GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - February 2014

FTSE 100	**6,510**	S&P 500	1,782
Resistance	6,837	Gold	$1,245
Support	6,438	GBP/EUR	1.2189
VIX	18.4%	GBP/USD	1.6432

Introduction:

Last month we advised investors "*the rally enjoyed by the equity market since mid-December has taken the indices up to levels where we see profit-takers coming in.*"

Despite the FTSE 100 gaining more than 100 points at one stage, it subsequently fell on profit taking, a weaker than expected job report in the US, a disappointing manufacturing figure in China and pressure in Emerging Market currencies. This brought the market down 3.5%, its worst January performance since 2010. We view this debate as healthy, and remain steadfast in our long-term positive outlook.

Our short-term cautious stance on the equity market saw us recommending the International Personal Finance 6.125% 08/05/20 bond. Despite this, it still put in a decent performance, gaining 1.8%.

Economics:

Last month we noted that "*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.*" Not that we expected investors to take out $9.1bn from emerging market stock and bond funds this past week, with equities seeing their biggest outflow ($6.4bn) since August 2011.

A sharp increase in Turkish interest rates alleviated the pressure for a mere 18 hours as the political backlash ensued. Bank of America Merrill Lynch now fears that "*we are in a negative feedback loop of weak currencies, higher interest rates, weak growth and capital outflows. This feedback loop needs to play out and that means emerging market assets need to become much cheaper. Only then will people come back to buy*".

We are of the opinion that emerging market assets are cheap and those investors with a medium-term time horizon should consider investing in both emerging market equities and debt to benefit from the underlying themes that still exist – low debt to GDP levels, developing economies and favourable demographics.

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Market Commentary (cont)

In Europe things are hardly rosy with Eurozone unemployment stubbornly stuck at 12% for the third month running. Whilst this was to be expected, inflation in January eased to below half of the ECB's target. BNP Paribas feels that whilst the growth outlook is improving for the currency bloc, the ongoing problems in the banking sector, which are manifested through ongoing credit contraction, will continue to act as a drag on both growth and inflation. Given that the Eurozone's recovery is likely to remain gradual, we believe that the ECB is more likely than not to eventually take further action to its recent 25bps rate cut.

Despite its immediate effects on emerging markets, last month's decision by the FED to begin trimming its bond buying programme has generally been seen as a positive step. Indeed, the continuation of the programme could pose a significant threat with banks already building up risky bets threatening financial stability in the longer term.

Technical Analysis:

Last month's analysis ("*With the RSI reading 67, we feel the market is overbought and a correction is likely*") again proved spot on. Looking ahead, the market has reverted to oversold levels. Lying at 6,510, the FTSE 100 is within just 75 points of its recent low, is at the lower end of the lower Bollinger band and is now 43 points below the upwards-sloping 200 day moving average. With the RSI reading at just 22, we feel the market is oversold and that a bounce is likely, which has happened on the previous occasions the RSI reached this level over the last two years.

"The illusion of randomness gradually disappears as the skill in chart reading improves" – John Murphy

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

The January Barometer ☹

Historically, the returns in January have signalled the returns for the rest of the year. If they are positive, the returns for the whole year tend to be positive and vice versa. First mentioned by Yale Hirsch in the Stock Trader's Almanac in 1972, a variant has it that returns for the whole year can be predicted by the direction of the market in just the first 5 days of the year.

Whichever variant you use, statistically 2014 is likely to be a down year if the past has anything to go by.

February ☺

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%.

February is the 3rd best performing month, rising 59% of all the years in February, with an average return of 1%. In fact, the market has only fallen 5 times in February in the last 20 years.

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%.

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Market Commentary (cont)

Seasonality (cont):

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.

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%.

Quote of the Month:

"Money, if it does not bring you happiness, will at least help you be miserable in comfort" – *Helen Gurley Brown*

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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. 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 overweight. Following such a large fall in the market, we feel that technically the equity markets are due a bounce, having reached extreme oversold readings. Fundamentally, the positive catalysts are still in place:

1) Corporate capex outlays as a share of GDP remain at record lows in Europe and consolidation activity is near 20 year lows. J.P.Morgan Cazenove believes that a change here could go a long way in delivering the next upleg in market sentiment, and convince investors that the recovery should be seen as sustainable
2) Corporates are turning a corner with earnings still at recession lows, but the majority of industries are seeing an improvement. UBS sees 2014 as the first year of double-digit growth for 4 years
3) Corporate balance sheets are stronger than before the crisis, with net debt/equity ratios at their best levels in 20 years and relatively high cash hoards. There is therefore enough dry powder for corporates to execute if the sentiment were to improve
4) Eurozone PMIs have regained their upward momentum and are now consistent with at least a 10% EPS growth rate
5) The start of the tapering process is finally behind us, offering increased clarity for investors. The distinction between tapering and tightening has been established and the US yield curve is now steeping again
6) Equities are seeing consistent inflows, in contrast to bonds. This should remain the case in the near term as seasonally the biggest inflows occur at the start of the year. In terms of valuations, equities remain an attractive asset class relative to fixed interest.

