24 November 2012

Woodhall's Weekly

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Markets reacted to news very positively this week. Thanksgiving took some time out of the S&P 500 but it still broke back through 1,400 and the Dow through 13,000 in a Black Friday surge (so called as the first day of holiday shopping to put stores back in the black).

We had a lot to cheer about. The Fiscal Cliff worriers took comfort from negotiations, a cease fire in Gaza, German business confidence took an unexpected jump, Bloomberg's confidence reading for the US was the best in a decade, HSBCs preliminary PMI read for China's manufacturing was back above 50 (at 50.4) for the first time in 13 months. France did lose its AAA rating by one notch, but in a week of festivities, no one really seemed to care.

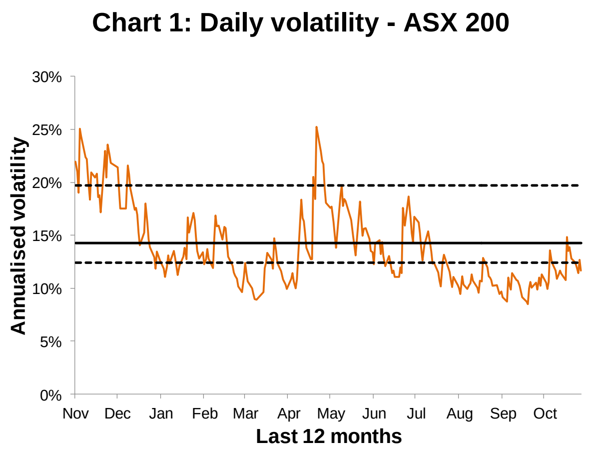
Our market gained 1.8% for the week reducing mispricing for the index to -1.5%. However, that left Telcos exposed with its 3.5% sector gain producing overpricing by 8.4% (Chart 6). Our 12-month ahead forecast for that sector is now less than 1% capital gain. The next impact of current overpricing and flat expectations does not bode well for the sector, even though expected yields remain strong.

The capital gains forecast for the ASX 200 continues to strengthen (at 11.8%) so the market is looking good, particularly at the Fear, Disorder and Volatility indexes (Charts 1-3) are very much in the zone to back a rally. At 4,413, we price the ASX 200 currently at 4,480 and the growth forecasts take the index to 4,520 for the end of the year. However, the current mood could well lead to a rally with a run into overpricing of a few percent. Whichever way, the current 8.8% year-to-date on the index does not need much help to make for a very respectable result for the year.

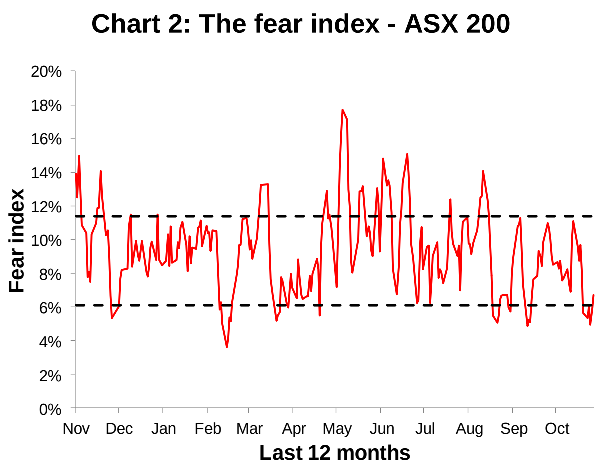
The sectors to watch remain in the resources-related camp. They are all underpriced: Energy (-6.3%), Materials (-4.5%) and Industrials (-5.1%). Their capital gains forecasts for the next 12 months are all strong.

At home, there is not much happening on the economic front but Julia Gillard must be finding it tough in the rummaging through correspondence from her days in law practice. The RBA did not cut rates in November but it is poised to do so if necessary. With the China freight train gaining momentum, that may not be necessary.

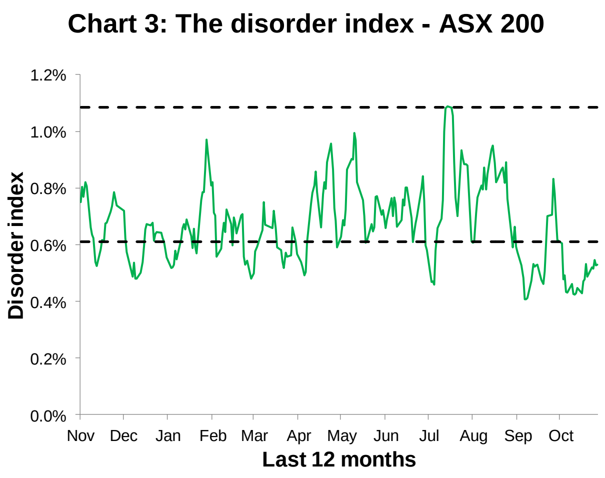
Since the official China PMI is usually bigger than the flash HSBC read, there could be some excitement when it is released at the start of next month. The last three months (August, September, October) have been gaining momentum at 49.2, 49.8 and 50.2. The flash PMI went up from 49.1 to 50.2 so an official read over 51 is not out of the question. If it does, China related sectors might have their underpricing eroded very quickly - and a rally into New year could still see that 4,600 handle.



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.

