17 September 2016

Woodhall's Weekly

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Good Friday

- **Wall Street on track**
- **Aus employment worries a little**
- **Fed Reserve next week**

Overview

There was a little wandering in the markets during the week but the important thing to me is that my forecast for June 30, 2017 on Wall St (Table 2b) is better than it started this financial year! Hilary sneezes and markets catch cold – but not pneumonia!

We'd had five negative weeks but Friday came good even if we were still -0.8% on the week. We couldn't quite hold on to 5,300 but we did largely shake off the -120 pts fall on Monday.

Our labour force data looked good to the uninitiated. The headline unemployment rate dropped from 5.7% to 5.6% so the masses rejoiced. But the confidence interval published by the ABS is so wide as to make that number absolutely meaningless.

The truth – as shown by the ABS – was that trend full-time employment was down but only by a tiny -400 jobs which confirms the reversal of the bad start to the year. But I am not rejoicing yet. At last Malcolm Turnbull has admitted he is not the best Prime Minister – but says he is the happiest. Possibly also delusional?

The new super rules make no sense (see my posts on Market Updates on www.woodhall.com.au) even after the changes yesterday.

But the big disturbance over the week was wondering what the Fed will do next week. Everybody knows they will do nothing but a whiff of some chance of a hike and markets started to dance to the tune.

So I am taking Friday (yesterday) for what it was: a lead into next week. We are falling so far being Wall Street and our rolling capital gains forecasts (Chart A-4) have slipped again.

I am plotting my overdue rebalance but JBH's leap yesterday, along with STO, makes me sit back and take notice. I did, however, decide to offer all of my Telstra to the buy-back.

Market expectations

My start-of-year 2016 eoy forecasts for the ASX 200 are given in Table 1a (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. And we add the new FY17 forecasts in Table 1b.

The original eofy forecast for June 30th 2017 (left-hand column in Table 1b) is 6,150 with a forecast high of 6,350 and a forecast low under normal volatility of 5,100. The 'high-volatility' forecast low is 4,785. See the IOZ:IVV:IHVV section for the

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.

WOODHALL INVESTMENT RESEARCH

decision rules surrounding these low and high forecasts.

Table 1a: ASX 200 range forecasts 2016

Forecast	Forecast origin		
Cal '16	1-Jan-2016	9-Sep-2016	16-Sep-2016
Low	5,100	5,200	5,150
High	6,150	5,700	5,650
End	5,850	5,550	5,500
Fair value	5,350	5,500	5,500
Exuberance	-0.7%	-2.8%	-3.4%
ASX 200	5,296	5,339	5,297

Table 1b: ASX 200 range forecasts FY2017

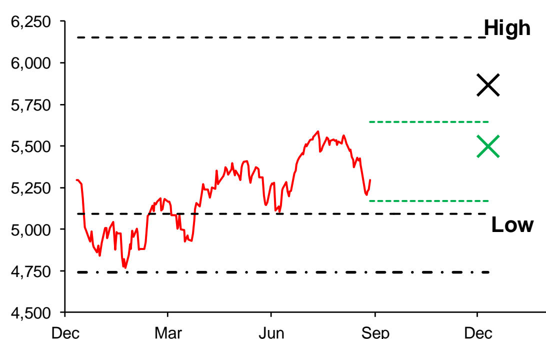
Forecast	Forecast origin		
FY '17	1-Jul-2016	9-Sep-2016	16-Sep-2016
Low	5,100	5,200	5,150
High	6,350	6,150	6,050
End	6,150	5,950	5,850
Fair value	5,350	5,500	5,500
Exuberance	-2.1%	-2.8%	-3.4%
ASX 200	5,233	5,339	5,297

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 to 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 date to the end-of-year and the greater is any mispricing.

The e-o-y 2016 forecast (Table 1a) has slipped a little further to 5,500. Fair value is steady at 5,500 which is well above where we started 2016. The eofy forecast slipped over the week to 5,850.

The index is well above the buy signal of 5,100 ('Low' Jul 1 forecast in Table 1b) but well short of the sell signal. The SPI is flat for Monday.

Chart 1: Graphical representation of Table 1a



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.

Our updated 2016 – and our FY17 – forecasts for the S&P 500 are given in Tables 2a and 2b. Because overnight data are not available to me 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 around 10am on a Saturday.

