



**Ron Bewley** PhD, FASSA

# Woodhall's Weekly

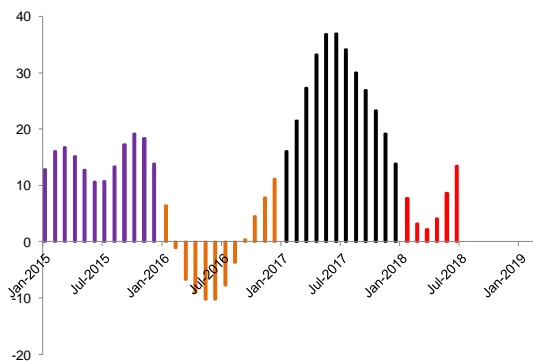
## Aussie jobs start recovery

- **Changes in full-time jobs on the increase in Australia**
- **China data OK**
- **Trump keeps stirring**

### Overview

Since the middle of 2017, the changes in (trend) full-time jobs were falling – almost to zero – as can be seen from the chart of the week.

### Chart of week: Changes in trend f/t Australian employment



Source: Woodhall and Thomson Reuters Datastream

The unemployment rate was static at 5.4% but full-time jobs surged by 13,400 for the month (in trend terms). All-in-all this jobs report was the strongest we have seen for some time. It is too early to tell if this is the start of something big – or why this series has reversed. It does put a damper on any hopes of the RBA cutting rates.

China had a big data drop at the start of the week. GDP growth came in at 6.7% which is about what

the official forecast was at the start of the year. However, it was down on the two previous quarters so some were alarmed. Not us!

China retail sales were spot on expectations at 9.4% but its Industrial Production missed at 6.0% against an expected 6.4%.

Trump had a busy week. He ‘mis-spoke’ at the Putin summit. Some were concerned in his security staff. But Trump corrected his meaning. He had simply said would rather than wouldn’t. We’re all capable of an error like that.

But Trump has now taken on his own Federal Reserve which is usually a ‘no no’ for a President. He is criticising the Fed’s hikes for appreciating the US dollar causing unnecessary pain for exporters.

What with trade wars and the rest we now have the start of a currency war to exacerbate the reaction to Trump tariffs. We still think this is mainly about Trump’s negotiating style rather than something deep-rooted so we are not panicking.

The ASX 200 only added 17 pts over the week but that is enough to make this new financial year look promising. As will be reported in the following sections our beginning of 2018 forecasts are still very much on track for the ASX 200 and the S&P 500. The US reporting season is going well and ours is about to start in August. We feel that we at least have another 12 months of the bull market and that’s as far ahead as we need to look.

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**General Advice Warning:** This note has been prepared without taking account of the objectives, financial situation or needs of any particular individual. Any individual should, before acting on the information in this note, consider the appropriateness of the information, having regard to the individual’s objectives, financial situation and needs and, if necessary, seek appropriate professional advice. Past returns are no guarantee of future performance.

## Market expectations

Our start-of-year 2018 eoy forecasts for the ASX 200 are given in Table 1 (left column) together with the latest calculations (right column) and last week's (middle column) for comparison. Chart 1 includes a trace of the index to compare with the forecasts highs and lows.

**Table 1: ASX 200 range forecasts 2018**

Forecast CY18	Forecast origin		
	30-Dec-2017	13-Jul-2018	20-Jul-2018
<b>Low</b>	5,750	5,950	6,000
<b>High</b>	6,750	6,650	6,650
<b>End</b>	6,400	6,350	6,350
<b>Fair value</b>	5,950	6,150	6,150
<b>Exuberance</b>	1.5%	2.3%	2.3%
<b>ASX 200</b>	6,065	6,268	6,286

Note: the latest forecasts in the right hand column do not provide updates of the original forecasts in the left column of numbers. Rather the latest forecasts facilitate an assessment of 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 current 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.

The eoy forecast for 2018 (left-hand column in Table 1) was 6,400 with a forecast high of 6,750 and a forecast low under normal volatility of 5,750. The 'high-volatility' forecast low was 5,300. [See the IOZ:IVV:IHVV section for the decision rules surrounding these low and high forecasts. The updated eoy 2018 forecast (Table 1, last column) is 6,350. Fair value is 6,150.

