GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - August 2013

FTSE 100	**6,452**	S&P 500	1,638
Resistance	6,660	Gold	$1,396
Support	6,320	GBP/EUR	1.1723
VIX	16.8%	GBP/USD	1.5516

Introduction:

Since our last market commentary, in which we moved to equalweight on equities (from overweight), the FTSE 100 has fallen 168 points (2.5%).

Gold has continued to rise, up 4.9% during the month and sterling has recovered somewhat against both the Euro and the US Dollar.

Our individual recommendations from last month did not fare so well with BATS down 3.8%, Imperial Tobacco down 1.9% and the iShares Emerging Markets Dividend ETF down 6.2%. We are still bullish on all three, in particular Emerging Markets. The old stock market adage "*only monkeys pick bottoms*" springs to mind and we continue to advise buying at these levels. Successful long term investing requires buying "*humiliation*" rather than "*exuberance*". Bank of America Merrill Lynch are advising those with a longer term outlook to start looking at Emerging Markets. While policy makers have yet to panic sufficiently for an inflection point in global risk, an improving long-term risk-reward trade-off could make Emerging Markets the comeback asset class of 2014.

On a more positive note, long-term core defensive stock Vodafone surged ~9% yesterday after the mobile telecoms giant confirmed it was in talks to sell its 45% stake in US joint venture Verizon Wireless to American partner Verizon for around $130bn.

Economics:

Good economic data is continuing to pore in.

US Q2 growth was revised up to 2.5% on an annual basis from an earlier estimate of 1.7%. Economists had forecast a rise to 2.2%. That was more than double the 1.1% rate of annual growth achieved in the first quarter of last year. The news will boost confidence that the world's biggest economy is turning a corner, with many economists predicting growth will continue to pick up pace in the second half of the year.

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Market Commentary (cont)

The strong economic data will also fuel expectations that the Federal Reserve will next month start to withdraw economic stimulus by "tapering" off its vast quantitative easing, or money-printing effort.

Europe has also seen a succession of welcome signs that the economy has reached a turning point with Q2 GDP data having confirmed the beginnings of a gradual, though still subdued recovery. However, the dramatic levels of unemployment means there is no room for complacency.

Inflation data out of Japan showed that prices are rising at their fastest rate in nearly five years, a sign of increased strength in the economy and a vindication of Shinzo Abe's massive fiscal and monetary stimulus programmes. Japan's economics minister, Akira Amari, declared that Japan is "*escaping from deflation*".

Technical Analysis:

The stock market is looking decidedly indecisive at the 6452 level, hovering close to its 20 & 50 day moving averages and trading in the middle of the bollinger bands. The FTSE 100 is still above the upward-sloping 200 day moving average, which is positive for the long-term. Barring a stock market shock, we feel the market will continue to trade sideways in the near term.

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

September

September is typically a reversal month. If markets have fallen in August, they tend to go up in September and vice versa. As August looks set to have fallen over 2.5%, this makes a gain in September a possibility.

Offsetting this, September is historically the worst month of the year for stocks with the DJIA losing more than 1% on average since 1896. Furthermore, equities have moved higher only 40% of the time in September versus nearly 60% for the other 11 months over the same 116-year period.

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 Commentary (cont)

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. On top of the negative seasonal factors that come into play at this time of year, we are wary of more fundamental concerns over the next few months. Whilst we do not believe that a crash will occur, Bank of America Merrill Lynch suggests that investors should certainly keep the word CRASH in the back of their minds. This stands for:

C for Conflict. Any escalation of Syrian/geopolitical tensions could send Brent oil prices to over $125/barrel, the level in 2008, 2011 and 2012 that helped trigger a correction in equities. Historically during oil price spikes, equities have underperformed bonds, which have underperformed cash.
R for Rates. The past 6 years have seen 520 rate cuts and an $11.5trn increase in global liquidity (as a result of asset purchases by the big 5 central banks). One of the worst things for markets right now would be another sell off in bonds, confirming that the period of maximum liquidity is past, thus removing one of the two biggest drivers of the bull market.
A for Asia. As in the Asian crisis of the 1990s, current account deficits are proving the Achilles Heel for Asian & Emerging Markets. Any deterioration should be monitored closely.
S for Speculation. Peaks in NYSE margin debt preceded peaks in the S&P 500 in 2000 and 2007. Margin debt reached a record high in April, but the S&P 500 continued to rally into July and August. This is a similar setup to previous peaks.
H for Housing. The rapid rise in rates has arrested the recent improvements in the US housing markets. To be really confident that we are shifting towards sustained higher growth, we need to see a combination of higher rates and higher growth. In the last couple of weeks we have seen the opposite from the housing market.

