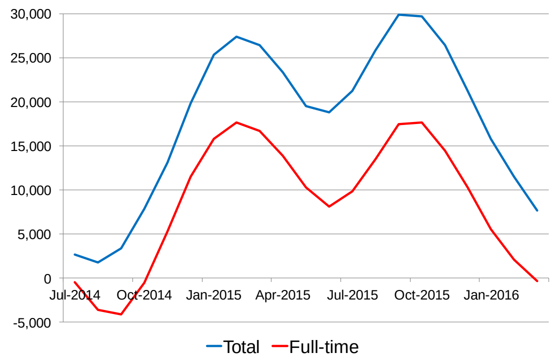
Overview

Very few data drops, such as the monthly Australian Labour Force Survey Reports, shed much light on new economic directions – statistical noise must always be navigated and trends usually emerge slowly. But this Thursday was different! I was watching TV at 11:30am in bed with a bit of a sore throat when 'talking TV heads' jumped at the 5.7% headline unemployment read – the lowest since late 2013. I shrugged it off because the margin of statistical error is published at ±0.2% for a change from one month to the next. No change!

When I got to my computer, I downloaded the full ABS data set. I looked at the trend data that the ABS recommends as it removes much of the noise that the headline number is buried in. The ABS only samples just under 30,000 households to form its estimate. When I looked at the trend changes in full-time and total employment – shown in the chart below – I took a deep breath.

I have been pushing my barrow for quite a while that our economy is in reasonable shape and a rate cut wouldn't hurt. Total employment had been increasing at around 20,000 a month or more since the beginning of 2015 and that is good but not great. A month ago that level was sort of broken but what is a month or two between friends? With trend full-time employment changes hitting zero this month and the total down to under 8,000 it is now time to act.

Australian trend changes in employment



It is not clear why employment growth has evaporated – it could be our strengthening dollar – but it has. I thought that a cut in rates could wait until after the elections – say an August cut. If I were on the Bank Board I would now ask for one in May. At 2% we have wiggle room and who cares if the budget is on the same day? Glenn – earn your pay – you have an army of well-trained staff who understand data too.

Of course we were in a similar position in mid/late 2014 and we then recovered nicely. This is not an emergency but why wait? And meantime the laughing Harrys celebrate a 5.7% unemployment read from a deliberately noisy number – a bigger sample would cost a lot more but be more accurate.

I don't think the RBA will cut on May 3rd but they might live to regret it. I would cut and have one

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more up my sleeve for later this year. The $A at over 77c is not helping us.

Meanwhile oil prices have risen in leaps and bounds – partly because of previously being oversold and partly in anticipation of Doha on Sunday (tomorrow). OPEC and Russia are getting together to discuss stabilising oil prices through supply control. It is doubtful that a cut will be decided but some sort of loose freeze might eventuate. Short sellers have burnt fingers so any drop in oil prices next week might be muted and a pop is quite likely on good news. The $A might go with it especially as iron ore prices just had a moment in the sun above $60 / tonne.

While we put the last nail in the China-bear coffin a couple of weeks ago, the data drop yesterday might have 'stabbed them with their steely knives' as the Eagles sang in Hotel California. Growth at 6.7% and a big beat on Industrial Output made them cower; a 10.5% Retail Sales against a 10.4% expectation made them confess.

But the big number was a couple of days before. China exports for the year came in at +18.7% after a bad previous month. Bring it on!

At home Westpac's Consumer Confidence read was down while NABs Business Confidence was up by the same amount.

The market certainly enjoyed last week being up +4.5% led by Materials (+9.1%), Financials (+6.3%) and Energy (+4.2%). The S&P 500 could only manage +1.6% on the week with a so-so start to the quarterly reporting season. But some of their banks got around double digit growth!

Brent oil was up +5.7% on the week and iron ore up +11.0%. The VIX ended the week at 13.6% - a quite low number given what has been going on.

So where does that leave me? In one word, happy! We have work to do at home in monetary and fiscal policy but it is entirely doable. US reporting season seems OK and the fundamentals as I measure them are great. The wolves are slinking away from the door.

