GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - January 2014

FTSE 100	**6,745**	S&P 500	1,848
Resistance	6,849	Gold	$1,206
Support	6,522	GBP/EUR	1.2026
VIX	13.7%	GBP/USD	1.6532

Introduction:

Since our last market commentary, in which we moved to overweight from equalweight on equities, the FTSE 100 has risen 90 points (1.4%).

After slipping back to below the 200 day moving average as tapering talks gathered momentum, the traditional Santa Claus Rally soon took hold as predicted and pushed the market to within 100pts of its 2013 high.

Our recommendations from last month put in a flat performance with the falls in HSBC and BATS offset by the positive performances from Centrica, United Utilities and Provident Financial. We are staying particularly bullish of HSBC and note Espirito Santo's recent price target of 850p, indicating potential upside of 28% on top of a 4.7% dividend yield.

Economics:

Last month's note that "*recent improvement in US payrolls has fuelled speculation that the FED could be looking to taper its large-scale asset purchase (QE) programme sooner rather than later*" proved correct with the FED subsequently tapering its QE programme by $10bn a month. Equally correct was our forecast "*we think concerns about broad market disruptions from FED tapering are probably overdone. This is especially true as long as the FED's effort to separate tapering from tightening remains successful*". In fact, after the FED announced tapering and its continued policy of low interest rates, the market enjoyed a terrific rally. Obviously, unwinding the whole programme is another matter and it seems all but certain that more turmoil lies head in 2014.

Indeed, some economists are not ruling out another financial crisis in 2014, as many central banks are unclear about how and when to remove the colossal stimulus they have provided to their economies over the last five years. Indeed, it would be unwise to rule out another financial crisis in 2014. Crashes did, after all, have a habit of breaking out every several years before the Big One in 2007. Nor should it be any

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Market Commentary (cont)

comfort that no one can see one coming in 2014. That's what they said last time.

However, with interest rates likely to remain at historically low levels until 2015 at the earliest, we do not believe that this is a likely scenario. The most vulnerable economies are those emerging markets with big current-account deficits, because they are likely to be the first targets for currency speculators. High on the list would be Brazil, South Africa, Turkey and India. The hot money could certainly leave as quickly as it arrived.

Perhaps the most concern to us is the Eurozone, which has yet to recover from the recession of 2008-2009. Indeed, four big legacy problems will continue to hold them back over the next 12 months: growth (or lack of), unemployment (currently 12%), deflation (increasing the real value of their debt) and zombie banks. Of course, the correlation between GDP and EPS is negligible so that should not put off investors from buying European shares.

Technical Analysis:

Last month's analysis ("*there is no reason for any dramatic move in the markets bar one based on fundamental or seasonal factors*") again proved spot on. Looking ahead, the market has reverted to overbought levels. Lying at 6,749, the FTSE 100 is within just 100 points of its 2013 high, within 16 points of the upper Bollinger Band and is now 177 points above the 20 day moving average. With the RSI reading 67, we feel the market is overbought and a small correction is likely.

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

January ☺

The variation in performance that exists between the 12 months of the year is statistically significant. For example, December is the FTSE 100's best performing month since 1984, rising 2.5% on average, 86% of the time. September is the worst month of the year, rising just 48% of the time, with an average return of -1%.

January is 9th in the ranking of monthly performance, rising 59% of all the years in January, with an average return of 0.5%.

First Quarter ☺

The FTSE All-Share has risen no fewer than 19 of the 25 years between 1990 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.

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Market Commentary (cont)

Seasonality (cont):

Second-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.

Chinese New Year – Year of the Horse

The Chinese calendar revolves around a 12 year cycle where each year is associated with an animal (rat, ox, tiger, rabbit, dragon, snake, horse, goat, monkey, chicken, dog and pig). Each New Year starts between 21st January and 21st February, the exact date being dependent upon a variety of complex factors. The best performing animals since 1950 have been the goat and the dog. The worst performing animals have been the chicken and snake.

This year is the year of the horse, a decent year historically for equities, with positive returns averaging ~7%.