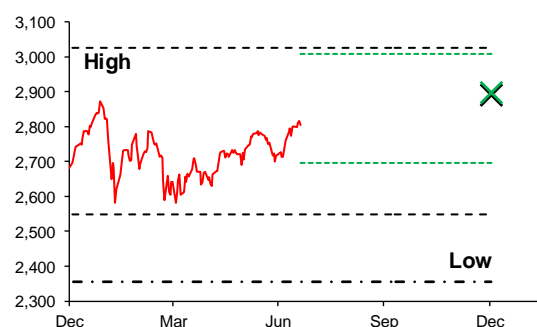
Our eoy 2018 forecasts for the S&P 500 are given in Table 2. Because overnight data are not available to us until the afternoon, the latest data for Wall Street will usually be presented for the day before the ASX 200 in this *Weekly* that we try to publish at around 10am on a Saturday.

**Table 2: S&P 500 range forecasts 2018**

Forecast CY18	Forecast origin		
	30-Dec-2017	12-Jul-2018	19-Jul-2018
<b>Low</b>	2,550	2,690	2,700
<b>High</b>	3,030	3,010	3,010
<b>End</b>	2,890	2,890	2,900
<b>Fair value</b>	2,620	2,760	2,760
<b>Exuberance</b>	-1.2%	1.6%	1.5%
<b>S&amp;P 500</b>	2,674	2,798	2,804

Note: see notes for Table 1.

**Chart 2: Graphical representation of Table 2**



Note: see notes to Chart 1.

Our original forecast for eoy 2018 was 2,890 with a high of 3,030 and a low of 2,550. The 'high-volatility' low was 2,360.

The updated eoy forecast for the S&P 500 is 2,900. Fair value was steady on the week at 2,760 which is 140 pts higher than at the start of the year.

## Market stats

Our market volatility index (Chart A-1 to be found in the Chart Appendix) is below average at 10.2%. Our Fear Index (Chart A-2) is in the zone at 7.8%. The VIX stands at 12.9%. Our Disorder index (Chart A-3) is in the zone at 0.6%.

Our updated 12-month capital gains forecast (Chart A-4) is +5.6%. The market is moderately expensive at +2.3% (Chart A-5). So that leaves the adjusted rolling 12-month capital gains' forecast at +3.2%. The comparable 12-month adjusted capital gains forecast for the S&P 500 stands at about +7.5%.

Sector pricing (Chart A-6) is such that Health (+10.0%) and Staples (+6.2%) are in correction territory. IT (+4.4%), Energy (+4.2%) and Discretionary (+3.3%) are heavily overpriced.

The yield play definitely waned during 2016 and 2017 but there was a big comeback for a while thereafter. However, from Table 3, we note Yield is still slipping back into underperforming across the

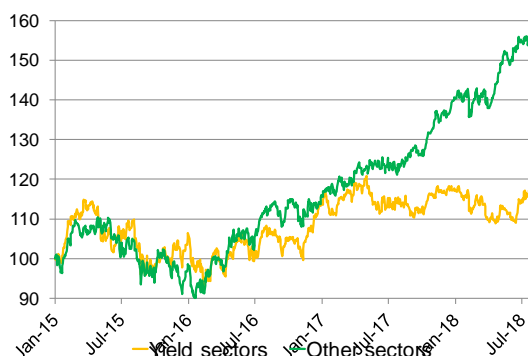
board as Materials got back into the swing but the banks threw yield a life-line in the last month.

**Table 3: Yield play - total returns**

Period	Sector		
	Yield	Other	Difference
<b>1 year</b>	1.6%	26.8%	-25.3%
<b>6 months</b>	1.4%	11.7%	-10.4%
<b>3 months</b>	7.6%	8.3%	-0.8%
<b>1 month</b>	3.2%	1.1%	2.1%

Chart 3 shows another interesting angle on the yield play. The yield sector and the 'other' sector moved roughly together for 2015, 2016 and the first half of 2017. Since then the yield play has gone nowhere while 'other' has powered on.

