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30th April 2013 – in progress

Sector Reviews: Round II

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Preface

I write a fortnightly column for the Switzer Super Report (www.switzersuperreport.com.au) in which I review each of twelve sectors of the ASX 200 in a cycle. At the beginning of each cycle I publish two or three general reports on the market as a whole. The reports collected in this volume are the reports as I submitted them. Since the editor at *SSR* often changes the layout and text, these reports do not reflect what was actually published.

The theme of the reports is that I am thinking in terms of building and rebalancing a High Conviction Fund – which I define in the first report. In essence it is a fund dominated by large companies that pass a certain hurdle based on broking analysts' consensus recommendations.

The next report focuses on the high yield sectors with a view to demonstrating how yield has taken centre stage with forecast yields being a constraint on capital gains. This report is followed by a general review of all of the sectors in one short note.

The S&P/ASX 200 has 10 major sectors – the so-called tier 1 GICS (Global Industry Classification Standard) sectors – but our Property sector – REITS or Real Estate Investment Trusts – is so dominant in the Australian market that S&P Financial sector can be broken down into Financials-ex-REITS and REITS. I refer to these as Financials and Property as more user-friendly terms.

Also because of the large number of companies in the Materials sector, I split up the discussion of this sector into Materials (Mining) and Materials (Nonmining). The latter subsector is dominated by building materials.

This review cycle started on 30th April 2013. I typically submit each report on alternating Tuesdays for the SSR to be published on the following Thursday.

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What is a High Conviction Fund?

It is a term often used but less often defined. My view is that it is a fund of quality stocks that can be left unmonitored for periods of time – usually without tinkering. There are no speculative stocks – from exploration nor corporate actions – in a High Conviction Fund. Importantly, a drop in price of one or more stocks is more likely to attract attention for any spare cash rather than a cause for abandonment!

I have my own rules for assembling a High Conviction Fund. At times like present, I would advocate 8 – 15 stocks if equally weighted but more if some stocks are given less weight. There are ways of determining the equivalent number of stocks for general portfolios. In more turbulent times – such as 2008 – 2010 – the optimal number of stocks is more like 12 – 20, and possibly more. I have papers in the *Switzer Super Report*, *Professional Planner*, and my website woodhall.com.au on these and many more associated issues.

I determine how much weight should be given to each of the 11 major sectors using my quantitative methods. Then, I allocate an appropriate number of stocks for each sector based on the size of the sector and the quality of the component stocks. Care should be taken not to have too much exposure to any one stock. Only companies from the ASX 100 belong in a High Conviction Fund in my world.

When I assemble a new portfolio, I only choose stocks with a 'good' consensus rating from brokers as published by Thomson Reuters. With '1' for a buy and '5' for a sell, I would only 'buy' a stock with a 2.5 or better. However, I would not sell unless the ratings fell well below that number. I have rules.

I like to think of rebalancing a 'High Conviction Fund' either once or twice a year. Rebalancing any more often is a sign of a trader's spirit.

The problem is that even big companies sometimes have mergers or divestitures associated with them, capital raisings and the rest. Real portfolio management is a full-time job but a High Conviction Portfolio should require less effort – but not no effort.

I also build High Octane Funds which seek out smaller capitalisation stocks of high consensus ratings. These are higher risk and possibly higher return funds. My High Fusion Funds are an amalgam of the High Conviction and High Octane Funds – and the blend of the two funds varies as other factors change.

Sector Review - Yield

30th April 2013

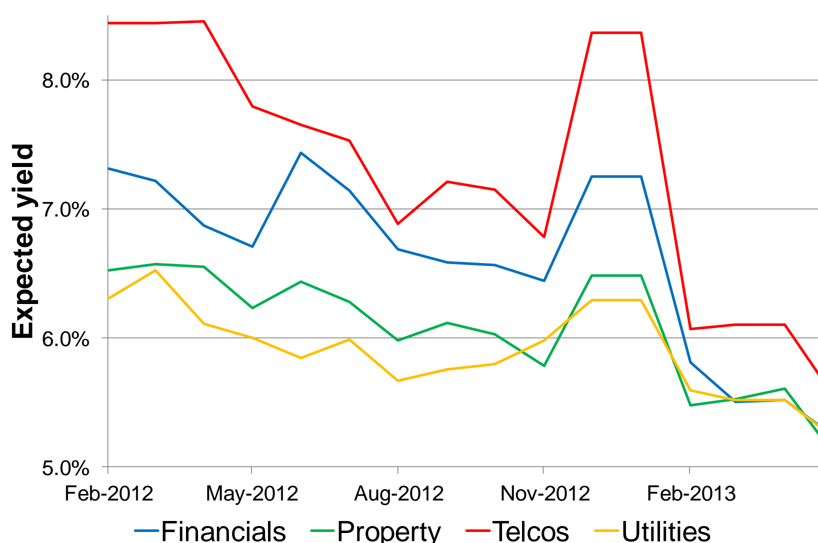
Having completed a full cycle of reports on each of the 11 major sectors of the ASX 200 since October 25th 2012, I now plan to update all of those reports – but turning my attention to any good stocks including those that are outside the top 100. A good, solid equities portfolio needs a core of top-100 stocks – but adding a few smaller capitalisation stocks might add that little bit extra. But before I get to the sector update, I will report on a two-part overview across all of the sectors.

A lot has happened over the last six months to change the balance of how sectors are performing. The key feature of this shift appears to have been the flight from cash to high-yielding stocks to supplement the income from an asset allocation. Of course, leaving the safety of term deposits and the like requires investors to have some renewed confidence in the market.

Four sectors are typically considered to be the high-yielding sectors: Financials (ex Property), Property, Telcos and Utilities. Many of these stocks come with franking credits which are particularly attractive for funds in pension mode. A yield of, say, 5% that is fully franked climbs to 7.1% [= 5 x (1 + 0.3/(1 – 0.3))] for a corporate tax rate of 30%. Of course the May budget may do something about corporate tax rates and/or the return of franking credits – so watch out!

The capital growth in these four sectors since the start of 2012 has been staggering: Financials (45.6%), Property (39.6%), Telcos (49.3%) and Utilities (27.1%). No doubt this stellar growth helped attract cash from the sidelines for yield and perhaps further capital gains. Interestingly, a distinct pattern emerged in the yields of these four sectors. As can be noted from Chart 1, there was a gap of about 2% points between the highest (Telco) and the lowest (Utilities) at the start of 2012. Since then, the massive – but disparate – capital growths forced yields down and to a much tighter cluster.

Chart 1: Yield compression



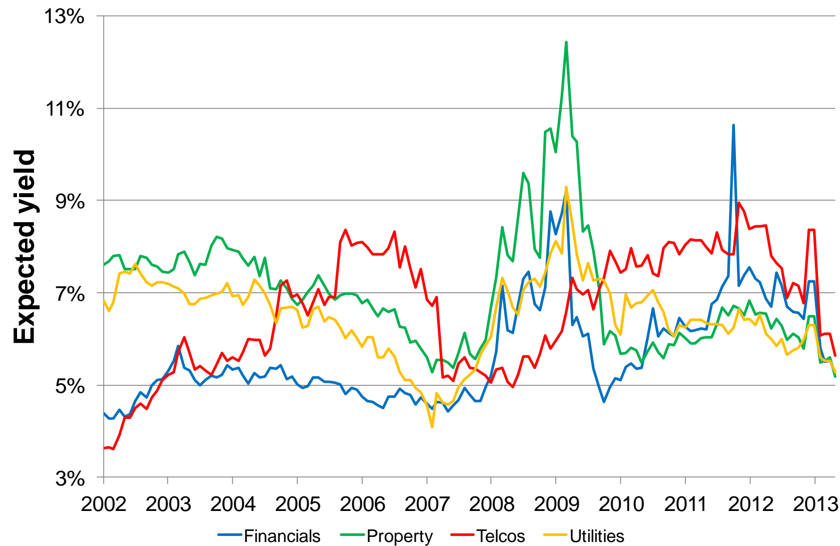
Source: Woodhall Investment Research and Thomson Reuters Datastream

What caused this conversion? All four sectors had attractive yields and investors needed to find enough stocks and get some sort of diversification to help reduce risk – particularly on the capital gains side. But there is a floor to how low these yields can reasonably fall.

There are risks associated with investing in stocks that are not shared by the almost riskless term deposits and the like. Investors need a premium over the term deposit rate to compensate for this additional risk – called the equity risk premium. It appears to me – by the nature of the convergence – that the 'floor' yield has almost been reached. Unless earnings improve and/or payout ratios increase, further capital growth in these sectors would force yields down further. As a result it looks to me that investors should not expect too much more capital growth but a fully franked dividend yield of over 7% still looks attractive – so no need to bail out if it is long term gains that the investor seeks.

This convergence is unusual. If we take the data used to construct Chart 1 back to 2002 – the earliest data we have – it becomes clear that the current behaviour is most unusual.

Chart 2: Expected yields since 2002



Source: Woodhall Investment Research and Thomson Reuters Datastream

Perhaps the nearest comparable period is in 2007 – just before the onset of the GFC. Stock prices then tumbled but dividends largely held up so the expected yields looked massive and many of these 'super' expected yields were converted into actual yields for those brave investors who bought at the bottom. Interested readers can go back to my reports on these sectors on the www.switzersuperreport.com.au site – and these will be updated in due course.

Yields are only one part of the story. At Woodhall, we currently have these sectors very overpriced – a topic to which I will return in my next column in a fortnight. However, interested readers can keep up with pricing and other measures each Saturday on www.woodhall.com.au with a general round-up on the first of each month.

