5 October 2019

Woodhall's Weekly

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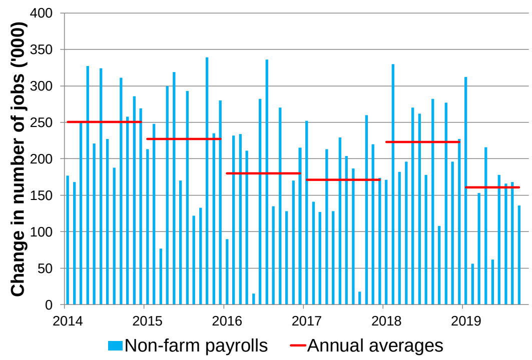
- **'Goldilocks' US jobs data print**
- **Aussie retail sales jump up**
- **Sydney and Melbourne property prices up 1.7% in a month**

Overview

With calls for a US economic slowdown always seemingly swirling below the surface, the nonfarm payrolls data provides a key insight into the economy.

The number of new jobs shown in the chart of the week came in at 136,000 or just below the expected 145,000. However, the two previous months' numbers were revised upwards by an impressive 45,000. If that weren't enough, the unemployment rate fell two notches to 3.5% or the lowest since December 1969. On the other hand, wages growth did miss at 2.9% after last month's 3.2%

Chart of the week: US nonfarm payrolls



Some called the print a 'Goldilocks' set of numbers because they were strong enough to dispel any thought of economic gloom but strong enough to put the Fed off its course of action.

Before the jobs report, the US ISM data dropped and they didn't look good. First came the manufacturing expectations which was the lowest read in 10 years. The services ISM print was well above the 50 level but well down on expectations and last month's print. Naturally, the recession spectre jumped out of the cupboard again and there was a big sell-off in equities. That's why equities jumped back on the nonfarm data.

Life was not helped by Donald earmarking European aircraft and agricultural industries for an upgrade in tariffs from mid-October.

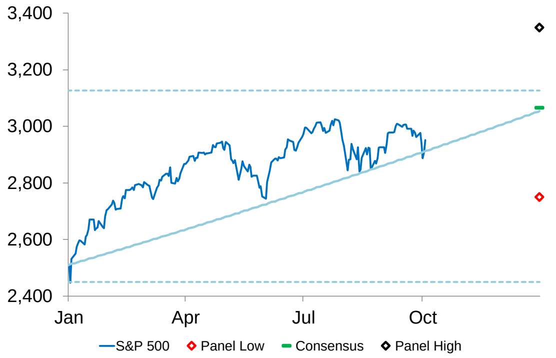
We were watching 'Antiques Roadtrip' on TV yesterday – in an episode set in the North of England. They reported the import duty on tea was 119% in the first half of the 18th century so smuggling was rife. Mid-century the tariff was slashed to 12.5% and smugglers went out of business. One route for the smugglers was to buy tea in Scandinavia as a legitimate trade and then take it as contraband into England. Not much has changed in 300 years. We just call it creative accounting and tax havens now.

However, it can be seen in chart-of-the-week 2 that the sell off only took the market to the trend line we predicted at the start of 2019 – and it happened to coincide with consensus forecasts. Too soon to throw out the baby with the bathwater.

The RBA cut our rate 25 bps to 0.75% on Tuesday. Two days later, our retail sales came in at +0.4% which was up from last month's negative read.

WoodHall Investment Research

Chart of the week 2: S&P 500 index



There were two camps on what +0.4% meant. One consensus camp had expectations at +0.2% and so +0.4% was a big beat. Another report expected +0.5% because they expected a 'double whammy' because the income tax cuts should be working their way through to sales.

The latest read refers to the month of August. Tax cuts were not possible until July and we doubt that anything like the full effect of the cuts could work their way through until at least October. The +0.4% quite possibly has some tax cut benefits boosting the read. Again, we are not worried.

