9 March 2013

Woodhall's Weekly

Ron Bewley PhD, FASSA

Individual sectors are out of kilter. Only Materials are cheap (-5.1%) and five of the sectors – the usual suspects these days – are very expensive being priced by our exuberance measure at well over +6%. Interestingly, China released its trade data yesterday and there were some interesting features. It is always hard to judge January and February data from China because the Lunar New Year moves around like Easter. But exports were up 21.8% on the year before but imports were down -15.2%. However, taken in aggregate with January, these data were very strong. An official forecast of 8.3% GDP growth for Q1 was put out there and that is a very solid number from the world's second biggest economy. But investors seem a little to risk averse at the moment to follow that lead.

Market volatility (Chart 1) almost got back to normal levels yesterday and our Fear Index (Chart 2) remained in the normal zone. Our Disorder Index (Chart 3) also remains in the normal zone but is elevated compared to previous months. This flick in disorder seems be to the dividend play that appears to be dominating market moves – and, of course, to stocks selectively going ex-div.

With analysts having had a reasonable chance to update their models following the reporting season, we note from Chart 4 that, after an initial slight drop in February, our 12-month-ahead capital gains forecasts have picked back up to the mid 12% range.

At home, our GDP read for Q4 came in line with modest expectations at +0.6% making it 3.1% for the year. Rates unsurprisingly remained unchanged at 3%. The ECB and the BoE also kept rates on hold.

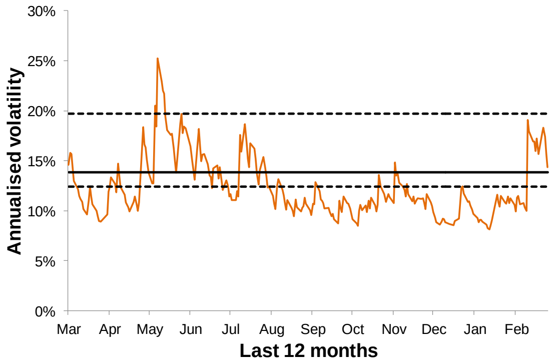
China has been complaining that three big miners had been manipulating iron ore spot prices. We suggested at the time China did just that in September last year and at the end of 2008. When big players meet big players in a market place who knows what really happens but the spot price is still high in the mid $140 a ton range.

The US provided the most exciting data this week – and given what China did – that is no mean feat. Consumer credit data was well up focusing on cars and education. Initial jobless claims came in at a six week low (340,000 against a forecast of 355,000) but overnight nonfarm payrolls came in at a whopping 236,000 given the forecast of 165,000. Furthermore hours worked went up across the board and unemployment fell to 7.7% from 7.9%.

So what for the market in coming weeks? It is hard to see much growth in the overheated sectors as the expected yield is now down to about 5.4%. But equally, it is hard to see a panic withdrawal from those sectors. Perhaps good data from China over the weekend will encourage investors into Materials stocks to erode some of the -5.1% mispricing.

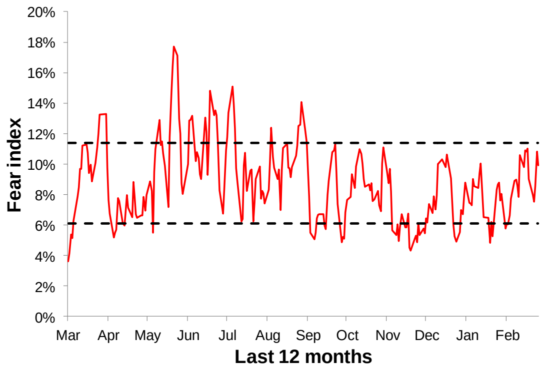
Woodhall Investment Research Pty Ltd. (ABN 17 141 486 160); www.woodhall.com.au

