W IR

10 December 2016

Woodhall's Weekly

Ron Bewley PhD, FASSA

You may not like Trump, but you have to love his market impact!

- **Santa Trump's 757 is on its way to a market near you.**
- **Will we have a recession?**
- **Big data drop next Thursday**

Overview

At the week-ending November 4th 2016, the ASX 200 closed at 5,181. A week – and a Trump victory later – the ASX 200 closed at 5,371. The next day, on the 12th November, I published in this *Weekly*,

"We finished last week so strongly on the ASX 200, it will take something to stop us. Our market is well under-priced and it would be easy for our market to pop again by 2% to 3% just to get back to fair value of 5,500 – and then it can grow from there.

Our January 1st forecast of 5,850 for the end of 2016 is now unlikely – but not impossible. But if it is missed, I would be happy if we make 5,850 in January or early February."

Already the market is 5,561 with fair value at 5,500 and the 5,850 target is now only 5.2% away – and not the 12.9% that was necessary to meet that target from the 4th November close only five weeks ago.

Naturally I am hanging on to my 5,850 e-o-y as I have all year – but what's in a number? The key to success is the investment decisions we make and not the number we forecast. Except for short-term event-plays I have been fully invested during 2016 and I bought more (by borrowing) on the dips.

At the start of the year, you might recall there was substantial gloom around. 2015 ended with the ASX 200 at 5,296 but it dipped sharply to the lowest close (so far!) for 2016 at 4,765 on the 12th February. The China stock market was then in turmoil, Brent oil dropped from $36.43 to a low of $25.91 tempting some big houses then to predict lows of $20 and even $10! Iron ore fell to $39.54. Oil is now around $55 and ore around $80!!! I held steady and increased my Materials holdings in my October 3rd rebalance.

On January 8th Bloomberg TV changed its programming to present a one hour special on the 'market crisis'. On January 12th headlines read that RBS implored us to "Sell everything except high grade government bonds" they were also reported to be predicting that major markets would fall by up to 20%. Morgan Stanley's [Jan 1] eoy-2016 forecast was 4,800; consensus was 5,700 and Credit Suisse's was 6,000.

On January 13th JP Morgan was reported to be urging us to "sell all of the rallies". AMP's Shane Oliver was reported to have cut his e-o-y from 5,700 to 5,500 on January 17th.

While there is a lot of luck in getting any market forecast even in the ball-park, our reasoning turned out to be largely correct: the China stock market was only going through teething problems and the China economy was strong. Oil and ore prices were unsustainably low.

Except for the Fed rate's meeting around the corner and OPEC's ratification meeting next Saturday, it is

Woodhall Investment Research Pty Ltd. (ABN 17 141 486 160); www.woodhall.com.au

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

not likely that we have any major shocks before New Year's Eve. If the Fed does not hike – as we think is the correct decision and might just happen (but probably not) – volatility will be short-lived because the Trump juggernaut will swamp all before its path. OPEC is done and dusted.

Out GDP growth figure came in at a miserable -0.5% for the third quarter – much worse than market expectations – and a miserable +1.8% for the year. The previous quarter misled some (the sheep) to think our economy was strong. A so-so +0.5% for the second quarter translated to a whopping +3.3% on the year because the economy was coming from a low base!

If we take the last two quarters together, the economy averaged only 0.075% per quarter. Not even one tenth of one percent! Haven't we almost had a recession already? So close! Heads in sand!

Having also had 10 consecutive months of negative full-time employment growth I think Phil Lowe – the new RBA governor – will not enjoy his Christmas dinner.

While a second consecutive quarter of negative growth is unlikely – which would be enough to call a recession in simplistic terms (the sheep) – it is far from impossible. Data are noisy. That would make Dr Phil the first RBA governor to preside over a recession in over a quarter of a century. And he's only been in the hot seat for a few months.

Had he cut in the last few months (as I said he should) there would have been much more of a chance of avoiding a recession. At least it would have looked like he was trying! Now his next chance to cut is on February 7th because they all have a nice holiday in January. Oh to be a central banker. And look at their pensions – let alone their salaries. ScoMo only went after us SMSF folk in his new super plans.

Before the RBA stayed on hold last Tuesday, HSBC's Paul Bloxham forecast the next move to be up and that would be in 2018. There are many more like that. I firmly believe – as I have for months – that there will be at least one, if not two cuts, before the RBA starts to hike.

We have a new set of employment numbers out on Thursday at 11:30 (only a few hours after the Fed decision) and things are not looking good on that front, even if the artificially deflated unemployment rate makes the uninformed (sheep) feel good.

I still have a little cash on hand (but I do need to draw a pension sometime) that I could use if we get a wobble. But Thursday is my daughter's birthday and – as I usually do – I'll be spending Thursday with her and my nearly two-year-old grandson. I'm more than happy to wait for Friday or miss an opportunity altogether! Thursday is the focus of every week for me.

