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Woodhall Weekly

Key points

Volatility: Market volatility has been high during the week but well down from the extreme levels experienced during the 'crises' of August and September.

Fear: Perhaps surprisingly, fear had descended to normal levels until the Euro meeting deliberations concluded. It would appear that, after a brief period of euphoria on the Wednesday and Thursday, deeper questions were being asked about the details of the bailout packages.

Disorder: Disorder is at normal levels but a sharp rise towards the end of the week is slightly unsettling. A combination of normal fear and normal disorder bodes well for market recoveries so that we do not yet conclude that this rally has a solid base.

Capital gains forecasts: They slid through the August reporting season but stabilised at above average levels - circa 10% for the next 12 months.

Market exuberance: No longer is the market massively under-priced but it is still cheap by historical standards.

Sectoral exuberance: Much of the market under-pricing resides in the resource-based sectors - including Industrials (mining services) - and Health and IT. The Consumer Discretionary, Financials and Telcos sectors are no longer cheap.

Summary: The main market factors are currently all political. If they are successfully resolved, the market looks ready for a big rebound. The G-20 meetings on November 3rd and 4th might be the place where relative certainty is established. We argued in our "Off to the races" paper of October 17th that a rate cut is needed. If it happens on Melbourne Cup Day, the market should be a lot higher by the end of next week. Either way, we should have a much clearer view next week about where the market is heading.

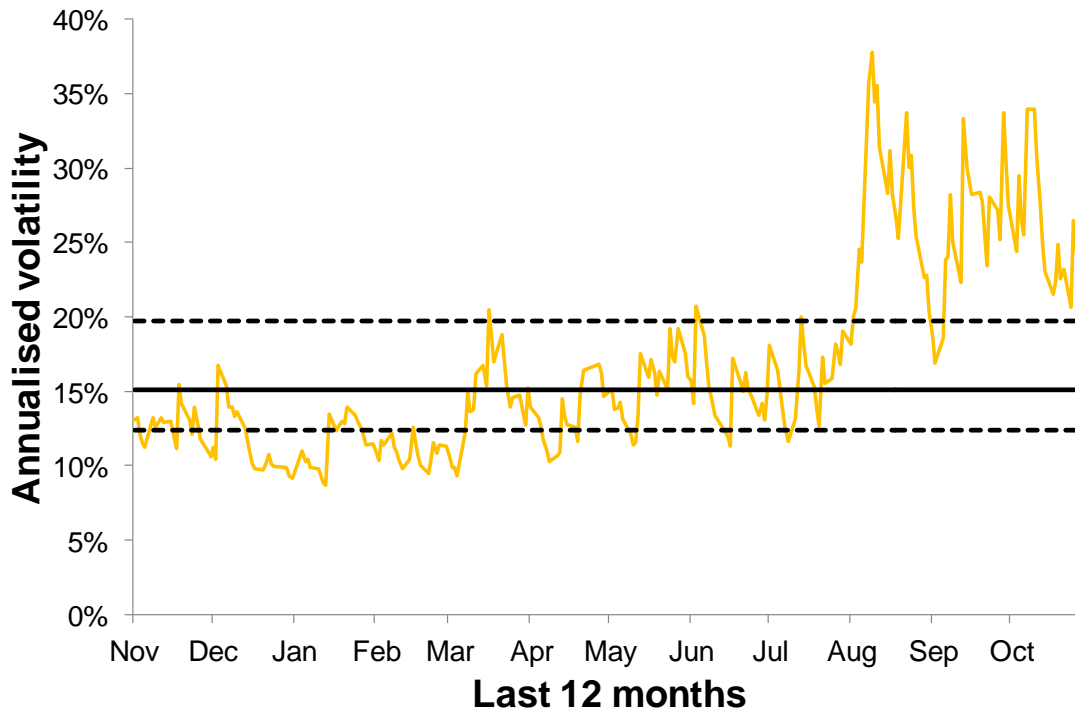
The good mid-week inflation data for Australia and GDP growth for the USA were a big positive.