Sector Rotation

14th May 2013

From time to time, investors should consider whether they have allocated the 'right' amount of their equity funds across sectors. Data on market capitalisations are shown in the last column of Table 1 for each of the 11 major sectors of the ASX 200. That is, say, the value of stocks in the Energy sector is 5.5% of the value of the whole ASX 200. 'Index huggers' - who want behaviour in their investments to match as closely as possible that of the index – should try to match these market cap. weights.

Table 1: Sector statistics

Sector	P/E ratio		Forecast	Forecast	Consensus	Exub-	Market	Adj. cap.
	historical	forward	yield	cap. gain	rec.	erance	cap.	gain
Energy	18.0	15.1	3.9%	20.7%	2.40	0.8%	5.5%	19.9%
Materials	13.8	10.5	3.3%	27.4%	2.21	-11.0%	17.2%	38.4%
Industrials	17.1	14.6	4.1%	15.7%	2.67	0.6%	6.1%	15.1%
Discretionary	18.7	15.8	2.6%	16.8%	2.46	8.5%	5.1%	8.2%
Staples	19.1	17.8	4.3%	7.4%	3.11	5.1%	8.6%	2.4%
Health	22.7	20.2	2.3%	11.7%	2.75	5.7%	4.6%	6.0%
Financials	14.3	13.5	5.4%	5.3%	2.76	8.8%	39.0%	-3.5%
Property	16.8	16.0	5.1%	4.8%	2.76	9.8%	6.2%	-4.9%
IT	19.4	17.1	3.3%	12.7%	2.69	4.5%	0.6%	8.2%
Telco	16.6	16.1	5.5%	2.9%	2.97	11.3%	5.4%	-8.4%
Utilities	17.3	16.0	5.4%	8.3%	2.66	2.1%	1.8%	6.3%
ASX 200	15.6	13.9	4.5%	11.7%	2.66	3.8%	100.0%	7.8%

Source: Woodhall Investment Research and Thomson Reuters Datastream; data to close 13th May 2013

Depending on which stocks the investors chooses to represent each sector, the investor's fund will evolve away from these index weights and rebalancing from time to time might be desirable. Of course, strict adherence to such rebalancing means that good sectors are being penalised by selling off outperforming sectors to prop up the underperformers. Some latitude in following sector weights is, therefore, highly desirable.

An investor who wants to try and outperform the index needs to take positions on some or all sectors. For most of this financial year it would have been a great benefit to have been 'overweight' in the high yielding sectors of Financials, Property, Telco and Utilities. Not only did these sectors provide good yields, they also happened to have strong capital growth as funds migrated from term deposits to higher yielding assets.

I contend that there is little (if any) prospect for further capital growth in these sectors as higher prices would drive yields down below that which investors need to compensate them for the additional risk they are taking on over term deposits.

Last week was a stellar week for Materials stocks – including BHP, RIO miners and some building products companies – as this sector's sub-index grew by 8.4%, and Energy stocks grew by 4.8% over the week. Perhaps unsurprisingly, the prices of these stocks started slowly this week. But is it time to get into these and other non-high-yielding sectors?

As can be noted from Table 1, all of the forward price-to-earnings ratios (P/E) are lower than the historical. From these numbers alone, it is not clear whether prices are too low or earnings forecasts are too high. At Woodhall Investment Research we analyse lots of company-specific data from brokers to arrive at forecasts for sector capital gains over the following 12 months and a measure of 'exuberance' or mispricing.

For example, we are predicting a capital gain of 5.3% for the Financials sector (including the big four banks) fundamental (or fair price) but we have priced the sector as over-priced by 8.8%. As a result we need to (approximately) subtract the exuberance from the growth forecast to get an estimate of -3.5%. While the forecast yield is 5.4% (or about 7.5% including franking credits) the combined total return (growth plus yield) is marginal. However, investors who bought at lower prices are facing a very nice yield and do not need to worry about short-run mispricing behaviour.

Taking this approach to analysing the statistics in Table 1, Energy and Materials stocks are looking really good. This is the position I took on Switzer TV on March 19th and April 30th – and elsewhere – and videos of these interviews are archived on www.switzer.com.au. But, of course, there are many risks involved in these and all sectors. Expected return is only one component of good decision making. Industrials, including mining services companies, were badly hit in 2012/13 to date but are also starting to rebound. Their prospects are also good by our measures.

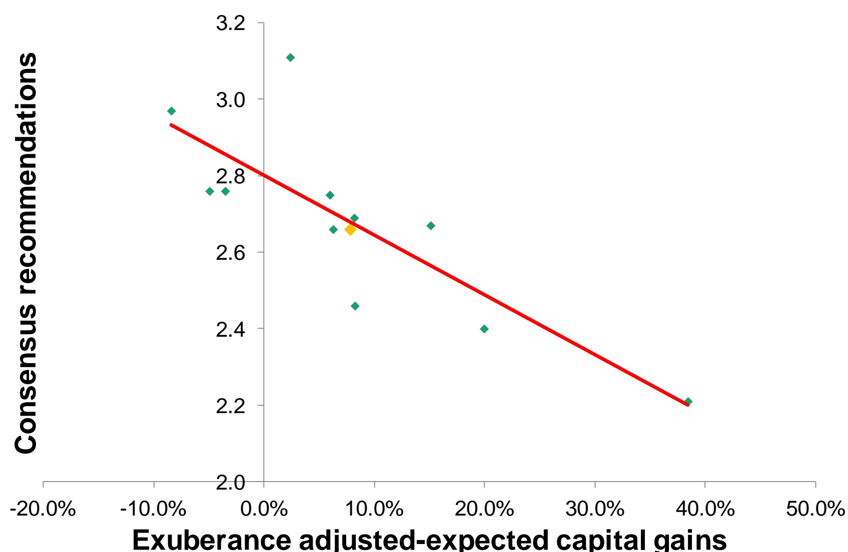
Consumer Staples stocks (such as Woolworths and Wesfarmers) were highly overpriced earlier in the year by our measures and without the yield to back up such overpricing. When Coca Cola Amatil reported a profit downgrade last week, sector mispricing fell to more reasonable levels. In our thinking, any exuberance measure above 6% is cause for some concern unless another story – such as yield – backs up the mispricing.

Consumer Discretionary stocks (such as David Jones and Myers) have the next to lowest projected yield and a worrying degree of overpricing. The weaker dollar might help this sector but its prospects do not look good by our measures. Health and IT are in the middle ground.

But do our measures compare with those of others? Thomson Reuters supplies the broker forecasts of dividends and earnings of companies we use in our analysis. They also provide a 'consensus recommendation' for each company which we aggregate into sector recommendations – which are shown in Table 1. These recommendations are on a scale of 1 for a buy to 5 for a sell. Of course the averaging of recommendations over brokers and companies within sectors means that the extremes of 1 and 5 are almost impossible to attain.

To give this process some clarity I have plotted the sector recommendations against our exuberance-adjusted capital growth forecasts in Chart 1. Each green diamond represents a sector and the yellow diamond is the index. The red line is a line of best fit through the data on the 11 sectors.

Chart 1: Relationship between recommendations and growth forecasts



Source: Woodhall Investment Research and Thomson Reuters Datastream data to close 13th May 2013

Two sectors stand out. The diamond at the top – which is Consumer Staples, and that at co-ordinates 8.5% and 2.5 – and is well below the red line – which is Consumer Discretionary. I take this lack of concordance between the two approaches to add an additional layer of risk to both sector forecasts.

So my conclusion is that it might be time to move some funds from high yield stocks to resources stocks – leaving a bit more room for cash-on-the-sidelines to take the place of those funds migrating from high yield.

The Energy Sector

27th May 2012

I last reviewed this sector for the Switzer Super Report in November 2012 using data up to the close of 5th November 2012. After now having been through the cycle of reviewing all sectors of the ASX 200, it is time to assess how our analysis performed over the last 6 months and suggest any new directions.

I argued that the High Conviction part of a superfund portfolio should focus on the biggest of the top 100 companies – but excluding those with a consensus rating of 2.5 or worse – that is better than a hold (nb. 1 is a buy, 3 a hold and 5 a sell). I excluded Worley Parsons and Caltex as being better classified as Industrials. I excluded Paladin and Whitehaven Coal because of undue risk. Since my last review Paladin has fallen from the top 100 to the bottom half of the 200. Linc Energy left the top 200 to be replaced by Maverick Drilling

The stocks in the Energy sector of the ASX 200 are listed in Table 1 together with the capital gain – or change in stock price – and the consensus recommendation at the last review.

Table: Change in stock price and consensus recommendation since last review – ranked by constituent index and price growth

Relevant index	Code	Company	Price growth 5/11/2012 to 27/5/2013	Consensus recs. 5/11/2012	Consensus recs. 27/05/2013
ASX 100	CTX	CALTEX AUSTRALIA	25.2%	3.3	3.4
	ORG	ORIGIN ENERGY	20.2%	2.1	2.4
	STO	SANTOS	11.7%	1.9	2.0
	OSH	OIL SEARCH	9.1%	1.8	1.9
	WPL	WOODSIDE PETROLEUM	7.6%	2.4	2.5
	BPT	BEACH ENERGY	-14.9%	2.3	3.0
	WOR	WORLEYPARSONS	-18.2%	2.8	2.2
	AUT	AURORA OIL & GAS	-22.2%	2.8	2.3
	WHC	WHITEHAVEN COAL	-24.6%	1.7	2.3
Small Caps	HZN	HORIZON OIL	2.6%	1.4	2.1
	KAR	KAROON GAS AUSTRALIA	1.5%	1.6	1.8
	AWE	AWE	-9.7%	2.2	1.9
	AQA	AQUILA RESOURCES	-12.5%	2.1	2.5
	SXY	SENEX ENERGY	-12.6%	1.8	2.3
	PDN	PALADIN ENERGY	-15.1%	2.3	2.4
	DLS	DRILLSEARCH ENERGY	-29.4%	2.2	1.9
	BRU	BURU ENERGY	-43.3%	1.7	1.7
	MAD	MAVERICK DRL.& EXP.	-61.6%	1.0	1.5
	CPL	COALSPUR MINES	-66.5%	1.5	2.4

Source: Thomson Reuters Datastream

Note: consensus recommendations are often revised for a few days and so those listed for 5/11/2012 might not be the same as in my earlier report.