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 1a includes a trace of the index to compare with the forecasts highs and lows. And we add the FY17 forecasts in Table 1b.

Table 1a: ASX 200 range forecasts 2016

Forecast	Forecast origin		
CY16	31-Dec-2015	2-Dec-2016	9-Dec-2016
Low	5,100	5,350	5,500
High	6,150	5,550	5,650
End	5,850	5,500	5,600
Fair value	5,350	5,500	5,500
Exuberance	-0.7%	-1.1%	0.9%
ASX 200	5,296	5,444	5,561

Table 1b: ASX 200 range forecasts FY2017

Forecast	Forecast origin		
FY '17	30-Jun-2016	2-Dec-2016	9-Dec-2016
Low	5,100	5,250	5,350
High	6,350	5,950	6,050
End	6,150	5,750	5,800
Fair value	5,350	5,500	5,500
Exuberance	-2.1%	-1.1%	0.9%
ASX 200	5,233	5,444	5,561

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

The e-o-y 2016 forecast (Table 1a) is up to 5,600. Fair value is still 5,500 which is well above where we started 2016 (5,350).

The eofy forecast climbed to 5,800. The SPI is up +17 pts (at 7:30am) for Monday.

Chart 1a: Graphical representation of Table 1a

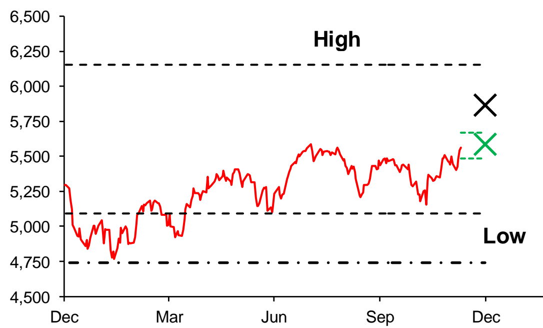
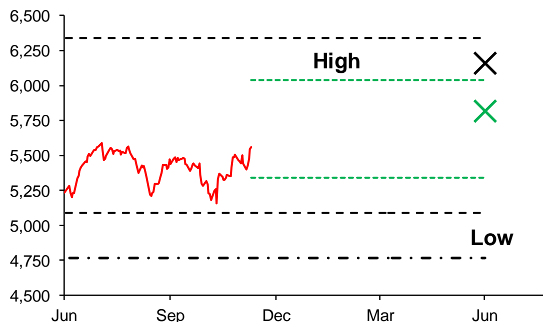


Chart 1b: Graphical representation of Table 1b



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 for the S&P 500 pushed back up to 2,270. Fair value is also well up to 2,250.

The eofy forecast update in Table 2b is 2,460. The high forecast is 2,520 and the low under normal volatility is 2,190.

Table 2a: S&P 500 range forecasts 2016

Forecast	Forecast origin		
CY16	31-Dec-2015	1-Dec-2016	8-Dec-2016
Low	1,980	2,160	2,220
High	2,450	2,250	2,300
End	2,360	2,230	2,270
Fair value	2,100	2,200	2,250
Exuberance	-3.3%	-1.5%	0.6%
ASX 200	2,044	2,191	2,246

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

Forecast	Forecast origin		
FY '17	30-Jun-2016	1-Dec-2016	8-Dec-2016
Low	2,050	2,140	2,190
High	2,610	2,500	2,520
End	2,530	2,440	2,460
Fair value	2,100	2,200	2,250
Exuberance	-0.8%	-1.5%	0.6%
ASX 200	2,099	2,191	2,246

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 2a: Graphical representation of Table 2a

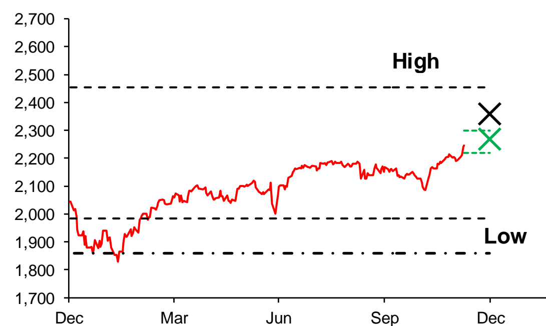
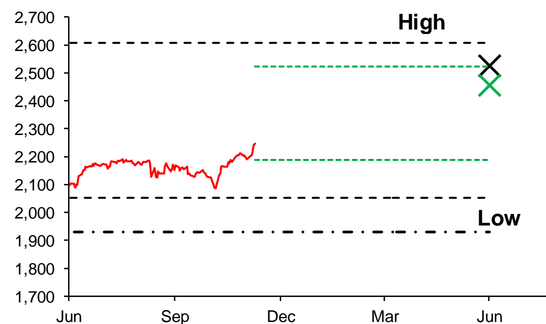


