An assessment of the August reporting season

Slides for Ron Bewley interview on Switzer TV 3/9/2013

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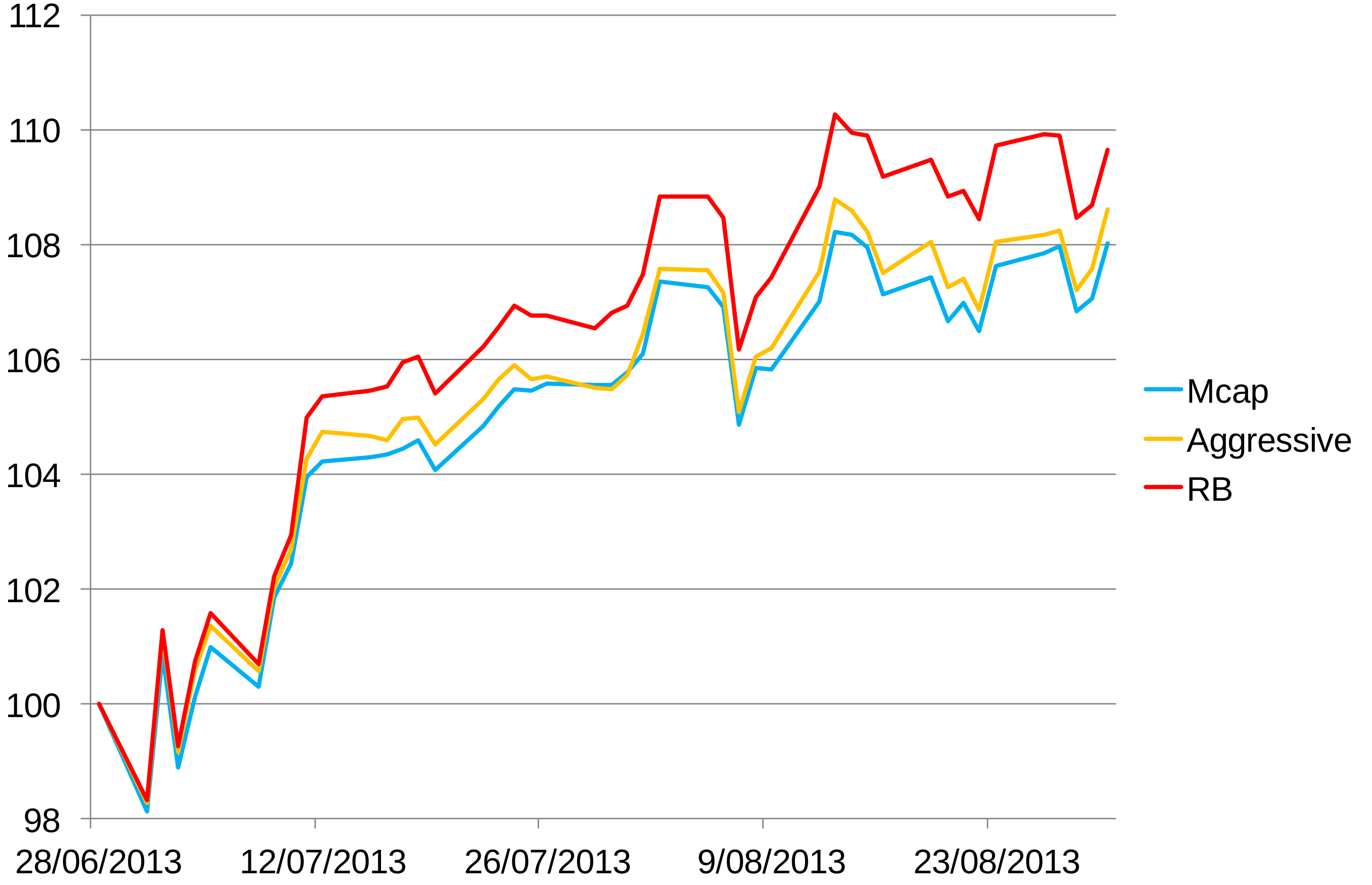
Chart 1: Capital gains – under different investment strategies