Market's Decennial Cycle

Since 1801, the strongest years for the FTSE All-Share have been the 2nd, 3rd and 5th years in the decades. The market has risen 14 out of the 21 decades in these years, with an average return of over 4%. The weakest has been the 10th being the only year to have a negative average change (-1.2%).

The 4th year has been positive in 13 of the 21 decades, rising on average 6.2%.

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. Therefore, 'strategically', it pays to be in the market. Also, 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 and thus maintain a 'tactical' view.*

Our allocation to the stock market reverts to equalweight. The rally enjoyed by the equity market since mid-December has taken the indices up to levels where we see profit-takers coming in. This is purely a tactical call and does not in any way change our overall bullish stance towards equities. It is simply that the profit taking and talk of tapering may overshadow the good news of a global pick-up in earnings. Indeed, the key drivers for the recovery in earnings are still in place:

1) a pick up in the top line as global GDP growth accelerates
2) an improvement in margins from close to 10-year lows
3) higher operational leverage

Also, we believe that valuations are not yet stretched and there is an upside potential from the flow of funds as money comes out of fixed income products.

Market Commentary (cont)

Tweet of the Month:

During the month, we reflected upon what 2014 may bring for equities. Here we look in detail at what the investment community has to say. The consensus sees global GDP growth accelerating to 3.7% in 2014 (from 2.8% in Q3 2013) with risk in equities to the upside.

UK FTSE 100 Y/E Target = 7,400

UBS has set a 2014 FTSE 100 target of 7,400, calculated using a P/E ratio of 12.8x. They believe that much of the recovery over the past few years has been based on a multiple expansion (the P/E has risen from 8.6x to 12.6x) but the 9.7% upside will be driven by earnings growth going forward (they predict earnings growth of 9% in 2013 and 7% in 2015).

USA S&P 500 Y/E Target = 1,960

The general consensus is that trading on 18x earnings, the US stock market has reached fair value. UBS believes that any further rally based on a US recovery is likely to be lacklustre. Credit Suisse has a 2014 S&P 500 price target of 1960, signalling just 6% of further upside.

Europe DJ Stoxx 600 Y/E Target = 370

Following a re-rating of almost 50% since summer 2012, European equities now trade on a P/E of 13.5x - in line with their long-term average. For the bull market to continue, earnings growth needs to come through and we think it will. UBS forecasts 10% earnings growth in both 2014 and 2015. This has left the region the most favoured of the investment analyst community with large potential upside ahead - Nomura (17%), Merrill Lynch (12%), Barclays (27%), Citi (14%) and Goldman Sachs (14%). This is based on said earnings growth, favourable ECB action on deflation, improvement in global growth and a rise in margins. So, which European country to buy? We like Germany - the DAX trades close to its maximum discount relative to Europe, is significantly more geared to the global economy and has a terrifically strong domestic consumer base, having avoided the massive leveraging seen in other European countries.

Emerging Markets MSCI EM Y/E Target = 1,185

UBS believes that a bearish view on EM is now largely priced in and that EM will not continue to under-perform. Indeed, Credit Suisse believes that there is a good 20% of total return to the end of 2014.

Recommended Investments:

Fixed Interest

The International Personal Finance 6.125% 08/05/20 bond recently fell 4% on news of a £2.4m fine from its Polish regulator. We felt the fall was overdone, as the market initially feared that their whole Home Collection service was under threat. The bond and the shares of the former overseas arm of Provident Financial have recovered significantly and we still feel the issues offers excellent value with a GRY of 6.3% based upon the current price of 99.20. The bond is senior unsecured debt, ranking alongside all other debt with covenants (min. interest cover of 2x and max. gearing of 3.75x) designed to protect bondholders.

