WEALTH

ASX is expected to fall in tandem with any Wall Street downturn

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If Wall Street yields to the inevitable and unleashes a sharemarket reversal in the weeks ahead, the ASX will drop with it.

Certainly, history strongly suggests as much and key signals from the levels of cash held by fund managers to the increase in short positions in the local market show investors are not prepared to bet the ASX would withstand for long a US-triggered sell-off.

A strong earnings season this year could provide some buffer against a Wall Street-led reversal. However, key results offered by our biggest stocks in the opening weeks of the earnings season are flat to disappointing; under-cooked results from market leaders AMP, Suncorp, Ansell and arguably Rio have left the local market exposed.

Meanwhile, the continuing fallout from an alleged money- laundering scandal at CBA — the bellwether stock for the wider market — has clouded what was a passable, if modest, result last week.

As the barometer of funds management holdings, the JP Morgan Fund Manager Radar has shown cash levels rising across the market all year — ironically, in the latest reading for July 31 the US investment bank reported cash hoarding may have peaked. (Some managers had cut back cash levels).

Fund manager Roger Montgomery says he is now keeping “relatively high levels of cash” across his funds. Montgomery worries the key measure of value in local stocks — the price/earnings ratio — at 18 times is higher than it was before the global - financial crisis.

As for the US, Montgomery points out that their p/e ratio at 21 times is “materially higher” than the average since 1970 of 16.

The lag in Australian sharemarket valuations should in theory cushion us from a global fall — that is, we might have less further to fall if the bears get the upper hand. Nonetheless, the dollar value of short positions across the market is back near its high for the year, having lifted sharply in recent weeks.

Separately, high-profile money managers are announcing bold shorting strategies.

The “absolute returns” specialist VGI, for example, says it now has a quarter of its entire holdings in “short positions”.

At the same time, some of the best-known stocks on the ASX show high levels of shorting interest; Harvey Norman, for example, has 11 per cent of its entire share register held by the "shorts". Similarly, Myer has 16 per cent of its register shorted.

Australian stocks have not improved to anything like the same degree as stateside shares in the past five years. Put simply, US shares have soared to record levels beyond their previous GFC highs, while our own ASX remains about 1000 points behind where it was in November 2007.

The other emerging threat for the local market is the potential of index funds and exchange traded funds to accelerate any volatility in the market.

ETFs have been the most successful sector of the ASX in the past year. Indeed, the local sector is showing annual compound growth figures in the order of 35 per cent. With new ETF products being added to the local market every month, single stock price movements will be immediately mirrored across the ETF landscape, possibly accelerating a US-led fall.