In the last review we identified three stocks as fulfilling our requirements of being the biggest in the top 100 of the Energy Sector and with a rating better (lower) than 2.5. They were WPL, ORG and STO. Based on their then current recommendations and their one-year histories, I favoured them in order as 1) STO, 2) WPL and 3) ORG.

The index for the sector grew by 5.9% over the same period – far less than the ASX 200 but a well diversified portfolio often requires exposure to all sectors. Five stocks beat the index (CTX, ORG, STO, OSH, and WPL. None of these were in the bottom half of the ASX 200. Since we have been through a testing time in equity markets, it is not surprising that smaller cap stocks performed relatively poorly. Since we excluded CTX on classification grounds, that leaves four outperforming stocks and all three in our 'selection universe' were in that set. Of course there is an element of chance in the performance of stocks from my selection process but the methodology is designed to help the chosen set to outperform the index as a group and on average – not each time.

As it happened, ORG finished above STO and WPL but an important maxim for investing is that one does not need to choose all of the best stocks – but just try and avoid the bad.' There is nothing in the current data that makes me want to change my selection process for the next half year. But if I wanted to add a stock, OSH would now interest me with its new top rating in the top 100.

Going forward, it can be noted from Table 2 that the Energy sector has the second highest (adjusted for current mispricing) forecast for growth over the next 12 months (22.3%) from Woodhall's analysis. Currently the Energy sector is rated as cheap; exuberance (or mispricing) is negative (-1.2%). The forecast yield is moderate at 4.0%.

At this moment the market is a little 'fearful' by our Fear Index contained in our Woodhall Weekly published each Saturday on our website www.woodhall.com.au. As a result, it may not be a good time to buy but, if the sector

forecasts remain strong for Energy, a buy might be appropriate as soon as the level of fear falls to back to normal levels. Please see the video on Switzer.com.au from my interview on Switzer TV; 27th May, 2013.

Table 2: Variation in consensus recommendations for selected stocks

	P/E ratio		Forecast	Forecast	Consensus	Exub-	Market	Adj. cap.
Sector	historical	forward	yield	cap. gain	rec.	erance	cap.	gain
Energy	17.9	15.0	4.0%	21.1%	2.4	-1.2%	5.7%	22.3%
Materials	13.4	10.3	3.5%	26.9%	2.2	-14.9%	17.3%	41.8%
Industrials	16.0	13.7	4.5%	15.7%	2.7	-5.3%	5.9%	21.0%
Discretionary	17.9	15.0	2.7%	17.5%	2.5	0.5%	5.1%	17.0%
Staples	18.3	17.0	4.6%	7.7%	3.2	-0.5%	8.6%	8.3%
Health	21.8	19.4	2.4%	11.9%	2.7	0.4%	4.6%	11.4%
Financials	13.4	12.7	5.7%	5.5%	2.8	2.0%	38.7%	3.4%
Property	16.0	15.2	5.3%	5.2%	2.8	4.4%	6.3%	0.8%
IT	19.7	17.3	3.2%	13.2%	2.7	3.9%	0.7%	9.3%
Telco	16.1	15.6	5.7%	3.2%	3.0	7.6%	5.5%	-4.4%
Utilities	16.3	15.2	5.6%	7.2%	2.7	-2.6%	1.8%	9.9%
ASX 200	14.9	13.3	4.7%	11.8%	2.7	-1.7%	100.0%	13.5%

Note: the estimates in the Table are current to the close of business 27th May 2013. They are based on Thomson Reuters Datastream data and Woodhall Investment Research's analysis. Exuberance is a measure of mispricing with +6% our reference point for calling a possible correction or prolonged sideways movement. Cheap sectors (negative exuberance) can become cheaper! The capital gain for the following 12 months and the adjusted gain factors in the current level of exuberance.

The Materials (Mining) Sector

11th June 2013

Since my last review of this sector on this website – using data up to 16th November 2012 – six stocks have exited the ASX 200 and only one has entered as mining stocks got beaten up. Although there is little doubt that the mining boom is not what it was, it seems many investors are treating China as though its infrastructure spend is over. I think this part of the market has been very oversold.

The China manufacturing PMI out on June 1st surprised the market with a 50.9 as it only expected a 50.0 demarcating the difference between improving and deteriorating conditions in manufacturing (and not contraction – as in recession – that some mistakenly write about). The preliminary 'flash' PMI a week or two before was only a 49.6 which caused another bout of jitters. The Materials sector is the only sector with a negative total return (including dividends) year-to-date. The sector's capital gain since my last review is -7.8% against a +9.2% for the ASX 200 both y-t-d.

Last review I favoured BHP and RIO but was not attracted by Newcrest and Fortescue – among others. Lynas and Atlas were my smaller stock picks. The performance of all stocks in this sector are shown in Table 1 – along with the Thomson-Reuters consensus broker recommendations (1 = buy down to 5 = sell).

Table 1: Data on companies in the ASX 200's Materials (Mining) sector

Index	Code	Company name	Capital gains from 16/11/2012 - 7/5/2013	Consensus recs.	
				16/11/2012	7/05/2013
ASX 100	ILU	ILUKA RESOURCES	32.7%	2.53	2.71
	BHP	BHP BILLITON	0.5%	2.11	2.00
	RIO	RIO TINTO	-6.5%	1.81	1.80
	LYC	LYNAS	-7.2%	2.90	2.10
	FMG	FORTESCUE METALS GP.	-13.8%	2.29	2.20
	PNA	PANAUST	-22.8%	2.16	2.40
	RRL	REGIS RESOURCES	-29.2%	1.94	2.40
	OZL	OZ MINERALS	-43.0%	2.90	2.30
	AGO	ATLAS IRON	-46.2%	2.15	2.20
	NCM	NEWCREST MINING	-49.7%	2.53	2.40
	PRU	PERSEUS MINING	-55.8%	1.94	1.90
Small Caps.	CDU	CUDECO	-13.6%		
	IGO	INDEPENDENCE GROUP	-19.7%	2.75	2.60
	SFR	SANDFIRE RESOURCES	-20.1%	2.82	2.00
	OGC	OCEANAGOLD CDI.	-20.7%	3.50	2.50
	MGX	MOUNT GIBSON IRON	-24.4%	2.50	2.60
	WSA	WESTERN AREAS	-24.5%	2.40	2.20
	NST	NORTHERN STAR	-42.3%	1.00	1.50
	BDR	BEADELL RESOURCES	-46.2%	2.15	2.20
	AQG	ALACER GOLD CDI.	-46.9%	2.50	2.60
	EVN	EVOLUTION MINING	-53.9%	2.08	2.00
	TRY	TROY RESOURCES	-54.5%	2.67	1.70
	RSG	RESOLUTE MINING	-58.0%	3.33	3.10
	MML	MEDUSA MINING	-59.5%	1.71	1.70
	MBN	MIRABELA NICKEL	-60.0%	2.22	2.50
	KCN	KINGSGATE CONSOLIDATED	-62.1%	3.33	3.64
	SBM	ST BARBARA	-63.3%	2.50	2.00
	SLR	SILVER LAKE RESOURCES	-73.5%	1.67	2.40
	SDL	SUNDANCE RESOURCES	-77.0%	2.00	3.00
	DML	DISCOVERY METALS	-90.5%	3.00	3.60

Note: the estimates in the Table are current to the close of business 7th June 2013. They are based on Thomson Reuters Datastream.

Iluka, the mineral sands company was the only stock to do well but that was largely due its price being in a temporary dip at the time of the last review. Three of my stocks beat the Materials Index (BHP, LYC and Lynas) and all three now have improved ratings. Atlas suffered the fate of most junior and mid-tier miners and its rating has slipped a fraction. However, the success of Atlas going forward depends upon its negotiations and planning over gets its iron ore to port. I still like it and I am sticking with the other three too. Lynas got through all of its political/regulatory hurdles in Malaysia but rare earth prices have fallen.

None of the Small Cap mining stocks in Table 1 came close to beating the Materials index which is unsurprising given the environment. The new entrant into this index, Northern Star, had the best possible rating of a 1.0 at my last review (but outside the ASX 200) and still has an impressive rating of 1.5 – being halfway between an outright buy and a market outperform. During this time, its stock price has fallen -42.3%. Troy Resources and Medusa Mining are also attracting the attention of the analysts – but not me.

We can see the prospects of this sector in comparison to the other sectors of the ASX 200 in Table 2 – noting that Materials – mining and non-mining – appears as a single entry. The exuberance column, which measures

whether a sector is expensive or cheap, shows Materials is not only the cheapest (-14.9%) but very cheap in absolute terms. It seems that these stocks have been very oversold. As this sector also has the highest forecast capital gains (24.9%) over the next 12 months – making an adjusted capital gain (capital gain – exuberance) of 39.8% - makes this sector attractive subject to a risk assessment – of course!

