GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - May 2013

FTSE 100	**6,597**	S&P 500	1,654
Resistance	6,839	Gold	$1,414
Support	6,238	GBP/EUR	1.1674
VIX	14.5%	GBP/USD	1.5199

Introduction:

Since our last market commentary, in which we remained equalweight on equities, the FTSE 100 has risen 150 points (2.3%). Gold has drifter lower, recovering slightly at $1,414/oz and sterling has lost ground against the Euro and the USD. Traders are talking about taking risk off the table, ahead of the next raft of economic data, which could explain the markets pull-back in the last few days.

Our recommendations from last month were mixed with BG Group up 12.2%, Imperial Tobacco up 4% but Rio Tinto down 2.2% and our gold and silver recommendations extending their recent falls. We are still buyers of miners and precious metals and explain the rationale later in the commentary.

Economics:

Economically, much of the world is still in poor shape. Spanish GDP figures released yesterday revealed the economy shrank 0.5% in Q1. Retail sales in Germany fell unexpectedly in April, down 0.4% compared with March and consumer spending in France also fell in April, dipping 0.3% - both signs of a weakening economy. Social unrest is increasing in Europe with Frankfurt today hosting members of the 'Blockupy' movement, protesting against those institutions responsible for pushing austerity measures in Southern Europe. Emerging markets are faring little better with India's economic growth falling to its slowest pace in a decade, as reforms to encourage investment and improve industry performance stalled. There's also a rumour knocking around the City that Chinese manufacturing output, released tomorrow, has leaked early and is lower than expected. Over in the US, underwhelming GDP and jobless figures are proving to be a welcome treat for liquidity addicted market participants. Paradoxically, traders now view bad news on the economy as good news, as it increases the likelihood that central banks will keep their stimulus programmes going. That is good news for gold, which we will discuss in further detail later.

Technical Analysis:

The market had a cracking April, moving higher with strong momentum. This momentum, however, now appears to be breaking down with the RSI falling below the key 50 level and the ADX pointing down. Near-term support lies at the 50 day moving average at 6484. Overall, the market still looks like it should be bought into on any pull-back with its 200 day moving average still sloping upwards.

Market Commentary (cont)

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

June

The old 'Sell in May' saying does work over time, but historically it is actually June when the market tends to fall. The UK equity market has fallen on average 0.3% in June since 1935 and the DJIA (with a longer record) has fallen on average 0.2% in June since 1900, rising less than half of the time.

Sell in May and go away; don't come back till St Leger Day

Historically, this is the worst time of the year. Since 1966 to 2009, the FTSE All-Share has returned an average of just 0.7% between May Day and Halloween (it is known as the Halloween effect in the US) compared with 7.8% between Halloween and May Day.

Our pagan ancestors knew this, which is why *Beltane* is a time of festivity (where people look ahead to fertility, plenty and joy) while *Samhain* marks the beginning of the "*darker half*" of the year. In March & April lighter evenings and warmer days cheer us up, which makes us more willing to take risks such as buying shares. So prices rise to high levels, which are difficult to sustain over the summer. In the autumn the darker nights make us more gloomy, with the result that prices fall to low levels from which they recover.

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 allocation to the stock market remains equalweight. Offsetting the weak economic data, J.P. Morgan is sticking with its call that markets will not see the typical seasonal weakness this time around and expect them to continue grinding higher based on the following rationale:

1) Although the markets have moved higher on the back of multiple expansion rather than EPS growth, the major market driver - asset reflation (the price-boosting impact of the massive QE injection of excess liquidity into the financial system) - will remain dominant as the prospective yield on equities continues to beat the ones offered by most other assets. For example, Eurozone aggregate high grade credit is yielding 1.9%, vs. the equity dividend yield of 3.8%.

2) Asset reflation should lead to increased buybacks. 38 MSCI Europe names have bought back stock so far this year and were rewarded by the market, outperforming by 4%.

3) Markets are still not expensive. Europe is trading on a 12.4x 12m forward P/E multiple , still below the long term median of 12.8x.

Market Commentary (cont)

4) The latest Euozone flow of funds survey shows that equities remain underowned in institutional portfolios.

As a result, J.P. Morgan has raised its end-2013 S&P 500 target to 1,715, indicating 3.7% further upside. Despite this, the unrelenting rally in stocks in an environment of no great news on earnings and the economy is making many investors uncomfortable, and therefore we remain equalweight with a preference for quality defensive corporates.