For whatever reason, Sydney and Melbourne residential house prices were reported to have risen each by +1.7% in the preceding four weeks. Would the RBA have cut if they had met on Friday instead of Tuesday? Maybe not.

Boris's Brexit continues to lurch from pillar to post. He nearly had a deal for a big delay before Northern Ireland left the EU – until the Republic scuppered it.

The question we ask ourselves is, if the UK had never entered the EU would it be scrambling to join now? If not, the long-term solution for maybe centuries or more should we just get out now and adjust to long-term prosperity.

Our futures are up by +55 pts for Monday's open. Volatility (Chart A-1) is unsurprisingly high but fear (Chart A-2) and disorder (Chart A-3) are both below the zone indicating a little bit of complacency.

While we are still optimistic about the run-in to Christmas, more wobbles are likely to unsettle some investors.

If Thursday and Friday's trade talks in Washington get anywhere, we might even see a little spurt back to new highs!

Market expectations

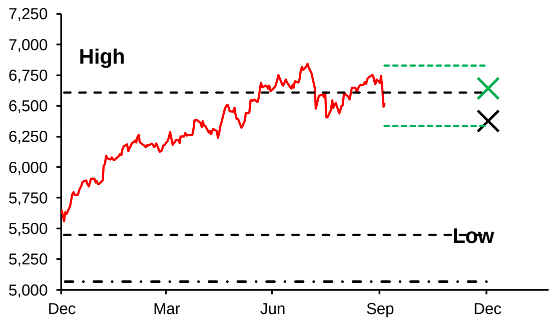
Our start-of-year 2019 eoy forecasts for the ASX 200 are given in Table 1 (left column) together with the latest calculations (right column) and last week's (middle column) for comparison. Chart 1 includes a trace of the index to compare with the forecast highs and lows.

Table 1: ASX 200 range forecasts 2018

Forecast	Forecast origin		
CY19	**31-Dec-2018**	**27-Sep-2019**	**4-Oct-2019**
Low	5,450	6,500	6,350
High	6,600	7,000	6,850
End	6,400	6,800	6,650
Fair value	6,100	6,600	6,650
Exuberance	-7.1%	1.8%	-1.7%
ASX 200	5,646	6,716	6,517

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 6,650. Fair value is 6,650.

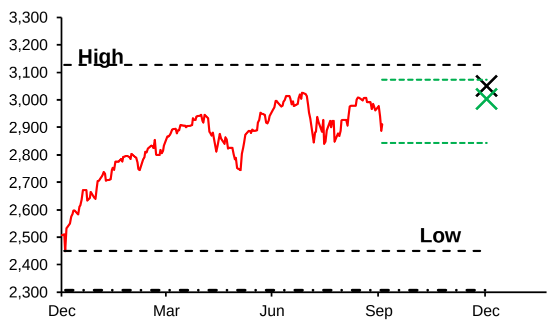
It should be stressed that when markets are heavily mispriced, the speed with which mispricing is eroded is key to making a good forecast. In this table we assume that it takes 12 months to erode the mispricing which is possibly a very conservative assumption. Our eoy 2019 forecasts for the S&P 500 are 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	Forecast origin		
CY19	31-Dec-2018	26-Sep-2019	3-Oct-2019
Low	2,450	2,900	2,840
High	3,130	3,140	3,070
End	3,050	3,060	3,000
Fair value	2,900	2,970	2,970
Exuberance	-13.3%	0.4%	-1.9%
S&P 500	2,507	2,978	2,911

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 3,000. Fair value is 2,970

Market stats

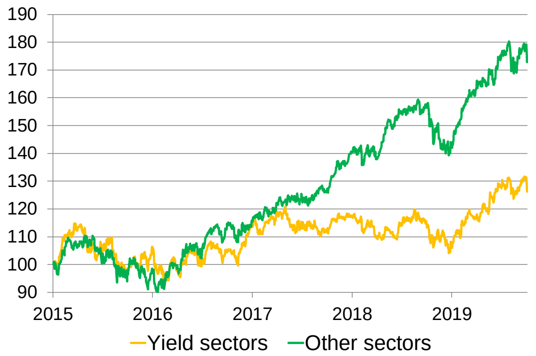
Our market volatility index (Chart A-1 to be found in the Chart Appendix) is above average at 18.7%. Our Fear Index (Chart A-2) is below the zone at 5.7%. The VIX stands above average at 17.0. Our Disorder index (Chart A-3) is at the bottom of the zone at 0.6%.