Table 2: ASX 200 sector statistics

Sector	P/E ratio		Forecast	Forecast	Consensus	Exub-	Market	Adj. cap.
	historical	forward	yield	cap. gain	rec.	erance	cap.	gain
Energy	17.2	14.3	4.1%	21.4%	2.4	-4.5%	5.7%	25.9%
Materials	12.8	10.0	3.6%	24.9%	2.1	-14.9%	17.4%	39.8%
Industrials	15.4	13.2	4.6%	15.4%	2.7	-7.9%	5.9%	23.3%
Discretionary	17.3	14.6	2.8%	17.2%	2.5	-3.4%	5.2%	20.5%
Staples	17.4	16.0	4.8%	8.4%	3.2	-4.6%	8.5%	13.0%
Health	21.2	18.8	2.4%	12.3%	2.8	-2.5%	4.7%	14.7%
Financials	12.6	11.9	6.1%	5.5%	2.8	-3.7%	38.1%	9.2%
Property	15.2	14.5	5.6%	5.0%	2.8	-1.2%	6.6%	6.2%
IT	18.4	16.4	3.5%	11.3%	2.7	-4.0%	0.7%	15.4%
Telco	15.2	14.7	6.0%	3.2%	3.1	0.6%	5.4%	2.6%
Utilities	16.0	14.8	5.7%	7.8%	2.7	-4.4%	1.8%	12.2%
ASX 200	14.2	12.6	4.9%	11.6%	2.7	-5.5%	100%	17.1%

Note: the estimates in the Figure are current to the close of business 7th June 2013. They are based on Thomson Reuters Datastream and Woodhall Investment Research's analysis of that data.

Although Materials stocks are not known for their dividends, 3.6% is not a bad forecast yield particularly if the likes of BHP start paying higher dividends because it is putting some investments on hold. Goldman Sachs talked up the rotation from Financials into Mining at the end of May. That has been my theme for months and it seems to be even more compelling today. Of course a little more cash might come off the sidelines and into high yield Financials (now that they are cheap at -3.7%) to accompany further investment in Mining stocks.

The Materials (Non-Mining) Sector

25th June 2013

In my last review of the Non-mining stocks in the Materials sector (December 7th 2012), I was lukewarm about all of these stocks. Essentially none of them is big enough to challenge their mining counterparts for a place to represent the Materials sector as high conviction stocks – and none seemed likely to add some spice as smaller cap stocks. I favoured Amcor (international packaging) over Orica (chemicals and explosives). I did not like the steel companies due to their seeming dependence on government support.

As it turns out from Table 1, Bluescope Steel (+44.0%) did very well and Amcor (+21.2%) put in a credible effort. The Materials sector as a whole did very poorly (-14.3%) because of the problem that faced the mining stocks. If we compare the capital gains in Table 1 to the gain of +4.6% for the ASX 200 over the same period, four stocks of the top 100 (BSL, AMC, AWC, JHX) beat the ASX 200 and two Small Cap. stocks (DLX and FBU) also beat.

Table 1: Data on companies in the ASX 200's Materials (Non-mining) sector

Index	Code	Company name	Capital gains from	Consensus recs.	
			3/12/2012 - 21/6/2013	16/11/2012	21/06/2013
ASX 100	BSL	BLUESCOPE STEEL	44.0%	2.22	2.30
	AMC	AMCOR	21.2%	2.64	2.60
	AWC	ALUMINA	7.0%	2.94	3.60
	JHX	JAMES HARDIE INDS.CDI.	5.2%	3.29	3.60
	SGM	SIMS METAL MANAGEMENT	3.7%	2.38	2.00
	BLD	BORAL	3.0%	3.00	2.90
	ABC	ADELAIDE BRIGHTON	2.2%	2.64	2.90
	ARI	ARRIUM	-10.1%	2.60	2.80
	IPL	INCITEC PIVOT	-12.5%	2.13	2.60
	ORI	ORICA	-24.5%	3.50	2.50
Small Caps.	DLX	DULUXGROUP	25.7%	2.75	2.80
	FBU	FLETCHER BUILDING (ASX)	9.8%	2.60	2.10
	NUF	NUFARM	-24.5%	3.50	2.50
	IMD	IMDEX	-33.3%	2.64	3.30

Note: the estimates in the Table are current to the close of business 21st June 2013. They are based on Thomson Reuters Datastream.

The current consensus recommendations for Amcor are till just outside of our comfort zone of a 2.5 (for an overweight call on a scale of 1 for a buy to 5 for a sell) but the recent falls in the dollar and the growing strength of the US may help AMC in coming months. Orica is still out of favour with me even though its rating has improved substantially. I would like to see it stay a bit better than 2.5 for a while longer.

The recommendation of SGM has strengthened to a 2.00 from a 2.38 and continues to attract my interest but not yet my funds.

Turning to Table 2, the Materials sector remains very underpriced (exuberance – my measure of underpricing - is -17.9%) but all sectors are currently cheap by my measure with the ASX 200 being underpriced by -4.6%. Our capital gains forecast continue to rank the sector as the next prospect (+25.1%) over the next 12 months and our capital gains forecast adjusted for exuberance is a whopping +43.0%.

Table 2: ASX 200 sector statistics

Sector	P/E ratio		Forecast	Forecast	Consensus	Exub-	Market	Adj. cap.
	historical	forward	yield	cap. gain	rec.	erance	cap.	gain
Energy	17.4	14.6	4.0%	20.4%	2.4	-3.9%	5.8%	24.3%
Materials	12.6	9.8	3.7%	25.1%	2.1	-17.9%	16.9%	43.0%
Industrials	15.6	13.5	4.5%	14.9%	2.7	-7.4%	5.9%	22.3%
Discretionary	16.8	14.4	2.9%	15.1%	2.4	-2.0%	5.1%	17.1%
Staples	17.4	16.0	4.8%	8.5%	3.2	-2.9%	8.5%	11.4%
Health	21.6	19.2	2.4%	12.1%	2.7	-1.2%	4.8%	13.3%
Financials	12.9	12.1	6.0%	6.3%	2.7	-1.8%	38.8%	8.1%
Property	14.9	14.2	5.7%	5.1%	2.7	-2.5%	6.5%	7.5%
IT	19.1	17.1	3.4%	11.1%	2.7	-1.4%	0.7%	12.5%
Telco	14.9	14.5	6.0%	3.1%	3.1	-0.8%	5.3%	4.0%
Utilities	15.8	14.6	5.8%	7.5%	2.5	-5.5%	1.8%	13.0%
ASX 200	14.3	12.7	4.9%	11.6%	2.6	-4.6%	100%	16.2%

Note: the estimates in the Figure are current to the close of business 7th June 2013. They are based on Thomson Reuters Datastream and Woodhall Investment Research's analysis of that data.

As the financial year draws to a close, one would expect some turbulence from investors re-arranging their portfolios for the year ahead. On top of that, the tapering of QE is aggravating the situation but there is an undeniable strength emerging in the US economy and policy makers are at last on top of starting to solve the

problems of the European economy. This strength in these real economies can only benefit this non-mining sub-sector.

The falling dollar creates some issues because of the uncertainty it brings to planning but, if it settles down to a figure well below parity, the lower dollar might also benefit some of the Non-mining Materials stocks. However, I still favour other parts of the ASX 200 – in particular, the big miners in the broader Materials sector and the big banks until the market fully absorbs the tapering talk and the China credit squeeze.

The Industrials Sector

9th July 2013

It seems that again our method for choosing High Conviction stocks within each sector has paid off. In our last review of the Industrials Sector on 18th December 2012 the three biggest stocks with a suitable consensus recommendation of 2.5 or better (with 1 being a buy and 5 a sell) were Transurban, Aurizon and Asciano.

As can be seen from Table 1 their capital gains over the last 6 months or so were 10.4%, 17.7% and 8.9% respectively. While not stunning returns they each easily beat the sector's gain of 5.2% and the broader index return of 5.6%. Seek was the top performer but its recommendation of 2.58 just missed the cut and its size also put it out of contention.

Asciano had its recommendation improve from 2.07 to 1.80 over the period but the ratings for Transurban (2.38 to 2.70) and Aurizon (2.33 to 2.60) slipped under the radar. These deteriorations in rankings are not enough to disqualify them from a hold but they are no longer all buys. The new top three buys are Asciano, Qantas and Downer EDI although I would personally never touch an airline. Give that this sector is not large by market capitalisation as a share of the ASX 200 index at 5.8%, two stocks would probably be enough for most High Conviction portfolios.

Table 1: Data on companies in the ASX 200's Industrials sector

Index	Code	Company name	Capital gains from 14/12/2012 - 5/7/2013	Consensus recs. 14/12/2012	5/07/2013
ASX 100	SEK	SEEK	35.5%	2.58	2.80
	BXB	BRAMBLES	26.9%	2.43	2.60
	AZJ	AURIZON HOLDINGS	17.7%	2.33	2.60
	TOL	TOLL HOLDINGS	15.5%	2.79	2.90
	TCL	TRANSURBAN GROUP	10.4%	2.38	2.70
	AIO	ASCIANO	8.9%	2.07	1.80
	LEI	LEIGHTON HOLDINGS	-0.5%	2.71	3.40
	SYD	SYDNEY AIRPORT	-1.2%	3.17	2.90
	ALQ	ALS	-5.0%	2.94	3.10
	QAN	QANTAS AIRWAYS	-5.7%	2.31	2.10
	DOW	DOWNER EDI	-8.4%	1.94	2.00
	MIN	MINERAL RESOURCES	-10.7%	1.60	2.29
	MND	MONADELPHOUS GROUP	-31.6%	2.67	3.50
	UGL	UGL	-34.6%	2.81	3.10
Small Caps.	MMS	MCMILLAN SHAKESPEARE	28.3%	1.83	2.40
	GWA	GWA GROUP	23.4%	3.00	3.30
	MQA	MACQUARIE ATLAS ROADS	19.4%	2.63	3.10
	SKE	SKILLED GROUP	15.6%	2.14	1.80
	MRM	MERMAID MARINE AUS.	15.6%	1.85	2.50
	TPI	TRANSPACIFIC INDS.GP.	10.1%	2.33	2.20
	QUB	QUBE HOLDINGS	9.9%	2.30	2.80
	VAH	VIRGIN AUSTRALIA HDG.	3.6%	2.54	2.20
	CAB	CABCHARGE AUSTRALIA	-4.6%	3.11	3.70
	BKN	BRADKEN	-10.0%	2.24	2.50
	CSR	CSR	-14.1%	2.29	2.50
	CDD	CARDNO	-14.1%	2.29	2.50
	SVW	SEVEN GROUP HOLDINGS	-16.3%	1.88	2.50
	DCG	DECMIL GROUP	-17.5%	1.38	2.30
	SAI	SAI GLOBAL	-19.6%	2.20	3.00
	NWH	NRW HOLDINGS	-33.9%	2.00	2.90
	EHL	EMECO HOLDINGS	-50.0%	2.62	3.30
	TSE	TRANSFIELD SERVICES	-59.9%	2.85	3.00
	ASL	AUSDRILL	-62.2%	2.33	2.80
	BLY	BOART LONGYEAR	-64.3%	2.50	3.40

Note: the estimates in the Table are current to the close of business 5th July 2013. They are based on Thomson Reuters Datastream.