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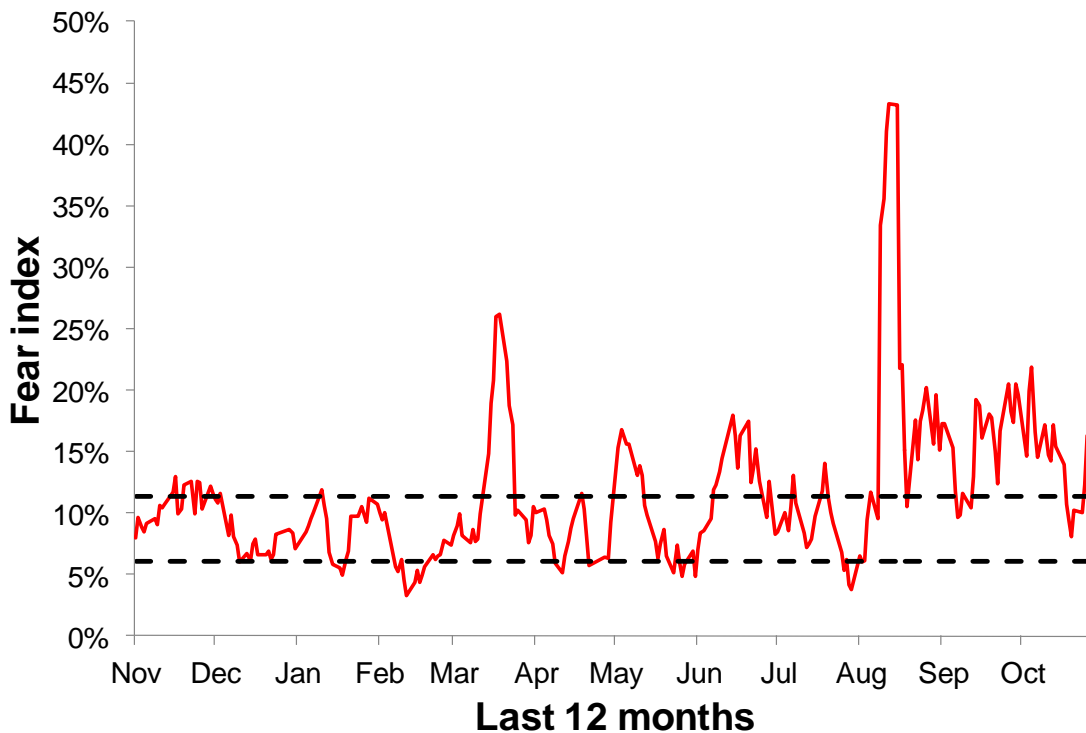
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Chart 1: Daily Volatility - ASX 200



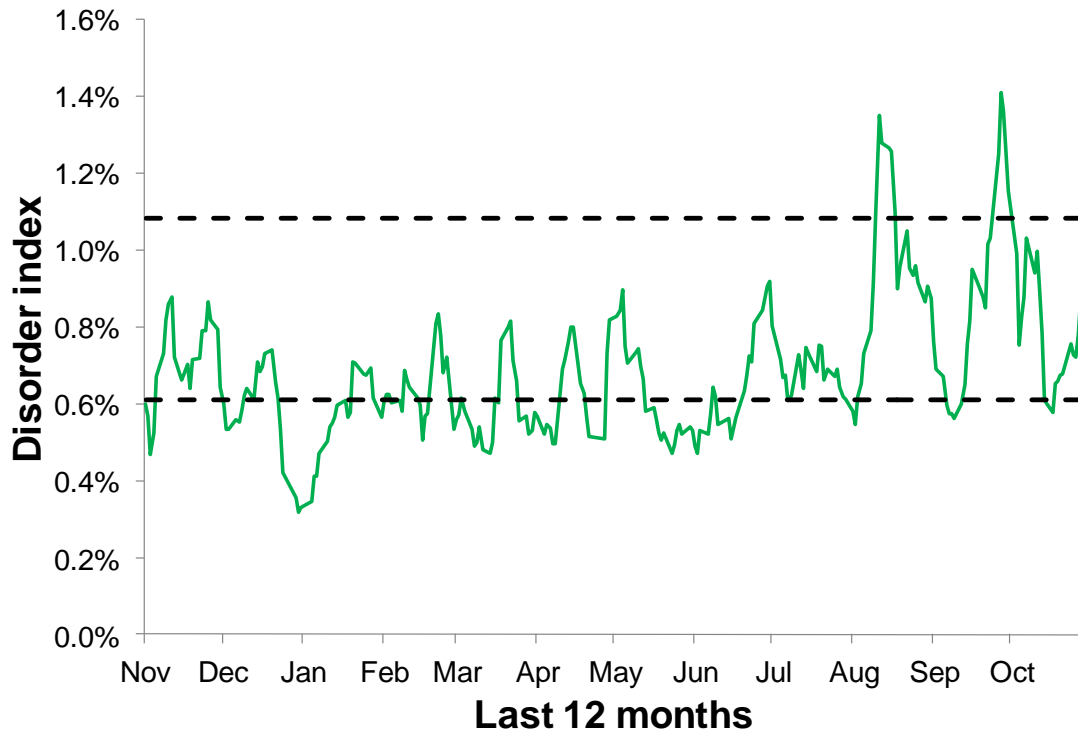
Notes: The solid black line denotes the current average volatility since January 2010; the lower dotted line denotes the average volatility pre GFC; the upper dotted line denotes average volatility during the GFC.