The eoy forecast has slipped to 2,290. Fair value is 2,190 which is well above that at the start of the year. The S&P 500 is above buy territory on the IOZ:IVV strategy.

The eofy forecast update in Table 2b has slipped to 2,550. The high forecast is 2,620 and the low under normal volatility is up at 2,110.

Table 2a: S&P 500 range forecasts 2016

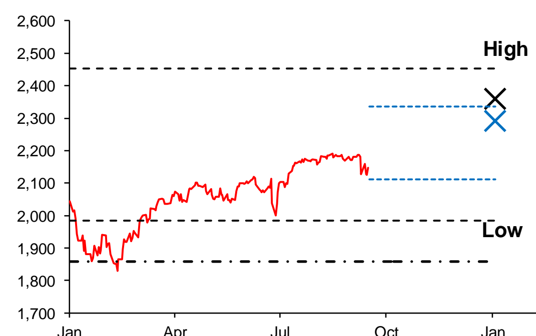
Forecast	Forecast origin		
Cal '16	1-Jan-2016	8-Sep-2016	15-Sep-2016
Low	1,980	2,140	2,110
High	2,450	2,380	2,340
End	2,360	2,320	2,290
Fair value	2,100	2,190	2,190
Exuberance	-3.3%	-0.3%	-2.0%
S&P500	2,044	2,181	2,147

Table 2b: S&P 500 range forecasts FY 2017

Forecast	Forecast origin		
FY '17	1-Jul-2016	8-Sep-2016	15-Sep-2016
Low	2,050	2,140	2,110
High	2,610	2,640	2,620
End	2,530	2,560	2,550
Fair value	2,100	2,190	2,190
Exuberance	-0.8%	-0.3%	-2.0%
S&P500	2,099	2,181	2,147

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 to 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 date to the end-of-year and the greater is any mispricing.

Chart 2: Graphical representation of Table 2a



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.

Market stats

Our market volatility index (Chart A-1 found in the Chart Appendix) is a little above average at 15.9% but it is recovering from a mid-week spike. Our Fear Index (Chart A-2) is a little elevated at 13.9%. The VIX is slowly recovering from 17.5% a week ago to 15.4% overnight. Our Disorder index (Chart A-3) is in the normal range. As a result, conditions are a little too hectic for rebalancing.

Our 12-month capital gains forecast (Chart A-4) is down 1% point to +9.5% over the week. The market is below fair pricing at -3.4% (Chart A-5). So that leaves the adjusted 12-month capital gains' forecast at +13.3%. The comparable 12-month adjusted capital gains forecast for the S&P 500 stands at just above +24%.

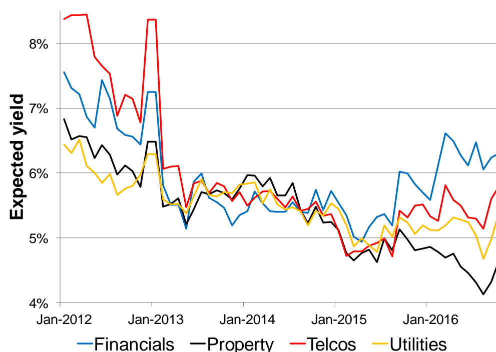
Only one sector (Chart A-6) is currently overpriced. JBH's stellar Friday (after announcing the Good Guys deal) helped Discretionary to +3.7%. Telcos are very cheap at -9.2% as is Energy -12.5%.

Oil prices did fall over -5% over the week so extra care should be taken in the Energy sector. And the TLS buy-back might be distorting signals in the Telco sector.

As can be noted from Dividend Compression (Chart 3), the co-movement we observed for about three years from January 2012 has broken down. The expected yield for Financials is 6.3% plus franking credits and 4.6% for the ASX 200.

The yield play definitely waned during 2016. 'Other' sectors are beating the 'high yield' sector total returns by +14.6% y-t-d. The return on high-yield sectors is below par at -3.0% this year while 'other' has gained +11.6%. Yield seekers have been paying the price. Big dividends are not much use if the capital losses more than offset them!