Tweet of The Month:

In August, we tweeted that the USD is on a multi-year uptrend, which will see European aerospace players significantly benefitting vs. their US peers. Here we discuss in further detail why the USD is rising, why the European aerospace companies will benefit and, more importantly, which company you should buy.

The USD's uptrend is driven principally by 1) Superior US growth, 2) Economic and monetary policy experimentation in Japan (Abenomics) highlights the scope that central banks outside of the US have to weaken their currencies against the dollar, and 3) China rebalancing away from investment provides downside risks for China-linked currencies (AUD, CAD). By 2015, Deutsche Bank expects the EUR/USD to reach 1.10, USD/JPY 115 and AUD/USD 0.85. Emerging Market currencies may also weaken.

European aerospace companies will obviously benefit as their products will be cheaper to international buyers, including those in the US. On top of this, the sector is benefitting from a number of factors, which will render it less cyclical over the next decade, including:

Market Commentary (cont)

1) Backlogs are at record levels (>8 years)
2) As long as oil trades in the $80-125/bbl range, airlines will continue to favour buying new aeroplanes versus flying old, inefficient ones (B737, 767, early A320s)
3) Long term growth potential in Emerging Markets driven by rising middle class affluence
4) Global traffic growth is growing at ~6% p.a. on average over 2010-13.
5) Airlines are in a stronger financial position compared to history, with balance sheets relatively unleveraged.
6) Low interest rates and accommodative lending has made financing for new aeroplanes very accessible.

Bank of America Merrill Lynch believes such drivers will remain largely in place over the next couple of years in a 3-4% global GDP growth environment and their research suggests that 1,700-2,100 new orders over 2014-2017 could be made.

We would advise our clients to buy **EADS** to profit from this scenario. Trading at EUR43.76, the stock has substantial potential upside to the target prices of most investment banks (e.g. Deutsche Bank=EUR48, Bank of America Merrill Lynch=EUR55 & J.P.Morgan Cazenove=EUR65).

The company has transformed itself since its IPO in July 2000 when EADS was far from a normal company. In the last 8 months alone it as increased its free float from ~50% to ~70%, it has appointed a fully independent board, and it has begun a major share buyback. The company is also embarking on new aeroplane development and cost-cutting measures. During the recent unveiling of its strategy review, which we regard as a positive catalyst for the group's future, the company announced that EADS will be renamed Airbus from July 2014 onwards and the company will remain mostly exposed to commercial activities with expansion in Defence and Space no longer being pursued. Management will also aim to reduce costs in these activities to raise overall margins to 8-10% by 2015. EADS currently trades on 11.6x 2014 P/E, a substantial discount to its closest peer Boeing, which trades on a 15x 2014 P/E.

Recommended Investments:

Equities

1) British American Tobacco - 3274p, 14.7x P/E, 4.5% yield
Trading at a discount to global peers, J.P.Morgan Cazenove has a 4102p price target, indicating 25% potential upside.

2) Imperial Tobacco - 2139p, 10.2x PE, 5.4% yield
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 40% upside.

3) iShares Emerging Markets Dividend ETF (SEDY.L) - 1660p
Emerging market equities have reacted poorly to talk of Fed tapering, leaving this low-cost (0.65% p.a.) ETF that tracks emerging market dividend paying companies looking good value on a yield of 4.9%.

Fixed Interest

1) Intermediate Capital Group 6.25% 19/09/20
A senior ranking of the bond, combined with the excellent track record of the company, implies that the bond offers a good risk/return ratio trading on a 5.7% GRY. See trading note of 22/08/13 for further details.

Market Commentary (cont)

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)
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).

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