The futures market is down -4 pts for Monday's open but that will mean nothing if nice noises come from Doha over the weekend. But nearly all of last week's underpricing at -5.1% vanished in the week to leave it at just -0.8%.

Market expectations

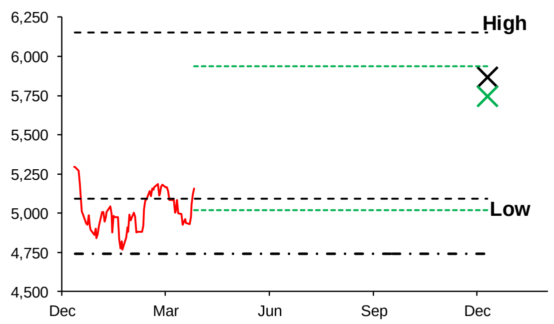
Our start-of-year 2016 forecasts for the ASX 200 are given in Table 1 together with the latest calculations and last week's for comparison. Chart 1 includes a trace of the index to compare with the forecasts highs and lows

Table 1: ASX 200 range forecasts

Forecast	Forecast origin		
Cal '16	1-Jan-2016	15-Apr-2016	8-Apr-2016
Low	5,100	5,000	4,850
High	6,150	5,950	5,850
End	5,850	5,750	5,700
Fair value	5,350	5,200	5,200
Exuberance	-0.7%	-0.8%	-5.1%
ASX 200	5,296	5,158	4,938

Note: the latest forecasts in the right hand column do not provide updates of the original forecasts in the middle column. Rather the latest forecasts facilitate an assessment to the degree to which the original forecasts are on track, or not. Moreover, exuberance is assumed to be eroded over a 12-month period and so the 'latest' forecasts are less reliable the closer is the date to the end-of-year and the greater is any mispricing.

Chart 1: Graphical representation of Table 1



Note: the low and high are based on 'normal' volatility levels. The high volatility low allows for well above normal volatility and a breach of which starts to suggest the base-line forecasts may no longer be relevant. The dashed black lines are derived from average volatility assumptions; the dot-dash line corresponds to high volatility.

Given the high volatility experienced in quarter 1 the lower dash-dot low is a more appropriate forecast that is based upon 25% volatility. Since the index has not breached the lower 'high volatility' low there is no evidence yet of any failure in the forecast procedures. The index is no longer in buy territory for the geared IOZ:IVV strategy discussed below.

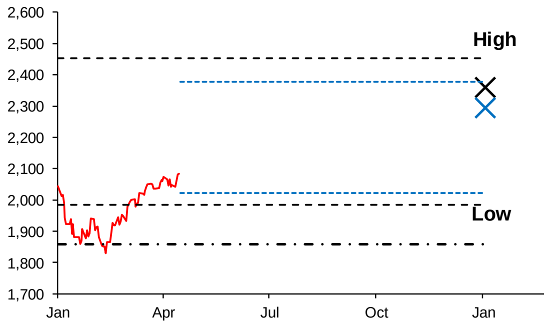
Our updated 2016 forecasts for the S&P 500 are given in Table 2. Because overnight data are not available until the afternoon, the latest data for Wall Street will usually be presented for the day before the ASX 200 in this Weekly that we try to publish around 10am on a Saturday.

Table 2: S&P 500 range forecasts

Forecast	Forecast origin		
Cal '16	1-Jan-2016	15-Apr-2016	8-Apr-2016
Low	1,980	2,020	1,990
High	2,450	2,380	2,360
End	2,360	2,290	2,280
Fair value	2,100	2,070	2,060
Exuberance	-3.3%	0.7%	-0.8%
ASX 200	2,044	2,083	2,048

Note: the latest forecasts in the right hand column do not provide updates of the original forecasts in the middle column. Rather the latest forecasts facilitate an assessment to the degree to which the original forecasts are on track, or not. Moreover, exuberance is assumed to be eroded over a 12-month period and so the 'latest' forecasts are less reliable the closer is the date to the end-of-year and the greater is any mispricing.

Chart 2: Graphical representation of Table 2



Note: the low and high are based on 'normal' volatility levels. The high volatility low allows for well above normal volatility and a breach of which starts to suggest the base-line forecasts may no longer be relevant. The dashed black lines are derived from average volatility assumptions; the dot-dash line corresponds to high volatility.

