



Ron Bewley PhD, FASSA

Woodhall's Weekly

Spotlight on US jobs

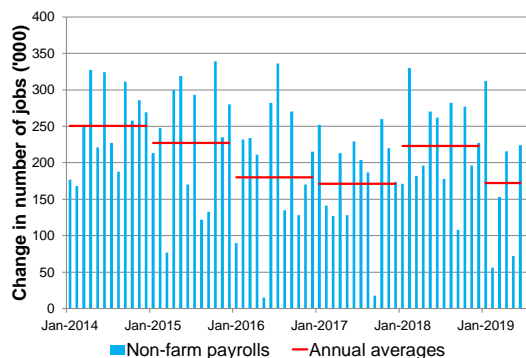
- Payrolls bounce back
- RBA hits panic button
- Aus gov passes \$158bn tax break

Overview

Yesterday, the latest Dow-Jones forecast for US nonfarm payrolls was 165,000. In the previous month, the expectation was 180,000 with an outcome of only 75,000. Clearly the market was not factoring in any material downturn in jobs for last night with a robust forecast of 165,000. After all, the unemployment rate and the wage growth rate are more important and are more stable.

The outcome, illustrated in the chart of the week, was 224,000 jobs – a blockbuster. The unemployment rate was up one notch to 3.7% but that is still near the 50-year low. Wages growth was down a notch to 3.1%. The 75,000 jobs from the previous month was revised downwards to 72,000!

Chart of the week: US nonfarm payrolls



Clearly, jobs are still on a roll. The 2019 y-t-d average is only 1,000 jobs different from the 2017 average.

It must be depressing for all those “wishin’ and a hopin’” that Trump’s policies will fail. But if, like all good doomsayers, they wish the same thing for long enough, one day they may seem right. Meanwhile, the rest of us will have made a good few bob on the markets.

The week started off well too. No sooner had Xi and Trump talked turkey in Japan, Trump straddled the DMZ with Kim in Korea. They actually shook hands on both sides of the Korean dividing border. That’s the first time a sitting US president has set foot in North Korea. Nobody noticed that day the China manufacturing PMI remained at 49.4.

Of course, Trump had to throw another spanner in the works as he tweeted about a possible new tariff on \$4bn of EU imports to the US.

On Tuesday, the RBA cut again by 25 bps to 1.00%. We thought this cut was unlikely because it would show panic. So desperate must the board have felt after having held firm for two and a half years with a chorus of “the only way is up”, that, in a handful of months, it has gone from a 50:50 chance of a cut to two cuts in succession.

There was no new data of merit last month to change any cool-headed economist’s mind. It can only be the realisation by the board that it screwed

up bigtime that caused the board to hit the panic button.

On Thursday night, ScoMo burst through the senate with \$158bn of tax reforms. The immediate effect is modest – middle and low-income earners will get bigger tax rebates (about \$1,000 each) for their FY19 returns. Going forward, tax rates will be lowered in two stages (providing some new government does not rescind the bill after the next election) so that 30% will be the maximum marginal rate up to \$200,000 within five years.

With Lowe and ScoMo marching arm-in-arm on policy stimulation, our economy is, at last, looking much safer. Refrains of Joan Baez singing “We shall overcome” are playing while the credits roll!

With our market closing at only 1% off the all-time high of 6,828.7 in late 2007, we are almost there. But we should realise that our high payout ratios make the last close on the accumulation index to be about 65% higher than the 2007 peak. You had to be in it to win it.

But let's close off our overview with some further thoughts on the US Fed. Last night's jobs report should not affect the Fed decision on July 31st. Rather, the next Fed move is really an acknowledgement that they got caught up with the momentum with the December 2018 rate hike. A cut or two just let's us know that they think the new 'neutral rate' is closer to 2% than 2.5%.

The CME Fedwatch tool (after the jobs number) has a rate cut on July 31st priced in at 100%. (Remember nothing is certain but Powell will hint in his two days of testimony before Congress this week). The same tool has a 46% chance priced in for three or more cuts this year. We think they are “whistling Dixie”!

We predict that the US economy will remain strong enough to make two cuts the maximum for the remainder of this year. US inflation data, out this week, will give us some strong pointers.

At home, we rejoice in another 2% gain this week but exuberance is now +4.5% (Chart A-5) which is a bit close to the 6% line we use to call a correction or a prolonged sideways movement. The index is also above the dotted line in Chart 1.

We are not banking on much in the way of further gains in the coming weeks. It might well be time to take some profits off the table. Meanwhile, our SMSF portfolio has posted an outperformance of 9.8% in the last six months. Too good to be true? We await like a cat ready to pounce if we see trouble.

