13 October 2012

Woodhall's Weekly

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After a stellar week to start October, last week was flat as it consolidated.. Only the IT sector - down -2.6% - produced some action. On the other hand, the S&P 500 - down -2.2% on the week - had its worst week in four months as their earnings season which just got underway did less than excite.

The big turnaround story was the price of iron ore. After most having written off the China growth story, the Chinese came back from their 'golden week' holiday and iron ore prices shot up 7% and 6% in consecutive days pushing the price back to $117 after a low of $87 in September. Sam Walsh - chairman of RIO - finished the week in an article in the AFRs glossy saying there is plenty of growth left yet. The World Bank, in all of its wisdom - revised its forecasts for the world and pencilled China in for 7.7% in 2012 and 8.2% for 2013. Isn't this scenario better than the one the world asked for when China was overheating? Some people are never happy.

As the US hurtles towards a very closely contested Presidential election, one former CEO claimed their statistical agency was fudging the data to make unemployment look good for the election. This week there was a major downside first jobless claims figure on top of that but it seems that one state - probably California - couldn't get the right data in time. The Bloomberg market surprise indicator is showing a strengthening US economy.

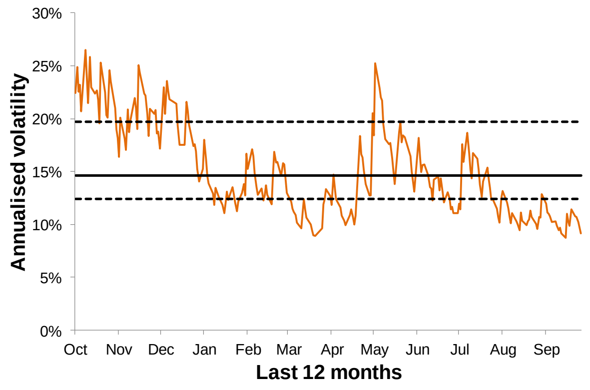
At home, the government rejoiced in unemployment going up from 5.2% to 5.4% as it showed people were prepared to look for work. Employment was up 14,500 but down in part time work. It is not clear how the RBA will react to this data, if at all, on Melbourne Cup Day.

Volatility in our market remains very low - which is a strong sign - and our fear and disorder indexes also look really good. Our market is a little overpriced by our exuberance measure at +1.6% but the Health sector continues to defy gravity at +8.0%. There are few bargains left with the cheapest sector, Industrials, being priced at -2.6%. The danger here for some investors is that if the China story strengthens - as we think it will - investors will move back into the resources sector and, therefore, will have to sell some defensives or reduce cash holdings.

The US market is priced at par with no sectors looking problematic. Both the S&P 500 and the ASX 200 price indexes are expected by us to grow by about 11.5% over the next 12 months but, of course, our dividend yields are about double those of the S&P 500.

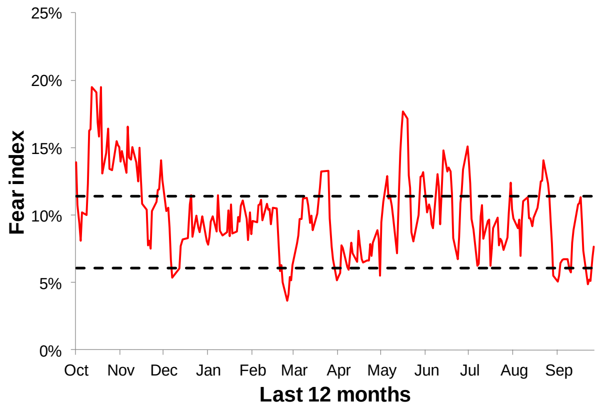
There is a plethora of data due out of China this week. Over the weekend we get trade data followed by inflation, GDP growth and Industrial Production. Earnings' season continues in the US so there will be plenty of news to assimilate. Since we think China has already bottomed, there could be some good news from there but the US is unlikely to excite. After all, the 'Fiscal Cliff' looms large (tax changes coming into force) before the end of the year. At least the noises from Europe remain a little subdued.

Chart 1: Daily volatility - ASX 200



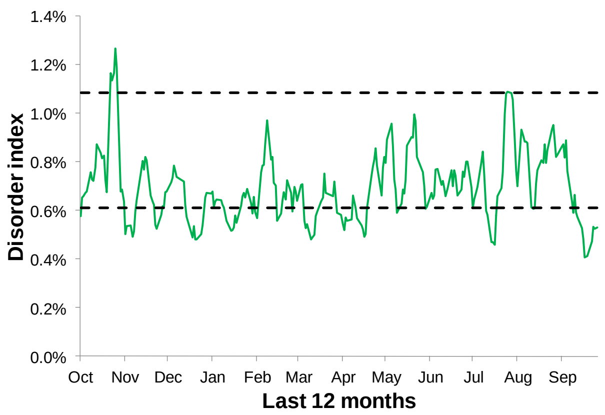
Notes: The solid black line denotes the current average volatility since January 2010; the lower dotted line denotes the average volatility pre GFC; the upper dotted line denotes average volatility during the GFC.