Tweet of The Month:

This month we retweeted an article on why Goldman Sachs is urging its clients to switch from banks to miners.

Goldman believes that the macroeconomic backdrop is now shifting. Analyst Matthew Ross points out that not only have mining stocks underperformed banks by 90% since then end of 2010, but mining valuations are at 10-year lows against financial equities.

With a little help from China, global growth is on the up, which is one of the reasons behind Goldman's change of tack. The miners will also benefit from a lower Aussie dollar, Ross claimed. "*While structural factors will lower growth rates (Banks: weak mortgage growth, Miners: falling China demand), we think the valuation gap is excessive,*" said Goldman's mining guru. "*Both have healthy balance sheets, but we view the banks as more constrained. Miners can do more on cost-out and would benefit more from a change in government, in our view.*"

Liberum Capital are also bullish on the sector, noting that the sector's yields are at multi decade highs vs. bonds and at levels not seen since the turn of the millennium vs. the FTSE 100. The mining sector is now back on an "ex-growth" yield of 4%, vs. an average of 3.1% following the advent of the super cycle.

They argue that current yields appear to be pricing in dividend growth between 2%-4% annually with no upside from specials or buybacks - too conservative in their view, given cash coverage ratios 1.5x-4.0x from 2014.

Some very basic analysis using a Dividend Discount Model suggests that current yields, providing they are robust, are sending out a clear 'buy' signal. Liberum has run stress tests assuming iron ore at $90/t, copper at $2.50/lb and all other commodities at spot and found that under this scenario, Rio Tinto, BHP Biliton and Glencore Xstrata continue to cover dividends through free cash generation once committed capex rolls off.

We continue to favour our favourite mining name, Rio Tinto, currently trading on a dividend yield of 4.4% and a low P/E multiple of 8.1x.

Market Commentary (cont)

Recommended Investments:

Equities

1) Rio Tinto - 2919p, 8.1x P/E, 4.3% yield

Mining sector yields are at multi-decade highs vs. bonds and at levels not seen since the turn of the millennium vs. the FTSE 100. Despite the prospect of negative headwinds from falling iron ore, we think RIO is pricing in sustained iron ore prices below $90/t (unlikely in our view), whilst dividend coverage looks extremely robust under stressed commodity prices. Deutsche Bank has a 4489p price target, suggesting 54% potential upside.

2) iShares DJ Emerging Markets Select Dividend - 1880p

Emerging markets have come off in recent weeks. This leaves this low-cost (0.65% p.a.) ETF that tracks emerging market dividend paying companies looking good value on a yield of 4.4%.

Fixed Interest

1) CLS 5.5% 31/12/19 - 102.70

Unrated corporate bond with a GRY back at 5%. Good value in this low interest rate environment. See research note of 28/08/12 on our website for further details.

2) Tullett Prebon 5.25% 11/06/19 - 100.50

Investment grade corporate bond with a GRY back above 5%. Good value in this low interest rate environment.

3) iShares Emerging Markets Local Government Bond ETF - 6112p

Emerging markets have come off in recent weeks, leaving this low-cost (0.5% p.a.) ETF looking like good value. The fund tracks the emerging market government debt of eight countries and has a average maturity of 8 years and GRY of 5.4%. See research note of 17/02/12 on our website for further details.

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. Fidelity argue that there are four possible mechanisms through which it could do so, even if we discount the possibility that printing money is inflationary:

i-Insofar as QE reduces bond yields, it reduces the opportunity cost of holding gold - which is the income foregone. This should increase demand for the metal.
ii-Gold should benefit if increased QE generates more uncertainty - say about its impact upon the economy or about the pace and timing of its eventual reversal. Uncertainty is often good for gold.
iii-The weaker growth that triggers more QE might attract investors into gold simply as they look for good ways to diversify equity risk.
iv-If a sufficient number of investors believe that QE will boost the gold price, for whatever reason, then gold will rise. Some beliefs can be self-fulfilling.

Gibraltar Asset Management Limited
One Irish Place, PO Box 166, Gibraltar
Telephone: +350 200 75181 Website: www.gam.gi

Gibraltar Asset Management

STOCKBROKERS & INVESTMENT MANAGERS

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).

Printout from Alpha Terminal - 31/05/2013 09:32