Market expectations

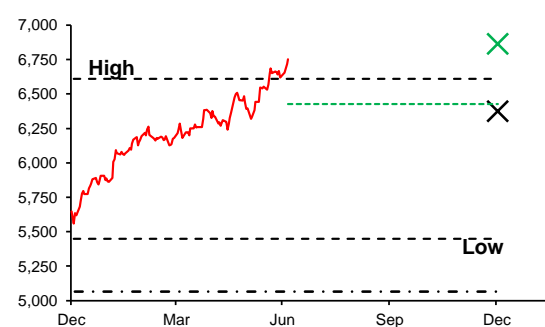
Our start-of-year 2019 eoy forecasts for the ASX 200 are given in Table 1 (left column) together with the latest calculations (right column) and last week's (middle column) for comparison. Chart 1 includes a trace of the index to compare with the forecast highs and lows.

Table 1: ASX 200 range forecasts 2018

Forecast CY19	Forecast origin		
	31-Dec-2018	28-Jun-2019	5-Jul-2019
Low	5,450	6,300	6,450
High	6,600	7,100	7,200
End	6,400	6,800	6,850
Fair value	6,100	6,400	6,450
Exuberance	-7.1%	3.0%	4.5%
ASX 200	5,646	6,619	6,751

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 2019 (left-hand column in Table 1) was 6,400 with a forecast high of 6,600 and a forecast low under normal volatility of 5,450. The 'high-volatility' forecast low was 5,050. The updated eoy 2019 forecast (Table 1, last column) is 6,850. Fair value is 6,450.

It should be stressed that when markets are heavily mispriced, the speed with which mispricing is eroded is key to making a good forecast. In this table we assume that it takes 12 months to erode the mispricing which is possibly a very conservative assumption. Our eoy 2019 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 post at around 10am on a Saturday.

Table 2: S&P 500 range forecasts 2018

Forecast CY19	Forecast origin		
	31-Dec-2018	27-Jun-2019	4-Jul-2019
Low	2,450	2,820	2,880
High	3,130	3,180	3,230
End	3,050	3,070	3,110
Fair value	2,900	2,900	2,900
Exuberance	-13.3%	0.8%	3.2%
S&P 500	2,507	2,925	2,996

Note: see notes for Table 1.

Chart 2: Graphical representation of Table 2



Note: see notes to Chart 1.

Our original forecast for eoy 2019 was 3,050 with a high of 3,130 and a low of 2,450. The 'high-volatility' low was 2,300.

The updated eoy forecast for the S&P 500 is 3,110. Fair value is 2,900

Market stats

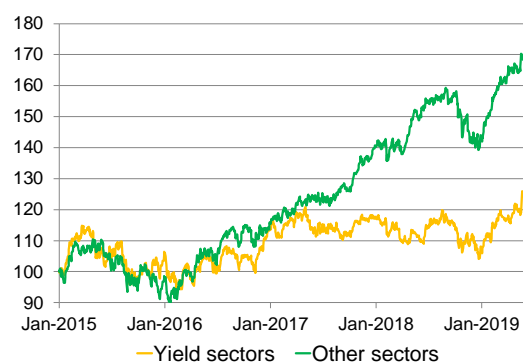
Our market volatility index (Chart A-1 to be found in the Chart Appendix) is below average at 10.0%. Our Fear Index (Chart A-2) is in the zone at 9.1%. The VIX stands at 13.3%. Our Disorder index (Chart A-3) is in the zone at 0.9%.

Our updated 12-month capital gains forecast (Chart A-4) is +8.4%. The market is expensive at +4.5% (Chart A-5). So that leaves the adjusted rolling 12-month capital gains' forecast at +3.5%. 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 Property (+10.0%), Materials (+8.2%), Health (+7.5%) and Telcos (7.2%) are significantly overpriced – above the 6% line! Only two sectors are, perhaps, not also too expensive to buy.

Chart 3 shows an interesting angle on the yield play. Our composite yield sector (Financials-x-REITS, REITS, Telcos and Utilities) and the 'other' (seven) sector moved roughly together for 2015, 2016 and the first half of 2017. Since then the yield play went nowhere and slipped since mid-2018. However, yield is having a new lease of life after the May 2019 election. The 'other index' performed very strongly until October 2018. Since then the other sector fell strongly – then rallied in 2019.

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



SMSF Share Portfolio

We last rebalanced our share portfolio in our SMSF on 1st February 2019. We kept the style at 100% High Conviction. There are again 23 stocks in the portfolio. No adjustments were made to the new model portfolio prescription.