The index is now well above the dashed low line so it is too late to buy in the IOZ:IVV strategy (below). The blue cross for the updated e-o-y forecast is getting back to near the original prediction – confirming our view that our modelling is on track. Moreover, our 12-month-ahead capital gains forecast continues to hold above +15%. This index is in hold territory.

Market stats

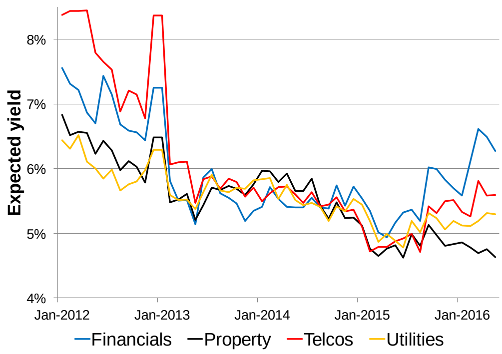
Our market volatility index (Chart A-1 found in the Chat Appendix) is a bit above normal at 16.6%. Our Fear Index (Chart A-2) fell right into the range at 7.6%. The VIX is 13.6 – or below its average. Our Disorder index (Chart A-3) is within the normal zone. The conditions for trading are quite good.

Our 12-month capital gains forecast (Chart A-4) held the recent increases at +15.2%. The market is underpriced at -0.8% (Chart A-5). So that leaves the adjusted 12-month capital gains' forecast at +16.1%. The comparable 12-month adjusted capital gains forecast for the S&P 500 stands at +14%.

The Materials sector is low a little overpriced (Chart A-6) at +4.3% but well below the 6% trigger level. Property is also a little warm at +3.4%. Energy is the cheapest sector at -6.6%.

As can be noted from Dividend Compression (Chart 3) I have updated, Financials (the blue line) has broken away from the other three high-yield sectors. But it did come back a bit over the week. The expected yield for Financials is 6.3% plus franking credits and 4.6% for the ASX 200.

Chart 3: Dividend Compression



The yield play definitely waned during the start of 2016 but it was fighting back – until the last few weeks. 'Other' sectors are now beating the 'high yield' sector total returns by +9.7% y-t-d (up from +5.5% four weeks before). High yield sectors have lost -5.7% this year while 'other' has gained +4.0%.

The IOZ:IVV:IHVV Update

The strategy is back in positive territory at +1.9% pa since inception (Table 3) but the IVV-IHVV leg is up +6.4% pa. The IOZ part of the strategy is -2.5% pa. The new table below shows that I am now 60.2% hedged in the Wall Street component. The domestic share of the portfolio is 48.7%.

Table 3: Returns on IOZ:IVV strategy

15-Apr-2016			Current allocation	
ETF	Return	IRR pa	Total	USA
IOZ	-2.2%	-2.5%	48.7%	
IVV+IHVV	5.5%	6.4%	51.3%	100.0%
IVV	12.2%	5.6%		39.8%
IHVV	1.5%	23.2%		60.2%
Total	1.6%	1.9%	100.0%	

NB The figures in the "Return" column are not annualised; IRR is the internal rate of return (pa) that compensates for the different buy and sell points. See notes in the Strategy Section for further explanation and charts.

The Charts 6 to 9 in the strategy section now include a yellow square to show where the hedging trades were made. The red diamonds denote the buys. I have also included a currency chart to show where the hedging trades were made in that metric.

By comparing Charts 7 and 8 since the yellow squares it can be seen that the hedged index made a nice little profit but the unhedged has been flat. The currency increases cancelled out the SP 500 gains.

The AUD has fluctuated in a range of about 75c – 77c since I started hedging at 76.0c. But one thing I have noted is that IHVV did not trade at all on several days since I bought. However, the market maker seems to be doing a good job when I do buy – even when I was a very large part of the day's trade!