Our updated 12-month capital gains forecast (Chart A-4) is +6.4%. The market is slightly under-priced at -1.7% (Chart A-5). So that leaves the adjusted rolling 12-month capital gains' forecast at +8.2%. The comparable 12-month adjusted capital gains forecast for the S&P 500 stands at about +12.5%.

Sector pricing (Chart A-6) is such that Health (+2.3%), Discretionary (+0.5) and Staples (+0.1%) are the only sectors that are (slightly) over-priced. All other sectors are under-priced.

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 with high yield.

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 August 2019. We kept the style at 100% High Conviction. There are 20 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%	8.3%	5.0%
5 years	13.7%	8.8%	4.9%
3 years	17.1%	10.6%	6.5%
2 years	20.5%	12.0%	8.4%
1 year	23.6%	10.1%	13.5%
6 months	17.2%	6.8%	10.4%
3 months	3.2%	-2.2%	5.4%

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 +5.0% 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 five stocks (ALQ, APT, LLC, RWC and SGR) beating the index by more than 10% since August 1st 2019 and one stocks trailing by more than -10% (S32).

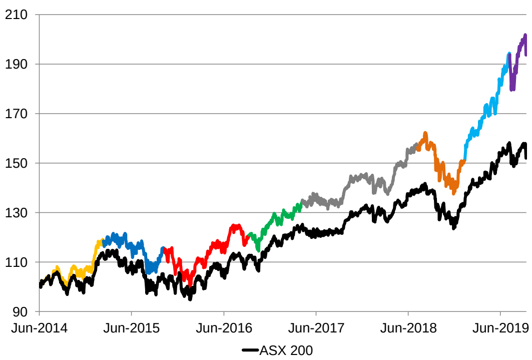
Table 4: Individual stock total returns

	ALL	ALQ	AMC	ANN	APT	AZJ	BHP	CSL
Return	1.7%	14.7%	-9.6%	-5.0%	28.7%	0.2%	-11.5%	3.5%
Alpha	4.4%	17.5%	-6.9%	-2.2%	31.4%	3.0%	-8.7%	6.2%
	FLT	**LLC**	**MQG**	**PDL**	**RIO**	**RMD**	**RWC**	**S32**
Return	2.8%	16.8%	-0.4%	-9.7%	-9.7%	1.9%	10.7%	-20.7%
Alpha	5.6%	19.6%	2.4%	-7.0%	-6.9%	4.6%	13.5%	-17.9%
	SEK	**SGR**	**SUN**	**TWE**	**ASX200I**			
Return	-0.6%	9.7%	3.4%	2.5%	-2.8%			
Alpha	2.2%	12.5%	6.2%	5.3%	0.0%			

