GIBRALTAR ASSET MANAGEMENT
STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - May 2014

FTSE 100	**6,780**	S&P 500	1,884
Resistance	6,855	Gold	$1,284
Support	6,620	GBP/EUR	1.2156
VIX	13%	GBP/USD	1.6879

Introduction:

Last month we advised investors "*the market has unwound its overbought levels and we see a lot of value, particularly at a stock-specific level…further inflows into equities are supporting our constructive view on the stock market along with rising bond yields, which are important for the sustainability of the positive outlook*"

The market subsequently rose 182 points (2.76%). Our only recommendation was William Hill, which rose 5.7% (including the 7.9p dividend) to 354.7p. The market is still bullish with BNP Paribas yesterday recommending their clients buy the stock on valuation grounds. Numis is particularly bullish with a 500p price target.

Economics:

The US economy barely grew at all in the first quarter of the year with GDP rising 0.1%, far below economists' forecasts of 1.2%. That was a big surprise and a major disappointment, fuelling fears that the US recovery is much more fragile than hoped. However, some of the decline is clearly explained by adverse weather over the winter and will be reversed in the coming quarter. We rule out that the Fed will modify its policy outlook on the back of yesterday's GDP report and the gradual tapering is set to continue in the coming months.

In Europe, weaker than expected inflation data released yesterday means that the ECB will not be launching a QE programme anytime soon. Inflation in the eurozone rose from 0.5% in March to 0.7% in April. Though economists had expected 0.8%, a pickup in inflation is welcome following fears of deflation in the single currency bloc.

Thankfully, the UK economy is at least providing some news to cheer about with the statistics office reporting yesterday that GDP expanded 0.8% in the first quarter, the fifth consecutive quarter of growth. We believe there are signs that this will become a long-lasting recovery. The significant growth problems over the past few years have been because financial crises are painful, our main trading partner had a crisis, there were substantial austerity measures that needed to be taken and we had an unsustainable

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

Market Commentary (cont)

boom before the bust. Those problems are now fading. This recovery is not a debt-fuelled boom. Indeed, debt is barely growing There are always risks to the recovery but the UK's highly adaptable monetary policy is working and firms and households, quite rightly, are preparing for a brighter future.

Technical Analysis:

Last month's analysis (*"An easing of geopolitical tensions will, we feel, see the market grind higher in what is statistically, the second highest month of the year"*) again proved spot on with the market rising 182 pts. Looking ahead, the market has reverted to overbought levels with the RSI at 68% and the FTSE closing above its upper Bollinger band of 6774. With the market now 163 pts above its 200 day moving average, the market is due a correction. It is not uncommon for markets to stay overextended for long periods of time but with the seasonally strong month of April out of the way and the weaker summer months ahead, we would not be buyers at these levels.

"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*

<u>The January Barometer</u>

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.

<u>May</u>

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%.

May is the 3rd worst performing month, rising just 47% of all the years in May, with an average return of -0.2%. There are only three months since 1970 where the market has an average return of below zero, the other two being June and September.

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

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.

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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%.

Quote of the Month:

"One of the funny things about the stock market is that every time one person buys, another sells, and both think they are astute" – William Feather

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 market has rebounded nicely over the last month and has reverted to levels which many could view as lofty. Seasonal factors will also have a significant impact on the markets with the '*sell in may, go away*' mentality starting to take hold. Indeed, May is traditionally the 3rd worst performing month of the year.

So why not go underweight? Well, though geopolitics (think Ukraine) could always drive further '*risk off*' market sentiment, we believe that the fundamental backdrop remains constructive for equities, especially European stocks.

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Market Commentary (cont)

Market Outlook (cont):

1) JPMorgan Cazenove's base case remains that yields should move higher as disinflation eases and Q2 activity picks up. This is bullish for equities.
2) Though P/E multiples in Europe are at elevated levels, we think robust earnings growth will offset this. Indeed, the gap between PMIs and EPS revisions has never been so big. At its current level of 54 (a 3 year high), PMI points to EPS growth of 15%. This suggests that projections should not just start to stabilise soon, but perhaps move higher in the second half of the year.
3) The Capex/GDP ratio is up for two quarters now, indicating that companies are more comfortable about future growth.
4) The recovery is broadening to include the consumer with consumer confidence making new cycle highs. Retail sales are also picking up.
5) Peripheral yields are making record lows, likely reflective of the dramatically improved investor appetite, further helping the liquidity picture.

Thus, we have two contrasting forces – seasonal weakness versus improved fundamentals. In this market, we advocate using dips as an opportunity to add further to Euro recovery plays – banks (BNP Paribas), periphery (Iberdrola) and cyclicals (Allianz, Delta Lloyd & Ageas).