Chart 2: The fear index - ASX 200



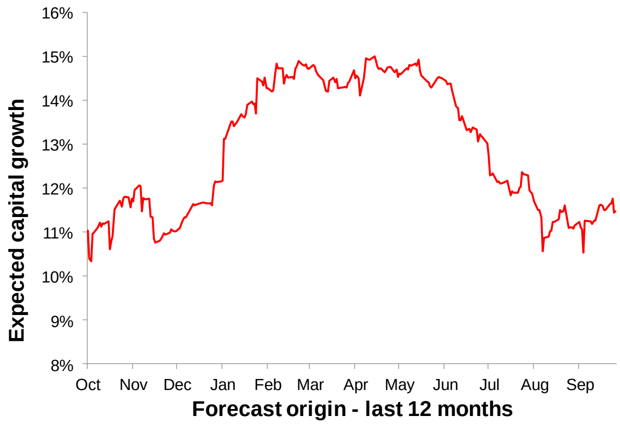
Notes: The two dotted lines denote the range where fear resided pre-GFC for two thirds of the time

Chart 3: The disorder index - ASX 200



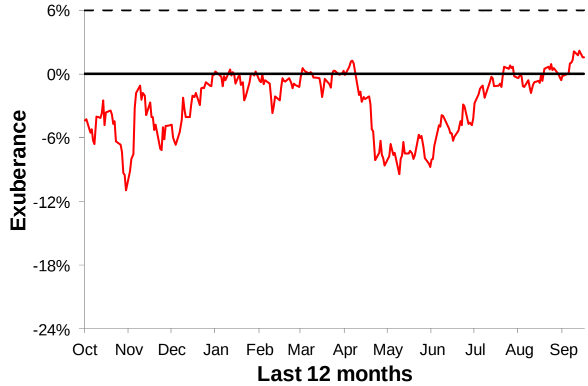
Notes: The two dotted lines denote the range where disorder resided pre-GFC for two thirds of the time.

Chart 4: Forecasts of capital growth - ASX 200



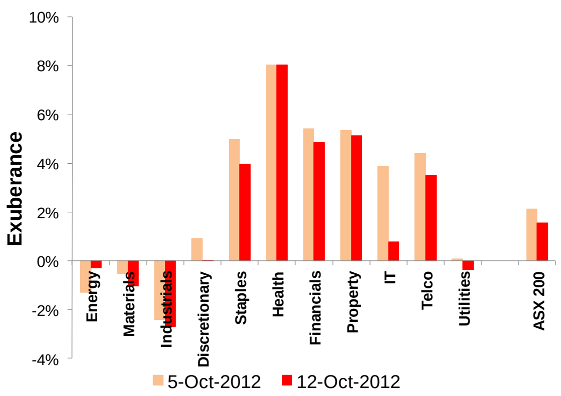
Note: These forecasts are updated daily for the following 12 months. Dividends should also be taken into account when assessing possible performance.

Chart 5: Exuberance over time - ASX 200



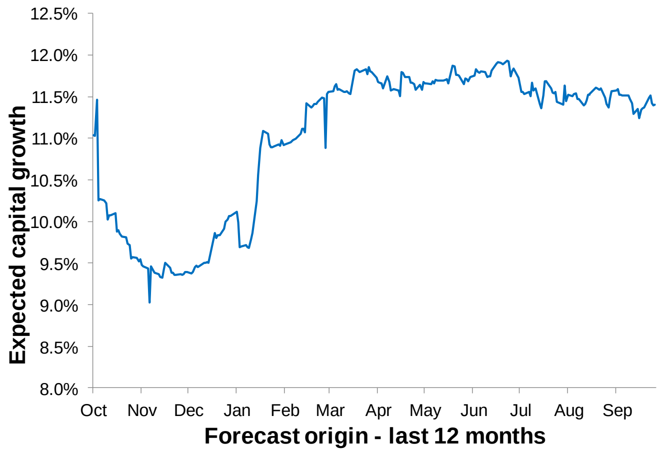
Notes: 0% represents 'fair pricing' and the dotted line at 6% represents possible overheating preceding a correction. Cheap markets (below the 0% line) can get a lot cheaper before they recover!

Chart 6: Sectoral exuberance - ASX 200



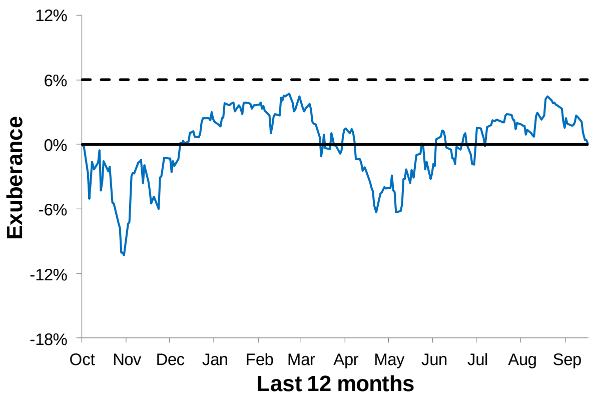
Notes: Our *Guide to Woodhall's Publications* should be consulted for a better understanding of how all nine charts are constructed.

Chart 7: Forecasts of capital growth - S&P 500



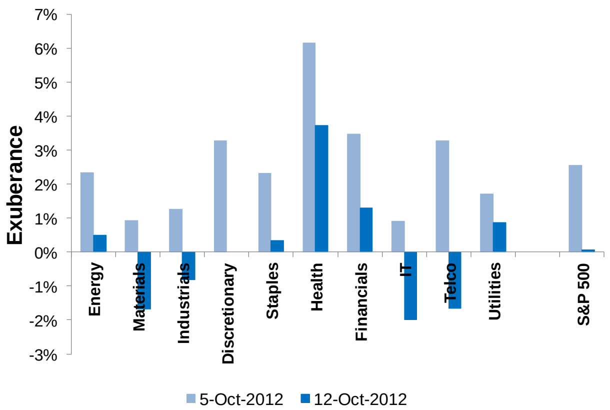
Note: These forecasts are updated daily for the following 12 months. Dividends should also be taken into account when assessing possible performance.

Chart 8: Exuberance over time - S&P 500



Note: 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!

Chart 9: Sectoral exuberance - S&P 500



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