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

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

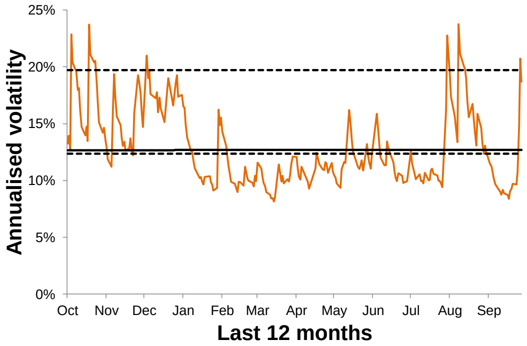
Chart 4: SMSF and ASX 200 total returns



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

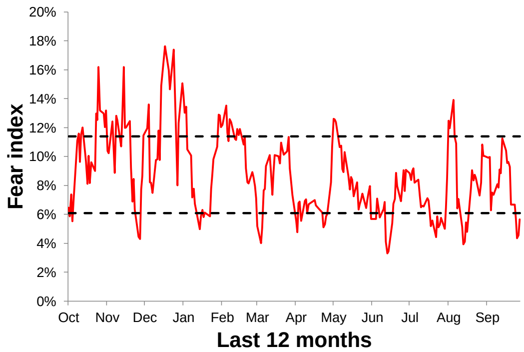
Chart Appendix

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.

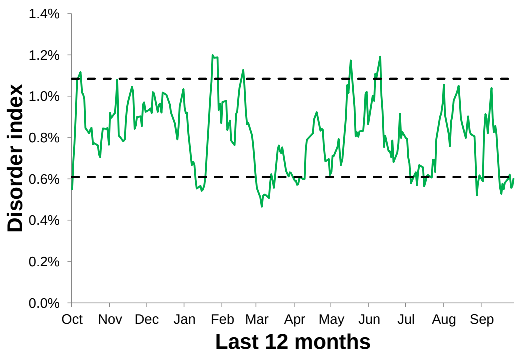
Chart A-2: Fear index



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.

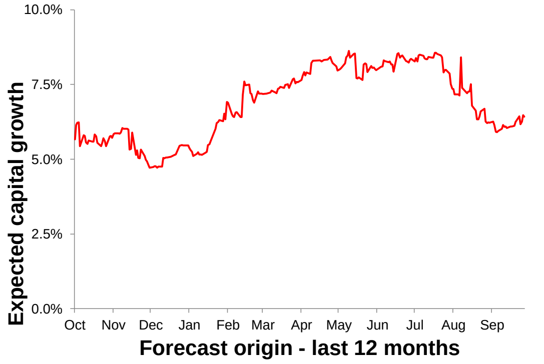
Chart A-3: Disorder index

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.



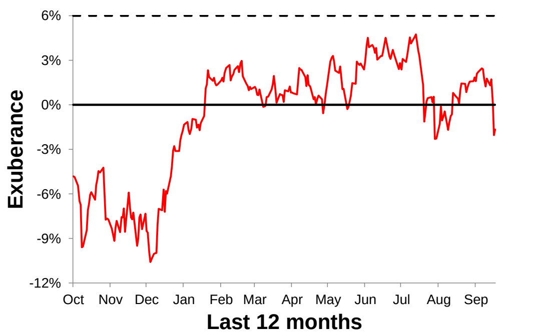
might indicate investors and traders are lurching from sector to sector in search of a new trend.

Chart A-4: 12-month capital gains forecasts



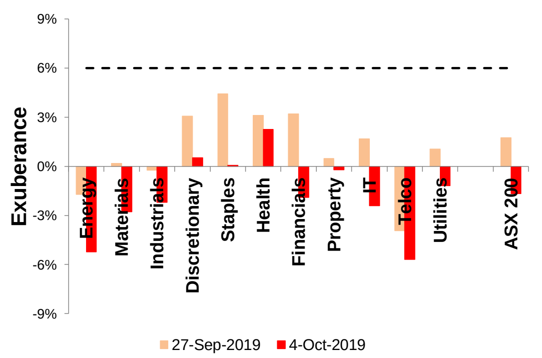
Notes: Each business day we update our estimates for capital gains on the ASX 200 for the following 12 months. For example, the left-most estimate on the vertical axis is a forecast for the 12 months concluding today. The right hand estimate is for the 12 months from today.

Chart A-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-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- 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 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 (Christine Lagarde from 1st November 2019); Chancellor of Germany, Dr Angela Merkel, since 22nd November 2005; President of France, Emmanuel Macron, since May 2017.

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, Boris Johnson, since 24th July 2019; Chancellor of the Exchequer, Sajid David, since 24th July 2019; 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)