Tweet of the Month:

"The Coppock indicator is mostly negative for the world's stock markets at the present time"

Edwin Coppock, author of the Coppock indicator, was an American economist and devout churchgoer. He was asked by the Episcopal Church to identify buying opportunities for long-term investors. After some reflection, Coppock concluded that setbacks in the stockmarket were rather like bereavements. They took time to get over, and required a period of mourning before things could return to normal. The Church bishops advised him that this period took between 11 months and 14 months. Coppock took this answer and used it to convert stock market data into a 10-month weighted average of the percentage difference between the market index now versus where it was 11 and 14 months ago.

If the index is less than zero - the weighted average is still showing that the index is down each month on its position 11-14 months previously - then the market is still '*grieving*' over past losses and should be avoided. A buy signal is generated when the indicator is below zero and turns upwards from a trough, indicating that our mourning period is over. Coppock's guide is designed solely to work on identifying the transition from bear market to bull market. Because it based on the idea of the purging of grief over previous losses, it will not work identifying market tops. However, whilst Coppock himself did not offer any conditions under which his indicator would issue a sell signal, technical analysts have suggested that peaks whilst posting positive values might at least work as a cautionary alert to the possible end of a bull trend.

Despite the coppock indicator turning down last month for many of the world's major stock markets (S&P 500, Dax 30, FTSE 100 & Eurostoxx 50), these sell signals occur quite often without any lasting effect. That said, the risk of a more serious correction in US equities is clearly greater today after months of rampaging gains.

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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 Drax Group Plc in the second quarter (663p, 22x P/E, 2.2% yield, 27% upside to average broker target). More sophisticated traders may look to use a CFD to gain leveraged upside to the sector as well as create their own hedge fund by shorting the weakest sector whilst going long the strongest sector via CFDs.*

Seasonal Tendency

The market tends to trade fairly flat for the first two weeks of May and then prices drift lower in the second half. *Going short the market mid-month via a CFD would be best to capture this move.*

Weakest Weeks

The week starting 19th May is the 8th weakest week of the year, falling 57% of the time, posting an average loss of 0.3%. The week starting 26th May is the 5th weakest week of the year, falling 60% of the time, posting an average loss of 0.3%. *Going short the market mid-month via a CFD would be best to capture this move.*

Strongest Days

The 2nd of May is the year's 3rd strongest day rising 76% of the time, posting an average increase of 0.5%. *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.*

Market Commentary (cont)

Trader's Corner (cont):

Weakest Days

The 30th of May is the year's weakest market day falling 78% of the time, posting an average loss of 0.4%. *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.*

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, May has statistically been a weak month for GBP/USD, falling on average ~0.75%. *Going short GBP/USD via a CFD would be best to capture this move.*

Recommended Investments:

Equities

1) JPMorgan Senior Secured Loan Fund

With the stock market facing competing forces of improving fundamentals against geopolitical and seasonal upwinds, our recommendation this month is a bit of a wide ball.

The JPMorgan Senior Secured Loan Fund is an investment trust that trades on the LSE (JPSL.L). JPSL came to the market in December with the objective of providing investors with a high level of income and a secondary objective of capital appreciation by investing in North American non-investment grade floating rate corporate credit instruments, principally senior secured loans. The company's assets and income are hedged back into sterling. Dividends will be paid semi-annually in 2015, moving to quarterly in 2016.

The fund generates 1% more than its peers as it has a higher exposure to cyclical sectors and it takes more liquidity risk (17% of the portfolio is invested in smaller - sub $300m - issues. The fund should generate strong relative returns as an increase in interest rates becomes imminent and is ideal for investors looking to limit duration risk.

The fund offers loans to small companies on a secured basis. JPSL's portfolio is fully invested in a diversified portfolio of 110 issuers across 24 industries, yielding almost 6%. The portfolio is focused on single B credits (67.9% of the portfolio) with a small exposure to CCC credits (4.1%) and no exposure to unrated issues.

The attraction of the fund is that it offers an entirely different return profile to bonds due to their LIBOR linked coupon (very short duration) and lower price volatility (due to their secured status). Loans will typically outperform high yield bonds as interest rates rise. The FED has led the market to anticipate that QE should halt by the end of 2014 and interest rates start to rise in the later months of 2015.

Trading at 99.25p to 101p, the fund is trading at a premium of 1.6% to its NAV of 99.41p. We can pick these up in the market at around 99.5p, which equates to a **prospective dividend yield of 5%**.

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Market Commentary (cont)

Investment Calendar:

1st May	International Worker's Day
2nd May	3rd strongest market day of the year
	Nonfarm payroll report
5th May	May Day Bank Holiday – LSE closed
8th May	MPC interest rate announcement at 12 noon
14th May	Full moon
16th May	Options Expiry Day
19th May	Start of the market's 8th weakest week of the year
21st May	ECB Meeting
26th May	Spring Bank Holiday – LSE closed
	Start of the market's 5th weakest week of the year
28th May	New Moon (markets tend to reach tops around this time)

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 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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