1st May 2012

Woodhall's Wrap

Ron Bewley PhD, FASSA

The Big Picture

It would have been easy to have been distracted by all of the political shenanigans during April - perhaps especially billionaire Clive Palmer's launch of his Titanic II project and his desire to stand against Wayne Swan in the next election - and the former RBA governor, Bernie Fraser, calling for a 0.5% rate cut - on the last day of April (not the first!). However, to do so would have caused one to have missed a beautiful set of figures on the stock market.

The ASX 200 climbed to within a whisker of 4,400 - notching up a 1.4% gain over April - in the process recording the fourth successive solid return this year (January, 5.0%, February, 0.8%, and March, 0.8%). All of our indicators for volatility, fear, exuberance and market expectations have performed admirably for months. We are dead on track for the 4,800 year end as we predicted at the beginning of this year - and expected dividend yields are very strong at 5.9% plus franking credits.

We gave the S&P 500 the slip in April. After being left behind this year before April 1, the S&P 500 slipped -0.8% over April so we made up a creditable 2.2% over the month. So how can this all be?

As we - and almost everyone else - foreshadowed at the beginning of the year, the big European debt rollovers for the year were all in quarter 1. We did have a little Spanish wobble in the first few days of April but that crisis seems off the boil for some time. Of course the austerity measures mean slow growth or recession for much of Europe but even Spain beat expectations last night when its GDP growth came in at -0.3%, not too negative!

US growth has slipped a little - down to 2.2% (annualised) for Q1 - but the Federal Reserve is ready to play backstop with QE3 should growth slip further. The jobs number on Friday should tell an important story.

China keeps rolling along. After recently lowering its 5-year plan target growth from 8% to 7.5% the squeamish ran for cover but the IMF just came out with a forecast for China growth of 8.2% for 2012 and higher for the year after. Not too shabby.

Our overseas drivers are settling down so Australia is looking quite good - on average. I am bemused by the call for a rate cut today - especially the 0.5% calls. There is no magic lever that the RBA can pull to get growth into the domestic sector. A rate cut only releases funds for consumption if people lower their mortgage repayments - and they didn't do much of that with the last two cuts. People are scared and scared people do not spend - they save. That has been our problem since the onset of the GFC.

What will restore confidence? In Roman times they held games with gladiators and chariots in the circus. Perhaps we should enshroud Canberra with a Big Top and try to forget them for a while. Confidence comes from having a clear view of where one is heading. Who has that view now?

Woodhall Investment Research Pty Ltd (ABN 17 141 486 160) is a Corporate Authorised Representative (No. 359080) of Infocus Securities Australia Pty Ltd (ABN 47 097 797 049) AFSL No. 236523. Ron Bewley is an Authorised Representative (No 385661) of Infocus Securities Australia Pty Ltd (ABN 47 097 797 049) AFSL No. 236523.
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.
Disclaimer: Any opinions expressed in this publication are those of the author/s and do not necessarily reflect the views of Infocus Securities Australia Pty Ltd.
www.woodhall.com.au

Asset Classes

Australian Equities

The ASX 200 seemed to break its link with the S&P 500 during much of April. Often we shrugged off negative leads only to ignore some of the positive. All in all we made a creditable 61 points or 1.4% over the month. We shouldn't want bigger gains because big gains create bubbles and bubbles burst. Our forecast for the next 12 months - to May 1, 2013 - is 15.2%. That should take us to around 4,800 by the year end. It might seem a long time to get back to those levels but getting back is the main thing.

The volatility for the ASX remained at pre-GFC levels. Indeed our forecast for the next three months is for less than 10% (annualised) - below the long term average pre-GFC level of 12.5%! With expected dividend yield for the whole market close to 6% without franking credits, and term deposit rates expected to fall, the anticipated RBA rate cuts might give equities a little boost - even if it does nothing for our economy. Certainly, the banks, with an expected grossed up yield of about 13%, could at least tempt some superannuants out of deposits.

We have the Materials sector very underpriced with Health, Financials, Property and Telcos a bit overpriced.