Market Commentary (cont)

Quote of the Month:

"Forecasts may tell you a great deal about the forecaster; they tell you nothing about the future" – Warren Buffett

Trader's Corner:

Quarterly Sector Strategy

The following sectors can be have been found to be the strongest/weakest in the FTSE 350 over the year's four quarters:

Quarter	Strongest Sector	Weakest Sector
1st	Industrial Engineering	Pharmaceuticals
2nd	Electricity	Construction & Materials
3rd	Software & Computer Services	Oil & Gas Producers
4th	Beverages	Banks

This suggests a strategy which cycles a portfolio through the four strong sectors throughout the year – Industrial Engineering from 1st January to 31st March, Electricity from 1st April to 30th June, Software & Computer Services from 1st July to 30th September and Beverages from 1st October to 31st December. Over the last 10 years, this strategy would have grown a £1,000 portfolio into £13,300, compared with a buy-and-hold in the FTSE All-Share of £1,669. *Investors looking to trade this strategy, could look to buy shares in Weir Plc (2106p, 15x P/E, 2% yield, 12.5% upside to average broker target) in the first quarter. More sophisticated traders may look to use a CFD to gain leveraged upside to the sector or even create their own hedge fund by shorting Pharmaceuticals whilst going long Industrial Engineering via CFDs.*

Seasonal Tendency

The market has a tendency to climb during the first few days of the year (the Santa Claus Rally officially finishes on 4th January) as the euphoria of December spills over the New Year. However, this excitement then starts to wane and the market falls for the next two weeks. Indeed, the second week of January is the weakest week for the market in the whole year, rising on average just 28% of the time with an average loss of 0.5%. Canny traders should then look to capitalise from the resultant upswing, which takes place in the final week of the month (the year's 7th strongest week, rising on average 0.9%, 66% of the time).

The January Effect

This describes the tendency of small-cap stocks to outperform large-cap stocks in January. The FTSE Small Cap has outperformed the FTSE 100 by an average of 2.7% in January since 1995, underperforming the market just 3 times. *One way to play this would be to buy the iShares MSCI UK Small Cap ETF whilst simultaneously going short the FTSE 100 via a CFD.*

Market Commentary (cont)

Trader's Corner (cont):

Outperformance of FTSE 250 vs. the FTSE 100

The FTSE 250 tends to outperform the FTSE 100 in the first 3 months of the year as well as in August. In the more troublesome months of September (the year's worst performing historical year) and October (the year's most volatile month), the reverse applies. *The obvious way to play this trend is the go long the FTSE 250 and short the FTSE 100 via CFDs from 1st January to the 31st of March.*

Strongest Weeks

Two statistically significant weeks that have historically performed well in January are Week 1 (has risen 69% of the time since 1984, on average 1.2%) and Week 5 (has risen 66% of the time since 1984, on average 0.9%). *Going long the market via a CFD would be best to capture these moves.*

Weakest Week

Week 2 (starts 6th January) is the weakest week of the whole year, rising just 28% of the time and posting an average loss of 0.5%. *Going short the market via a CFD would be best to capture this move.*

Strongest Day

The 26th of January is the year's 3rd strongest day rising 80% of the time, posting an average increase of 0.7%. *Traders looking to profit may look to go long the FTSE 100 with a CFD or take out a binary bet for the FTSE to finish up.*

Weakest Days

The 7th of January is the year's 5th weakest day falling 71% of the time, posting an average loss of 0.2%. The 20th of January is the year's 6th weakest day falling 70% of the time, posting an average loss of 0.5%. *Traders looking to profit may look to go short the FTSE 100 with a CFD or take out a binary bet for the FTSE to finish down.*

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Investment Calendar:

1st January	New Moon (markets tend to reach tops around this time)
3rd January	US Nonfarm payroll
6th January	Year's weakest historical week
7th January	Year's 5th weakest market day (falls 71% of the time with a 0.2% loss)
9th January	MPC interest rate announcement at 12 noon
	ECB Meeting
16th January	Full Moon (markets tend to reach lows around this time)
17th January	Options Expiry Day
20th January	US Market Closed (Martin Luther King Day)
	ECB Meeting
	Year's 6th weakest market day (falls 70% of the time with a 0.5% loss)
22nd January	MPC meeting minutes published
	World Economic Forum, Davos begins
26th January	Year's 3rd strongest day (rises 80% of the time, posting an average increase of 0.7%)
28th January	FOMC meeting until 29th January
31st January	Chinese New Year of the Horse

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).

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9/1/14
14 RSI (simple - Daily)
80
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40
20
14 ADX (Daily)
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30
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