Tweet of the Month:

"*Investing should be more like watching paint dry or watching grass grow. If you want excitement, take $800 and go to Vegas*" - Paul Samuelson

This is borne out in economic research which consistently finds that people who trade a lot end up poorer for it. There are three main reasons for this:

1) They are overconfident about their ability to pick winners

2) They are prone to egocentric framing (only thinking from their point of view). An easy antidote to this is to ask before buying a stock "*Why is someone willing to sell me this?*"

3) They fail to appreciate that a lot of news is just noise, which conveys no signal about future returns

There are, however, general principles that have been proven to pay off over the long run, such as the tendency for quality (profitable, growing companies) and defensive and stocks to do well.

Quality, defensive stocks won't make you rich overnight. They are the antithesis to stocks which offer the small chance of a large, quick gain. These tend to be overpriced relative to the market, thus making the former underpriced. It is the many years of slight outperformance of these shares that add up nicely over the long term.

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Market Commentary (cont)

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 (2148p, 14.8x P/E, 2% yield, 11% 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 tends to rise over the first 2 ½ weeks of February and then subsequently drift lower. *Going long the market via a CFD would be best to capture this move.*

Gold Strength

Gold tends to enjoy good gains in February rising almost 60% of the time since 1986 with an average gain of over 1.5%

Seasonality of GBP/USD

On 15th August 1971, President Nixon announced that the US was ending the convertibility of the US dollar to gold and this led to the end of the Bretton Woods system and fixed-rate currencies, such as sterling, became free-floating. Since then, February has statistically been a weak month for GBP/USD, falling on average over 1.5%. *Going short GBP/USD via a CFD would be best to capture this move. Alternatively, buying a share that derives the majority of its earnings in USD and that historically performs well in February is an option e.g. BG Group.*

Market Commentary (cont)

Trader's Corner (cont):

First Trading Day of the Month

Of the 352 months since 1984, the market has risen 214 times (60.8%) on the first trading day (FTD) of each month, with an average rise of 0.24%. This is significantly greater than the average for all days, where the market has risen 52.3% of the time with an average return of 0.03%.

The first trading day (FTD) of February is the strongest FTD of all months in the year, rising 61% of the time posting an average gain of 0.6%. *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.*

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 Day

The 17th of February is the year's 6th strongest day rising 75% of the time, posting an average increase of 0.4%. *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.*

Recommended Investments:

Equities

Following the large market sell-off, we are recommending a larger basket of shares than normal that will hopefully benefit from some sort of reversion to the mean:

1) Aberdeen Asset Management	385p, 11.8x P/E, 4.7% yield, 491p average broker target (28% upside)
2) BG Group	1042p, 13.2x P/E, 1.7% yield, 1317p average broker target (26% upside)
3) BHP Biliton	1791p, 11.8x P/E, 4.1% yield, 2173p average broker target (21% upside)
4) British American Tobacco	2921p, 13.4x P/E, 4.9% yield, 3674p average broker target (26% upside)
5) Diageo	1822p, 16.4x P/E, 2.9% yield, 2123p average broker target (17% upside)
6) GlaxoSmithKline	1582p, 13.7x P/E, 4.9% yield, 1745p average broker target (10% upside)
7) HSBC	624p, 11.0x P/E, 5.0% yield, 777p average broker target (25% upside)
8) Imperial Tobacco	2237p, 10.3x P/E, 5.8% yield, 2517p average broker target (13% upside)
9) Tesco	320p, 11.0x P/E, 4.6% yield, 355p average broker target (11% upside)
10) Unilever	2343p, 18.0x P/E, 4.0% yield, 2526p average broker target (8% upside)

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Market Commentary (cont)

Investment Calendar:

February is a quiet month in general, with the exception of FTSE 100 announcements, where it is the busiest with 34 companies announcing their prelims.

6th February	MPC interest rate announcement at 12 GMT
	ECB Meeting
7th February	US Nonfarm report
14th February	Full Moon (markets tend to reach lows around this time)
17th February	6th Strongest Market Day, rising 75% of the time, posting an average gain of 0.4%
	Washington's Birthday – Wall Street closed
21st February	Options Expiry Day

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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FTSE 100
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Index
6800
6600
6400
6200
6000
5800
5600
5400
6510.21
b
b
B
B
B
3/2/12
Apr
Jul
Oct
'13
Apr
Jul
Oct
'14
10/2/14
14 RSI (simple - Daily)
80
60
40
20
14 ADX (Daily)
40
30
20