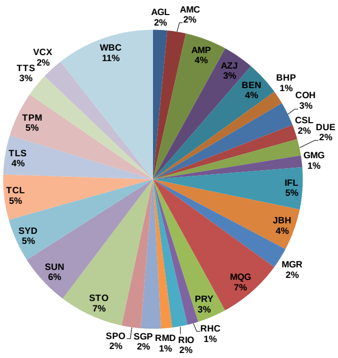
There is nothing in recent behaviour to suggest to me that the underlying forecasts for the ASX 200 or the S&P 500 have been proven to be invalid. Indeed, my ASX forecasts have strengthened over the last 12 months. I plan to flag any perceived weaknesses if and as they eventuate.

SMSF Share Portfolio

I last 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 might be soon over. Indeed, it might already be over. This 50:50 strategy is, in essence, an each-way bet which I intend to keep for the medium term given my sectoral analyses.

There are 29 stocks. My current holdings are given in Chart 4.

Chart 4: 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 +4.4% (annualised). After all of the turbulence of recent times the portfolio is still returning +6.4% pa which I think is not bad for a super fund in these times.

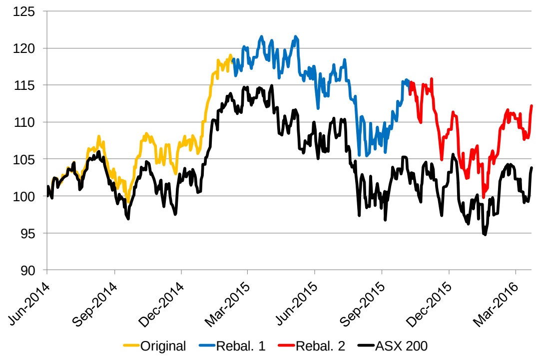
Table 4: Annualised returns from SMSF

	Portfolio	ASX 200	Alpha
Cap gains	0.8%	-2.6%	3.4%
Tot rets	6.4%	2.1%	4.4%

Note: Since June 25th 2014

The returns chart (Chart 5) shows the recent outperformance as well as the trend gains. The period from sometime in November 2015 to sometime in February 2016 was so far the worst for the SMSF.

Chart 5: SMSF and ASX 200 total returns



Note: the different coloured sections show the impact of rebalancing in March and November 2015.

Table 5: Price changes since Nov 2nd, 2015 and current broker forecasts

Stock	Price	Price change: From low	Price change: From high	Target	Rec
SANTOS	4.17	68.1%	-22.9%	4.23	2.57
AMCOR	14.76	21.4%	-1.2%	11.10	2.39
BHP BILLITON	19.28	35.8%	-17.9%	14.92	2.62
RIO TINTO	48.20	30.2%	-5.2%	37.37	2.56
SPOTLESS GROUP HOLDINGS	1.22	34.1%	-44.8%	1.81	2.25
AURIZON HOLDINGS	4.09	19.6%	-27.2%	4.35	2.50
SYDNEY AIRPORT	6.75	15.2%	-1.5%	6.60	2.58
TRANSURBAN GROUP	11.29	14.4%	-1.1%	11.11	2.54
JB HI-FI	22.50	30.1%	-4.7%	23.00	2.56
TATTS GROUP	3.78	6.8%	-13.9%	3.95	2.67
COCHLEAR	104.76	20.5%	-1.8%	95.55	3.15
CSL	101.58	10.1%	-5.9%	85.32	2.39
PRIMARY HEALTH CARE	3.79	75.5%	-1.6%	3.00	3.33
RAMSAY HEALTH CARE	61.74	10.1%	-9.2%	65.40	2.50
RESMED CDI.	7.73	6.9%	-7.6%	6.79	2.58
AMP	5.79	15.3%	-2.4%	6.18	2.13
BENDIGO & ADELAIDE BANK	9.00	11.8%	-24.7%	9.50	2.86
IOOF HOLDINGS	8.71	17.9%	-10.0%	8.75	2.25
MACQUARIE GROUP	65.54	12.3%	-21.0%	80.00	2.08
SUNCORP GROUP	12.39	15.8%	-9.7%	12.38	2.23
WESTPAC BANKING	30.90	10.1%	-8.2%	33.81	2.40
GOODMAN GROUP	6.73	17.0%	0.0%	7.00	2.10
MIRVAC GROUP	1.94	10.9%	-4.2%	2.05	2.46
STOCKLAND	4.30	13.8%	-1.8%	4.60	1.90
VICINITY CENTRES	3.21	20.7%	0.0%	3.08	2.10
TELSTRA	5.24	4.8%	-7.6%	5.59	3.00
TPG TELECOM	11.13	22.3%	-3.0%	11.10	2.64
AGL ENERGY	18.24	12.5%	-4.0%	19.32	2.73
DUET GROUP	2.24	1.8%	-8.2%	2.35	3.00

