New York Securities Pty Ltd

Monthly Newsletter – November 2014

HISTORY REPEATS, DID YOU TAKE ADVANTAGE?

Like clockwork, the month of October proved once again to be bearish for stocks. Equally, the rising bearish wedge was a statistical success adding weight to its significance as a bearish technical indicator. As the market finds its new groove, hopefully we have provided you with enough educational material to recognize the bearish pattern down the road and use it to your advantage to hedge, take profits and/or use it to add to a long term portfolio.

Leading up to the pullback, we discussed on numerous occasions the market dysfunction that existed and resulted in what we deemed to be "unsustainable price levels", so it shouldn't have been a surprise to anyone when the pullback occurred. It was just what market participants searching for value needed. In all, the S&P/ASX200 XJO retraced from its high of 5672.7 to a low of 5122 retreating 9.7%, just shy of a technical correction and not too distant from the prediction of 5078 modeled on the VIX as mentioned in last month's issue:

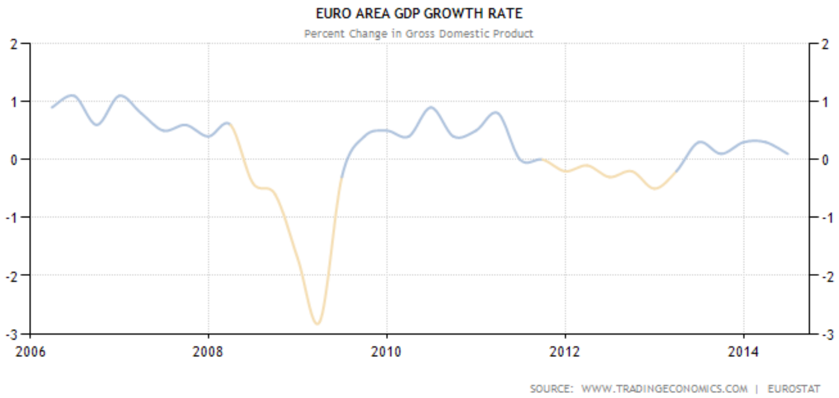
The 5122 low, in our view, is unlikely to be tested in the short term due to the strength of the penetration (Point A) through the short term downtrend (blue line). What we do expect is given the RSI is now in "overbought" territory (at point B) a modest pullback to 5400 will prevail, with possible range trading between 5300 -5400 before the market builds confidence for a second run in the latter part of the year.

Despite the swift nature of the recovery, the good news is the consolidation we believe will come to fruition around the 5300-5400 will provide a second chance opportunity to find some value.

AFSL: 317392 ABN: 70 111 049 800
Shop 11 "South Shore Piazza" 85 South Perth Esplanade, South Perth, WA 6151 | PO Box 1196, South Perth, WA 6951 | P: (08) 9363 1700 | F: (08) 9367 2450 |
E: info@nysecurities.com.au
W: www.nysecurities.com.au

EUROZONE DILEMMA

The European Union is trying its best to "dress up" its flagging financial system. Faced with an outcome of negative GDP growth for the second quarter, Euro Stat the statistical branch of the European Commission slapped on the red lipstick and overhauled how it calculated its national accounts. The result was unsurprisingly favorable providing a modest boost to second quarter GDP of 0.1% from a forecasted flat 0.0% (under the old accounting methods) enough to keep its head above water and defer the onset of a possible third recession in six years for another day:



How did the formula change? In essence Euro Stat reclassified some activities that were not previously included in the national accounts nor recognized as "economic activity" and by doing so boosted its accounts. Here are some examples:

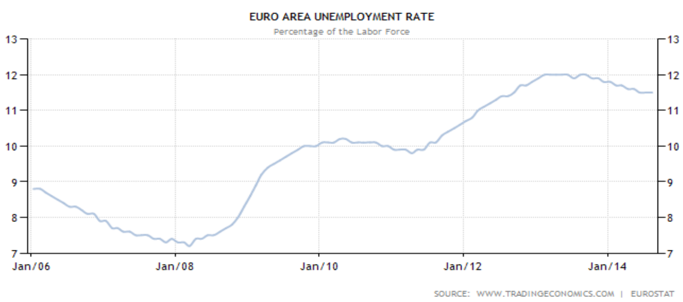
- Reclassifying R&D as investment rather than consumption in the course of production
- Recognizing expenditure on weapon systems and
- Recognizing some illegal activities including prostitution, drug-peddling and cigarette/alcohol smuggling as economic activity.