The relative prospects for the sector can be deduced from Table 2. With an exuberance read of -5.6%, the sector is cheap and the prospective capital gains are not bad at +12.4% over the coming 12 months giving an adjusted forecast gain of 19.0%. The forecast yield of 4.4% is not bad either. These statistics, combined with the tumbling Aussie dollar make the sector a little more attractive than it was a few months ago.

With the increased volatility in the market over recent times from the discussions about tapering QE3 and the China credit squeeze, extra care should be taken when entering the market. As is often the case, dollar-cost averaging – or breaking the total intended investment in a stock into several smaller parcels – might be the way to go – depending on the size of the total investment.

Table 2: ASX 200 sector statistics

Sector	P/E ratio historical	P/E ratio forward	Forecast yield	Forecast cap. gain	Consensus rec.	Exub-erance	Market cap.	Adj. cap. gain
Energy	17.8	14.5	3.9%	23.7%	2.3	-1.7%	5.8%	25.4%
Materials	12.2	9.6	3.8%	24.4%	2.2	-18.0%	16.1%	42.4%
Industrials	16.5	14.4	4.4%	13.4%	2.7	-5.6%	5.8%	19.0%
Discretionary	18.2	16.1	2.6%	12.5%	2.4	2.0%	6.0%	10.5%
Staples	17.6	16.2	4.8%	8.0%	3.2	-1.4%	8.4%	9.4%
Health	22.3	19.7	2.3%	12.3%	2.7	2.2%	4.9%	10.2%
Financials	13.1	12.3	5.9%	6.4%	2.7	-0.2%	38.7%	6.6%
Property	15.1	14.3	5.6%	5.4%	2.7	-0.6%	6.5%	6.0%
IT	18.4	16.5	3.5%	10.8%	2.7	-3.1%	0.7%	13.8%
Telco	15.7	15.2	5.7%	3.3%	3.1	3.4%	5.5%	-0.1%
Utilities	16.1	14.9	5.7%	7.8%	2.5	-2.4%	1.8%	10.2%
ASX 200	14.5	12.9	4.9%	11.4%	2.6	-2.7%	100%	14.0%

Note: the estimates in the Figure are current to the close of business 8th July 2013. They are based on Thomson Reuters Datastream and Woodhall Investment Research's analysis of that data.

The Industrials Sector

9th July 2013

It seems that again our method for choosing High Conviction stocks within each sector has paid off. In our last review of the Industrials Sector on 18th December 2012 the three biggest stocks with a suitable consensus recommendation of 2.5 or better (with 1 being a buy and 5 a sell) were Transurban, Aurizon and Asciano.

As can be seen from Table 1 their capital gains over the last 6 months or so were 10.4%, 17.7% and 8.9% respectively. While not stunning returns they each easily beat the sector's gain of 5.2% and the broader index return of 5.6%. Seek was the top performer but its recommendation of 2.58 just missed the cut and its size also put it out of contention.

Asciano had its recommendation improve from 2.07 to 1.80 over the period but the ratings for Transurban (2.38 to 2.70) and Aurizon (2.33 to 2.60) slipped under the radar. These deteriorations in rankings are not enough to disqualify them from a hold but they are no longer all buys. The new top three buys are Asciano, Qantas and Downer EDI although I would personally never touch an airline. Give that this sector is not large by market capitalisation as a share of the ASX 200 index at 5.8%, two stocks would probably be enough for most High Conviction portfolios.

Table 1: Data on companies in the ASX 200's Industrials sector

Index	Code	Company name	Capital gains from 14/12/2012 - 5/7/2013	Consensus recs. 14/12/2012	Consensus recs. 5/07/2013
ASX 100	SEK	SEEK	35.5%	2.58	2.80
	BXB	BRAMBLES	26.9%	2.43	2.60
	AZJ	AURIZON HOLDINGS	17.7%	2.33	2.60
	TOL	TOLL HOLDINGS	15.5%	2.79	2.90
	TCL	TRANSURBAN GROUP	10.4%	2.38	2.70
	AIO	ASCIANO	8.9%	2.07	1.80
	LEI	LEIGHTON HOLDINGS	-0.5%	2.71	3.40
	SYD	SYDNEY AIRPORT	-1.2%	3.17	2.90
	ALQ	ALS	-5.0%	2.94	3.10
	QAN	QANTAS AIRWAYS	-5.7%	2.31	2.10
	DOW	DOWNER EDI	-8.4%	1.94	2.00
	MIN	MINERAL RESOURCES	-10.7%	1.60	2.29
	MND	MONADELPHOUS GROUP	-31.6%	2.67	3.50
	UGL	UGL	-34.6%	2.81	3.10
Small Caps.	MMS	MCMILLAN SHAKESPEARE	28.3%	1.83	2.40
	GWA	GWA GROUP	23.4%	3.00	3.30
	MQA	MACQUARIE ATLAS ROADS	19.4%	2.63	3.10
	SKE	SKILLED GROUP	15.6%	2.14	1.80
	MRM	MERMAID MARINE AUS.	15.6%	1.85	2.50
	TPI	TRANSPACIFIC INDS.GP.	10.1%	2.33	2.20
	QUB	QUBE HOLDINGS	9.9%	2.30	2.80
	VAH	VIRGIN AUSTRALIA HDG.	3.6%	2.54	2.20
	CAB	CABCHARGE AUSTRALIA	-4.6%	3.11	3.70
	BKN	BRADKEN	-10.0%	2.24	2.50
	CSR	CSR	-14.1%	2.29	2.50
	CDD	CARDNO	-14.1%	2.29	2.50
	SVW	SEVEN GROUP HOLDINGS	-16.3%	1.88	2.50
	DCG	DECMIL GROUP	-17.5%	1.38	2.30
	SAI	SAI GLOBAL	-19.6%	2.20	3.00
	NWH	NRW HOLDINGS	-33.9%	2.00	2.90
	EHL	EMECO HOLDINGS	-50.0%	2.62	3.30
	TSE	TRANSFIELD SERVICES	-59.9%	2.85	3.00
	ASL	AUSDRILL	-62.2%	2.33	2.80
	BLY	BOART LONGYEAR	-64.3%	2.50	3.40

Note: the estimates in the Table are current to the close of business 5th July 2013. They are based on Thomson Reuters Datastream.

The relative prospects for the sector can be deduced from Table 2. With an exuberance read of -5.6%, the sector is cheap and the prospective capital gains are not bad at +12.4% over the coming 12 months giving an adjusted forecast gain of 19.0%. The forecast yield of 4.4% is not bad either. These statistics, combined with the tumbling Aussie dollar make the sector a little more attractive than it was a few months ago.

With the increased volatility in the market over recent times from the discussions about tapering QE3 and the China credit squeeze, extra care should be taken when entering the market. As is often the case, dollar-cost averaging – or breaking the total intended investment in a stock into several smaller parcels – might be the way to go – depending on the size of the total investment.

Table 2: ASX 200 sector statistics

Sector	P/E ratio historical	P/E ratio forward	Forecast yield	Forecast cap. gain	Consensus rec.	Exub-erance	Market cap.	Adj. cap. gain
Energy	17.8	14.5	3.9%	23.7%	2.3	-1.7%	5.8%	25.4%
Materials	12.2	9.6	3.8%	24.4%	2.2	-18.0%	16.1%	42.4%
Industrials	16.5	14.4	4.4%	13.4%	2.7	-5.6%	5.8%	19.0%
Discretionary	18.2	16.1	2.6%	12.5%	2.4	2.0%	6.0%	10.5%
Staples	17.6	16.2	4.8%	8.0%	3.2	-1.4%	8.4%	9.4%
Health	22.3	19.7	2.3%	12.3%	2.7	2.2%	4.9%	10.2%
Financials	13.1	12.3	5.9%	6.4%	2.7	-0.2%	38.7%	6.6%
Property	15.1	14.3	5.6%	5.4%	2.7	-0.6%	6.5%	6.0%
IT	18.4	16.5	3.5%	10.8%	2.7	-3.1%	0.7%	13.8%
Telco	15.7	15.2	5.7%	3.3%	3.1	3.4%	5.5%	-0.1%
Utilities	16.1	14.9	5.7%	7.8%	2.5	-2.4%	1.8%	10.2%
ASX 200	14.5	12.9	4.9%	11.4%	2.6	-2.7%	100%	14.0%

Note: the estimates in the Figure are current to the close of business 8th July 2013. They are based on Thomson Reuters Datastream and Woodhall Investment Research's analysis of that data.