Chart 1: Market volatility



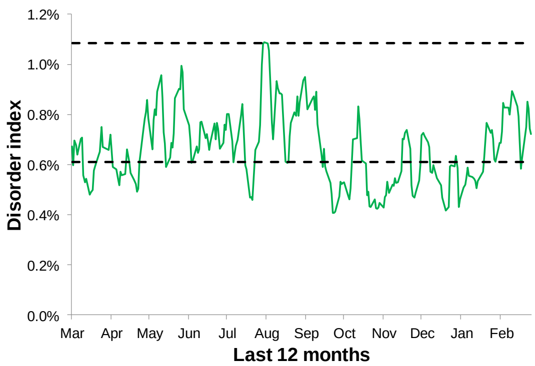
Notes: The solid black line depicts the average volatility since January 2010; the lower dotted line depicts the average volatility pre the GFC; the higher dotted line depicts the average level of volatility during the GFC - up to December 2009. The brown line is a daily estimate of the ASX 200 index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

Chart 2: Fear index



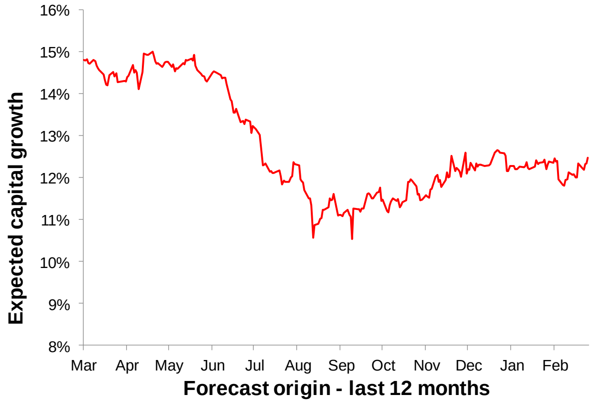
Notes: The fear index is a measure of 'excess' volatility denoting behaviour outside the open/close values each day. The two dotted lines depict the band in which the fear index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate complacency. Extended 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 3: Disorder index



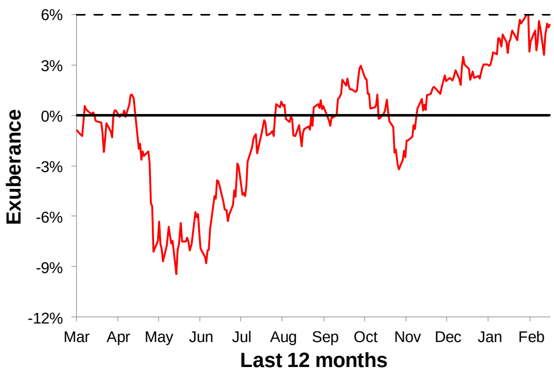
Notes: The disorder index measures the degree to which the 11 sectors' daily returns move in harmony. The two dotted lines depict the band in which the disorder index resided before the GFC in two thirds of days. Extended periods below the lower dotted line might indicate belief that there is little 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 4: 12-month-ahead capital gains forecasts



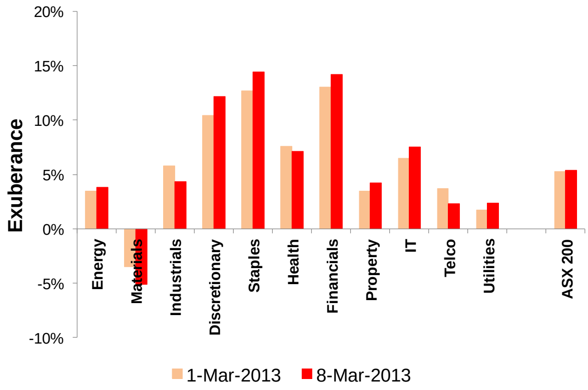
Notes: Each business day we update our estimates for capital gains on the ASX 200 for the following 12 months. For example, the left-most estimate on the vertical axis is a forecast for the 12 months concluding today. The right hand estimate is for the 12 months from today.

Chart 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 an extended period for the market to move sideways for an extended period.

Chart 6: Sector exuberance



Notes: The estimates in this chart are based on the same notions as for Chart 5. More detailed information on mispricing is contained in our companion weekly publication in the same section of our website