We couldn't have made that up if we tried!

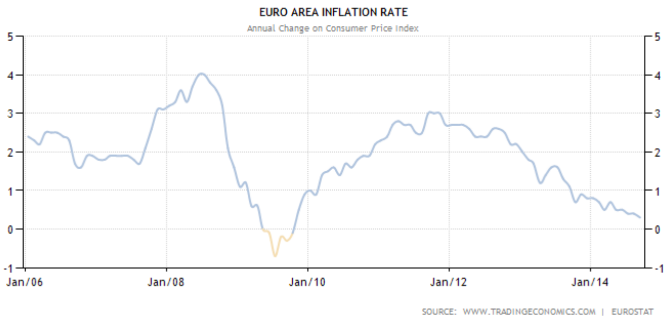
DEFLATION CONCERN

As the EU statisticians contemplate including children's lemonade sales in the next quarters national accounts, we all know playing with the numbers does little to hide reality, it simply props up the figures short term and bides time. After all, despite all its efforts to date the EU is fragile at best and is facing stagnation and deflation. Below is a graphical representation of the financial "progress" since from 2006-2014.

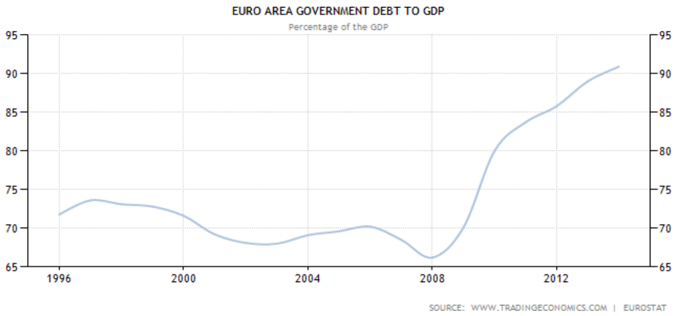
1) Unemployment Rate remains persistently high at 11.5%



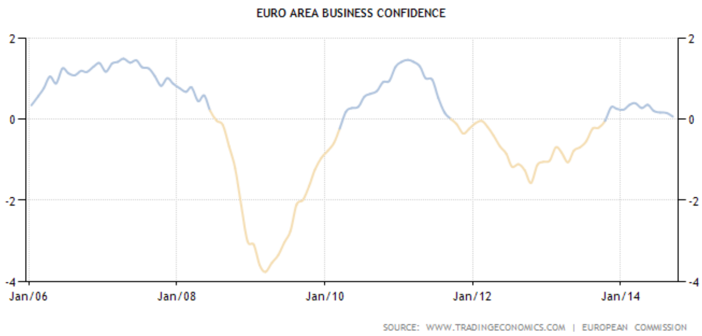
2) Inflation Rate is well below the EU target of 2%, risk of deflation emerging



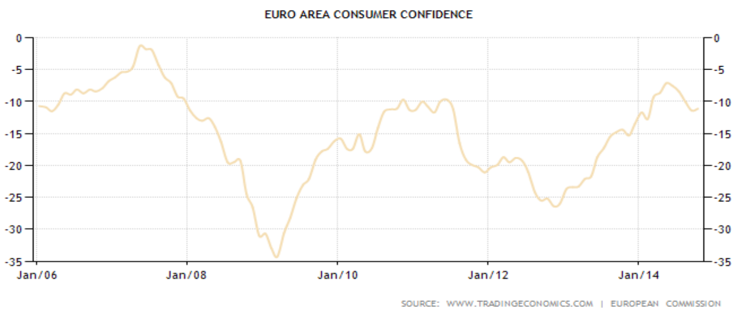
3) Government Debt to GDP hits new record at 93.9% (Q1, 2014)



4) Business confidence remains near zero, confidence waning



5) Consumer's lack confidence with the direction of the economy.



