GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - July 2014

FTSE 100	**6,743**	S&P 500	1,960
Resistance	6,884	Gold	$1,327
Support	6,710	GBP/EUR	1.2519
VIX	12%	GBP/USD	1.7132

Introduction:

Last month we advised investors that considering that the FTSE 100 was lying 199 points above the 200 day average and at a "*triple top*", some sort of pullback was likely.

As it happens, the market fell 101 points (1.5%) after the market failed to break the recent high of 6,863. Our only recommendation was the Ladbrokes 5.125% 16/09/22 bond, which has risen 3% in the secondary market since its issue.

Economics:

In Europe, the banking crisis rumbles on. This time it is Bulgaria's turn as the country's banks were hit by a spate of bank runs amid speculation that its banking sector is wobbling, though officials have blamed it on individuals spreading misinformation in order to destabilise the financial system. In response, the European Commission has approved a request by Bulgaria to extend a credit line of £1.35bn. Authorities in Brussels also tried to calm saver's worries, noting that its banking system was well capitalised with higher levels of liquidity compared to its peers in other member states.

Elsewhere in Europe, poor Eurozone inflation figures came in at 0.5% in June, the ninth month that inflation has been below the target of 2%, underlining the fact that the ECB was right to announce new stimulus measures earlier in the month. The ECB is probably happy with this low inflation rate, as long as outright deflation is avoided. Nevertheless, the resultant high real interest rates and debt burdens will add to the costs of periphery rebalancing.

The UK's economy appears to have finally burst through its pre-crisis peak to a new record level, almost £65bn larger than 2008 according to the Office for National Statistics. The new figures, to be published in September, incorporate for the first time such corporate activities as prostitution. Never again can the British be described as prudes.

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Market Commentary (cont)

Economics (cont):

Unfortunately the world's largest economy shrunk much more than previously thought in the first quarter - 2.9% - the steepest rate of decline since the first quarter of 2009, when output tumbled 5.9%. Weak consumer and healthcare spending wiped the equivalent of $15bn off the US economy, which is now predicted to be overtaken by China in just five years. The fall in GDP led Fitch to cut its forecast for growth this year to just 2% from 2.8%.

Technical Analysis:

Last month, we felt that the FTSE would struggle to break past its recent high of 6,863 and that we would rather wait for a pullback to the 6,645 level before buying into the market. In the event, the market did not break past its previous high, and has fallen back to 6,743. With the ADX at 16, the trend has broken down and we do not see the market moving much either way from here. The FTSE is now just 66 points above its 200-day moving average. If anything, the picture looks slightly bullish with the RSI at 30 and the index lying just above the lower Bollinger band.

"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.

July ☺

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%.

July is historically the 5th best performing month of the year, rising 55% of the time, with an average return of 0.8%.

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:

"Listen to what the market is saying about others, not what others are saying about the market" – Richard Wyckoff

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 equalweight. After having fallen 1.5% and with the RSI unwound and looking even oversold at 30%, we are no longer inclined to continue swimming against the tide.

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Market Commentary (cont)

Market Outlook (cont):

July is not a bad month historically for equities, but which market looks best at this moment in time? In our mind, the US market looks fully valued. The UK is also under the spotlight with rising interest rate expectations (which decrease the value of equities), sterling strength (75% of the FTSE 100 equities come from outside the UK), the defensive nature of its leading index and large amounts of political event risk (Scottish independence, General Election in 2015 and potential EU withdrawal in 2017). Indeed, global investors have just turned net sellers of the UK over the last month.

We favour European equities, which could see 40%+ EPS growth over the next three years, the most for any of the major regions. Whilst the P/E of 14.5x is the highest it has been in 12 years, it does not yet price in the potential for this superior earnings growth. Equity inflows remain supportive, outpacing those of bonds for the second year in a row. PMIs are in expansion territory, which is consistent with above average P/E multiples. We advise adding beta to portfolios – Cyclicals' earnings are holding up better than those of Defensives, and Cyclicals are more leveraged to accelerating economic activity. They have undershot the multiple expansion seen over the last few years where the bulk of the expansion was due to the re-rating of Defensives – bond proxies. We particularly like Daimler, Allianz, Ageas, Adidas, Societe Generale & Axa.

Tweet of the Month:

"The DAX is the worst performing large Eurozone market year-to-date. Is now the time to buy?"