Notes

- The previous chart is based on the ‘aggressive’ weights published in our Quant Quarterly for July 1; RB represents my personal weights merely as an illustration that I do not personally follow this strategy; Mcap represent weights derived from market capitalisations (market price x number of shares on a free float basis)
- These weights are only examples to show possible aggressive strategies
- When stocks go ex-dividend, such as CBA and Telstra in August, the stock price typically falls by the size of the dividend more than if the stocks had not gone ex-dividend.
- On the next slide, our 12-month ahead capital gains forecasts are shown for each day over the past year. Our forecasts are based on an aggregation of broker forecasts of dividends and earnings. Our current forecast (on the right of the red line) is 10.4%. On the left the forecast made a year ago for the 12-months ending now was 11.3%. The forecast at the beginning of 2013 was nearly 12.5%. Updates of this chart are given in our *Weekly.*
- Much of the fall in expectations over recent months is due to falling expectations for mining. Since we have maintained over this past year that analysts were too pessimistic on China we would add a qualitative overlay to our forecasts. Our analysis of PMI and other data from China and elsewhere are updated in our monthly *Woodhall Wrap* under the *Market Updates* tab.
- In the final chart, we reproduce the weights for August used on the Switzer interview of August 5th and available on www.switzer.com.au and this website. The analysis suggests that there should be a big switch from Materials into Property for this ‘aggressive’ strategy. However, both sectors are cheap (by exuberance) and we would add our qualitative overlay. It is time to wait for a few weeks to see if analysts update their forecasts before possibly acting.

