GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - June 2014

FTSE 100	**6,844**	S&P 500	1,923
Resistance	6,863	Gold	$1,245
Support	6,645	GBP/EUR	1.2322
VIX	11%	GBP/USD	1.6758

Introduction:

Last month we advised investors that competing seasonal and fundamentally constructive views on equities would largely cancel themselves out and that we would not be buyers at those levels.

As it happens, the market rose 64 points (0.9%), nothing dramatic but a continuing grind upwards in this bull market. Our only recommendation was the JPMorgan Senior Secured Loan Fund, which has hovered around the same level, as expected. We like this fund, currently yielding 5%, a yield which will only increase as US interest rates pick up.

Economics:

Revised US Q1 GDP figures released on Thursday showed the American economy actually shrunk 1% rather than increased 0.1% - the first time it has reversed in three years. This is deeply worrying and the fall was much sharper than expected. Some argue that this was most likely the result of extreme weather, a temporary setback in an otherwise robust recovery. Others like the Economic Cycle Research Institute (ECRI) think that this is more than just weather related, as leading indicators were already weakening late last year. They believe a snap-back is likely in the 2nd quarter; however, the economy is below stall-speed, even according to the Fed's own model. The ECRI noted that the housing recovery has rolled over into a "*cyclical downswing*" and though the economy may muddle through, the recoveries have been getting weaker with each cycle for the past 40 years. Indeed, the US seems to be endlessly masking the effect by stealing a little growth from the future with artificial stimulus. Weak M4 figures recently released (a dynamic measure that signals economic health a few months ahead) are a sign that the US is not recovering properly and the taper (the Fed has cut its bond purchases from $85bn to $45bn a month) is clearly chipping away at a key prop of the economy. US treasuries have fallen to an 11-month low of 2.41%, a pattern that normally signals a slowdown, evidencing a growing unease amongst investors that something is not right with the world's largest economy.

Over in Europe, the ECB has its own battles as it fights to prevent the 18-nation bloc from being sucked

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

Market Commentary (cont)

into a Japanese-style deflationary trap. Analysts expect the ECB President, Mario Draghi, to imminently introduce a negative deposit rate, meaning the central bank would charge lenders to hold money with it overnight, as well as cut interest rates from 0.25% to 0.15%.

Thankfully, the UK economy continues to grow strongly with retail sales surging at their fastest rate in ten years in April and employment increasing by a record amount in March. The recovery is broad-based and is likely to be sustained. The case for an interest rate hike as early as November is getting stronger and stronger.

Technical Analysis:

Last month, we felt that the FTSE was likely to correct with overbought RSI readings and high absolute readings. We did note though that it was not uncommon for markets to stay overextended for long periods of time and that strength continued into May, though only by 64 points. Looking ahead, the market has unwound its overbought RSI reading to 54% and the ADX, lying at 22, is suggesting there is now a strong trend in the markets. We feel though that the FTSE will struggle to break past its recent high of 6,863 and would rather wait for a pullback to the 6,645 level before buying into this market.

"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.

June

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%.

June is historically the 2nd worst performing month of the year, rising just 40% of the time, with an average return of -0.8%. The market has only risen once in the last seven years in June and the market falls can be quite large – the FTSE has fallen over 3% in June in eight years since 1982.

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.

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Market Commentary (cont)

Seasonality (cont):

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.

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:

"In the business world, the rear-view mirror is always clearer than the windshield"
– Warren Buffett

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 turns to underweight. The market is high in absolute terms and seasonal factors (e.g. 'sell in May, go away') are unlikely to disappear in what is historically the 2nd weakest

Market Commentary (cont)

Market Outlook (cont):

month of the year.

Just looking at the charts, you can see that the FTSE 100 is 199 points above the 200 day moving average and is at a "*triple top*". Some form of pullback is likely from here. US treasuries yields have fallen 60bps to 2.41%, a bearish sign for the equity markets. Bond investors are usually right.

We feel that improving fundamentals (e.g. US earnings revisions are now positive for the first time in three years) support our constructive view on equities. Investment Bank Credit Suisse has just increased its year-end S&P 500 target to 2,020 (5% further upside), FTSE 100 to 7,300 (6.7% further upside) and Euro Stoxx 50 to 3,600 (11% further upside). With most stock market gains tending to come in the 4th quarter, we would argue that the next four months will need to be rather flat before setting itself up for its traditional strong finish to the year.