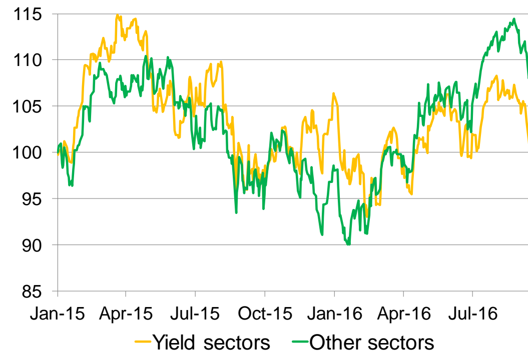
Chart 3: Dividend Compression



Interestingly, there has been a sharp movement up in expected yields this month for Property, Utilities and Telcos. It is hard to know what impact the Telstra buy-back is having on these data.

But Chart 4 shows a more interesting picture. The yield sector lost relative to 'other' around the end of 2015 but the two lines got back together in February but broke free again at the end of June.

Chart 4: Total returns indexes for 'yield' and 'other' aggregated sectors

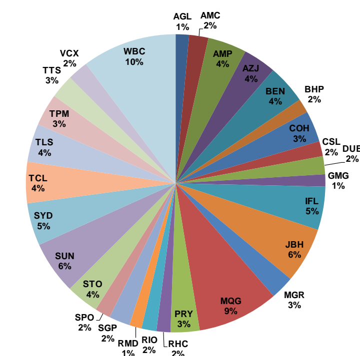


SMSF Share Portfolio

I last rebalanced my SMSF on November 2, 2015. I combined my new Yield Conviction portfolio with a High Conviction portfolio in about equal proportions. The notion behind the strategy is to note that I believed the pure yield play might be soon over. This 50:50 strategy is, in essence, an each-way bet which I intend to keep for the medium term given my sectoral analyses.

There are 29 stocks. My current holdings are given in Chart 5.

Chart 5: Current holdings



The performance of my domestic equities in my SMSF portfolio – including the impact of the March 5th 2015 and the November 2nd rebalances – against the ASX 200 since late June 2014 is shown in Table 3. That corresponds to an outperformance

of +4.0% (annualised). After all of the turbulence of recent times the portfolio is still returning +7.9% pa for more than two years.

Table 3: Annualised returns from SMSF

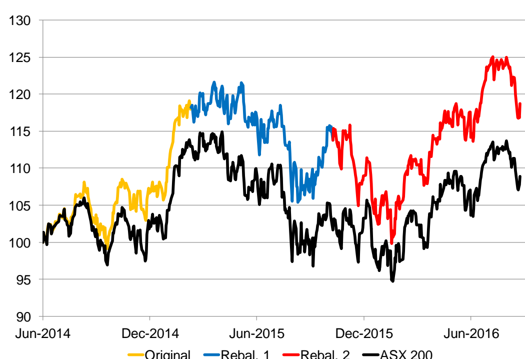
	Portfolio	ASX 200	Alpha
Cap gains	2.4%	-0.9%	3.3%
Tot rets	7.9%	3.9%	4.0%

Note: Since June 25th 2014

The yield on the SMSF has averaged 5.5% (without franking credits) compared to 4.8% for the benchmark.

The returns chart (Chart 6) shows the recent outperformance as well as the trend gains. The period from sometime in November 2015 to sometime in February 2016 was so far the worst for the SMSF.

Chart 6: SMSF and ASX 200 total returns



Note: the different coloured sections show the impact of rebalancing in March and November 2015.