Indeed, the DAX is back to its cheapest level vs the Eurostoxx50 since 2003, derating by 23% since the peak in 2009. Research conducted by J.P. Morgan Cazenove ("JPM") has found that it is also the most attractive Euro market on a P/E metric, at 12.8x, and is the only one that has derated year-to-date. Other reasons to be bullish include:

1) DAX is a big global cycle play, and the Global PMI has just advanced to the best levels since February 2011. JPM expects global GDP growth to accelerate to an above-trend pace in H2, driven by both developed and emerging markets. The DAX is the most Cyclical European index with 57% share of Cyclicals vs only 27% in Defensives. Cyclical stocks tend to outperform in such a climate.

2) The DAX is a good way to play an improvement in Emerging Market and China sentiment. JPM has turned positive on the region in the last few months after nearly three years of being cautious.

3) DAX is a big FX play. JPM expects the Euro to weaken further (to 1.30 vs the dollar by December). This would be an important positive for DAX earnings, as it derives 56% of its revenues outside the Eurozone.

4) DAX is showing resilient earnings trends with EPS revisions having turned positive most recently and are the highest in two years.

JPM is recommending such names as Volkswagen, Infineon Technologies, SAP, Siemens, Heidelberg Cement and Thyssen Krupp AG. Alternatively, investors can buy an ETF that tracks the DAX at a very low cost. The xtrackers DAX ETF (XDDX) trades on the London Stock Exchange in sterling with a TER of just 0.09%.

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. Investors looking to trade this strategy could look to buy shares in Computacenter in the third quarter (603.5p, 12.7x P/E, 3.1% yield, 21% upside to the 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 July the market starts strong, the first week being historically the year's 5th best performing week. It tends to have a dip in the third week before rising strongly in the final week, which happens to be the strongest week of the year. *Going long the market via a CFD on the 28th of July would be best to capture this move.*

Strongest Weeks

The week starting 28th July is the strongest week of the year, rising 79% of the time, posting an average gain of 0.6%. *Going long the market via a CFD would be best to capture this move.*

Weakest Weeks

The week starting 7th July is the 3rd weakest week of the year, falling 62% of the time, posting an average loss of 0.6%. The week starting 21st July is the 4th weakest week of the year, falling 62% of the time, posting an average loss of 0.4%. *Going short the market mid-month via a CFD would be best to capture this move.*

Market Commentary (cont)

Trader's Corner (cont):

Strongest Days

The 28th of July is the 8th strongest day of the year, rising 75% of the time, posting an average gain of 0.2%. The 29th of July is the 9th strongest day of the year, rising 75% of the time, posting an average gain of 0.5%. *Going long the market via a CFD would be best to capture this move.*

Weakest Days

The 8th of July is the 2nd weakest day of the year, falling 75% of the time, posting an average loss of 0.2%. *Going short the market mid-month via a CFD would be best to capture this move.*

Recommended Investments:

Equities

1) Carillion 314p, 9.9x P/E, 5.4% yield
Construction & Support Services company that is trading on a very cheap P/E multiple and a good yield. Stock is below its upward-sloping 200-day moving average and oversold with an RSI reading of just 30%. Potential 24% upside to the average broker price target.

2) GlaxoSmithKline 1576p, 14.6x P/E, 5.0% yield
Pharmaceutical giant trading at the bottom end of its trading range. Shares below 200-day moving average. Potential 9% upside to the average broker price target.

3) HSBC 597p, 10.5x P/E, 5.2% yield
Banking group with an emphasis on emerging markets. Stock at a "*triple bottom*" on the charts and extremely oversold. Good dividend yield and low valuation. Potential 15% upside to the average broker price target.

4) Vodafone 196p, 18.5x P/E, 5.9% yield
Global telecommunications giant, which is trading at an 18-month low. Potential 14% upside to the average broker price target.

Market Commentary (cont)

Investment Calendar:

3rd July	ECB Meeting
4th July	Independence Day – Wall Street closed
	Nonfarm payroll report
7th July	3rd weakest market week
8th July	2nd weakest market day
10th July	MPC interest announcement at 12 noon
12th July	Full moon (markets tend to reach a low point around this time)
17th July	ECB Meeting
18th July	Options Expiry Day
21st July	4th weakest market week
26th July	New Moon (markets tend to reach tops around this time)
28th July	Strongest market week
	8th strongest market day
29th July	9th strongest market 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)
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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