Chart 2b: Graphical representation of Table 2b



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 to be found in the Chart Appendix) is just above normal levels at 13.9%. Our Fear Index (Chart A-2) is in the zone at 9.4%. The VIX stands at 11.9%. Our Disorder index (Chart A-3) is normal high at 0.8%. Conditions remain quite reasonable – outside of those smaller

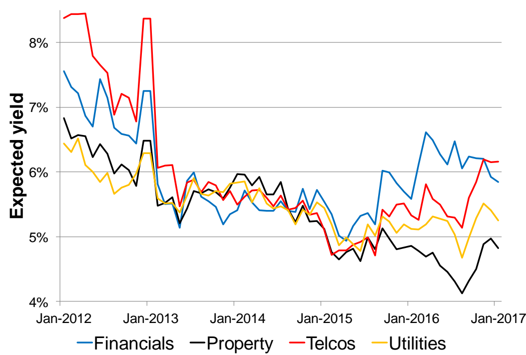
stocks with big P/E's that are being buffeted about on profit downgrades

Our 12-month capital gains forecast (Chart A-4) climbed to 9.4%. The market is just above fair pricing at +0.9% (Chart A-5). So that leaves the adjusted 12-month capital gains' forecast at +8.4%. The comparable 12-month adjusted capital gains forecast for the S&P 500 stands at about +17%.

Sector pricing (Chart A-6) is such that Materials (+3.0 %) and Financials (+5.3%) are the most over-priced. Health (-11.2%) and Telcos (-8.2%) are the cheapest but additional care should be taken with these sectors as high P/E stocks are being brought back in line.

As can be noted from Dividend Compression (Chart 3), the co-movement we observed for about three years from January 2012 broke down. But there has been an interesting move in the last few weeks. They are starting to get back together – but only slowly.

Chart 3: Dividend Compression



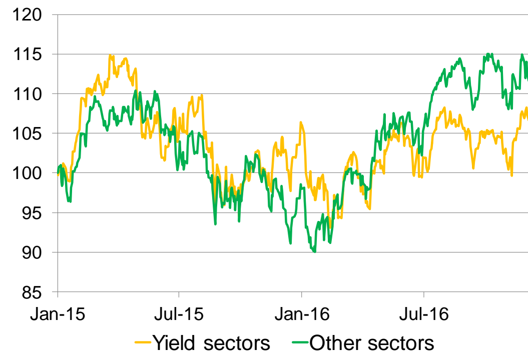
The expected yield for Financials is 5.9% (plus franking credits) and 4.5% for the ASX 200.

The yield play definitely waned during 2016. 'Other' sectors are beating the 'high yield' sector total returns (including dividends) by +11.1% y-t-d which is well down from 15.2% two weeks ago. The return on high-yield sectors is above par at +4.8% (including dividends) this year while 'other' has gained +15.9%.

The yield play has been back in force in the last fortnight and it should be watched. 'Yield' sectors gained 4.1% over 'Other' in two weeks.

Chart 4 shows another 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. It is now almost back up to the green line.

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

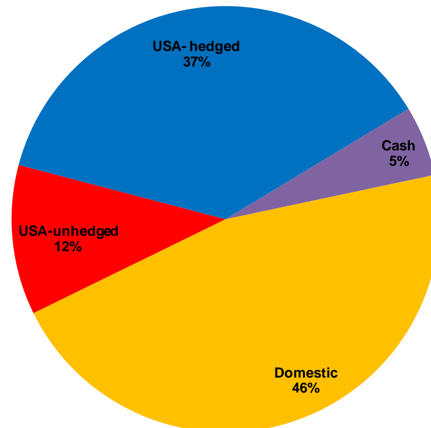


SMSF Share Portfolio

I last rebalanced my domestic share portfolio in my SMSF in the week of October 3rd, 2016. It is 100% High Conviction by my definition. I will keep my narrative on the rebalance in the section just before the Chart Appendix until the next rebalance.

As discussed in the overview, I sold some JBH yesterday to take profits. I am a bit worried about the Amazon story – but not yet enough to sell all.

Special chart: Asset allocation on SMSF



There are currently 22 stocks in my direct equity portfolio. My current holdings are given in Chart 5.

The performance of my domestic equities in my SMSF portfolio – including the impact of the March 5th 2015, the November 2nd 2015 and the October 3rd 2016 rebalances (and the Nov 29 mini-rebalance) – against the ASX 200 since late June 2014 is shown in Table 3a. That corresponds to an outperformance of +3.2% pa (annualised) since

inception. After all of the turbulence of recent times the portfolio is still returning +9.1% pa for over two and a half years in a broadly sideways market (excluding dividends).

