23 December 2011

Woodhall's Weekly

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Key points

Volatility: Market volatility hovered just above the mean of volatility during the GFC - the upper dotted line. With Christmas around the corner, volumes were too low to get a better result.

Fear: Fear - or irrational volatility - not only spent a few days in the normal range but closed just below it. The first time in six months! The VIX too had a good week finishing at just above 20%.

Disorder: Disorder - a measure of the lack of similarity in returns across sectors of the market again spent another week in the normal zone. Controlled fear and disorder are, in our opinion, necessary conditions for a market to sustain a rally. We now have that in spades but the festive signal is unlikely to produce a catalyst for the next rally.

Capital gains forecasts: Forecasts for the next 12 months remained steady at around 11%. 2012 is shaping up for quiet but solid growth to end 2012 at the high end of the 4,000 range - maybe even flirting with 5,000 along the way.

Market exuberance: Underpricing held steady at about -5% equating to fair value on the ASX 200 of about 4,350 with 11% to come next year. Finishing 2012 at just under 5,000 seems good right know but that's where we were two years ago. Telco is starting to look expensive.

Sectoral exuberance: Little has changed since last week. It has been a sluggish build up to Christmas for all sectors. More detail is contained in our companion weekly publication *Woodhall's ASX 200 Exuberance Stats*.

Summary: The US got an even better jobs' report than last week. Even US housing looked to have bottomed - but much of that was due to a downward revision of the previous five year's worth of data. Australian retailers seem to be struggling. Maybe the fat retail margins of years gone by have gone forever.

Merry Christmas and a Happy New Year to our readers.

All data are sourced from Thomson Reuters Datastream.

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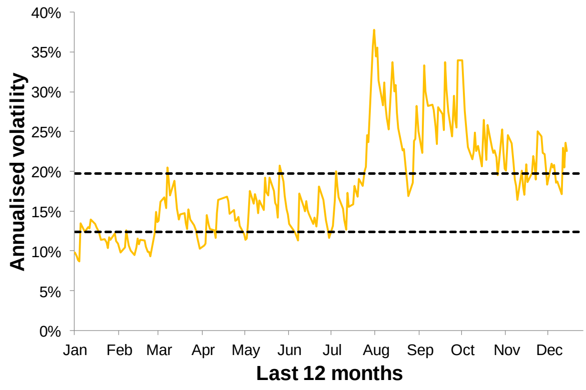
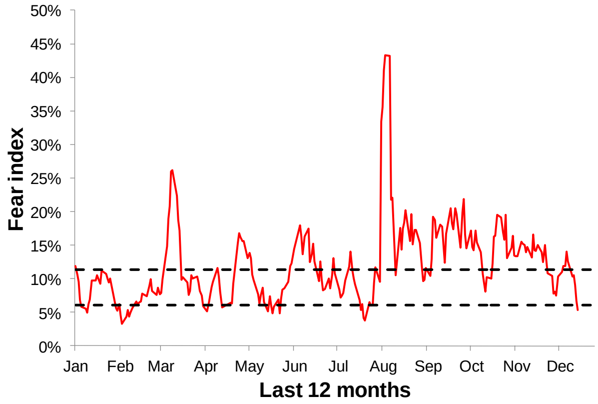
Chart 1: Daily volatility



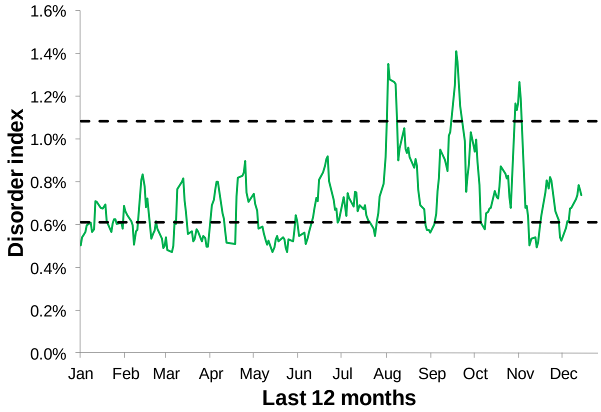
Notes: The solid black line denotes the current average volatility since January 2010; the lower dotted line denotes the average volatility pre GFC; the upper dotted line denotes average volatility during the GFC.

Chart 2: The fear index



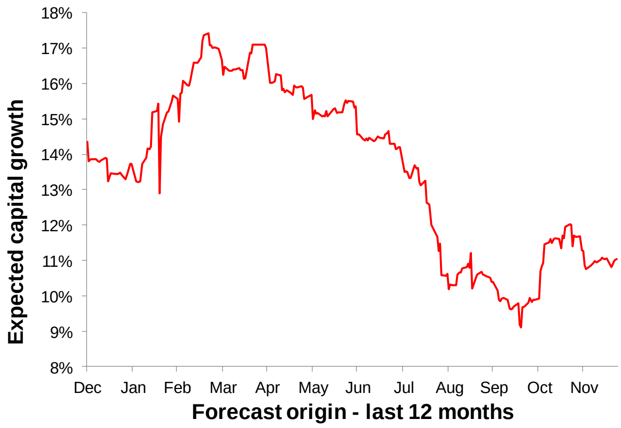
Notes: The two dotted lines denote the range where fear resided pre-GFC for two thirds of the time

Chart 3: The disorder index



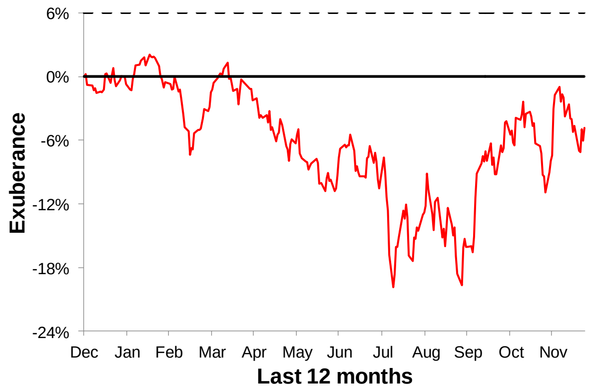
Notes: The two dotted lines denote the range where disorder resided pre-GFC for two thirds of the time.

Chart 4: Forecasts of capital growth



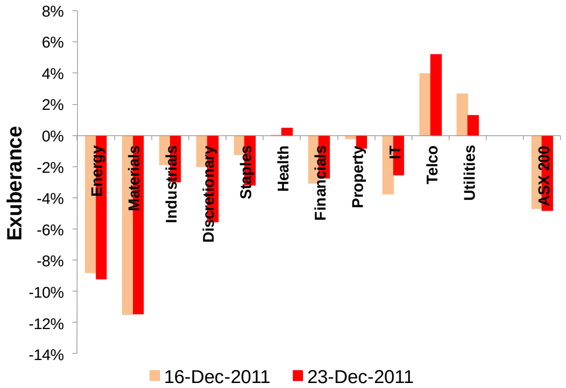
Note: These forecasts are updated daily for the following 12 months. Dividends should also be taken into account when assessing possible performance.

Chart 5: Exuberance over time



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



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