28 April 2012

Woodhall's Weekly

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Key points

Volatility: The ASX 200 was flat over the week while the S&P 500 charged back above 1,400 for a 1.8% gain. Volatility remains at normal levels - which is great - but it would also be great to follow these leads better.

Fear: Our measure of fear - or irrational volatility - hung around the lower end of the normal range.

Disorder: Disorder - a measure of the lack of similarity in returns across sectors of the market - stayed around the lower tramline. Controlled fear and disorder is, in our opinion, a necessary condition for the market to sustain this rally.

Capital gains forecasts: Our forecast for the next 12 months climbed back above 15% from 14.5%. Last week's treatment on mining services stocks did not yet translate into profit downgrades.

Market exuberance: Exuberance for the market finished again at about par. Perhaps the market is waiting for some direction from the RBA on rates next week. The slightly softer US GDP growth - at 2.2% - might encourage the Federal Reserve to give more thought to QE 3.

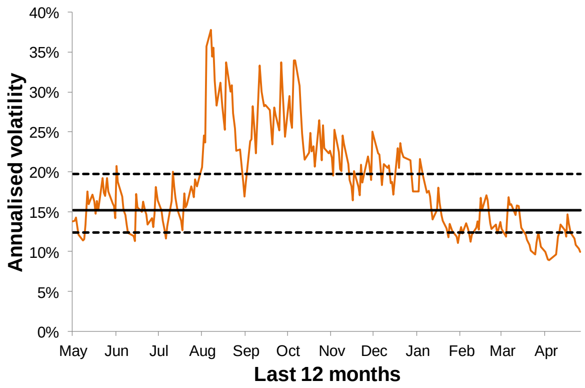
Sectoral exuberance: The Materials sector slipped further to -7.5% from -5.1%. Friday's sell-off on CSL helped the Health sector to retreat from the trigger point of 6% to a more comfortable 5.2%. Telco's exuberance jumped from 2.6% to 6.1% overpricing - a bit too hot to handle!

Summary: The US economy slowed a little in the first quarter - from 3% to 2.2% annualised. Too strong to fear a double dip but not enough to make big inroads into their unemployment. Their consumer spend remained strong - it was just inventories that lagged behind.

Australia seems to be staking its future on one or more interest rate cuts. No one seems to be articulating how this will work. Is it just blind faith in textbook economics? An austere budget could knock the market after a brief post RBA rate cut. While it might not help, it does seem close to inevitable now.

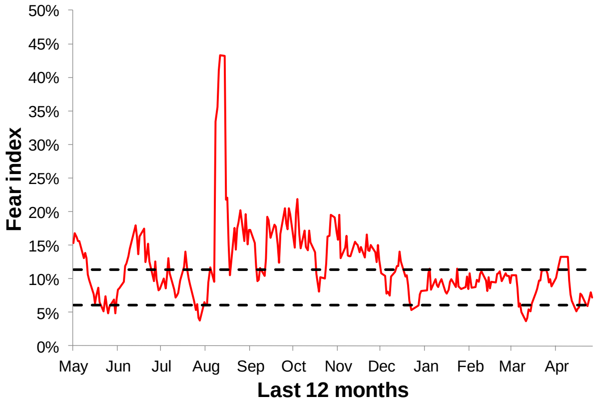
All data are sourced from Thomson Reuters Datastream.

Chart 1: Daily volatility



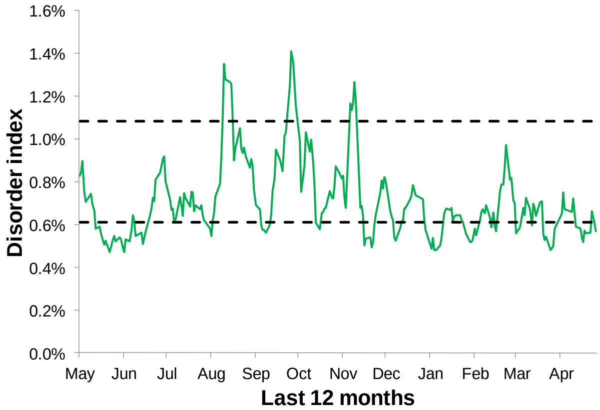
Notes: The solid black line denotes the current average volatility since January 2010; the lower dotted line denotes the average volatility pre GFC; the upper dotted line denotes average volatility during the GFC.