Table 3: Total returns from SMSF portfolio

Period	Portfolio	ASX 200	Alpha
Since inception	13.4%	9.2%	4.1%
5 years	12.9%	8.8%	4.1%
3 years	17.2%	13.7%	3.5%
2 years	17.9%	13.0%	4.9%
1 year	21.2%	13.4%	7.8%
6 months	32.2%	22.4%	9.8%
3 months	14.7%	10.1%	4.5%

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

The performance of domestic equities in our SMSF portfolio – including various rebalances – against the ASX 200 since late June 2014 is shown in Table 3. That corresponds to an outperformance of +4.1% p.a. (annualised) since inception. The portfolio has been returning +13.4% p.a.

In Table 4, we show the performance (including dividends) of the individual stocks since the last rebalance.

We have six stocks (GMG, MFG, NCM, RMD and XRO) beating the index by more than 10% since

February 1st 2019 and five stocks (ALQ, CIM, SUN, TAH and TWE) trailing by more than -10%.

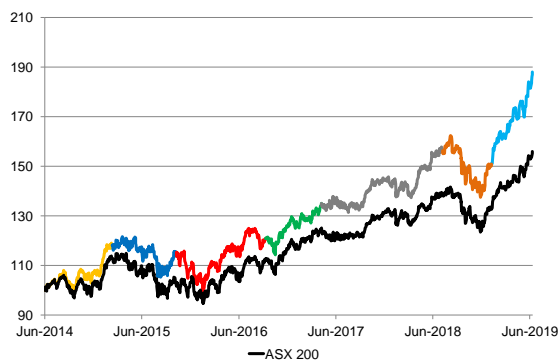
Table 4: Individual stock total returns

	ALL	ALQ	BHP	BXB	CIM	CSL	CWN	GMG
Return	20.3%	7.4%	20.2%	16.6%	5.2%	16.1%	9.2%	39.6%
Alpha	2.7%	-10.2%	2.6%	-1.0%	-12.4%	-1.5%	-8.4%	22.0%
	LLC	MFG	MQG	NCM	RIO	RMD	SCG	SGP
Return	17.1%	98.5%	13.6%	30.2%	20.8%	36.1%	7.6%	22.1%
Alpha	-0.5%	80.8%	-4.0%	12.6%	3.1%	18.4%	-10.0%	4.5%
	SHL	SUN	TAH	TCL	TWE	WBC	XRO	ASX200
Return	20.7%	6.5%	0.9%	27.8%	0.0%	18.8%	46.1%	17.6%
Alpha	3.1%	-11.2%	-16.7%	10.2%	-17.6%	1.2%	28.5%	0.0%

Note: Since February 1st 2019. Returns include dividends.

The returns chart (Chart 4) shows the recent performance using colours to denote rebalanced portfolios.

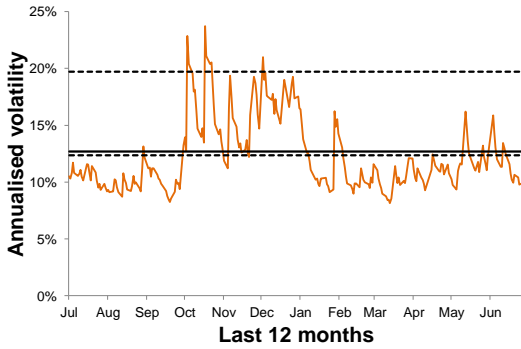
Chart 4: SMSF and ASX 200 total returns



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

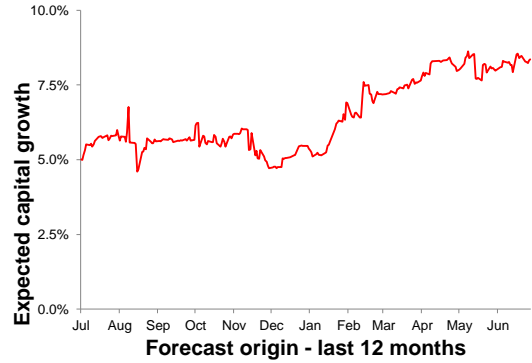
Chart Appendix

Chart A-1: Market volatility



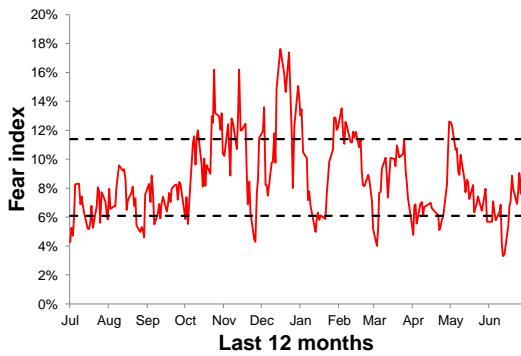
Notes: The solid black line depicts the average volatility since January 2010; the lower dotted line depicts the average volatility pre the GFC; the higher dotted line depicts the average level of volatility during the GFC - up to December 2009. The brown line is a daily estimate of the ASX 200 index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