The ECB has attempted to avoid following in the footsteps of the US Fed in launching full scale unconventional monetary policy or “Quantitative Easing” due to their concerns over inflation. Ironically their unwillingness to increase money supply and instead favor the “sterilization” of bond purchases has now resulted in **deflationary concerns**. If the current trend of disinflation and anemic growth continues, the Euro Zone is likely to be drawn into a deflationary spiral. Here’s how a deflationary spiral plays out in theory:

- As prices fall consumers are likely to defer spending, leading to lower levels of consumer demand for goods and services. As demand falls for goods and services, businesses cut inventories/production leading to further employment risks, sticky wages and fall in business investment spending leading to falling economic growth.
- Additionally deflation discourages borrowing and investment and could lead to an unwanted tightening of money supply, exactly what the Euro Zone does not need as they struggle to raise the rate of economic growth. Conceptually, interest rates cannot fall below zero, so if (for example) deflation is running at -2% pa the adjusted real interest rate is +2% providing an incentive to save against a environment of falling asset prices. This leads to an unwanted tightening of money supply through the lack of demand for money and further pressure on economic growth.

<u>SHOULD WE BE CONCERNED?</u>

In terms of direct trade, the Eurozone isn’t a significant trading partner of Australia, in fact the Eurozone doesn’t break the top ten. The concern lies through its influence over our biggest trading partners in the Asia Pacific Region, particularly China and Japan and its influence in the global banking system;

For now market participants maintain a calm temperament over the Eurozone dilemma, primarily because the ECB will begin a fresh new program of purchasing Asset Backed Securities (assets other than Real Estate/Mortgages) in November and because the ECB has kept the door open for full scale quantitative easing. In addition, the exit of the US Feds six year bond-buying program last week has thrown weight behind the use of full scale quantitative easing given the outcome has been favorable for the US economy and hasn’t brought with it the inflationary pressures/asset bubbles that the ECB fears most.

Over the next few months we aren’t expecting the Australian market to outperform. Confidence is a difficult emotion to recoup after significant retracement followed by a swift recovery, so given the mixed positions of world economies it’s unlikely there will be any near term catalyst that will spur market participants to shift a greater weight towards risk assets. The best indication we have on where the markets are heading is through our technical analysis, as shown earlier and so we expect consolidation between 5300 and 5400 prior to an upswing leading into the New Year.

Performance of Key Indices

Equities	*Close*	*Change (M)*	*Change % (M)*
All Ordinaries	**5505**	**+188.4**	**3.5%**
S&P/ASX200	**5526.6**	**+213.2**	**4.0%**
Dow Jones (US)	**17390.52**	**+292.10**	**1.7%**
NASDAQ	**4630.74**	**+50.5**	**1.1%**
S&P500	**2018.05**	**+14.7**	**0.7%**
FTSE 100 Index	**6546.47**	**-273.3**	**-4.0%**
Nikkei 225 (Japan)	**16413.76**	**+989.2**	**6.4%**
10-year bond rate (US)	**2.337%**	**+0.0001**	**-0.3%**

Upcoming RBA Events

Reserve Bank Board Meeting – 4th November
Statement on Monetary Policy – 7th November
Minutes of the RBA meeting – 18th November

ABS releases March

Retail Trade (September) – 4th November
International Trade in Goods and Services (September) – 4th November
Labour Force (October) – 6th November
Housing Finance (September) – 10thNovember
Lending Finance (September) – 12th November
Wage Price Index (September) – 12th November
Sales of New Motor Vehicles (October) -17th November

Upcoming US Economic Releases

ISM Manufacturing Index – 3rd November
International Trade (September) – 4th November
US Employment Situation (October) – 7th November
Retail Sales (October) – 14th November
FOMC Minutes (October) – 19th November
Producer Price Index (October) – 18thNovember
Existing Home Sales (October)–20th November
GDP – 25th November
New Home Sales (October) – 26thNovember
Durable Goods Orders (October) – 26th November
Jobless Claims – Weekly Basis