



Monthly Newsletter - May 2014

NO NEED FOR PANIC AS HISTORY SETS TO REPEAT

As we continued to review the large set of economic, company specific and technical data during the month, we became increasingly convinced the old adage “Sell In May And Go Away” would once again play out in our market in 2014, just as it has in previous years (also illustrated in the chart below (**red vertical lines**)):

- 400 Index point drop in May 2010
- 400 Index point drop in May 2011
- 400 Index point drop in May 2012
- 600 Index point drop in May 2013

What really sealed the deal for us, was the pattern we noticed forming when observing the 5 year chart of the XJO S&P/ASX 200 Index (“XJO”), fitting our theory of where this market is headed from a short and long perspective.

RISING BEARISH WEDGE FORMATION

Technically, our observation of the XJO from a long term perspective revealed a pattern known as a “**Rising Bearish Wedge**”. As shown below, this pattern is formed by Index/Price movements bound by trend lines slanting in an upward direction (**black lines**).



Notably, the upper rising resistance line (**top black line**) is formed by a series of higher highs, coinciding with a slowing momentum (we have used Relative Strength Index). This “coincidence” is the key characteristic of the “**Rising Bearish Wedge**”, reflecting buyers are, over time, becoming increasingly reluctant to pay higher stock prices, leading to a slowing of buying momentum. Eventually, as the momentum in buying weakens, sellers take control over price movements leading to lower share prices and as a result a lower Index level.

SO HOW DO WE SEE THIS PLAYING OUT?

FIRST AND FOREMOST, given the positive Macroeconomic themes that continue to emerge from the larger economies of the US, Japan, Europe and our biggest trading partner, China, the “Rising Bearish Wedge” pattern in our opinion, **remains in play from a long term perspective**. Despite the negative consequence of this pattern playing out at some point in time, it doesn’t hinder the XJO index advancing to 6000 in 2015, a level that we and many market analysts are anticipating and is suggested by the bearish wedge formation itself.

In the **IMMEDIATE SHORT TERM** we envisage a higher index level in **Early May** as a number of Large Cap Companies retest upper resistance levels leading to a lift of the XJO index to 5600. **Why?** Companies specifically weighted toward those offering high yield, have been carrying the Index to new highs as investors continue the “hunt for yield” but it’s more so, the technical indicators and optimism of higher dividends that suggest stocks of this nature will retest previous highs in the immediate short term.

However, our concern is the combination of the ongoing theme of “hunt for yield”, a limited number of quality high yield stocks available in on the Australian market and sluggish growth in other industries has created over time “excessive optimism” on earnings growth for high yield stocks and as a result, has been priced into the markets at an unreasonable pace. Essentially, market participants from a short term perspective are setting themselves up for disappointment during the May period, in particular the financial sector where we will hear from the major banks as they post their half year results/trading update (*ANZ 1st May, WBC 5th May, NAB 8th May and CBA 14th May*).

AS THE ABOVE PLAYS OUT, we find it difficult to conclude any rational investor would continue to add to portfolios at extended levels, therefore we are of the opinion new highs short term will be met with low conviction buying, eventually conceding to selling pressure. Our prediction is a short term fall of between;

- **200-400 points** and either
- **A retest of lower support of 5400** as the “Rising Bearish Wedge” pattern indicates above or
- **A continuation of selling to retest 5200** leading to a flattening of the “Rising Bearish Wedge” pattern extending the time frame of the Index reaching 6000 as we and market analysts anticipate.

WE REITERATE: THERE IS NO NEED FOR PANIC, rather opportunities will present themselves. The long term macroeconomic themes remain healthy amongst global markets, so rather than hit the sell button on your portfolio we suggest a few ideas you should consider to benefit from a pullback in May:

- Take advantage of the cheaper prices we believe will present themselves during the period i.e. Add to existing portfolios or purchase stocks you may have been eyeing out for a long period but never managed to obtain at reasonable prices.

- Sell Call Options over part/all of your portfolio to generate additional yield/income for the month.
- Buy Put Options on specific stocks for a short term trade i.e. the banks.

Please discuss these ideas with your broker and ensure they meet your risk appetite, financial objectives, situation or needs.

Performance of Key Indices

<i>Equities</i>	<i>Close</i>	<i>Change (M)</i>	<i>Change % (M)</i>
All Ordinaries	5516.1	113.1	2.09%
S&P/ASX200	5536.1	141.3	2.62%
Dow Jones (US)	16448.74	-8.92	-0.05%
NASDAQ	4074.401	-124.59	-2.97%
S&P500	1869.43	-2.91	-0.16%
FTSE 100 Index	6700.16	101.79	1.54%
Nikkei 225 (Japan)	14288.23	-539.6	-3.64%
10-year bond rate (US)	2.70%	-0.0002	-0.61%

Upcoming RBA Events

Reserve Bank Board Meeting – 6th May
Statement on Monetary Policy – 9th May
Minutes of the RBA meeting – 20th May

ABS releases March

Producer Price Index (March) – 2nd May
Building Approvals (March) – 5th May
Retail Trade (March) – 7th May
Labour Force (April) – 8th May
Housing Finance (March) – 13th May
Lending Finance (March) – 16th May
Wage Price Index (March) – 21st May

Upcoming US Economic Releases

ISM Manufacturing Index – 1st May
US Employment Situation (April) – 2nd May
International Trade – 6th May
Producer Price Index – 14th May
Consumer Price Index – 15th May
Housing Starts – 16th May
FOMC minutes – 21st May
Existing Home Sales - 22nd May
New Home Sales – 23rd May
Durable Goods Orders – 27th May
GDP – 29th May
Jobless Claims – Weekly Basis

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