**Chart 3: Total returns indexes for 'yield' and 'other' aggregated sectors**



### SMSF Share Portfolio

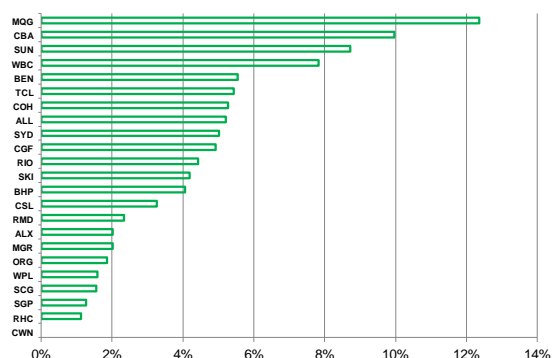
I last rebalanced my share portfolio in my SMSF on May 1<sup>st</sup> 2017. It was set at 50% High Conviction and 50% High Yield by my definitions. Normally I consider rebalancing after six months but have not done so for reasons other than to do with markets.

There are currently 22 stocks in my domestic direct equity portfolio.

The performance of my domestic equities in my SMSF portfolio – including various rebalances – against the ASX 200 since late June 2014 is shown in Table 4. That corresponds to an outperformance of +3.3% p.a. (annualised) since inception. The portfolio is returning +11.7% p.a. over more than four years.

In Table 5, I show the performance (including dividends) of the individual stocks since the last rebalance.

**Chart 4: Current holdings**



**Table 4: Total returns from SMSF (domestic equities)**

Period	Portfolio	ASX 200	Alpha
<b>Since inception</b>	11.7%	8.5%	3.3%
<b>3 years</b>	10.1%	8.0%	2.1%
<b>2 years</b>	13.0%	11.7%	1.3%
<b>1 year</b>	16.8%	13.9%	2.9%
<b>6 months</b>	10.6%	6.7%	3.9%
<b>3 months</b>	11.4%	8.0%	3.3%

Note: Since June 25th 2014. Returns include dividends. For periods above one year, the returns are annualised.

**Table 5: Individual stock total returns**

Return	ALL	BEN	BHP	CBA	CGF	COH	CSL		
Alpha	61.1%	-3.8%	44.3%	-8.3%	-2.1%	51.5%	55.3%		
Return		MGR	ALX	MQG	ORG	RHC	RIO	RMD	
Alpha		3.6%	23.3%	41.3%	31.8%	-17.6%	41.7%	64.9%	
Return									
Alpha		-7.5%	12.2%	30.2%	20.7%	-28.7%	30.5%	53.6%	
Return		SCG	SGP	SKI	SUN	SYD	TCL	WBC	WPL
Alpha		7.8%	-8.3%	-4.8%	11.7%	9.8%	2.8%	-8.7%	13.6%
		-3.3%	-19.4%	-15.9%	0.6%	-1.3%	-8.3%	-19.8%	2.5%

Note: Since May 1<sup>st</sup> 2017. Returns include dividends.

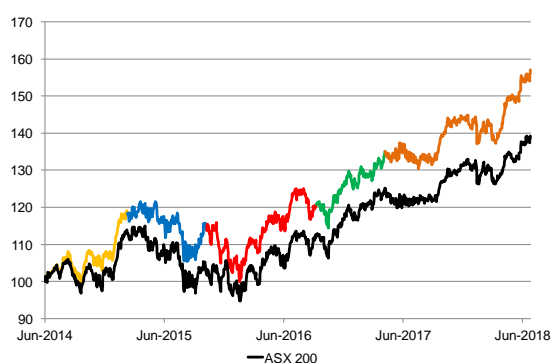
We have 9 stocks beating the index by more than 10% since May 1 2018 (ALL, BHP, COH, CSL, ALX, MQG, ORG, RIO and RMD) but 7 (BEN, CBA, CGF, MGR, RHC, SGP, SKI, and WBC) are trailing by more than -10%.

The returns chart (Chart 5) shows the recent performance using colours to denote rebalanced portfolios as well as the trend gains.

Table 6 shows the gap between broker forecasts for one year hence (Target) and current price. A negative value for T/P - 1 expressed as a percentage change therefore indicates brokers on average think the stock is overpriced.

There are two stocks with a recommendation at worse than 3.0: COH which has been one of our best performers; and BEN. COH has had a poor rating throughout its share-price rise from around \$50 to over \$200!

Chart 5: SMSF and ASX 200 total returns



Note: the different coloured sections show the impact of rebalancing.