Table 4: Price and current broker forecasts

Sector	Stock	Price	Target	Rec	T/P - 1
Energy	SANTOS	3.48	3.77	2.79	8.3%
Materals	AMCOR	15.30	12.75	2.46	-16.7%
	BHP BILLITON	20.09	15.68	2.65	-22.0%
	RIO TINTO	46.60	42.18	2.44	-9.5%
Industrials	SPOTLESS GROUP HOLDINGS	0.98	1.19	2.80	20.9%
	AURIZON HOLDINGS	4.36	4.65	2.86	6.7%
	SYDNEY AIRPORT	6.60	7.31	2.54	10.8%
	TRANSURBAN GROUP	10.85	12.00	2.50	10.6%
Discretionary	JB HI-FI	30.00	29.50	2.86	-1.7%
	TATTS GROUP	3.86	4.04	2.82	4.5%
Health	COCHLEAR	136.72	121.65	3.09	-11.0%
	CSL	102.90	83.62	2.67	-18.7%
	PRIMARY HEALTH CARE	3.80	4.00	3.17	5.3%
	RAMSAY HEALTH CARE	77.94	80.19	2.40	2.9%
	RESMED CDI.	8.64	7.02	2.33	-18.8%
Financials	AMP	5.36	5.85	2.87	9.1%
	BENDIGO & ADELAIDE BANK	10.23	9.70	3.00	-5.2%
	IOOF HOLDINGS	8.97	8.93	2.58	-0.5%
	MACQUARIE GROUP	81.39	83.00	2.43	2.0%
	SUNCORP GROUP	12.49	13.60	2.50	8.9%
	WESTPAC BANKING	29.59	32.38	2.53	9.4%
Property	GOODMAN GROUP	7.05	7.40	2.64	5.0%
	MIRVAC GROUP	2.18	2.27	2.36	4.1%
	STOCKLAND	4.52	4.85	2.67	7.3%
	VICINITY CENTRES	3.11	3.25	3.09	4.3%
Telcos	TELSTRA	5.10	5.30	3.31	3.9%
	TPG TELECOM	11.84	11.63	2.22	-1.8%
Utilities	AGL ENERGY	17.18	19.51	2.82	13.6%
	DUET GROUP	2.44	2.60	3.00	6.6%

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.

I have decided to try and sell all of my TLS in the buy-back. And I think I'll make a play for JBH in its REO. I am trying to think of some selective selling to cash in order to get a kitty to make some 'cheap' buys.

Table 4 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.

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 2017:*

Buy IOZ at 5,100 from Table 1b (up to maximum levels determined by risk assessments) and start to sell at 6,350 for new investments. If the ASX 200 falls to 4,785 it might be prudent to exit the strategy until clarity emerges and then buy back in at (well) above 4,785 and below 5,100.

For old investments start to take profits (lightly) at 6,150 (the 2016 forecast high in Table 1a) and more aggressively at 6,350.

Buy IVV:IHVV at 2,050 (up to maximum levels determined by risk assessments from Table 2b) and sell at 2,610 for new investments. If the S&P 500 falls to 1,930 it might be prudent to exit the strategy until clarity emerges and then buy back in at (well) above 1,930 and below 2,050.

For old investments start to take profits (lightly) at 2,450 (the 2016 forecast high in Table 2a) and more aggressively at 2,610.

The difference between the price index for the ASX in Chart 7 and the IOZ accumulation index in Chart 11 is more than stunning. Charts 7 to 10 are still based on the price indexes as this is the metric where the signals are being made.

The strategy is performing well at +8.1% pa since inception (Table 5) (including dividends). The IVV-IHVV leg is up +12.0% pa. The IOZ part of the strategy is up +6.3% pa. The table below shows that I am now 60% hedged in the Wall Street component. The domestic share of the portfolio is 48%.

Table 5: Total returns on IOZ:IVV strategy

16-Sep-2016	Inc divs.	Current allocation	
ETF	IRR pa	Total	USA
IOZ	6.3%	48%	
IVV+IHVV	10.0%	52%	100%
IVV	9.4%		40%
IHVV	12.0%		60%
Total	8.1%	100%	
Indexes		Alpha pa	
ASX 200	4.1%	2.2%	
S&P 500	6.1%	3.2%	
S&P 500 ($A)	9.2%	2.8%	

NB: IRR is the internal rate of return (pa) 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) starts on 22/12/2014 when IHVV first became available.

I have also included the benchmarks for each ETF in Table 5 so I can calculate any outperformance from the buying low – selling high strategy.

The Charts 7 to 11 in the strategy section now include a yellow square to show where the hedging trades were made. The red diamonds denote the buys. I have also included a currency chart to show where the hedging trades were made in that metric.

The AUD has fluctuated in a range of about 72c – 78c since I started hedging at 76.0c in late February. Because the $A fell from 78c to 72c before retracing to over 77c, a fleet-of-foot trader might have better performed than my sit and wait philosophy.

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. Indeed, my ASX forecasts have strengthened over the last 12 months. I plan to flag any perceived weaknesses if and as they eventuate. I can't define a composite benchmark as the allocations are expected to evolve over time. But all three components are well ahead!

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) I show both the S&P 500 expressed in $US (unhedged) and $A (hedged).