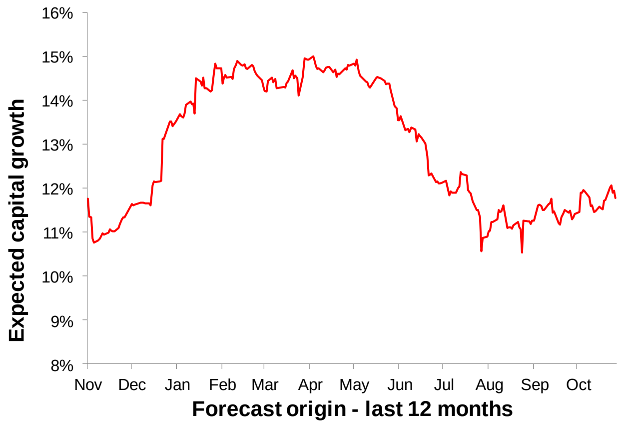


Notes: The two dotted lines denote the range where fear resided pre-GFC for two thirds of the time



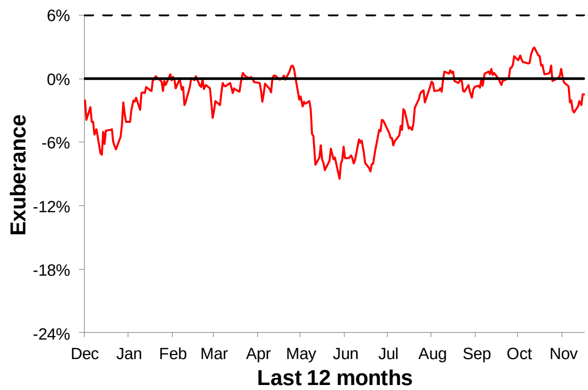
Notes: The two dotted lines denote the range where disorder resided pre-GFC for two thirds of the time.

Chart 4: Forecasts of capital growth - ASX 200



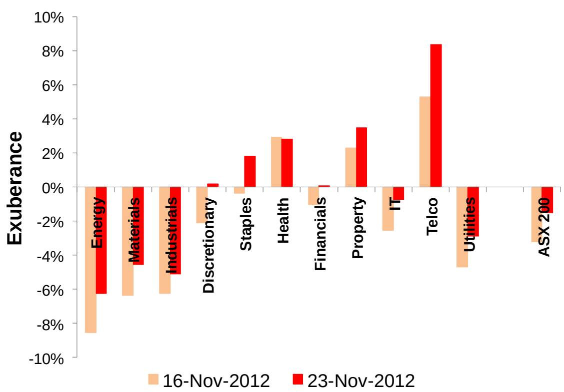
Note: These forecasts are updated daily for the following 12 months. Dividends should also be taken into account when assessing possible performance.

Chart 5: Exuberance over time - ASX 200



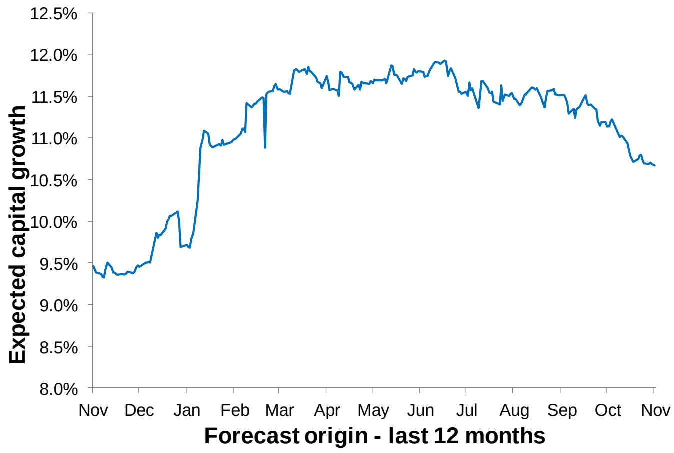
Notes: 0% represents 'fair pricing' and the dotted line at 6% represents possible overheating preceding a correction. Cheap markets (below the 0% line) can get a lot cheaper before they recover!

Chart 6: Sectoral exuberance - ASX 200



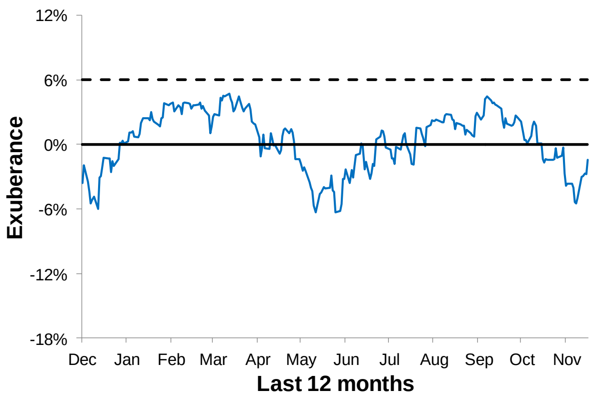
Notes: Our *Guide to Woodhall's Publications* should be consulted for a better understanding of how all nine charts are constructed.

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



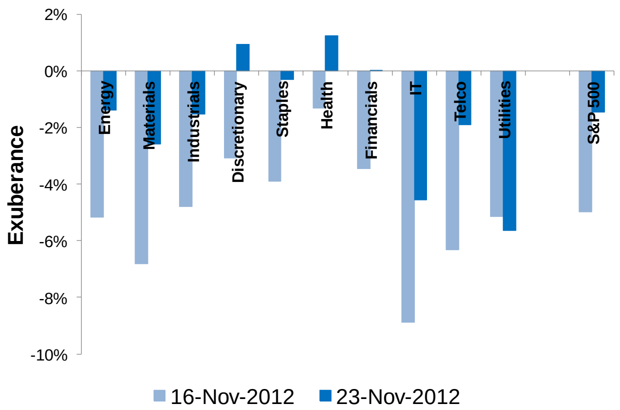
Note: These forecasts are updated daily for the following 12 months. Dividends should also be taken into account when assessing possible performance.

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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