The Discretionary Sector

23rd July 2013

While I have not been fond of this sector for quite some time, I did make some assertions in my last review of this sector on January 10th 2013. Recall my high convictions stocks are the largest stocks by market capitalisation subject to a consensus recommendation of 2.5 or better (where 1 is a buy and 5 is a sell). My conclusions were:

"The NWS recommendation was also very good until the second half of last year. But again, it did improve in the last couple of days."

"CWN has the best recommendation but it too has slipped a bit. This looks to be the best of the bunch on recommendations alone."

"The only stock that interests me in this sector is Flight Centre but today does not seem to be the best time to buy - at least according to broker forecasts of target prices, our measure of exuberance, and the strength of the trend."

The essence of my hesitation at the time was that the sector was overpriced by +4.8%. It can be noted from Table 1 that Flight Centre not only turned out to be the best performing Large Cap stock it did so with a capital gain of 61.5%! Since News Corp split up its business into FOX and NNC, it is difficult to say what an investor might have done in reaction to the split, but FOX was the second best performer at 46.8%. Crown came in at 16.4% below the sectors' gain of 22.4% over the same period while the ASX 200 grew by 5.9%.

Table 1: Data on companies in the ASX 200's Consumer Discretionary sector

Index	Code	Company name	Capital gains from 4/1/2013 - 22/7/2013	Consensus recs. 4/01/2013	Consensus recs. 22/07/2013
ASX 100	FLT	FLIGHT CENTRE	61.5%	2.18	2.58
	FOX	TWENTY-FIRST CENTURY FOX CDI.'B'	46.8%	2.43	1.60
	ALL	ARISTOCRAT LEISURE	35.3%	2.93	3.09
	HVN	HARVEY NORMAN HOLDINGS	30.9%	3.46	3.33
	MYR	MYER HOLDINGS	18.6%	2.79	2.93
	CWN	CROWN	16.4%	2.08	2.10
	TAH	TABCORP HOLDINGS	9.4%	3.15	2.75
	DJS	DAVID JONES	7.1%	3.64	3.64
	TTS	TATTS GROUP	5.4%	3.00	3.17
	EGP	ECHO ENTERTAINMENT GROUP	-22.3%	3.15	2.73
	NNC	NEWS CL.B VTG.CS.CDI DEFERRED			3.00
Small Caps	GEM	G8 EDUCATION	70.6%	1.50	1.00
	JBH	JB HI-FI	64.5%	3.53	3.00
	REA	REA GROUP	62.6%	2.56	2.77
	SXL	SOUTHERN CROSS MEDIA GP.	40.0%	2.64	2.55
	IVC	INVOCARE	37.1%	2.82	2.82
	NVT	NAVITAS	32.2%	2.91	3.10
	TME	TRADE ME GROUP (ASX)	31.6%	3.33	4.00
	PBG	PACIFIC BRANDS	28.2%	2.67	2.46
	SUL	SUPER RETAIL GROUP	23.5%	2.11	2.22
	BRG	BREVILLE GROUP	19.7%	1.78	2.50
	AAD	ARDENT LEISURE GROUP	18.6%	2.63	2.50
	SWM	SEVEN WEST MEDIA	18.3%	2.00	2.07
	PMV	PREMIER INVESTMENT	15.7%	2.77	2.67
	TRS	THE REJECT SHOP	14.6%	2.73	2.80
	AHE	AUTOMOTIVE HOLDINGS GP.	13.4%	2.29	2.10
	DMP	DOMINO'S PIZZA ENTS.	3.4%	2.57	2.92
	TEN	TEN NETWORK HOLDINGS	-3.4%	3.57	3.23
	WTF	WOTIF COM HOLDINGS	-4.1%	3.15	3.37
	FXJ	FAIRFAX MEDIA	-6.5%	3.00	3.08
	GUD	GUD HOLDINGS	-22.3%	3.30	2.91
	BBG	BILLABONG INTERNATIONAL	-50.6%	2.73	2.70
	FWD	FLEETWOOD	-57.8%	2.55	3.70

Note: the estimates in the Table are current to the close of business 22nd July 2013. They are based on Thomson Reuters Datastream.

Since FLT has had its rating cut from 2.18 to 2.58 it now is not a buy as a high conviction stock using my methodology, but it would be reasonable to hold onto the stock while monitoring the recommendation going forward.

There are now only two Large Cap stocks that pass my filters: FOX and CWN – with a strong preference for FOX – but there are seven Small Cap stocks that have a good recommendation. Of the Small Cap stocks GEM is the stand-out. It has run hard over the last six months but a 'perfect 1' makes it worthy of further consideration.

The sector statistics, presented in Table 2, show that this sector is again overpriced at +3.2%. Its forecast capital gain at 12.6% is just above that for the broader index at 11.6%. While this may not be the best time to buy, the sector is not sufficiently overpriced to be too worried. Dollar cost averaging might prove to be important. Of

course, the dividends for this sector are almost the lowest of all of the sectors. However, the dollar at its new level in the low nineties might be enough to give the sector another boost.

Table 2: ASX 200 sector statistics

Sector	P/E ratio		Forecast	Forecast	Consensus	Exub-	Market	Adj. cap.
	historical	forward	yield	cap. gain	rec.	erance	cap.	gain
Energy	19.0	15.2	3.7%	25.9%	2.4	2.2%	5.8%	23.8%
Materials	13.5	10.6	3.5%	24.2%	2.2	-10.0%	16.9%	34.2%
Industrials	17.0	14.8	4.3%	13.8%	2.7	-2.9%	5.8%	16.7%
Discretionary	18.7	16.5	2.6%	12.6%	2.3	3.2%	5.7%	9.4%
Staples	17.9	16.6	4.7%	7.8%	3.3	0.2%	8.3%	7.5%
Health	22.9	20.3	2.3%	12.1%	2.7	3.9%	4.8%	8.2%
Financials	13.6	12.8	5.7%	6.4%	2.7	3.3%	38.8%	3.1%
Property	15.1	14.3	5.7%	5.4%	2.7	-0.8%	6.2%	6.3%
IT	19.0	17.1	3.3%	10.3%	2.7	-1.5%	0.6%	11.8%
Telco	16.1	15.6	5.6%	3.3%	3.1	5.5%	5.4%	-2.2%
Utilities	16.4	15.2	5.6%	7.6%	2.6	-0.3%	1.7%	7.9%
ASX 200	15.1	13.5	4.7%	11.6%	2.7	0.9%	100%	10.7%

Note: the estimates in the Figure are current to the close of business 22nd July 2013. They are based on Thomson Reuters Datastream and Woodhall Investment Research's analysis of that data.

The Staples Sector

6th August 2013

I have never owned any stock from this sector because I think I can do better elsewhere than just potentially chug along as we shop at Woolies (WOW) and Coles (WES) buying our Coke (CCL) and general groceries etc. These are great businesses but it is hard to think of them outperforming by much. Indeed, since my last review of this sector in January 2013, this sector has gained 7.3% against a 7.2% for the ASX 200. A good solid, predictable result and they pay solid dividends – currently 4.6%.

That I do not invest in this sector should have no impact on others pursuing returns in this sector. I just think I should declare my own position. As I showed on Switzer TV this week (5th August – and the notes are on my website www.woodhall.com.au) my portfolio optimiser suggests an aggressive investor might be overweight in this sector – largely due to the low expected volatility of this sector! Clearly I am prepared to accept more volatility in my own portfolio and ride the dips in search of better average returns.

Readers might refer to my definition of a High Conviction portfolio on my website (under the Investment Strategies tab) but, in short, my High Convictions stocks are the largest stocks by market capitalisation in a sector subject to a consensus recommendation of 2.5 or better (where 1 is a buy and 5 is a sell).

My conclusions at the last review were:

"None pass my 2.5 rule - and that failure is more or less peculiar to this sector. Possibly brokers have factored in the recent strong run in prices."

"I wouldn't buy either WOW or WES now (the sector is nearly back to +6% exuberance) but I might have been tempted when it was fairly priced by our measure!"

Turning to Table 1, only WOW and WES from the top 100 beat the ASX 200 (7.3%) in capital gains – and not by much. GFF did come in quite well (14.0%) from the bottom half of the top 200. GFF now just qualifies as a High Conviction stock on the recommendation criterion but it is not big enough by market cap as my definition insists on it being in the top 100 for inclusion.

Table 1: Data on companies in the ASX 200's Consumer Staples sector

Index	Code	Company name	Capital gains from 18/1/2013 - 2/8/2013	Consensus recs.	
				18/01/2013	2/08/2013
ASX 100	WOW	WOOLWORTHS	9.4%	2.93	3.50
	WES	WESFARMERS	7.5%	2.71	3.00
	MTS	METCASH	2.2%	2.93	2.80
	TWE	TREASURY WINE ESTATES	2.1%	3.31	3.30
	GNC	GRAINCORP	1.6%	3.36	3.00
	CCL	COCA-COLA AMATIL	-4.5%	3.21	3.46
Small Caps	GFF	GOODMAN FIELDER	14.0%	2.92	2.50

Note: the estimates in the Table are current to the close of business 2nd August 2013. They are based on Thomson Reuters Datastream.

The sector statistics, presented in Table 2, show that this sector is only just overpriced at +0.9% but its forecast capital gains are a modest 7.7%. While these statistics seem reasonable, recall it is a volatility bet – not one that brokers back with an outperform call.

It is also clear from Table 2 for readers who follow my column – as this table appears updated every two weeks – this update is the first where the under/overpricing distribution across the sectors is reasonably tight. Gone is the massive underpricing in the Materials sector and a general underpricing of the market at the start of July. The market is not too expensive to buy with an exuberance of +2.0% but it does suggest investors might have been better off getting into the market earlier – or perhaps waiting a while.