Chart A-4: 12-month capital gains forecasts



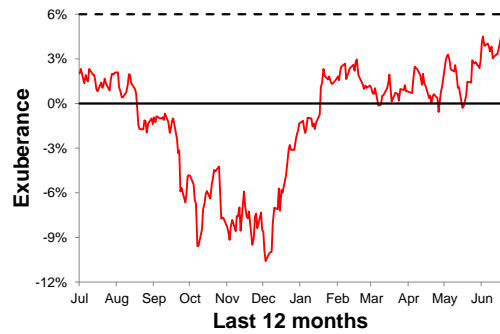
Notes: Each business day we update our estimates for capital gains on the ASX 200 for the following 12 months. For example, the left-most estimate on the vertical axis is a forecast for the 12 months concluding today. The right hand estimate is for the 12 months from today.

Chart A-2: Fear index



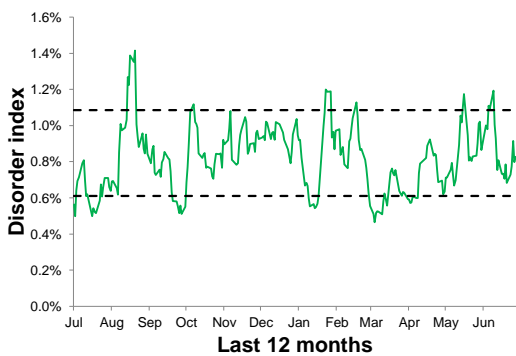
Notes: The fear index is a measure of 'excess' volatility denoting behaviour outside the open/close values each day. The two dotted lines depict the band in which the fear index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate complacency. Extended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



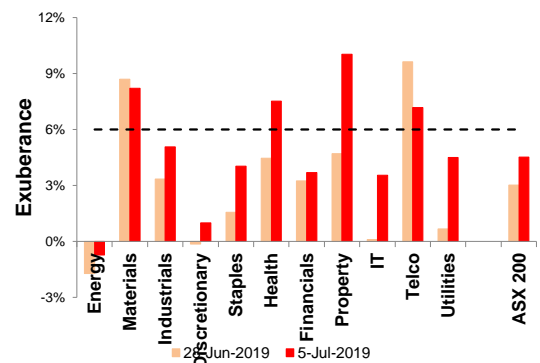
Notes: Exuberance is our measure of mispricing on the ASX 200. A value below the solid black line denotes the market is perceived to be cheap and above that line expensive. Experience suggests that exuberance above +6%, denoted by the dotted line, is an indicator of a potential correction of 6% to 10% - 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 23rd 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 1st of the month gets much less attention than the official but the preliminary, or 'flash', reading gets attention as a read a week or two before the official numbers.

China's shadow banking – In essence, the China government dictates what all banks must lend at and pay for deposits. As a result, if a potential borrower is deemed too risky at the prevailing rate, the banks refuse to lend (rather than increase borrowing rates as may happen here). The 'failed' borrower may then seek funding from the shadow banking system that is not so regulated.

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 28th 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-

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 1st. A reading less than 50 means the sector is decreasing in its growth rate – so if China growth slows from 8% to 7%, its PMI should be below 50. If the US speeds up from 2% to 2.5%, its PMI should be above 50. 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, Scott Morrison, (Liberal) since 24th August 2018; Treasurer, Josh Frydenberg, since 24th August 2018; Governor of the Reserve Bank of Australia (**RBA**), Dr Philip Lowe, since 18th September 2016.

China – President Prime Minister, Xi Jinping, since 14th November 2013; Premier, Li Keqiang since 15th 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 1st November 2011; Chancellor of Germany, Dr Angela Merkel, since 22nd November 2005; President of France, Emmanuel Macron, from May 2017; Prime Minister of Greece, Alexis Tsipras, since 21st September 2015.

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

New Zealand – Prime Minister, Jacinda Arden, October 2017; Governor of the Reserve Bank of New Zealand (**RBNZ**), Adrian Orr, since 27th March 2018.

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

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