Chart 5: Current holdings

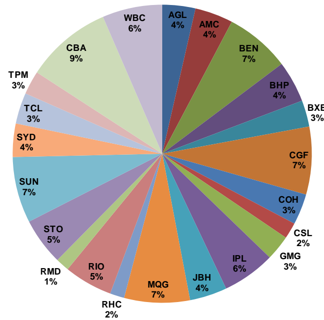


Table 3a: Total returns from SMSF

Period	Portfolio	ASX 200	Alpha
Since inception	9.1%	5.9%	3.2%
2 years	8.9%	7.6%	1.3%
1 year	13.7%	15.3%	-1.6%
6 months	5.4%	6.0%	-0.6%
3 months	3.3%	5.0%	-1.7%

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

In Table 3a I show that the recent 3-months underperformance (-1.7%) has pulled down the return since inception.

In Table 3b I show far more detail on the recent activity to better understand how the rebalance is going. Over the last two months, my SMSF has performed above benchmark at +0.4%.

Table 3b: Recent total returns from SMSF

Period	Portfolio	ASX 200	Alpha
Since Oct rebal	2.6%	2.2%	0.4%
2 month	2.1%	2.3%	-0.2%
1 month	8.4%	8.3%	0.1%
1 week	1.5%	2.2%	-0.6%
1 day	0.4%	0.3%	0.1%

Note: Since June 25th 2014. Returns include dividends.

In Table 4 I show the performance of the individual stocks. The healthcare stocks are under a cloud after a few profit downgrades in other stocks (including Telcos). High P/E stocks are generally being sold off. I'm going to wait. My four health stocks are up from what I paid and I think they are very good at these prices. Of course, selling at the top and buying back in now would have been better.

But, as I keep saying, Harry Hindsight isn't my broker.

JBH is a different kettle of fish. It too has been savaged but I am still about 40% up on what I paid. The issue here is quite specific. Investors are aware they face disruption from Amazon's mooted entry into the market. I decided to take some profits and re-assess the sector going to cash in the interim. It was one of my biggest holdings at 7%. Only CBA was bigger at 9% but BEN, CGF, MQG and SUN were similar at 7%. JBH is now a more modest 4%.

Table 4: Individual stock total returns

	AGL	AMC	BEN	BHP	BXB	CBA	CGF	COH
Return	13.2%	-6.1%	13.1%	11.8%	-3.1%	3.7%	7.0%	-18.2%
Alpha	10.7%	-8.5%	10.7%	9.4%	-5.5%	1.3%	4.6%	-20.6%

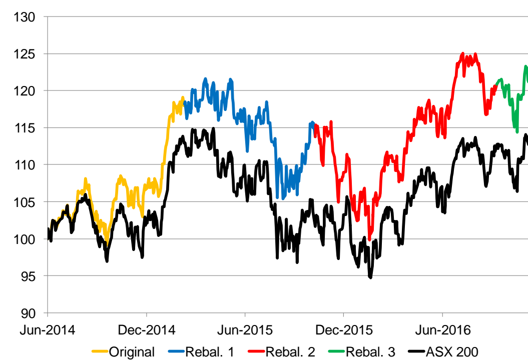
	CSL	GMG	IPL	JBH	MQG	RHC	RIO	RMD
Return	-10.5%	-1.5%	19.4%	-9.6%	2.7%	-14.1%	21.6%	-3.8%
Alpha	-12.9%	-4.0%	17.0%	-12.0%	0.3%	-16.5%	19.2%	-6.2%

	STO	SUN	SYD	TCL	TPM	WBC		ASX 200
Return	10.3%	6.8%	-2.7%	-5.8%	-7.8%	6.7%		2.4%
Alpha	7.8%	4.4%	-5.1%	-8.2%	-10.2%	4.3%		-0.3%

Note: Since October 7th 2016 (except CBA which is from 29th November 216). Returns include dividends. The 'alpha' under ASX 200 is for the portfolio for the same period.

The returns chart (Chart 6) shows the recent performance 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. That's when the yield play took a big hit.

Chart 6: SMSF and ASX 200 total returns



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

Table 5 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 only four stocks with a recommendation at 3.0 or worse: BEN, BHP, CBA, and COH. I argue in the rebalancing section (just before the Chart Appendix) for COH. For a yield stock like BEN, I am not worried by a 'hold' of 3.15 and it is nicely outperforming the benchmark in Table 4. I was

happy to buy CBA as a big, sturdy dividend play at 3.0 with some capital gains' prospects. It's already made some nice gains from Table 4. BHP is fine at 3.0.