Chart 2: ASX 200 12-month ahead capital gains forecasts

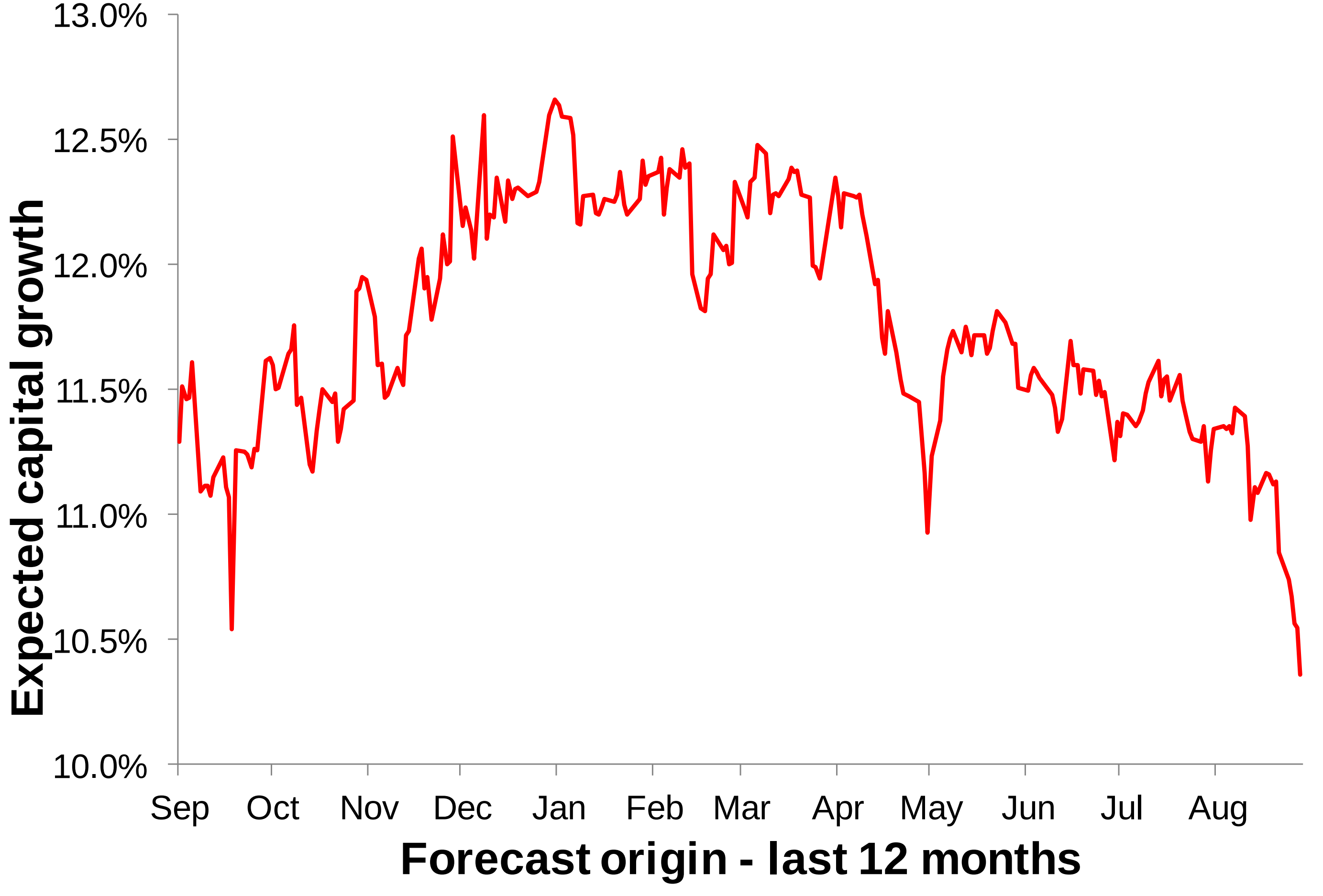


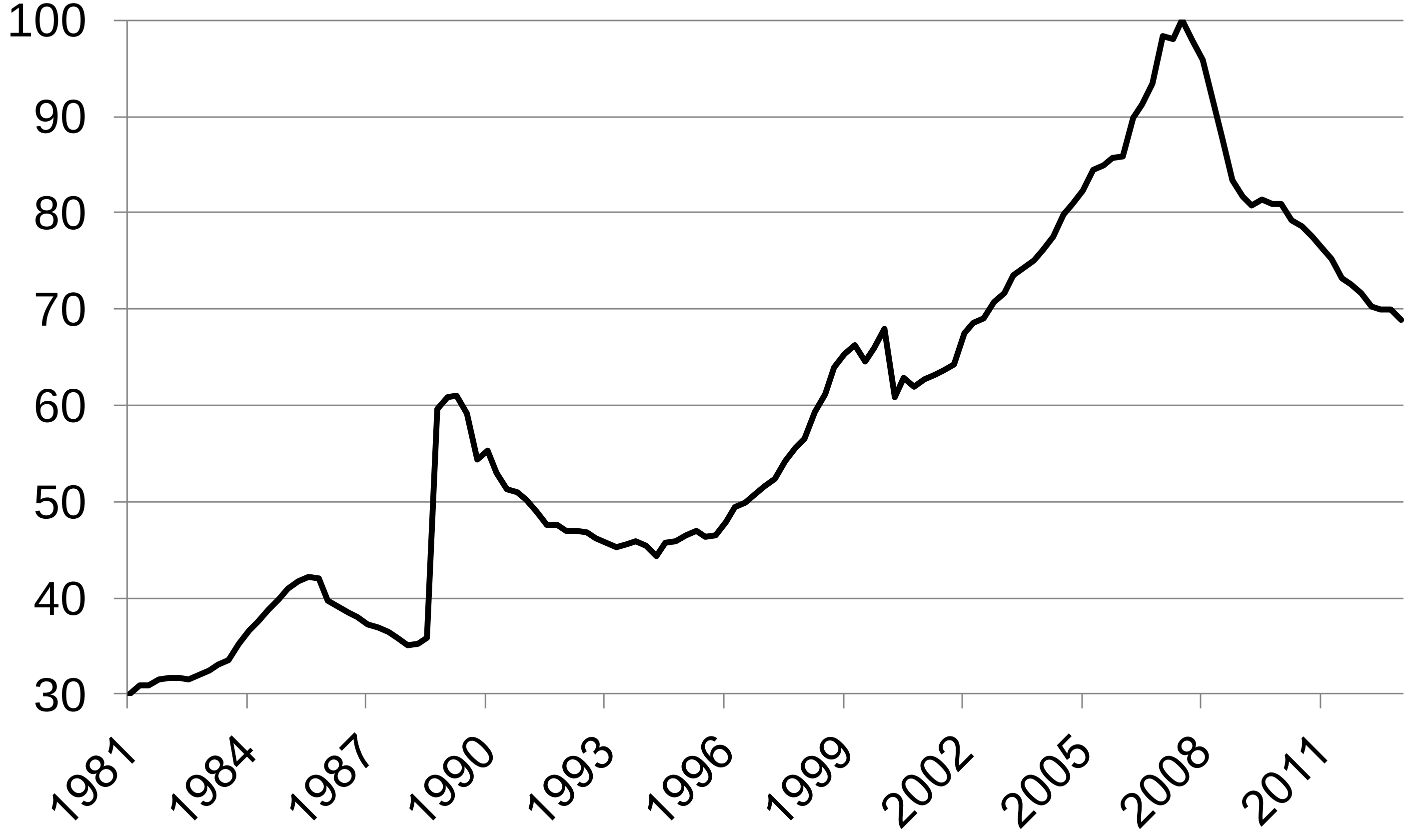
Chart 3: Rebalancing strategy

	Aug weights (%)		Sep weights (%)		Exuber-
Sector	**Market cap**	**Aggressive**	**Less agg.**	**Aggressive**	**ance (%)**
Energy	6	9	8	9	1.5
Materials	17	26	21	18	-3.8
Industrials	6	9	6	10	-0.2
Discretionary	4	6	5	6	4.9
Staples	9	13	11	13	2.2
Health	5	7	6	7	4.8
Financials	39	19	29	19	3.3
Property	7	0	5	6	-2.3
IT	1	0	1	1	-0.1
Telco	5	8	6	8	2.1
Utilities	2	3	2	3	-0.8

Notes

- The previous table shows that an ‘index-hugger’ would have about $17,000 of a $100,000 portfolio in the Materials sector that contains stocks such as BHP and RIO – at the beginning of August. However, based on certain updated forecast returns, volatilities and correlations, a certain type of aggressive investor would have wanted $26,000 in this sector. These numbers are circled in red
- Because of changes in forecasts over the month, the same aggressive investor might rebalance his portfolio to now have only $18,000 in Materials (blue circles) by selling the excess and placing in the other sectors as shown. A certain type of ‘less aggressive’ investor would now want $21,000 in Materials. That is, the less aggressive investor has bigger overweight exposure to Materials at this point in time! Portfolio construction is not simple but it can pay off.
- Currently, exuberance (gold circle) is -3.8% suggesting that the sector is underpriced by that amount and so there should be no rush to sell Materials!
- The major recipient of the rebalancing is Property. This sector attracted $0 in the Aug 1 aggressive allocation but $6,000 in the current (green circles). Property too is underpriced at -2.3%.
- So the dilemma is, Property is currently cheap and we need more in this example. Materials is currently cheap and we wish to downsize. In a perfect world this would be a good time under this strategy to put any dividend cheques or excess cash into Property while waiting for Materials to become fairly priced and then to start selling Materials. The proceeds of Materials sales might then be put into Property providing Property it is still appropriately priced.

Chart 4: Real, per capita other personal debt



Notes

- Other personal debt is from all financial institutions and excludes home loans, investment home loans and business loans.
- I have deflated the data to allow for population and CPI increases. I have rescaled the data to be equal to 100 at the 2007:Q4 peak
- This form of debt has fallen around 30% from the peak.
- This form of debt also ran hard before the 1990 recession and then fell
- The conjecture is that the current fall is overdone and debt will start to rise as soon as confidence returns.
- The savings ratio has been in double digits (as a percentage) for five years – and fairly constant.
- The US savings ratio jumped to 5% in the GFC and has since halved.