Gibraltar Asset Management

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - March 2013

FTSE 100	**6,387**	S&P 500	1,562
Resistance	6,533	Gold	$1,604
Support	6,271	GBP/EUR	1.1853
VIX	13.2%	GBP/USD	1.5159

Introduction:

Since our last market commentary, in which we remained negative on the markets and advised sticking with investments with a decidedly defensive bias, the FTSE 100 has risen 50 points (0.8%). Precious metals marked time and sterling has regained some ground against the Euro after the shenanigans in Cyprus.

Our stock recommendations performed well, both outperforming the wider index, with Apple rising 1.7% and Vodafone putting on an incredible 13%.

Fundamentals:

The Q4 results season is now largely complete and turned out to be the weakest earnings season for six quarters. Revenues, however, have been stronger, supported by early signs of an economic recovery in Q4. Given the uncertain growth background, companies are continuing to favour returning cash to shareholders, either via larger dividends or additional returns in the form of special dividends or share buybacks (e.g. Centrica and BP).

Unfortunately, the Cyprus situation is not helping. The country may be small but the precedent set by the bail-in of a broad range of bank creditors and the suggestion that such a process may be applied to the resolution of other euro area banks and banking systems is likely to have negative effects for the euro area economy as a whole. Not only will business confidence be affected, but euro area bank funding costs have already risen sharply in the last couple of weeks, implying a renewed tightening of financial and monetary conditions. This is not only affecting peripheral Europe. There has also been notable increases in core countries such as France and the Netherlands.

Technicals:

The momentum in the equity market has broken down with the ADX (a momentum indicator) having fallen from 30 to 20, close to a level that would indicate a trendless market. The RSI, at 53, is at a bullish level, and neither overbought nor oversold. In these conditions, any pullback should be treated as a buying opportunity. Support for the FTSE lies at the recent low of 6,271.

Gibraltar Asset Management Limited

One Irish Place, PO Box 166, Gibraltar

Telephone: +350 200 75181 Website: www.gam.gi

Market Commentary (cont)

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

Month of April 🙂

The FTSE All-Share posted a gain during the month of April in no fewer than 31 of the 37 years from 1970-2007. From 1900 to 2012, the DJIA produced an average return of 1.22%. The month has also been traditionally a strong period for gold, with average gains of 0.5% since 1968.

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 turns to neutral. The market is forecast to close higher at the end of the year by most investment banks. We cannot ignore the changing tide and are less pessimistic on the following rationale:

1) Many technical and tactical indicators have stabilised-the RSI is in the middle of its trading range and the VIX has moved up from the lows, signalling investor complacency has subsided.

2) Italian elections, a big source of risk for the markets, are behind us. The result was market unfriendly, but the political uncertainty is typically the greatest into and immediately post the event.

3) The CESI in the US has moved back into positive territory. While the CESI works better as a sell signal when it goes below zero, there is evidence of an improved risk-reward when it moves above zero.

Clearly, important headwinds remain. Corporate earnings are deteriorating. Global macro momentum, as captured in PMIs, is appearing to be rolling over. Potential sequestration in the US and further contagion in the Eurozone are also casting a dark shadow over the markets.

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Market Commentary (cont)

Following a consolidation phase, we are skewing towards our longer-term optimism and expect to add risk in Q2. Any large fall in the market we would use as a buying opportunity, particularly given the excess liquidity.

We prefer the FTSE 100 amongst the major markets. The US looks expensive. Europe has reached fair value. We note that Goldman Sachs has recently increased its 12 month target to 7,200, suggesting a further 12.7% upside. This is because despite the index rising sharply this year, in dollar terms, the index is only the fifteenth best performing stock market. Goldman thinks this will reverse in time, particularly as the majority of UK earnings are dollar, or at least non-sterling based. Only 19% of FTSE 100 company sales are to the UK; 45% of dividends are paid directly in dollars. The recent fall in sterling will give UK blue chips a boost to earnings simply as a result of the translation of earnings made overseas. The UK stock market's high exposure to global growth also make it a favourable market to Europe. The index is highly weighted to the resources sector and Goldman analysts argue that the recent sell-off in commodities is overdone. They expect tight inventories to support backwardation and high roll yields in oil markets and expect copper to rebound in the near term on improving demand fundamentals.

Recommended Investments:

Equities

We do not believe the move in sterling has been fully reflected in the more international facing names and recommend the following companies this month:

1) Aviva - 299p, 7.1x PE, ~5% yield
A real turnaround story. We feel the magnitude of the share price fall following the dividend cut looks excessive. Despite the cut, we continue to see appeal in Aviva and view the current weakness as a long-term buying opportunity. A continued delivery on its strategic plan will enable it to close the substantial valuation gap with its peers. Credit Suisse's 435p price target suggests 43% upside.

2) BG Group - 1127p, 14.x PE, 1.6% yield
Trading on a >30% discount to NAV, BG Group looks cheap on both a technical and fundamental level. We note that it was recently added to the Citi Focus List of European stocks and J.P.Morgan Cazenove has a 1600p price target, suggesting 42% upside.

3) Imperial Tobacco - 2260p, 10.6x PE, 5.2% yield
89% of Imperial's revenues derive from international markets. This makes the translation effect particularly relevant. A core defensive stock with a well covered dividend that is cheap on both a technical and fundamental level. Deutsche Bank has a 3000p price target, suggesting 33% upside.

4) Rio Tinto - 3096p, 6.7x PE, 3.7% yield
98% of Rio's revenues derive from non-sterling sources. Once the macro situation begins to stabilise, we believe there will be significant upside in Rio's share price. J.P.Morgan Cazenove has a 4400p price target, suggesting 42% potential upside.

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Market Commentary (cont)

Recommended Investments:

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, which is still expanding.

Chart Legend:

red dashed line	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)
thick red 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
6600
6500
6400
6300
6200
6100
6000
5900
5800
5700
5600
5500
5400
5300
5200
5100
5000
4900
6387.65
b
B
28/3/11
Jul
Oct
'12
Apr
Jul
Oct
'13
4/4/13
14 ADX (Daily)
30
20
20 RSI (simple - Daily)
80
40