Table 5: Price and current broker forecasts

Percentage change over week								
Price	Target Price	Consensus Rec.	Sector	Stock	Price	Target	Rec	T/P - 1
-1.6%	3.2%	5.1%	Energy	SANTOS	4.30	3.70	2.57	-14.1%
1.8%	-6.1%	-0.1%		AMCOR	14.45	12.10	2.46	-16.3%
3.8%	2.1%	-5.3%	Materals	BHP BILLITON	25.98	17.20	3.00	-33.8%
0.3%	0.0%	-0.2%		INCITEC PIVOT	3.38	3.37	2.21	-0.3%
7.9%	4.7%	-1.4%		RIO TINTO	62.65	46.49	2.69	-25.8%
1.8%	-3.7%	3.1%		BRAMBLES	11.82	10.13	2.46	-14.3%
5.1%	-1.3%	-0.2%	Industrials	SYDNEY AIRPORT	6.43	7.15	2.39	11.1%
0.2%	-2.1%	-2.9%		TRANSURBAN GROUP	10.03	11.75	2.43	17.2%
-3.4%	0.0%	0.9%	Discretionary	JB HI-FI	26.17	29.54	2.67	12.9%
-1.2%	2.3%	-0.4%		COCHLEAR	115.52	126.15	3.18	9.2%
-3.1%	-1.4%	-1.8%	Health	CSL	95.00	82.54	2.55	-13.1%
-0.7%	0.5%	2.0%		RAMSAY HEALTH CARE	68.54	80.19	2.33	17.0%
2.1%	-1.8%	-1.4%		RESMED CDI.	8.18	6.73	2.20	-17.7%
1.4%	1.7%	-2.4%		BENDIGO & ADELAIDE BANK	12.45	10.50	3.15	-15.7%
1.1%	4.2%	0.0%		CHALLENGER	11.00	11.02	2.57	0.2%
2.6%	0.0%	0.0%	Financials	COMMONWEALTH BK.OF AUS.	80.67	76.15	3.00	-5.6%
1.2%	0.0%	0.0%		MACQUARIE GROUP	85.24	83.98	2.43	-1.5%
4.8%	0.0%	0.0%		SUNCORP GROUP	13.39	13.55	2.43	1.2%
3.0%	0.0%	-1.1%		WESTPAC BANKING	32.28	32.50	2.47	0.7%
5.4%	0.0%	-0.2%	Property	GOODMAN GROUP	6.84	7.47	2.46	9.2%
6.3%	-5.7%	-0.2%	Telcos	TPG TELECOM	7.41	10.00	2.36	35.0%
0.7%	1.7%	-3.5%	Utilities	AGL ENERGY	21.17	20.85	2.31	-1.5%

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've included a special table below to show the real action in my rebalance over the first few weeks using actual buy and sell prices – and yesterday's closing prices. Those stocks I sold would have lost -0.4% over the two months or so had I not sold – while the buys gained +6.0% when the ETFs are included! That's about a +6.4 % benefit from not having sat on my hands in two months! Incidentally, VOC lost another 10% after I sold.

Special Table: Analysis of rebalancing

Code	Date	Price change
Sell all		
VCX	3/10/2016	-8.6%
SPO	3/10/2016	-11.9%
TTS	3/10/2016	13.1%
PRY	3/10/2016	-4.8%
AMP	3/10/2016	-10.2%
DUE	3/10/2016	11.6%
IFL	3/10/2016	0.2%
AZJ	4/10/2016	9.5%
MGR	4/10/2016	-5.9%
SGP	4/10/2016	-6.8%
Total		**-1.3%**
Sell some		
TCL	3/10/2016	-10.8%
MQG	3/10/2016	3.5%
WBC	3/10/2016	7.2%
SYD	3/10/2016	-7.1%
Total		**2.0%**
Sell total		**-0.4%**

Code	Date	Price change
Buy all		
BXB	4/10/2016	-1.6%
CGF	4/10/2016	6.8%
IPL	4/10/2016	19.9%
VOC - SOLD 29/11/2016		-25.7%
CBA	29/11/2016	3.1%
Total		**2.9%**
Buy more		
AGL	4/10/2016	12.2%
AMC	4/10/2016	-4.0%
BHP	4/10/2016	14.2%
GMG	4/10/2016	-5.3%
RIO	4/10/2016	20.0%
Total		**8.5%**
ETFs:	various	
IHVV	around	**8.2%**
IOZ	election	
Buy total		**6.0%**

Note: The VOC price change is up to the sale price I got on 29th November, 2016 when I sold at 4.52.

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 has been returning +11.4% pa since inception (Table 6) (including dividends). The IVV-IHVV leg is up +13.0% pa. The IOZ part of the strategy is up +9.9% pa. The table below shows that I am now 63% hedged in the Wall Street component. The domestic share of the portfolio is 49%.

Table 6: Total returns on IOZ:IVV strategy

9-Dec-2016	Inc divs.	Current allocation	
ETF	**IRR pa**	**Total**	**USA**
IOZ	9.9%	49%	
IVV+IHVV	13.0%	51%	100%
IVV	10.9%		37%
IHVV	18.4%		63%
Total	11.4%	100%	
Indexes		**Alpha pa**	
ASX 200	6.1%	3.8%	
S&P 500	7.7%	3.2%	
S&P 500 ($A)	11.3%	7.1%	

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 6 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 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 and then down again, a fleet-of-foot trader might have better performed than my sit and wait philosophy. I don't have the energy or the predictive ability!