Table 6: Price and current broker forecasts

Sector	Stock	Price	Target	Rec	T/P - 1
Energy	ORIGIN ENERGY (EX BORAL)	9.45	11.01	1.90	16.5%
	WOODSIDE PETROLEUM	34.45	26.11	2.78	-24.2%
Materials	BHP BILLITON	32.91	26.63	2.47	-19.1%
	RIO TINTO	80.08	66.57	2.28	-16.9%
Industrials	ATLAS ARTERIA	6.48	6.50	2.42	0.3%
	SYDNEY AIRPORT	7.18	7.29	2.58	1.5%
	TRANSURBAN GROUP	11.97	13.07	2.16	9.2%
Discretionary	ARISTOCRAT LEISURE	31.74	33.84	2.00	6.6%
Health	COCHLEAR	208.60	168.00	3.41	-19.5%
	CSL	203.20	141.84	2.33	-30.2%
	RAMSAY HEALTH CARE	56.94	62.28	2.41	9.4%
	RESMED CDI	14.87	10.17	3.00	-31.6%
Financials	BENDIGO & ADELAIDE BANK	11.26	11.00	3.16	-2.3%
	CHALLENGER	12.54	13.09	2.53	4.3%
	COMMONWEALTH BK. OF AUS.	75.90	75.25	3.00	-0.9%
	MACQUARIE GROUP	125.24	115.84	2.07	-7.5%
	SUNCORP GROUP	14.81	14.60	2.41	-1.4%
Property	WESTPAC BANKING	29.90	32.00	2.50	7.0%
	MIRVAC GROUP	2.26	2.38	2.45	5.3%
	SCENTRE GROUP	4.37	4.52	2.33	3.4%
Utilities	STOCKLAND	4.17	4.46	2.63	7.0%
	SPARK INFRASTRUCTURE GP.	2.27	2.51	3.00	10.6%

Note: T/P - 1 is the broker target price divided by the current share price minus one giving an indication where the price might move to over the coming 12 months.

## The IOZ:IVV:IHVV Update

**Decision rules:** given the data in Tables 1 and 2, I use the following decision rules – until new rules are formed, expected to be January 1 2019. These rules are based on calendar year forecasts for new money:

Buy IOZ at 5,750 from Table 1 (up to maximum levels determined by risk assessments) and start to sell at 6,750 for new investments. If the ASX 200 falls to 5,300 (high-volatility low) it might be prudent to exit the strategy until clarity emerges and then buy back in at (well) above 5,300 but below 5,750.

Buy IVV:IHVV at 2,550 (up to maximum levels determined by risk assessments from Table 2a) and sell at 3,030 for new investments. If the S&P 500 falls to 2,360 (high-volatility low) it might be prudent

to exit the strategy until clarity emerges and then buy back in at (well) above 2,360 but below 2,550.

For older investments, some regard is taken of the trigger points set when the investments were made.

Charts 6 and 7 are based on the price indexes as this is the metric where the signals are being made.

The strategy has been returning +13.0% pa since inception (Table 7) (including dividends). The IVV:IHVV leg is up +14.9% pa. The IOZ part of the strategy is up +11.2% pa. The table below shows that I am 49% hedged in the Wall Street component. The domestic share of the portfolio is 57%.

Table 7: Total returns on IOZ:IVV strategy

20-Jul-2018	Inc divs.	Current allocation	
ETF	IRR pa	Total	USA
IOZ	11.2%	57%	
IVV:IHVV	14.9%	43%	100%
IVV	13.3%		51%
IHVV	17.2%		49%
<b>Total</b>	<b>13.0%</b>	<b>100%</b>	
Indexes		Alpha pa	
ASX 200	8.6%	2.6%	
S&P 500	11.3%	1.9%	
S&P 500 (\$A)	14.2%	3.0%	

NB: IRR is the internal rate of return (p.a.) that compensates for the different buy and sell points and include dividends on the day they were paid and not the ex-div date. See notes in the Strategy Section for further explanation and charts. The index returns are based on a start date of 1/7/2014 for the ASX 200 and S&P 500 when the strategy was launched. The S&P 500 (\$A) return starts from 22/12/2014 when IHVV first became available.

I have also included the benchmarks for each ETF in Table 7 so I can calculate any outperformance from the buying low – selling high strategy. Annualised outperformance is eroded in the long-run to zero unless fresh buys are made or a sell signal arrives.