Tweet of the Month:

"Investment trust valuations are signalling a cautionary note for equities"

Investment Trusts have been around for over a hundred years and offer investors a way to obtain exposure to a broad spread of investments in a single purchase.

Due to their closed-ended nature (the company has a fixed capital structure), an investment trust can trade at a premium or a discount to its NAV. A premium may be warranted by a particularly well-regarded investment manager or underlying assets not yet reflected at its current value in its accounts (e.g. property). Likewise, a discount can arise from a lack of interest in the sector, a poorly-regarded investment manager or an illiquid underlying portfolio.

Whether you are looking to buy an investment trust or not, research has shown that watching the premium/discount data for the investment trust sector as a whole can provide worthwhile clues as to the outlook for the broader equity market. When investment trusts are collectively trading at a premium, investors are very optimistic about the future and when they are trading at a discount, investors are shunning risk. Doing the opposite of the crowd invariably produces superior returns.

Since 1980, the average discount to NAV has been 13.5%. Currently the discount is just 3.8%, not far from its narrowest ever discount of 3.2% reached in 2006.

If history is any guide, this is bad news for the outlook for UK stocks in general. Indeed, the sector is more dearly rated today than it has been for around 90% of the time since 1980. On those rare occasions when valuations got as high as they are now, trouble inevitably followed.

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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 (629p, 25x P/E, 2.0% 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

In an average June the market starts strong, hitting its month high on the second or third trading day, but prices then drift steadily down for the rest of the month. *Going short the market via a CFD on the 7th of June would be best to capture this move.*

Strongest Weeks

The week starting 30th June is the 5th strongest week of the year, rising 70% of the time, posting an average gain of 1%. *Going long the market via a CFD would be best to capture this move.*

Weakest Weeks

The week starting 16th June is the 2nd weakest week of the year, falling 67% of the time, posting an average loss of 0.9%. *Going short the market mid-month via a CFD would be best to capture this move.*

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Market Commentary (cont)

Recommended Investments:

Fixed Interest

1)Ladbrokes 5.125% 16/09/22

With the markets so high and interest rates so low, it makes sense to have a fixed interest recommendation this month. In what is only the second new issue of the year, Ladbrokes is launching a bond with a very enticing 5.125% coupon. The purpose of the bond is to refinance Ladbrokes existing bank debt, which is at the same interest rate but with a shorter time until maturity.

The Ladbrokes business was formed in 1886 initially as a horseracing enterprise and began trading as a bookmaker in 1902. It expanded its retail presence significantly after the legalisation of high street cash betting in 1961 and floated on the London Stock Exchange in 1967. Since 2000, the Group has enjoyed significant growth in online betting and gaming (873,000 active customers), in addition to its high street presence (Ladbrokes is the second largest retail player in the UK with 2,297 shops) and telephone betting service, which serves more than 35,000 active customers. In addition to the UK, the group also has significant operations in Ireland (295 shops), Belgium (359 outlets) and Spain (753 outlets).

This bond looks good value. Whilst it has been rated as BB (Outlook Stable), which indicates an elevated vulnerability to default risk in adverse business conditions, the company has consistently made money over the last five years. There is also a negative pledge whereby the Group undertakes to not create a security interest over their assets without including these bonds. The bond is unsecured, which means that investors would have the same level of seniority as banks in terms of being repaid in the event of the company going bankrupt.

The bonds will be issued on the Order Book for Retail Bonds and traded on the London Stock Exchange with a minimum subscription size of £2,000 and £100 thereafter.

The Offer Period ends on the 10th of June. However, many recent retail issues have closed early as sufficient capital had been raised. With the strength of the brand, strong cash flows and an experienced management team, we believe that this issue will do the same and fly off the shelves. With the odds being that this issue will also trade above par in the secondary market, we feel this is a good bet.

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Market Commentary (cont)

Investment Calendar:

5th June	MPC interest rate announcement at 12 noon
	ECB Meeting
6th June	US Nonfarm payroll report
11th June	FTSE 100 quarterly review
13th June	Full moon (markets tend to reach a low point around this time)
16th June	2nd weakest market week
17th June	Two-day FOMC Meeting begins
20th June	Options Expiry Day
27th June	New Moon (markets tend to reach tops around this time)
30th June	5th strongest market week

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 thin 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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