STO is now up +68.1% from its low since the last rebalance. JBH is up +75.5%. With six months up from the last rebalance, I will take a serious look at the May 1st portfolios I will generate to plan a possible rebalance.

The IOZ:IVV:IHVV Strategy

I plan to use the Table in the 'IOZ:IVV:IHVV 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:IHVV for a partially hedged exposure to the S&P 500]. 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 switch to IHVV – the hedged version of the S&P 500 ETF – when I think the currency is more likely to appreciate – or at least insure against it. When I am unsure, I blend IVV and IHVV.

Note that the irr is a single annualised return to summarise all of the buys of the three 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 – hence an implicit no-change assumption) I show both the S&P 500 expressed in $US (unhedged) and $A (hedged).

Chart 6: IOZ buy points - ASX 200

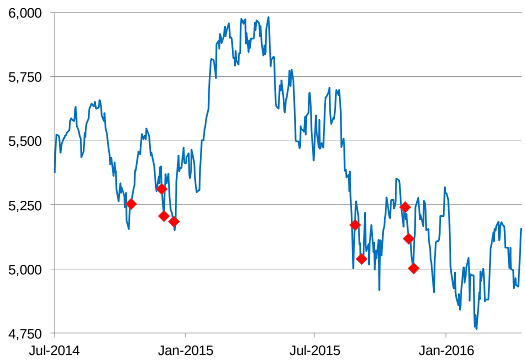


Chart 7: IVV buy points - S&P 500 ($US; hedged)

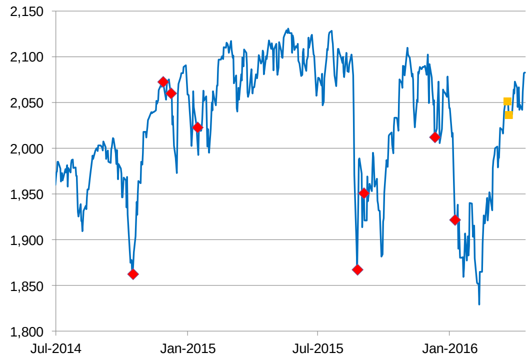


Chart 8: IVV buy points S&P 500 ($A; unhedged)

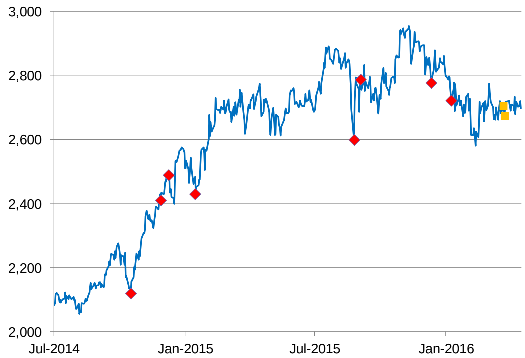
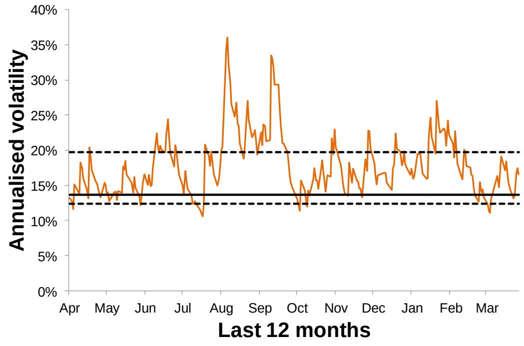


Chart 9: AUD hedging points

The charts in this strategy section include a yellow square to show where the hedging trades were made. The red diamonds are the buys. There is also a chart to show where the hedging trades were made in the AUD metric.