The Charts 6 and 7 in the strategy section now include a yellow square to show where the hedging trades were made. The red diamonds denote the buy points. The green boxes denote the sell points.

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. I plan to flag any perceived weaknesses if and as they eventuate.

## The IOZ:IVV:IHVV Strategy

(Except for the charts, this section does not usually change week to week)

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.

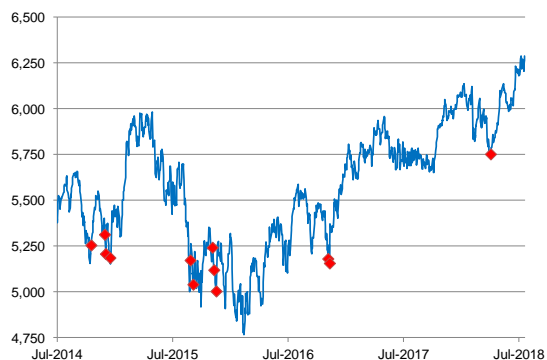
The basis of the strategy is to buy when the indexes (using ETFs) get very close to or cross the beginning of the year predicted low – and to sell when the indexes reach the predicted highs – as indicated in the 'Market Expectations' section. I do not use the weekly updated lows and highs for this purpose. 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 including dividends when paid and not when the ETF went ex-div.

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).

**Chart 6: IOZ buy points - ASX 200**



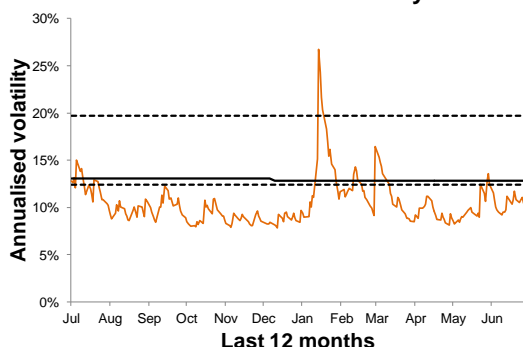
**Chart 7: IVV/IHVV Buys - S&P 500**



The charts in this strategy section include a yellow square to show where the hedging trades were made. The red diamonds are the buys. The green squares are the sells.

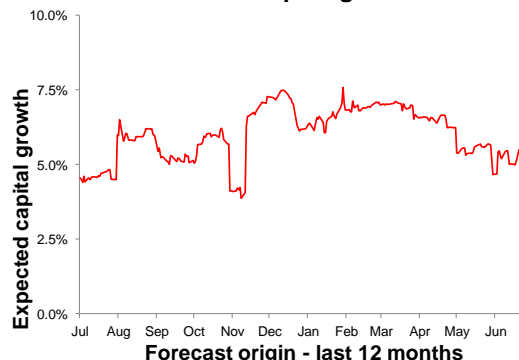
## Chart Appendix

**Chart A-1: Market volatility**



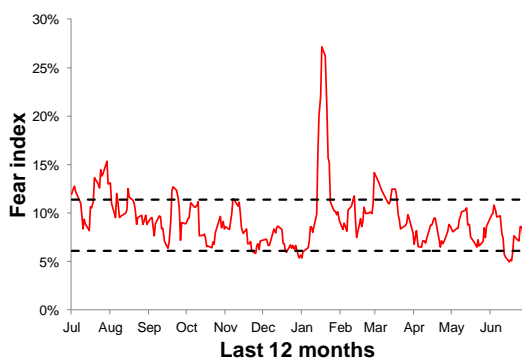
Notes: The solid black line depicts the average volatility since January 2010; the lower dotted line depicts the average volatility pre the GFC; the higher dotted line depicts the average level of volatility during the GFC - up to December 2009. The brown line is a daily estimate of the ASX 200 index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



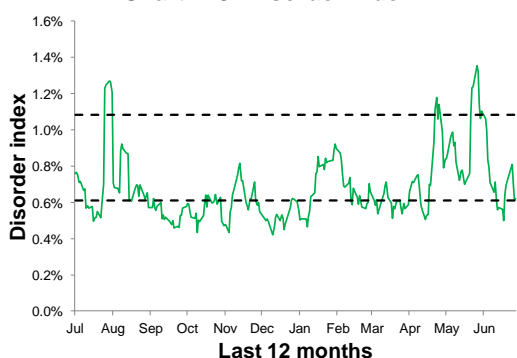
Notes: The fear index is a measure of 'excess' volatility denoting behaviour outside the open/close values each day. The two dotted lines depict the band in which the fear index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate complacency. Extended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