When exuberance is folded into the capital gains to produce the last column called 'adjusted capital gains', it is clear that my modelling expects little from Financials or Telcos over the next 12 months – but they do pay good dividends. Staples has the 9th best adjusted forecast out of 11 sectors.

Table 2: ASX 200 sector statistics

Sector	P/E ratio		Forecast	Forecast	Consensus	Exub-	Market	Adj. cap.
	historical	forward	yield	cap. gain	rec.	erance	cap.	gain
Energy	18.6	14.9	3.7%	25.6%	2.4	0.9%	5.6%	24.7%
Materials	14.1	11.2	3.3%	23.2%	2.2	-3.5%	17.0%	26.7%
Industrials	17.0	14.9	4.2%	13.1%	2.6	-1.7%	5.6%	14.8%
Discretionary	20.0	17.7	2.3%	12.4%	2.2	4.7%	6.6%	7.8%
Staples	18.0	16.7	4.6%	7.7%	3.2	0.9%	8.1%	6.8%
Health	23.4	20.7	2.2%	12.3%	2.5	4.9%	4.8%	7.3%
Financials	13.9	13.1	5.6%	6.2%	2.7	4.7%	38.7%	1.5%
Property	14.8	14.0	5.7%	5.3%	2.6	-2.6%	5.9%	7.9%
IT	19.2	17.3	3.2%	10.5%	2.7	0.6%	0.6%	10.0%
Telco	16.5	15.9	5.7%	3.8%	3.0	6.4%	5.4%	-2.7%
Utilities	16.1	14.8	5.7%	8.4%	2.7	-1.4%	1.6%	9.9%
ASX 200	15.5	13.9	4.6%	11.4%	2.6	2.0%	100%	9.4%

Note: the estimates in the Figure are current to the close of business 5th August 2013. They are based on Thomson Reuters Datastream and Woodhall Investment Research's analysis of that data.

The Healthcare Sector

20th August 2013

CSL, the plasma company, is by far the biggest Healthcare company – being more than 50% of this sector's top 200 market capitalisation. Resmed has products for sleep disorder; Sonic runs pathology services in Australia and overseas; Ramsay owns hospitals etc; Cochlear is a world famous ear implant producer; Ansell produces health protection products; and Primary produces goods and services for use by health professionals.

The Health sector may benefit going forward from an aging population. It is certainly considered by most to be a defensive sector as evidenced by the performance of many of these stocks through the GFC. However, the dividends are low by ASX 200 standards and often are not fully franked – or even franked at all – because of overseas exposure. They also typically trade on high P/E ratios compared to those of the broader index.

Although the Health sector is defensive, it has performed exceptionally well over the last 12 – 18 months. However, the capital gains for this sector since my last review on February 6th have been more modest at +9.2% but that is still well ahead of the ASX 200 that gained +3.9% over the same period.

In my previous review, CSL, RMD and PRY passed my test for inclusion as a high conviction stock. That is, they were in the top 100 and met my '2.5' broker recommendation status (please see my paper on the Market Updates tab of our website www.woodhall.com.au) for details. There appears to be a minor revision to the 6th February consensus recommendation from 2.50 to 2.53 after my review.

Even though these three stocks had run hard up to my last review, it can be seen from Table 1 that they took the first three places in gains since that date. I also put in a vote for COH which lost ground after it reported in this season. One perceived problem was that it has not yet got approval for its N6 product. It seems that approval is but a tick away and then it can recover from its recall of the N5 product. The new competition from China also seems overstated. People who can afford it will always have a superior implant placed in them. Of course China can fulfil demand from people with lesser resources.

Table 1: Data on companies in the ASX 200's Healthcare sector

Index	Code	Company name	Capital gains from 6/2/2013 - 16/8/2013	Consensus recs. 6/02/2013	Consensus recs. 16/08/2013
ASX 100	RMD	RESMED CDI.	25.0%	1.91	2.00
	PRY	PRIMARY HEALTH CARE	14.5%	2.53	2.85
	CSL	CSL	13.0%	2.50	2.67
	RHC	RAMSAY HEALTH CARE	12.2%	3.38	2.90
	ANN	ANSELL	7.6%	2.71	3.20
	SHL	SONIC HEALTHCARE	4.8%	2.79	2.70
	COH	COCHLEAR	-17.0%	3.40	3.50
Small Caps	SRX	SIRTEX MEDICAL	5.1%	2.40	2.20
	SIP	SIGMA PHARMS.	-3.7%	3.00	3.10
	ACR	ACRUX	-5.4%	2.00	2.30
	MSB	MESOBLAST	-12.8%	2.11	2.10

Note: the estimates in the Table are current to the close of business 16th August 2013. They are based on Thomson Reuters Datastream.

RMD is still the front-runner in terms of consensus recommendation. PRY and CSL have now slipped out of the 'buy window' possibly due to price rather than the strength of the companies. Although three of the four Small Cap stocks (SRX, ACR and MSB) have good recommendations, their size and recent performance fail to attract my attention.

The sector statistics, presented in Table 2, show that Health is fairly priced with an exuberance level of -0.2%. Its forecast capital gains are reasonable at 12.9%. Expected dividend yield is only 2.4% and, as I noted above, franking credits can be scarce in this sector.

There does seem to be a sector rotation underway – from defensives to cyclical and so it might be a little while before the expected gains over the next 12 months come to fruition. I am happy holding on to COH for the reasons given but I am not yet tempted to buy any of the other socks in this sector.

Table 2: ASX 200 sector statistics

	Sector	P/E ratio		Cons.	Market	Exub-	12 month forecasts		
		historical	forward	rec.	cap.	erance	yield	cap. gain	adj. gain
Resource-related	Energy	18.6	14.9	2.5	5.6%	0.0%	3.7%	25.6%	25.6%
	Materials	14.6	11.8	2.2	17.5%	-1.5%	3.2%	22.1%	23.6%
	Industrials	17.5	15.3	2.6	5.7%	-1.2%	4.2%	13.5%	14.6%
High yield	Financials	13.8	13.0	2.7	38.5%	3.7%	5.6%	6.0%	2.3%
	Property	14.8	14.1	2.6	5.9%	-2.5%	5.7%	4.7%	7.2%
	Telco	16.3	15.4	2.9	5.4%	6.6%	5.6%	5.5%	-1.0%
	Utilities	15.8	14.5	2.7	1.6%	-4.3%	5.9%	8.5%	12.8%
Other	Discretionary	19.8	17.7	2.3	6.6%	3.7%	2.3%	11.5%	7.8%
	Staples	17.8	16.6	3.3	8.0%	-0.4%	4.7%	6.7%	7.1%
	Health	22.4	19.7	2.6	4.6%	-0.2%	2.4%	12.9%	13.1%
	IT	19.7	17.4	2.6	0.7%	1.8%	3.2%	12.2%	10.5%
	ASX 200	15.5	13.9	2.6	100.0%	1.5%	4.5%	11.1%	9.6%

Note: the estimates in the Figure are current to the close of business 16th August 2013. They are based on Thomson Reuters Datastream and Woodhall Investment Research's analysis of that data.

The Financials-x-REITS Sector

3rd September 2013

When last I conducted a review of the Finance Sector (excluding Property Trusts) on the 19th February 2013, only one of the big four, NAB, had an acceptable consensus rating by my definition for inclusion in High Conviction portfolio. That is, they were in the top 100 and met my '2.5' broker recommendation status (please see my paper on the Market Updates tab of our website www.woodhall.com.au) for details. Not meeting these criteria does not mean they would not have been good investments – particularly for a yield play – but for those wanting growth, the other three did not look like good investments.

From Table 1, all four big banks produced returns well in excess of the ASX 200 index (at +1.4%) and naturally gained around the same as the Financials index (at 6.5%) being so large. But Challenger (+41.3%) and Henderson (+20.7%) in the top 100 and Magellan (+43.1%) in the next 100 kicked the lights out over the last six months. Is it worth venturing outside the big four?

There are currently five Financials' stocks with a recommendation better than a '2' in the top 200: MFG (1.50), LLC (1.93), FXL (2.10), SUN (2.10) and ANZ (2.40). While I would not abandon my overall strategy of choosing larger companies with good ratings, I am not against substituting some of my exposure to big banks with smaller investments in smaller cap stocks.

Table 1: Data on companies in the ASX 200's Financials-x-REITS sector

Index	Code	Company name	Capital gains from	Consensus recs.	
			18/2/2013 - 30/8/2013	18/02/2013	30/08/2013
ASX 100	CGF	CHALLENGER	41.3%	2.24	2.50
	HGG	HENDERSON GROUP CDI.	20.7%	2.25	2.60
	MQG	MACQUARIE GROUP	12.9%	3.20	2.70
	QBE	QBE INSURANCE GROUP	11.4%	3.00	2.90
	CBA	COMMONWEALTH BK.OF AUS.	10.7%	3.40	3.20
	IAG	INSURANCE AUS.GROUP	10.6%	2.50	2.90
	SUN	SUNCORP GROUP	7.7%	2.13	2.10
	NAB	NATIONAL AUS.BANK	7.6%	2.31	2.60
	BOQ	BANK OF QLND.	5.3%	2.75	3.00
	ANZ	AUS.AND NZ.BANKING GP.	4.2%	2.59	2.40
	WBC	WESTPAC BANKING	3.9%	2.69	2.80
	ASX	ASX	-0.4%	3.25	3.20
	BEN	BENDIGO & ADELAIDE BANK	-0.6%	3.33	3.10
	LLC	LEND LEASE GROUP	-8.1%	2.00	1.93
	AMP	AMP	-13.7%	2.73	3.00
Small Caps	MFG	MAGELLAN FINANCIAL GP.	43.1%	1.50	1.50
	FXL	FLEXIGROUP	3.8%	2.40	2.10
	IFL	IOOF HOLDINGS	2.2%	2.58	2.70
	PTM	PLATINUM ASSET MAN.	0.8%	3.50	3.40
	PPT	PERPETUAL	-2.2%	3.15	2.90
	FKP	FKP PROPERTY GROUP	-21.4%	3.33	3.20

Note: the estimates in the Table are current to the close of business 30th August 2013. They are based on Thomson Reuters Datastream.

