Gibraltar Asset Management

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - January 2013

FTSE 100	**6,303**	S&P 500	1,501
Resistance	6,350	Gold	$1,676
Support	5,898	GBP/EUR	1.1675
VIX	14.3%	GBP/USD	1.5821

Introduction:

Since our last market commentary, in which we reverted to a neutral stance on the markets and advised sticking with investments with a decidedly defensive bias, the FTSE 100 has enjoyed one of its best Januaries on record, rising 378 points (6.4%). Precious metals pretty much marked time as investor fear fell dramatically with the volatility index now standing at just 14.3% - at multi-year lows.

Despite this, our predominantly defensive recommendations from last month performed incredibly well with BG up 13%, BP up 12.5%, BATS up 5.2%, United Utilities up 10.9% and Vodafone up 10.9%. The average gain was a whopping 10.7%, far outperforming the wider market.

Fundamentals:

The US economy more than likely contracted in Q4 for the first time since 2009, leading the FED yesterday to keep its record-low interest rate of between 0% and 0.25%. Though this is partly due to weather-related disruptions, the apparent divorce between share prices and underlying economic reality has rarely looked as wide as it does now, with flatlining output but soaring equities. Robert Shiller's cyclically adjusted price earnings ratio (CAPE, which seeks to iron out the distortions of cyclical peaks and troughs in earnings by using a 10-year moving average) is showing both US and European markets to be much higher than their historical average. The market must be moving higher on other factors - a rotation out of bonds into equities, negligible returns on cash, underweight investment managers playing catch up and an absence of negatives increasing investor's appetite for risk.

Technicals:

The equity market looks extremely overbought from a technical perspective. The RSI, lying at 77, shows the market is overextended and any break below 70 will be a clear reversal of the recent uptrend. With the ADX at 40, the market is strongly trending but a fall below 40 is a classic reversal pattern. Again, the market is currently closer to the upper Bollinger band than the lower, signalling more potential downside than upside. Support for the FTSE lies at the recent low of 5,898.

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Market Commentary (cont)

Seasonality: *"History doesn't repeat itself, but it does rhyme" - Mark Twain*

First Quarter

The FTSE All-Share has risen no fewer than 19 of the 25 years between 1090 and 2005, posting an average gain of 4.2%.

November - April

Delaying re-entering the market from St. Ledgers Day to Halloween has yielded statistically significant outperformance with the FTSE All-Share rising an average 13.4% from Halloween to May Day since 1965. There is a 1-in-2,000 chance of this arising by chance in random data. One explanation for this is that as the nights draw in during winter, we become anxious and depressed, which means share prices fall and expected returns rise. This then leads to a decent winter rise.

First-Year U.S. Presidential Cycle

The stock market tends to bottom out during the second year of each new presidential term and then recover strongly in the final two years. This is due to each Administration ensuring that the economy is strong by re-election time. Unfortunately, the excessive stoking of the economic fires creates excesses, including over-priced stocks, leading to poor stock market returns in the first two years of the next term.

Market Outlook:

Over the long term (since 1962), the FTSE All-Share for has returned 7.2% per annum and that does not include the average 3.8% dividend yield earned on top. Considering inflation averaged 6.2% over the same period, it is vital that an investor invests in equities in order to preserve the purchasing power of their money. However, markets can be subject to swings in the interim and investors should be mindful of these with a view to protecting their capital.

Our current view on the stock market has turned to negative. We do not believe the dramatic fall in the VIX equates to the resolution of the global macro-economic risks but it is more than likely a result of a temporary rise in investor's appetite for risk. The market is forecast to close higher at the end of the year by most investment banks, but there will be dips along the way, which we believe investors should buy into. We believe one such dip may occur sooner rather than later, based on the following rationale:

1) The stock market is at a technical high - overbought and liable to a correction.

2) The VIX is at historic lows, perhaps signalling investor complacency.

3) The US CESI (the Citi Economic Surprise Index) has moved below zero. According to J.P.Morgan Cazenove, on the past 7 occasions when this happened, the average maximum upside was 1% and average drawdown was 8% over the next following months.

4) J.P.Morgan Cazenove note that though Q4 results are beating conservative expectations, EPS upgrades are failing to materialise. More companies are cutting guidance than raising it and the third quarter was the first in 4 years where global profit margins have fallen.

Market Commentary (cont)

5) Equities have enjoyed a very strong run over the past few months. Given that EPS revisions stayed in negative territory, the P/Es have rerated. The MSCI P/E multiple is now 13.2x, an outright premium vs the 10 year average.

6) A number of technical and sentiment indicators are starting to signal caution. For example, the US Investor Sentiment Bullish Reading index (published by the American Association of Individual Investors) is now in the top 5% of the historic observed readings. Backtests carried out by J.P.Morgan Cazenove show that forward equity returns from this level of bullishness are significantly below average.

With that in mind, we recommend investors take some risk off the table, either by refraining from placing new money into the market or underweighting cyclical stocks vs defensives for the time being.

Recommended Investments:

Equities
1) Apple - $456.83, 10.4x P/E, 0.6% yield
At these levels, having fallen 35% from their September high of $702, we recommend Apple to those investors with a healthy risk appetite. They have recently fallen on the back of poor results, but the figures were actually respectable, it was the guidance that led to many analysts reducing their price targets. Despite this, the shares look cheap on a multitude of levels. Technically, the shares are trading 22.3% below their 200 day moving average. Fundamentally, if you strip out the cash, the stock trades on a P/E multiple of ~6x. Deutsche Bank has a $575 price target, indicating potential 20.5% upside.

Commodities
1) Gold Bullion Securities - low cost ETF that holds allocated gold in a vault
2) ETFS Physical Silver - low cost ETF that holds allocated silver in a vault
Both will benefit from further quantitative easing and loss of confidence in Fiat currencies.

Fixed Interest
CLS 5.5% 31/12/19 - 5.6% GRY
iShares Emg Mkts Local Govt Bond ETF - 5.4% average GRY

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Market Commentary (cont)

Chart Legend:

— — — (red dashed)	20 day moving average	(signifies the short-term direction of the security. prices tend to gyrate around their 20 day m/a)
(red line)	50 day moving average	(signifies the medium-term direction of the security)
(red thick line)	200 day moving average	(signifies the long-term direction of the security - whether it is in a bull or bear market)
(green line)	400 day moving average	(signifies the long-term direction of the security - whether it is in a bull or bear market)
(blue line)	bollinger bands	(an indicator that measures 2 standard deviations away from the 20 day m/a)

Technical Analysis Guide:

RSI (relative strength index) - indicates whether a security is overbought (above 70) or oversold (below 30). Also when the RSI moves above 50 that is considered bullish (or vice versa).

ADX (average directional index) - indicates whether a security is in a trend (above 20) or not in a trend (below 20). For trending markets moving averages work best when considering lines of support/resistance. For non-trending markets Bollinger Bands work best (sell at upper band, buy at lower band).


FTSE 100
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Index
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6300
6200
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6000
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5600
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B
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31/1/11
Apr
Jul
Oct
'12
Apr
Jul
Oct
'13
7/2/13
14 ADX (Daily)
30
20
20 RSI (simple - Daily)
80
40