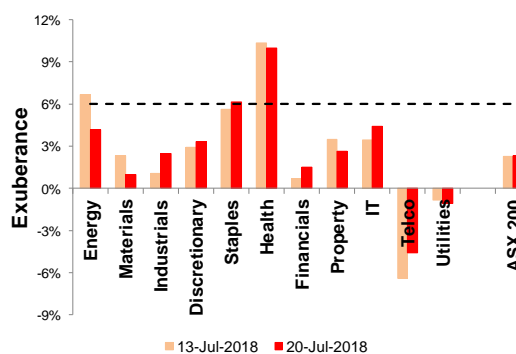
Notes: Exuberance is our measure of mispricing on the ASX 200. A value below the solid black line denotes the market is perceived to be cheap and above that line expensive. Experience suggests that exuberance above +6%, denoted by the dotted line, is an indicator of a potential correction of 6% to 10%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

**Bad debt, good debt** – Whether one is referring a household or national debt, the classification implies the following. Good debt is expected to produce income or other returns in the future – such as from infrastructure spending or buying a principal place of residence. Bad debt is used to finance 'recurrent' expenditure such as pensions or family holidays.

**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!

**Brexit** – on 23<sup>rd</sup> July 2016 Britain voted to leave the European Union. The process is expected to take at least two years and negotiations must take place to engineer a smooth transition.

**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 1<sup>st</sup> 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.

**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.

**International Monetary Fund (IMF)** – Managing Director, Christine Lagarde (French), since 28<sup>th</sup> June 2011. The IMF is charged with fostering global monetary cooperation.

**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** – Our 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.

**MYEFO** (Mid-year economic and fiscal outcome) is a mid-year update on the Australian Budget situation – usually in December.

**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 official statistics are published in the first few days of each month – with China on the 1<sup>st</sup>. 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. Note also the existence of the CAIXIN measure and its 'flash' or preliminary estimate.

**Savings ratio** – In Australia, the ratio of net savings to household disposable income defines the savings ratio.

**Short-run mispricing** – Our 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.

**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. Of course less new jobs are needed when the economy is running at full employment.

## Key people

**Australia** – Prime Minister, Malcolm Turnbull, (Liberal) since 14<sup>th</sup> September 2015; Treasurer, Scott Morrison, since 21<sup>st</sup> September 2015; Governor of the Reserve Bank of Australia (**RBA**), Dr Philip Lowe, since 18<sup>th</sup> September 2016.

**China** – President Prime Minister, Xi Jinping, since 14<sup>th</sup> November 2013; Premier, Li Keqiang since 15<sup>th</sup> March 2013; Yi Gang, President of the People's Bank of China (**POBC**) since March 2018.

**Europe** – President of the European Central Bank (**ECB**), Mario Draghi (Italian), since 1<sup>st</sup> November 2011; Chancellor of Germany, Dr Angela Merkel, since 22<sup>nd</sup> November 2005; President of France, Emmanuel Macron, from May 2017; Prime Minister of Greece, Alexis Tsipras, since 21<sup>st</sup> September 2015.

**Japan** – Prime Minister, Shinzo Abe, since 26<sup>th</sup> December 2012; Emperor, Akihito, enthroned 12<sup>th</sup> November 1990; Governor of the Bank of Japan (**BoJ**), Haruhiko Kuroda, since 20<sup>th</sup> March 2013.

**New Zealand** – Prime Minister, Jacinda Arden, October 2017; Governor of the Reserve Bank of New Zealand (**RBNZ**), Graeme Wheeler, since 26<sup>th</sup> September 2012.

**United Kingdom** – Prime Minister, Theresa May, since 11<sup>th</sup> July 2016; Chancellor of the Exchequer, Philip Hammond, since 13<sup>th</sup> July 2016; Governor of the Bank of England (**BoE**), Mark Carney (Canadian), since 1<sup>st</sup> July 2013.

**United States of America** – President, Donald Trump, from January 20<sup>th</sup> 2017 (4 year term); Chair of the Federal Reserve Bank (**Fed**), Jerome "Jay" Powell, since 5<sup>th</sup> February 2018 (4 year term)..