Since LLC and SUN are in the top 100, it is a no-brainer to at least consider them. ANZ is a genuine High Conviction stock – but what about MFG and FXL?

Magellan has had a spectacular run in the market and a massive run in funds-under management as a fund manager. I should declare a potential conflict of interest in that I am on an investment committee which has an MFG fund as one in which client's funds are invested. I would have no problem in investing my own funds in that company if I felt the need to invest in a managed fund. However, my concern is that, if by chance or management, their flagship fund has a bad quarter or two in terms of performance, could the gloss come off and the price run retrace a little? This is not a big chance in my opinion but that is why I would keep my MFG exposure small compared to that in the big banks.

FXL does retail point of sale finance for IT and electrical goods. I defer to brokers' knowledge of the company and the improvement in the rating from 2.40 to 2.10 over six months while the share price has only gone up by +3.8%. On this basis, if I were tired of just collecting dividend cheques from my preferred big banks, CBA and WBC, I could imagine reducing that banking exposure but say 10% - 20% and replacing it with investments in MFG and FXL – with a leaning towards FXL because of MFG recent strong capital gains.

From Table 2, it can be noted from my recent contributions to this column, our ASX 200 capital gains forecasts have slipped to as low as 10.4% for the next 12 months. When I take exuberance, or mispricing, into account (in the final column), the adjusted forecast becomes 9.1%. The adjusted capital gains forecast for Financials is only

2.1% but the expected yield without franking is 5.6%. This seems like a reasonable motive to take a good look at MFG and FXL.

Table 2: ASX 200 sector statistics

	Sector	P/E ratio		Cons.	Market	Exub-	12 month forecasts		
		historical	forward	rec.	cap.	erance	yield	cap. gain	adj. gain
Resource-related	Energy	18.7	15.4	2.5	5.7%	1.5%	3.7%	21.2%	19.8%
	Materials	14.2	11.7	2.3	17.0%	-3.8%	3.3%	20.4%	24.2%
	Industrials	18.1	16.1	2.5	5.8%	-0.2%	4.2%	11.8%	12.1%
High yield	Financials	13.8	13.1	2.8	38.4%	3.3%	5.6%	5.4%	2.1%
	Property	14.8	14.1	2.6	6.0%	-2.3%	5.7%	4.5%	6.8%
	Telco	15.6	14.6	3.0	5.2%	2.1%	5.8%	6.3%	4.1%
	Utilities	16.5	15.4	2.6	1.6%	-0.8%	5.6%	6.9%	7.7%
Other	Discretionary	20.6	18.0	2.3	6.7%	4.9%	2.3%	13.4%	8.5%
	Staples	18.5	17.1	3.3	8.2%	2.2%	4.5%	7.8%	5.5%
	Health	23.2	20.5	2.5	4.8%	4.8%	2.3%	11.5%	6.7%
	IT	19.7	17.6	2.6	0.7%	-0.1%	3.2%	11.5%	11.6%
	ASX 200	15.5	14.0	2.7	100.0%	1.3%	4.5%	10.4%	9.1%

Note: the estimates in the Figure are current to the close of business 30th August 2013. They are based on Thomson Reuters Datastream and Woodhall Investment Research's analysis of that data.

The Property (REITS) Sector

17th September 2013

In the previous review of this sector on the 4th March 2013, I reported that our forecast for capital gains over the next 12 months for the sector was -0.5% and so it could only reasonably be considered as a dividend play. As it turns out, the capital gain over the last six months for the sector was -1.4% compared to an ASX 200 gain of +1.4%. When dividends – but not franking credits – are reinvested the sector would have returned +4.7% compared to +7.3% for the broader index.

Only two stocks, Westfield Retail Trust (WRT) and Dexus Property Group (DXS), made the cut for High Conviction stocks with WRT being preferred to DXS. That is, they were in the top 100 and met my '2.5' broker recommendation status (please see my paper on the Market Updates tab of our website www.woodhall.com.au) for details.

From Table 1, both WRT and DXS lost ground but the sector also lost ground and the highest capital gain was +4.1% for Abacus Property Group. Over the period since my last review, WRT's recommendation has improved from 2.25 to 2.10, and DXS's has improved from 2.58 to 2.20. On that basis, there would be no need to change my preferences for this sector but there are now four more stocks that are worthy of consideration: MGR, SGP, IOF and FDC. In particular, IOF and FDC have particularly strong recommendations. Only Charter Hall Group (CHC) in the Small Caps group attracts attention.

Table 1: Data on companies in the ASX 200's Property sector

Index	Code	Company name	Capital gains from	Consensus recs.	
			4/3/2013 - 16/9/2013	4/03/2013	16/09/2013
ASX 100	**MGR**	MIRVAC GROUP	3.4%	2.77	2.50
	CPA	COMMONWEALTH PR.OFFE.FD.	3.2%	3.23	3.10
	SGP	STOCKLAND	2.4%	2.71	2.50
	IOF	INVESTA OFFICE FUND	1.7%	2.85	2.00
	GMG	GOODMAN GROUP	0.9%	2.79	2.70
	WDC	WESTFIELD GROUP	-1.4%	2.57	2.60
	WRT	WESTFIELD RETAIL TRUST	-2.3%	2.25	2.10
	DXS	DEXUS PROPERTY GROUP	-2.4%	2.58	2.20
	CFX	CFS RETAIL PR.TST.GROUP	-3.9%	2.69	3.10
	FDC	FEDERATION CENTRES	-7.5%	2.73	2.00
	GPT	GPT GROUP	-8.2%	2.82	2.90
Small Caps	**ABP**	ABACUS PROPERTY GROUP	4.1%	2.00	2.60
	ALZ	AUSTRALAND PR.GP.	0.3%	3.00	3.00
	BWP	BWP TRUST	-2.0%	3.88	3.50
	CHC	CHARTER HALL GROUP	-4.3%	2.63	2.30
	CQR	CHARTER HALL RETAIL REIT	-6.8%	3.46	3.20
	SCP	SHOPPING CENTS.AUSAN.PR. GP.	-7.1%	3.67	2.80

Note: the estimates in the Table are current to the close of business 16th September 2013. They are based on Thomson Reuters Datastream.

Turning to Table 2, the Property sector is slightly cheap (exuberance is -1.7%) and the adjusted capital gain is +6.3%. With a predicted yield of 5.7%, this sector is now very attractive indeed. Property is currently a viable alternative to Financials as that sector is quite overpriced at +4.6%.

However, it should be noted that no sector is sufficiently overpriced to warrant alarm but Discretionary (+5.5%) and Financials are getting close to that zone. The capital gains' forecast for the broad index has slipped since the start of the August reporting season – but only by about one percentage point. The adjusted gain forecast is only +8.0%. While that is a good number compared to long-run returns, it is not as exciting as many of the forecasts we made earlier in the year. However, we have reason to believe that the broker forecasts of dividends and earnings on which my calculations are based may soon be revised upwards.

The data from China has been so strong and unexpected by many and these results must surely have positive repercussions for the Materials sector forecasts. Also, the boost in confidence following the general election combined with some interesting movements in the household savings ratio and household personal loans leads me to believe there might soon be a boost to the broader economy. If Discretionary stocks are upgraded, that could be sufficient to erode the current high overpricing.

In conclusion, the Property sector is looking good so sticking with WRT and DXS seems reasonable but supplementing those holdings with IOF and FDC could pay dividends as all four stocks have yields above 6%!

Table 2: ASX 200 sector statistics

	Sector	P/E ratio		Cons.	Market	Exub-	12 month forecasts		
		historical	forward	rec.	cap.	erance	yield	cap. gain	adj. gain
Resource-related	Energy	19.1	15.6	2.6	5.8%	2.5%	3.6%	22.1%	19.7%
	Materials	14.6	12.1	2.3	17.2%	-0.1%	3.2%	19.5%	19.6%
	Industrials	18.8	16.8	2.5	5.9%	3.5%	4.0%	11.2%	7.8%
High yield	Financials	14.1	13.4	2.7	38.7%	4.6%	5.4%	5.6%	1.0%
	Property	14.8	14.2	2.6	5.9%	-1.7%	5.7%	4.6%	6.3%
	Telco	15.6	14.6	2.9	5.1%	1.6%	5.8%	6.2%	4.6%
	Utilities	16.2	15.0	2.5	1.6%	-3.0%	5.8%	8.2%	11.1%
Other	Discretionary	20.9	18.3	2.4	6.7%	5.5%	2.3%	13.1%	7.6%
	Staples	18.5	17.1	3.3	8.0%	1.7%	4.5%	7.9%	6.2%
	Health	23.1	20.5	2.6	4.6%	3.0%	2.3%	11.8%	8.9%
	IT	20.2	18.1	2.7	0.7%	1.8%	3.1%	11.3%	9.5%
	ASX 200	15.8	14.3	2.6	100.0%	2.4%	4.5%	10.3%	8.0%

Note: the estimates in the Figure are current to the close of business 16th September 2013. They are based on Thomson Reuters Datastream and Woodhall Investment Research's analysis of that data.