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

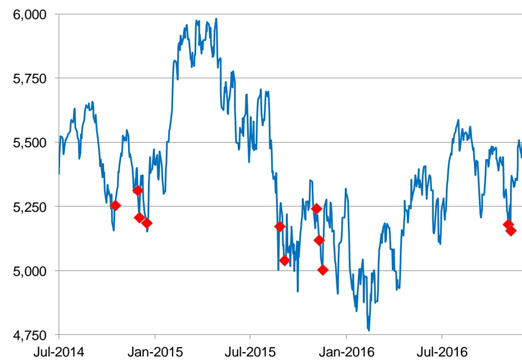


Chart 8: IVV buy points - S&P 500 ($US; hedged)

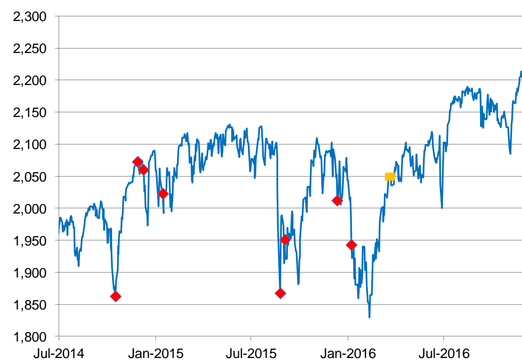


Chart 9: IVV buy points S&P 500 ($A; unhedged)

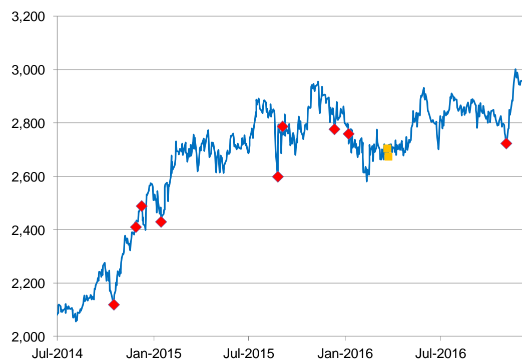


Chart 10: AUD hedging points

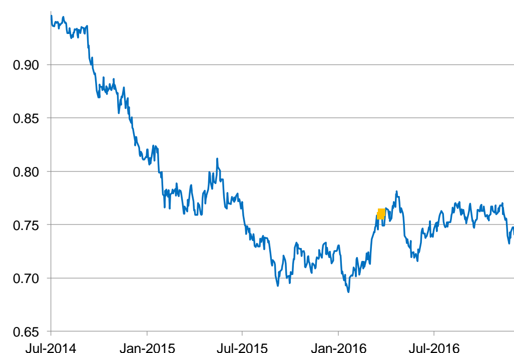
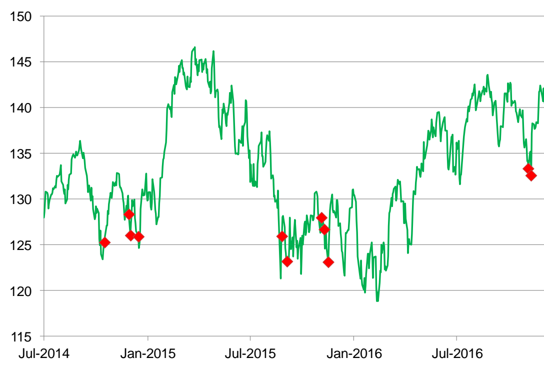


Chart 11: IOZ buys – IOZ accumulation index



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.

The October 2016 rebalance

After thinking about it for six months, I finally started the process of rebalancing on Monday, October 3rd – one month short of a year since the previous rebalance.

With the Monday being a holiday in NSW, I was particularly surprised by the strength of the market. I decided to do most of the 'sells' that afternoon and leave the buys to another day. In the table below, I show the new Conviction portfolio I had produced over the long weekend in my regular monthly update. The right panel shows my September 30th portfolio and weights.

Table: The rebalancing proposition

Conviction portfolio		Old portfolio	
Code	**share**	**Code**	**share**
AGL	3.50%	AGL	1.59%
ALL	7.24%	AMC	2.05%
AMC	4.66%	AMP	4.10%
BHP	4.25%	AZJ	3.82%
BOQ	6.49%	BEN	4.42%
BXB	3.13%	BHP	1.68%
CGF	7.28%	COH	3.47%
CSL	3.04%	CSL	1.67%
GMG	3.16%	DUE	2.00%
IPL	5.14%	GMG	1.36%
MQG	7.50%	IFL	4.50%
ORG	2.89%	JBH	5.78%
RHC	3.34%	MGR	2.60%
RIO	4.70%	MQG	8.78%
RMD	3.60%	PRY	3.24%
SUN	6.86%	RHC	1.53%
SYD	3.42%	RIO	1.77%
TCL	3.37%	RMD	1.30%
VOC	6.93%	SGP	2.37%
WBC	6.77%	SPO	1.83%
WPL	2.74%	STO	3.64%
		SUN	5.51%
		SYD	4.83%
		TCL	4.64%
		TLS	4.17%
		TPM	2.53%
		TTS	2.42%
		VCX	2.26%
		WBC	10.12%

I had a number of particular considerations to take into account. My old portfolio was a 50:50 blend of my Conviction and Hybrid Yield November 2015 portfolios. Since I decided to go 100% conviction this time around, there was going to be a lot of selling. I also wanted to hold about 20% cash – most unusual for me.