Chart 7: IOZ buy points - ASX 200

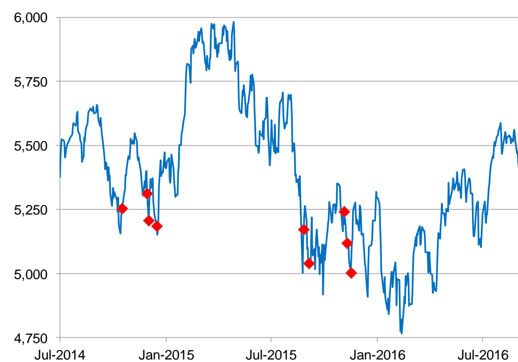


Chart 8: IVV buy points - S&P 500 ($US; hedged)

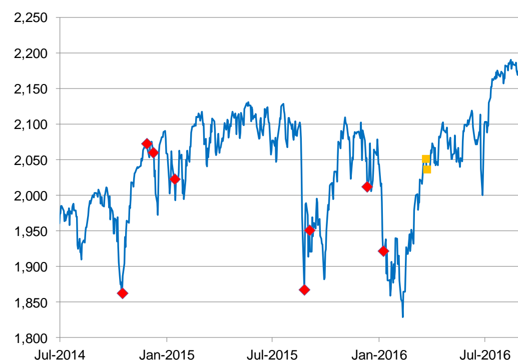


Chart 9: IVV buy points S&P 500 ($A; unhedged)

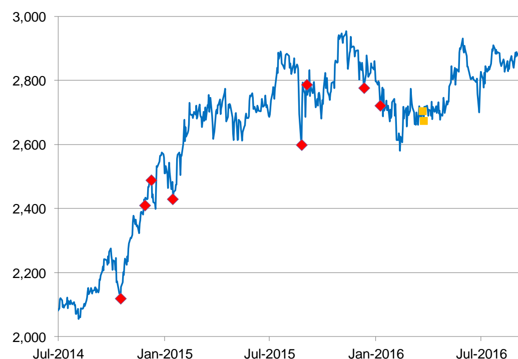


Chart 10: AUD hedging points

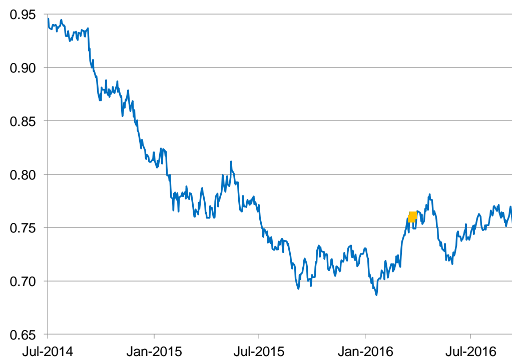
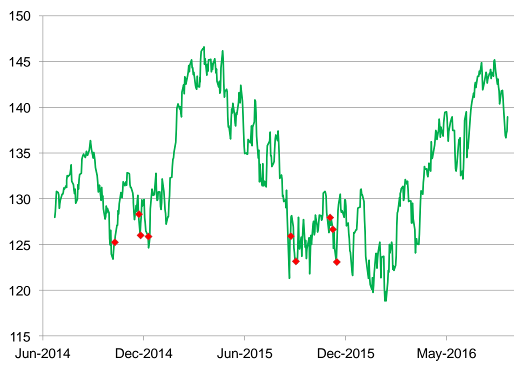


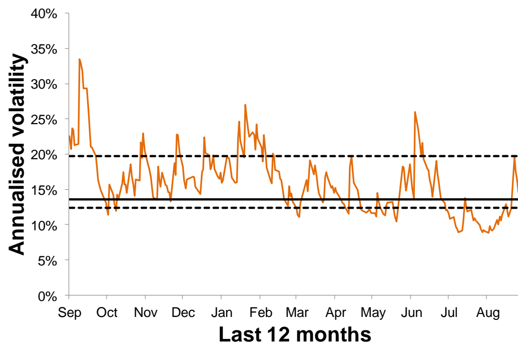
Chart 11: IOZ buy points – IOZ accumulation index



The charts in this strategy section include a yellow square to show where the hedging trades were made. The red diamonds are the buys. There is also a chart to show where the hedging trades were made in the AUD metric.

