21 January 2012

Woodhall's Weekly

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Key points

Volatility: Market volatility hovered around the post-GFC average all week. The ASX 200 posted a 1% gain over the week following last week's solid gain - totalling 4.5% for the year-to-date. All of this in spite of the European sovereign debt downgrades.

Fear: Fear - or irrational volatility - stayed within the tram lines making the current run of 'normal' fear nearly two months long. This result is a very encouraging sign of how the market may deal with future adverse shocks.

Disorder: Disorder - a measure of the lack of similarity in returns across sectors of the market - remained at low levels. Controlled fear and disorder are, in our opinion, necessary conditions for a market to sustain a rally.

Capital gains forecasts: Our forecast for the next 12 months improved a further 1% to close the week at 12.8% for the next 12 months. Given reporting season starts in a few weeks this is yet another encouraging result.

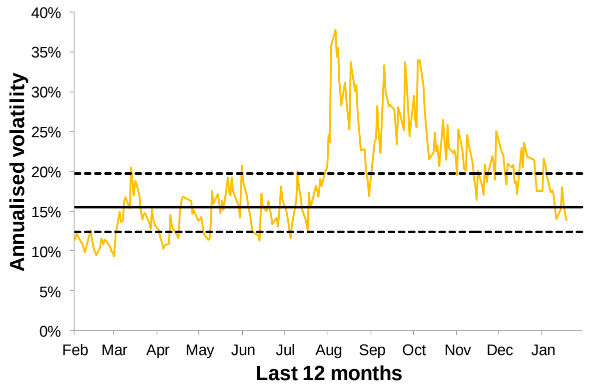
Market exuberance: The week closed with exuberance almost at fair price at -0.7%. If the market has another good few weeks, the market is in danger of needing a correction or sideways movement. A pause in the rally in the next week or two would be welcome.

Sectoral exuberance: The Resource sectors have almost come back to fair pricing after months of being cheap. With China reportedly poised to stimulate its economy, overpricing could happen soon to these sectors. Only Consumer Staples and IT are clearly cheap. The Telco sector, at 4.1%, is not seriously overpriced. More detail is contained in our companion weekly publication *Woodhall's ASX 200 Exuberance Stats*.

Summary: There was more good news from China and the US that helped spur on our market. All of our indicators are back to levels with which we feel comfortable. Yet another set of meetings over the weekend about Greek debt could influence our open on Monday but, if the news is bad, our market is less likely to over-react than it would have done late last year.

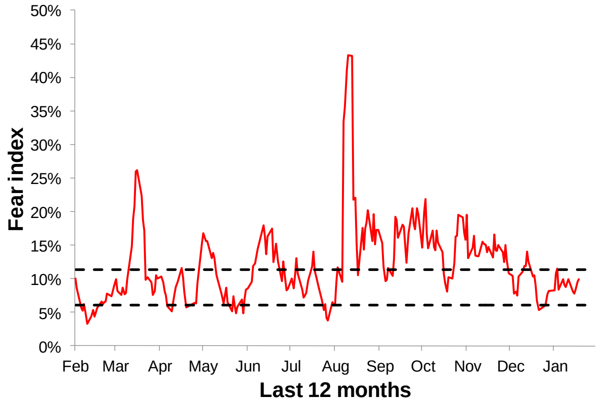
All data are sourced from Thomson Reuters Datastream.

Chart 1: Daily volatility



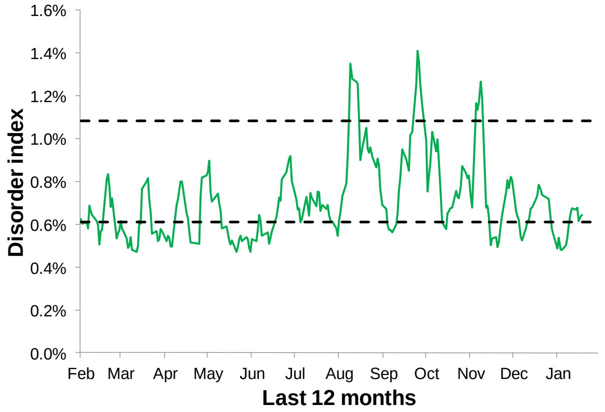
Notes: The solid black line denotes the current average volatility since January 2010; the lower dotted line denotes the average volatility pre GFC; the upper dotted line denotes average volatility during the GFC.

Chart 2: The fear index



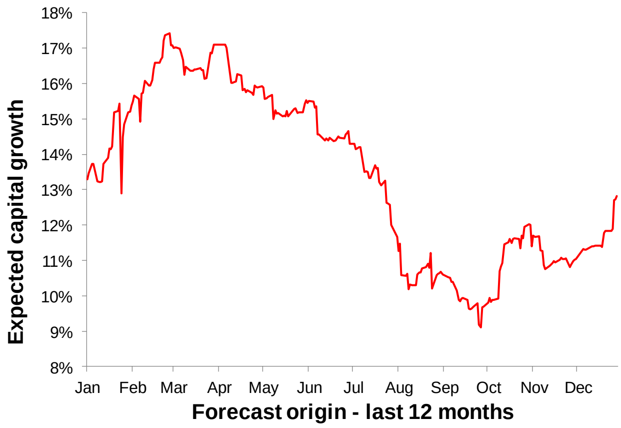
Notes: The two dotted lines denote the range where fear resided pre-GFC for two thirds of the time

Chart 3: The disorder index



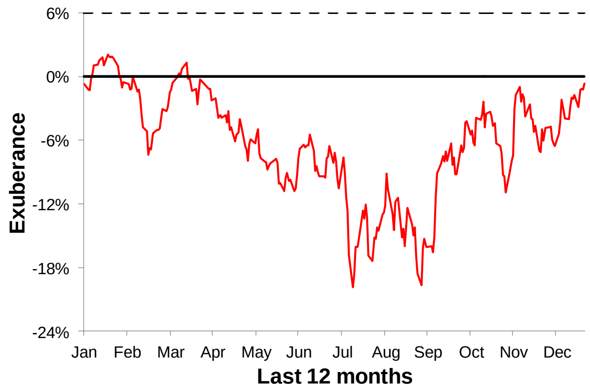
Notes: The two dotted lines denote the range where disorder resided pre-GFC for two thirds of the time.

Chart 4: Forecasts of capital growth



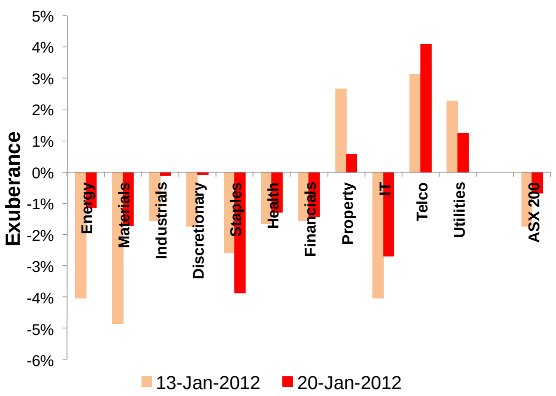
Note: These forecasts are updated daily for the following 12 months. Dividends should also be taken into account when assessing possible performance.

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.