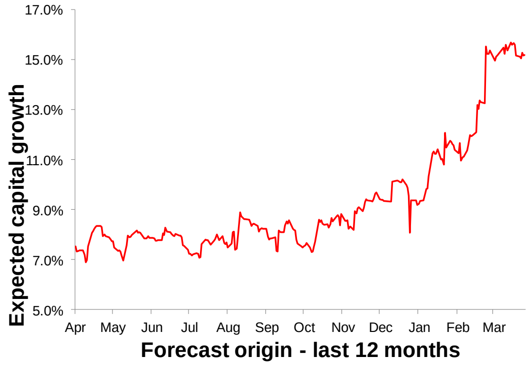
Chart Appendix

Chart A-1: Market volatility



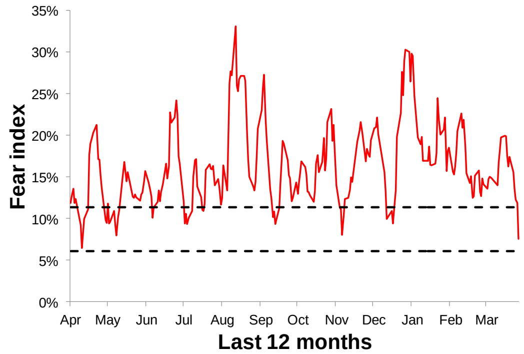
Notes: The solid black line depicts the average volatility since January 2010; the lower dotted line depicts the average volatility pre the GFC; the higher dotted line depicts the average level of volatility during the GFC - up to December 2009. The brown line is a daily estimate of the ASX 200 index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

Chart A-4: 12-month capital gains forecasts



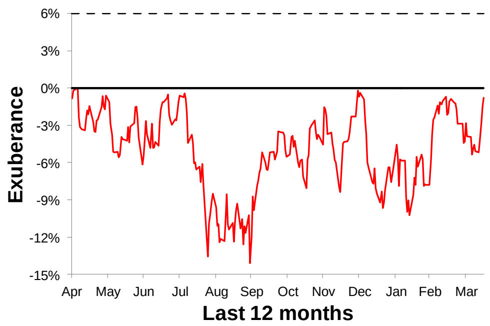
Notes: Each business day we update our estimates for capital gains on the ASX 200 for the following 12 months. For example, the left-most estimate on the vertical axis is a forecast for the 12 months concluding today. The right hand estimate is for the 12 months from today.

Chart A-2: Fear index



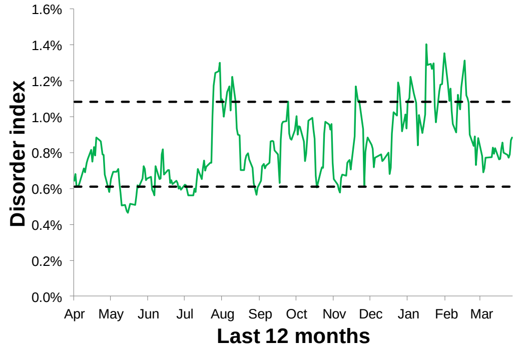
Notes: The fear index is a measure of 'excess' volatility denoting behaviour outside the open/close values each day. The two dotted lines depict the band in which the fear index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate complacency. Extended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



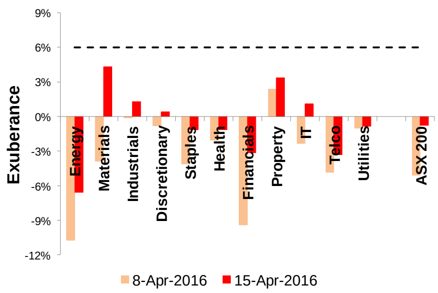
Notes: Exuberance is our measure of mispricing on the ASX 200. A value below the solid black line denotes the market is perceived to be cheap and above that line expensive. Experience suggests that exuberance above +6%, denoted by the dotted line, is an indicator of a potential correction of 6% to 10%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

Chart A-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 A-6: Sector exuberance



Notes: The estimates in this chart are based on the same notions as for Chart A-5. More detailed information on mispricing is contained in our companion weekly publication in the same section of our website

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.