Chart 2: The fear index

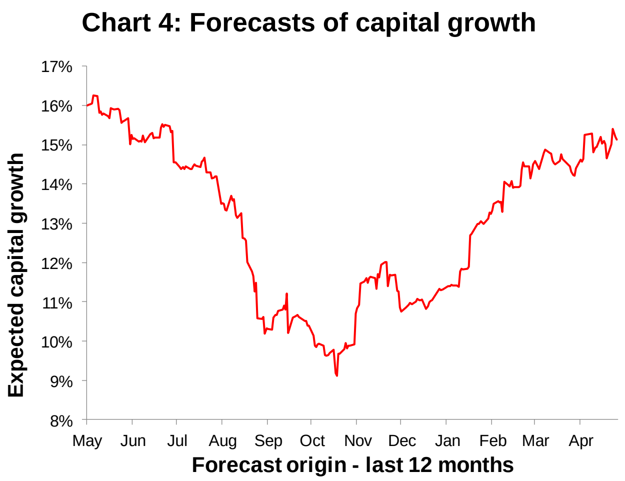


Notes: The two dotted lines denote the range where fear resided pre-GFC for two thirds of the time

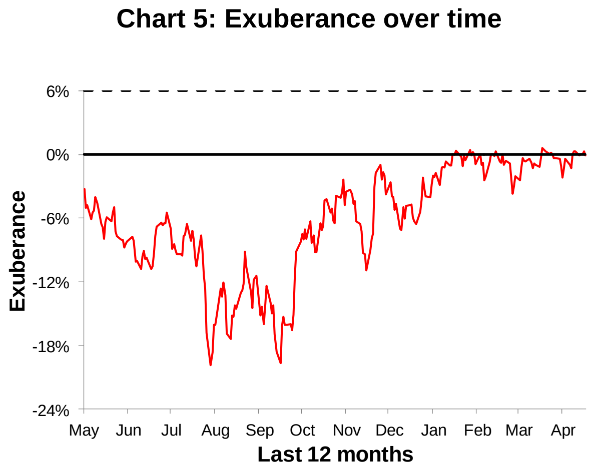
Chart 3: The disorder index



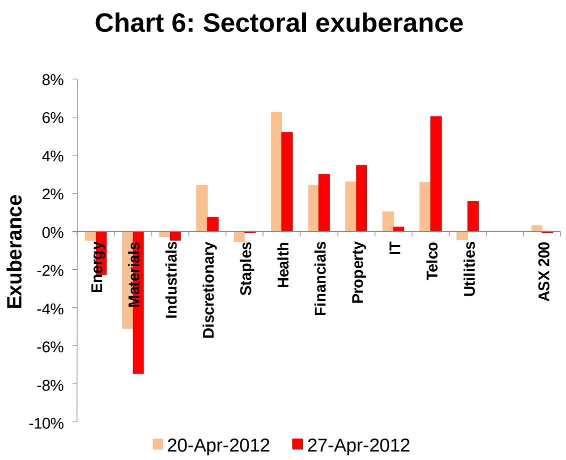
Notes: The two dotted lines denote the range where disorder resided pre-GFC for two thirds of the time.



Note: These forecasts are updated daily for the following 12 months. Dividends should also be taken into account when assessing possible performance.



Notes: 0% represents 'fair pricing' and the dotted line at 6% represents possible overheating preceding a correction. Cheap markets (below the 0% line) can get a lot cheaper before they recover!



Notes: Our *Guide to Woodhall's Publications* should be consulted for a better understanding of how all six charts are constructed.