Part of the reason for holding cash was to have a buffer going into the US Presidential elections next month – and part was because I want to invest in my High Octane portfolio. Since I have never invested in an octane portfolio before, I wanted a breather first. Octane – to me – requires quite a few stocks and an emphasis on market timing. More of that next week!

If I did not have a legacy portfolio, I possibly would have just bought the one in the left panel of the table. I chose to modify it because I have come to learn quite a bit about my existing stocks – so I made some substitutions – and it reduced transaction costs and effort.

I had already placed a request to sell all of my TLS in the buy-back offer. That transaction will not be completed until Tuesday 11th October. Since I do not yet know how many stocks they will buy, nor for how much, I decided to assume all will be sold and the proceeds will be added to the 20% cash – and I'll sort it all out later. I also am in the hunt for some extra JBH following their capital raising that hasn't yet arrived.

I chose not to substitute ALL for JBH in my Discretionary holding as the conviction portfolio dictates. I got attached to JBH. Also ALL (gambling) always worries me because of the chance of changes to regulation – and I vividly remember when the stock plunged over 10 years ago when it lost just one big contract in South American.

While I am in stocks for the long-haul, it will take some time to assess whether it was a wise move not to switch. In the first week (from Sep 30th to Oct 7th) ALL was up +4.2% against -0.1% for JBH. Not enough to sting (too much) – but I can always change my mind later! I think it is fine to rebalance just one stock in such circumstances. ALL does have a very strong recommendation at 2.0 – but that doesn't allow for my perception of its risk.

I also chose not to substitute BOQ for BEN. Both are regional banks but I am also holding the Queensland-based SUN. A little 'regional' diversification! In the first week, BOQ was down -2.8% after a moderate report while BEN was up +2.2%. I'm happy with that and it cancels the ALL:JBH play. Moreover, BEN is about to offer a share purchase plan that might be attractive.

I refuse to sell my COH! I have done so well backing that one for years when it was very unloved by brokers. I bought several times under $60 and sold most above $80. With current prices over $140, this last parcel is 'for the manager'. This meant I did not add to CSL, RHC and RMD as my model portfolio recommended. In the first week, COH was up +0.5% while the other three Health stocks are mixed: CSL (-0.6%), RHC (+1.1%) and RMD (+0.8%). Not much in it overall.

I also held on to STO. It is a bit of a risky stock but I like its chances against ORG and WPL. So no substitution there either. In the first week, STO was up +8.0% while the others were up a little less: ORG (+3.7%) and WPL (+4.3%). Got lucky there!

My final substitution was in the Telco space. My TLS will be sold soon – if only partially – and VOC was the putative substitute. TPM and VOC both took hammerings in recent times. I think the TPM fall was over-done on what didn't seem like a bad report. Therefore, I kept TPM and bought enough VOC to fill the Telco void once TLS has gone. That's about 50:50 TPM:VOC. When in doubt diversify more! VOC fell -10.0% while TPM fell -5.8%.

So, on Monday's rising tide I sold all of my holdings in AMP, DUE, IFL, PRY, SPO, TTS, VCX and the overweight part of MQG, SYD, TCL and WBC.

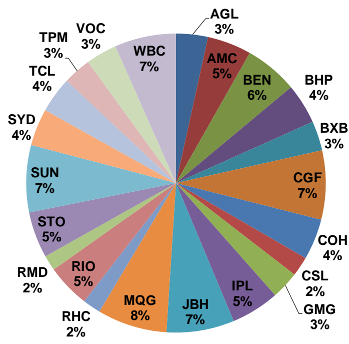
On Tuesday, the market fell so I bought all of my BXB, CGF, IPL and VOC. I topped up AGL, AMC, BHP, GMG, and RIO. I sold AZJ, MGR and SGP. That's 23 trades in two sessions!

I chose not to make some other trades as brokerage does not make small transactions economical – and the paperwork for tax records gets unnecessarily burdensome. I also took capital gains' calculations into account in a similar fashion.

Since I don't transact at closing prices, I wanted to evaluate my performance in making these transactions. As it happens, I sold 58% more than I bought – to generate my cash holding. The sells by the end of the week fell -0.8% while the 'buys' have fallen -0.3%. Not much in it – just a little bit ahead!

The new composition of my portfolio without the cash and TLS at the close on October 7th 2016 is in the following pie chart.

