Gibraltar Asset Management

Stockbrokers & Investment Managers

Market Commentary - February 2013

FTSE 100	**6,337**	S&P 500	1,515
Resistance	6,400	Gold	$1,601
Support	6,220	GBP/EUR	1.1551
VIX	14.7%	GBP/USD	1.5184

Introduction:

Since our last market commentary, in which we turned negative on the markets and advised sticking with investments with a decidedly defensive bias, the FTSE 100 has risen 34 points (0.5%). The market did fall to 6,260 at one stage with the volatility index flirting with the 19% level. Precious metals performed poorly with gold falling 4.5% and sterling has tumbled against the Euro and the US Dollar as a result of poor economic data and the UK being stripped of its AAA rating by Moodys.

Along with gold, our stock recommendation Apple also disappointed with a 2.7% fall. Our iShares Emg Mkts Local Bond ETF performed well with a 4.5% gain over the month.

Fundamentals:

February has been an interesting month for the markets from an economic standpoint. The UK was stripped of its AAA rating. Spanish GDP figures were revised down 0.8% for Q4 2012, meaning their economy shrank 1.9% over the last year, it's sixth straight quarter with GDP dropping at its fastest quarterly pace since mid-2009. On Monday night, anti-austerity parties appeared on track to win a majority of seats in the Italian parliament. This has a large effect on the European stock market. Italy is big enough to blow up the whole eurozone and this result is a damning indictment of Brussels-induced austerity measures. The ECB's OMT scheme cannot stand behind Italy's debt market without a vote in the German Bundestag and that will not be forthcoming if there is no united government, which is unlikely to be stable or long-lived. The reforms carried out by Mr Monti have covered the "low-hanging fruit" only, with the more difficult tasks ahead. With youth jobless rate of 37%, this has become a depression in the world's fifth largest economy by any measure of the imagination.

Technicals:

The equity market has unwound its overbought position from a technical perspective with the RSI having retreated to 53. This is a bullish level, which is countered by the ADX having fallen down through the 40 level, indicating the upward trend could be about to reverse. This view is supported by a 'bearish engulfing pattern' signalled on 14th February, which is a negative sign of things to come. Support for the FTSE lies at the recent low of 6,220.

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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 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 remains negative. 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 and liable to a correction.

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

3) J.P.Morgan Cazenove note that though Q4 results are beating conservative expectations, EPS upgrades are failing to materialise.

4) 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. The S&P 500 is trading at 15.5x earnings, a high absolute figure.

5) The Italian political situation is providing plenty of nervousness to the markets with eurozone policymakers falling over themselves to point out that they never said the crisis was over.

Market Commentary (cont)

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.

We see this market as being at a near-term consolidation, whilst retaining our longer-term optimism. Any large fall in the market we would use as a buying opportunity, given cheap relative valuations, excess liquidity, cautious long-term positions and an improving global growth outlook.

We do not believe that the so called "*Great Rotation*" has yet started. For example, year-to-date bond inflows of $39bn have outpaced equity inflows of $33bn. However, we shall maintain an eye on the following factors that could put it into play, namely: 1) a negative return on treasuries when rates rise, 2) a regulatory change & greater emphasis on liquidity favouring equity over bonds, 3) a switch into infrastructure investment, and 4) signs of growth in Europe.

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 - $444.57, 10.1x P/E, 2.4% yield

We are still recommending Apple to those investors with a healthy risk appetite. The stock is technically cheap. Fundamentally, if you strip out the cash, the stock trades on a P/E multiple of ~6x. The mean price target from the investment analysts covering the stock is $610, a potential gain of 37%. With talk of an iWatch as well as a potential dividend hike/stock split, the next few months could be just as interesting for Apple shareholders. as the last two.

2) Vodafone - 165p, 11x, 6% yield

Core defensive stock, trading at the lower end of it's trading range. Consensus price target amongst the analyst community comes in at 186p, 12.7% above the current level, not including the 6% dividend.

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 the loss of confidence in Fiat currencies. 80% of the change in the gold price is correlated with the size of the FED's balance sheet. Yesterday, Fed Chairman Bernanke stated they "*do not see the potential costs of the increased risk-taking outweighing benefits of promoting a stronger economic recovery*"...in other words, QE will continue until substantial labour market improvement.

Fixed Interest

CLS 5.5% 31/12/19 - 5.6% GRY

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GIBRALTAR ASSET MANAGEMENT

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Market Commentary (cont)

Chart Legend:

	20 day moving average	(signifies the short-term direction of the security. prices tend to gyrate around their 20 day m/a)
	50 day moving average	(signifies the medium-term direction of the security)
	200 day moving average	(signifies the long-term direction of the security - whether it is in a bull or bear market)
	400 day moving average	(signifies the long-term direction of the security - whether it is in a bull or bear market)
	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).

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14 ADX (Daily)
30
20
20 RSI (simple - Daily)
80
40