Foreign Equities

The overpricing in the S&P 500 we wrote about the last two months has been eroded by a fall in the market (-0.8%) and an improving fundamental. That market is now only 1% overpriced. The US reporting season was better than many were reported to be expecting. Unsurprisingly Apple smashed expectations. Consumers can't seem to get enough of iPhones and iPads. But Apple is now 10% off its peak price after a stellar run.

The VIX - considered to be a measure of fear on the S&P 500 - ended the month at 17%. The normal range pre-GFC was about 11% - 20% so the world is recovering - albeit slowly.

Major markets in Europe also finished fairly flat after a roller-coaster start due to a worry about Spanish debt. The Spain 25% unemployment read is a stark reminder of what it takes to get out of a debt crisis. Barcelona and Real Madrid, two of the world's top football clubs, were bundled out of the European Championship Semi-finals leaving the final to be played by an English and a German team. It is hard to miss the irony in that.

Bonds

There were a few jitters in the European bond auctions early in the month but it seems to have been a case of nerves still settling rather than a renewed crisis.

Interest Rates

We have been arguing for some time that our economy needs more than a rate cut or two - but we will probably get one today. If mortgagees just keep paying off their loans at the same rate, they will not be stimulating the economy - even if it is the wise thing for them to do. Most other people will be worse off (savers and retirees!) or much the same (credit card bingers and small business owners). Sadly there is no 'lever' in the RBA or Federal Treasury marked 'pull to restore consumer and business confidence'.

Currency

Our dollar has plateaued as it fell from around $1.10 to $1.04 via $1.025. An interest rate cut today might put some downward pressure on the dollar but commodity prices seem sufficiently firm. Presumably a 25 basis point rate cut has been priced in.

Oil

The WTI oil price rose 2% while Brent fell 4% to reduce the differential from $20 to $15 over April. The Iranian talks are possibly keeping the WTI above $100 a barrel and, at these prices, the price of oil is not helping the modestly growing US economy.

Gold

The gold price was flat for April and the price of silver fell about 4%. The price of copper was flat but at levels which are high enough not to worry too much about global growth.

There is some talk in the media that some traders are anticipating a QE3 and are already helping a gentle rally in commodity prices after the correction earlier in the month.

Regional Analysis

Australia

The budget is only a week away. It would be foolish to expect anything but a tough budget and most analysts wonder why it is wise to get the budget into surplus so quickly when the non-resource part of the economy is struggling. A deficit is probably the only way to get our economy moving.

With a new leadership challenge again on the front page of the Financial Review yesterday, it is difficult to see from where the boost in consumer confidence will come.

The sudden exit of Bob Brown from the leadership of the Greens party might have a big impact on its success at the next election. Every successful party needs a strong leader and, love him or loathe him, Bob Brown certainly got attention and made his point.

China

The 'flash' PMI number a week ago was not flash at all but that HSBC measure of growth is for manufacturing's smaller companies while the official PMI number measures growth in the larger companies.

The IMF might not have a brilliant track record for forecasting but it is at arm's length from China and it gave China a big tick for this year and next.

U.S.A.

Last month's employment data for the US broke the trend of good numbers so this Friday's update is very important. The US economy is growing under its own steam but not quickly enough to make major inroads into unemployment - which stands at 8.2%.

US consumption data just posted a 0.3% gain for Q1. Not exactly blazing a trail. All economic data are a bit wobbly so it is far too early to run for cover.

The election campaign is gaining momentum with Obama v Romney in November. While Obama looked dead in the water a year or two ago, the drop in unemployment from above 10% to 8.2% might get him across the line. But whoever wins, the US needs to sort out its response to its massive deficit.

Europe

With general elections springing up around Europe there is plenty of opportunity for people to voice their displeasure with austerity measures. While pain must be accepted, they need to take care that growth will not be so slow or negative as to not be able to reduce their deficits from tax revenue. This balancing act will take a really big effort.

With one-in-four Spaniards out of work and the Spain property market it tatters, that country remains the main problem. Italy is not home and hosed but recent figures suggest they have dodged the bullet.

Rest of World

Well North Korea proved it couldn't make rockets that take off and there is less bad news coming out of Iran.

With only three months to go to the London Olympics wouldn't it be great if nations could come closer together.