Chart: New portfolio after rebalance



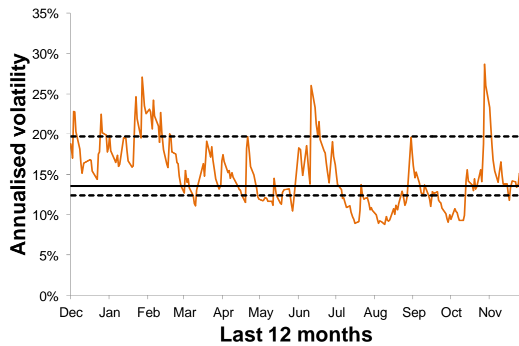
The changes in sector weights are shown in the table below. The biggest change is the increase in exposure to Materials which was offset by falls in Industrials, Financials and Property. Although the percentage point increase in Utilities is small, it does represent a doubling of the exposure.

Table: Sector weights at October 7th 2016

Sector	New	Old	Change
Energy	5.0%	3.6%	1.3%
Materials	22.2%	9.3%	12.9%
Industrials	7.9%	11.3%	-3.4%
Discretionary	7.3%	8.2%	-0.9%
Health	10.1%	11.2%	-1.1%
Financials	34.6%	37.4%	-2.8%
Property	3.0%	10.6%	-7.6%
Telco	6.4%	6.4%	0.0%
Utilities	3.4%	1.6%	1.8%

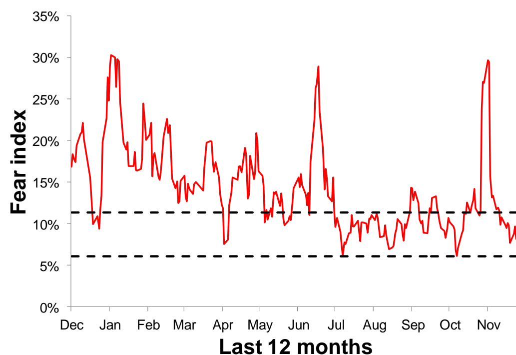
Chart Appendix

Chart A-1: Market volatility



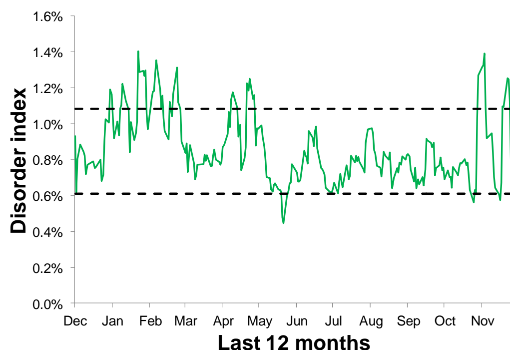
Notes: The solid black line depicts the average volatility since January 2010; the lower dotted line depicts the average volatility pre the GFC; the higher dotted line depicts the average level of volatility during the GFC - up to December 2009. The brown line is a daily estimate of the ASX 200 index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

Chart A-2: Fear index



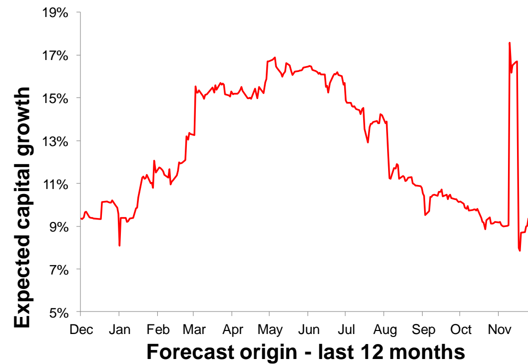
Notes: The fear index is a measure of 'excess' volatility denoting behaviour outside the open/close values each day. The two dotted lines depict the band in which the fear index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate complacency. Extended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



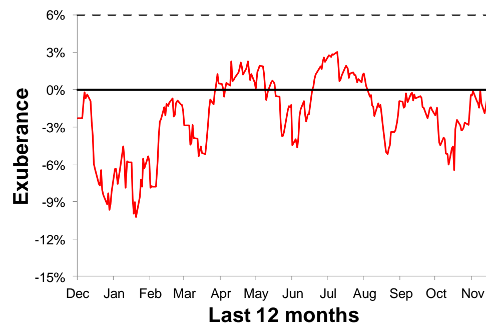
Notes: The disorder index measures the degree to which the 11 sectors' daily returns move in harmony. The two dotted lines depict the band in which the disorder index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate belief that there is little 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



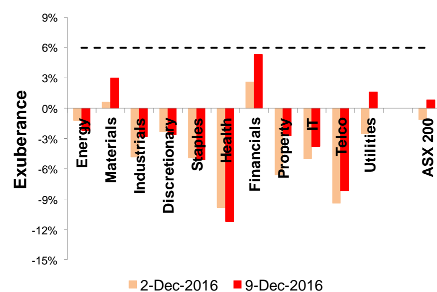
Notes: Each business day we update our estimates for capital gains on the ASX 200 for the following 12 months. For example, the left-most estimate on the vertical axis is a forecast for the 12 months concluding today. The right hand estimate is for the 12 months from today.

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!!!

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