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



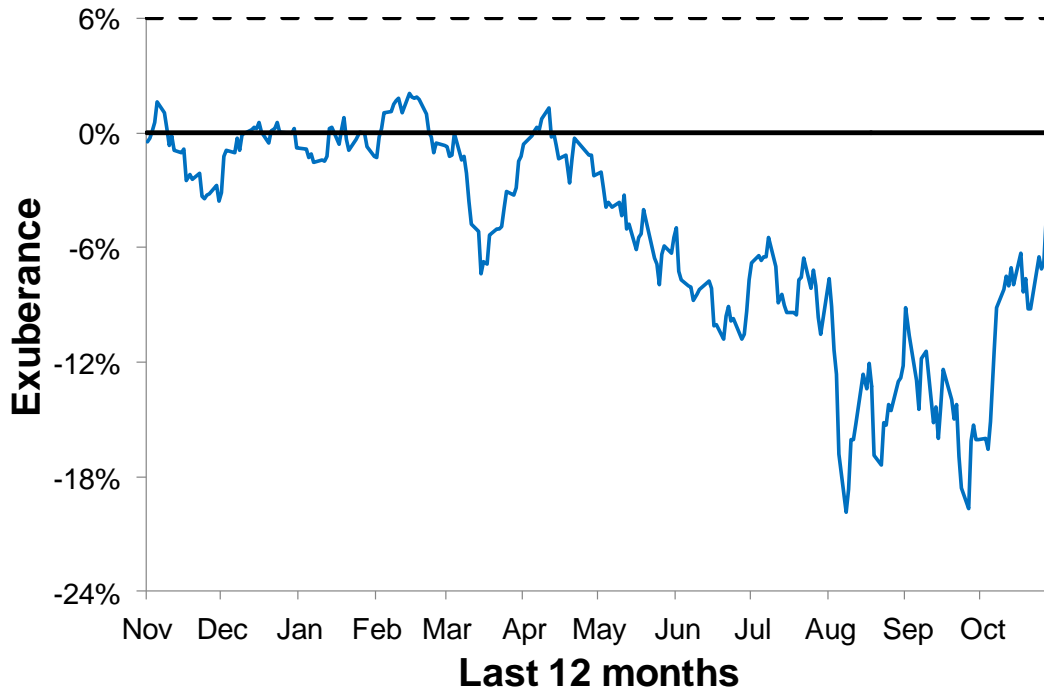
Notes: The two dotted lines denote the range where disorder resided pre-GFC for two thirds of the time.

Chart 4: 12-month ahead forecasts of capital growth - ASX 200



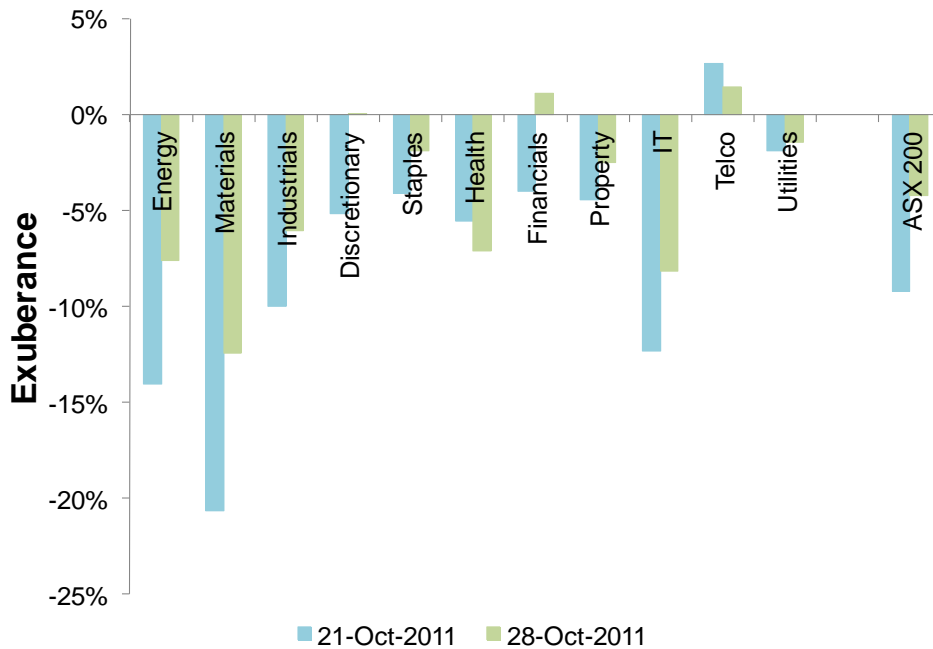
Note: These forecasts are updated daily for the following 12 months. Dividends should also be taken into account when assessing possible performance.

Chart 5: The exuberance index 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: The exuberance index at week's end - ASX 200 and 11 major sectors



Notes: The Quant Quarterly on Woodhall's website should be consulted for a better understanding of how all six charts are constructed. The *Woodhall Weekly* is published for a more regular update of some of the charts in the QQ. These charts should not be used to make investment decisions but they can be useful in provoking discussions with a licensed professional.