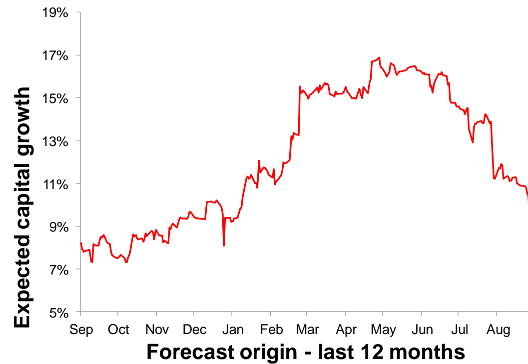
Chart Appendix

Chart A-1: Market volatility



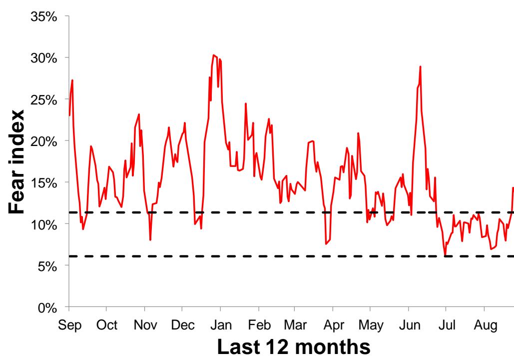
Notes: The solid black line depicts the average volatility since January 2010; the lower dotted line depicts the average volatility pre the GFC; the higher dotted line depicts the average level of volatility during the GFC - up to December 2009. The brown line is a daily estimate of the ASX 200 index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

Chart A-4: 12-month capital gains forecasts



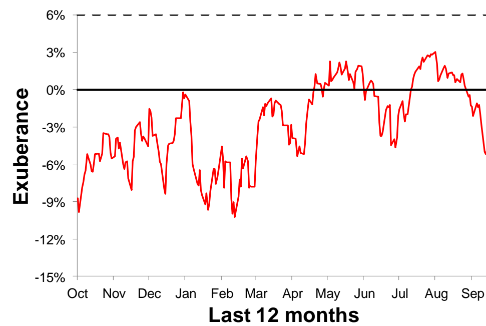
Notes: Each business day we update our estimates for capital gains on the ASX 200 for the following 12 months. For example, the left-most estimate on the vertical axis is a forecast for the 12 months concluding today. The right hand estimate is for the 12 months from today.

Chart A-2: Fear index



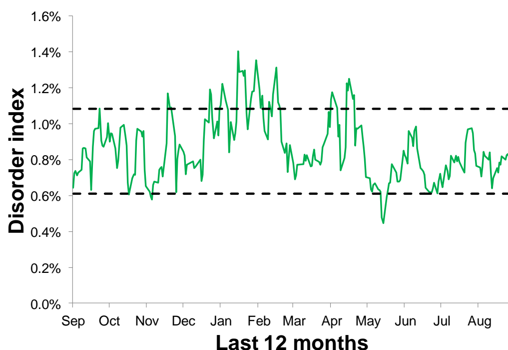
Notes: The fear index is a measure of 'excess' volatility denoting behaviour outside the open/close values each day. The two dotted lines depict the band in which the fear index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate complacency. Extended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



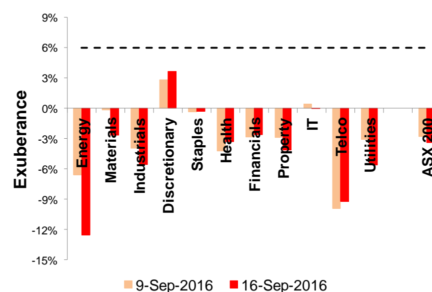
Notes: Exuberance is our measure of mispricing on the ASX 200. A value below the solid black line denotes the market is perceived to be cheap and above that line expensive. Experience suggests that exuberance above +6%, denoted by the dotted line, is an indicator of a potential correction of 6% to 10%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

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!

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.

It appears that any defaults in the shadow banking system would be covered by the Central Bank so there would not be the sort of contagion problems that arose in the US and Europe. However, a serious round of defaults in China would put a bit of a brake on growth.

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.

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 – This 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.

Short-run mispricing – This 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.

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 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.

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

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 – particularly in the context of the tapering discussions.