GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - October 2014

FTSE 100	**6,622**	S&P 500	1,972
Resistance	6,878	Gold	$1,208
Support	6,568	GBP/EUR	1.2843
VIX	16%	GBP/USD	1.6207

Introduction:

Last month, we moved to underweight on the stock market, noting that the market was overextended with the RSI at 85%, adverse seasonal factors were coming into play in September and a correction was on the cards.

In the event, the market fell 198 points (3.0%).Volatilty predictably rose to 16.3% and the USD strenghened to 1.6207 against the pound. Our only recommendation was Burford Capital 6.5% 19/08/22, which rose a quarter of a point.

Economics:

Though European growth remains modest and uneven, we do not think that the recovery will go off track. Unemployment is likely to stay structurally high, but signs of stabilisation and even modest improvements in employment are visible, even in the periphery. This should stabilise and improve wage dynamics, consumer confidence and household consumption. However, poor Q2 GDP data and risks emanating from the Russia-Ukraine make it clear that patience is needed. UBS has cut their GDP growth projection for 2014 to 0.9% (from 1%) and for 2015 to 1.4% (from 1.5%).

Countries outside of the Eurozone continue to outperform. UBS maintains their UK growth forecasts of 3.1% for 2014 and 2.8% for 2015. These forecasts are all the more plausible following the positive result from the Scottish Referendum (a 'Yes' vote would have been catastrophic for the wider economy considering the economic uncertainties it would have created).

The US economy appears to be strengthening. This is seen in a number of robust recent data - from credit demand, car sales, PMIs and consumer confidence to the number of job vacancies. With pretty much all parts of the economy humming, GDP growth is likely to reach 2.8% in the final two quarters of the year and 3% in 2015, with particular strength early in the New Year.

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Market Commentary (cont)

Technical Analysis:

Last month, we advised that with the FTSE 100 within 45 points of the upper Bollinger band and the RSI at an overextended 85%, we saw a correction on the cards and initially targeted the 200 day moving average at 6,712. In the event, the market fell 198 pouints to 6,622. Now with the RSI at 28%, the market has reverted to an oversold position. The FTSE 100 is lying 119 points below the 200 day moving average and the market is trading at the lower end of its rising trend channel. We see this as a good opportunity to buy into the dip.

"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.

October

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%.

Despite its reputation for volatility (since 1987, seven of the ten largest one-day falls in the market have occurred in the month of October), for the most part the market posts a positive return - rising 0.7% on average 76% of the time.

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.

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:

"I will tell you how to become rich. Close the doors. Be fearful when others are greedy. Be greedy when others are fearful" – 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 moves to overweight. October is historically a good time for equities (rising 0.7% on average, 76% of the time) occasionally punctuated by bone-jarring losses. However, we feel that any correction will be short lived. The August rally, following July's decline, showed that investors are anxious to buy into any dip, suggesting that corrections into year-end will only beget more bargain buying.

Technically, the market is oversold with the FTSE 100 lying 119 points under the 200 day moving average and trading just above its lower trend channel.

Market Commentary (cont)

Market Outlook (cont):

We feel that time is on the side of the bulls, at least through to 31st December. In every investing year, there comes a time when the losing side must capitulate or risk finishing further out of the money than the bulls or bears in charge. Capitulation breeds further outperformance for the winning side and further misery for the losers. It also sets the stage for reversal in the follow-on year. For now though, all the parts and pieces-the economy, interest rates, earnings, and market momentum-set the stage for a victory run into year-end.

Investment bank UBS is particularly bullish on European equities. Despite reducing their top-down 2014 EPS growth forecast from 10% to 7% and their year-end Eurostoxx 600 target from 370 to 360, they believe that the sharp depreciation in the Euro following more proactive action from the ECB is being underestimated. A weaker Euro has three effects: 1) it boosts economic growth, 2) it staves off deflation fears, and, 3) it supports corporate profits. In Q1 the Euro headwind was 7%, in Q2 it fell to 5%, and by the end of the year it will likely be a tailwind. And this is assuming it stays at current levels. UBS economists now expect EUR/USD to fall to 1.25 by year-end and 1.20 by end-2015. As the US macro data has sharply decoupled from Europe, look to gain exposure to stocks with high revenues from the US and those geared to a weaker Euro e.g. Airbus, BASF and BMW.

Tweet of the Month:

"*The European insurance sector is currently a source of very rich pickings for investors with cash dividend yields of up to 12.7% available*"

Research by investment bank J.P. Morgan Cazenove ("JPM") has found that dividend surprises - whether they be from progressive, special or high dividend payouts, have been a winning strategy in the UK. JPM found that there is a high correlation between high dividend payout surprises and share price performance. They have selected the following shares as providing the greatest share price support in the next 12 months, largely consisting of special dividend upside:

Company	Price	Price Target	Potential Upside	Yield	Yield (incl. special)
BRIT	244.5p	265p	8.4%	7.4%	12.7%
Catlin	523.5p	580p	10.8%	6.6%	10.5%
Standard Life	411.1p	432p	5.1%	22.1%	22.1%

BRIT and Catlin are both forecast to pay special dividends post a benign hurricane season. Standard Life is to reward shareholders with a £1.75bn capital return.

JPM believes that this strategy, in a low growth, low yield environment, will also prove to be a winning formula in Europe. They have selected the following stocks that have dividend upside surprise:

Company	Price	Price Target	Potential Upside	Yield	Yield (incl. special)
Munich Re	€156.20	€185	18.4%	8.9%	8.9%
Allianz	€127.15	€152	19.5%	6%	8.7%

Munich Re is expected to buy back shares to the tune of €1bn annually and Allianz is expected to move to a progressive dividend policy.

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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, compares 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 Diageo Plc in the third quarter (1778p, 18.6x P/E, 3.2% yield, 8% 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 month, the market trends to rise in the first two weeks, then to fall back, before a surge in prices in the last few days of the month. This is perhaps because October marks the end of the weak six-month period of the year, so many investors are looking to increase their exposure to equities towards the end of the month.

Going long the market via a CFD at the beginning of the month before switching to short on 13th October and then going long on 27th October would be best to capture this move.

Strongest Days

The 1st of October is the fourth strongest day of the year, rising 76% of the time, posting an average gain of 0.40%. The 31st of October is the 5th strongest day of the year, again rising 76% of the time, posting an average gain of 0.40%.

Going long the market via a CFD would be best to capture this move.

Weakest Days

The 22nd of October is the 10th weakest day of the year, falling 67% of the time, posting an average loss of 0.6%.

Going short the market via a CFD would be best to capture this move.

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Market Commentary (cont)

Recommended Investments:

Fixed Interest

1) Eros International 6.5% 15/10/21

Following demand for further diversification of fixed interest issuers (they have tended to occupy the property and financial services space), another interesting bond has arrived that we feel is suitable for medium-term investors looking for a good income stream.

Founded in 1977, Eros International Plc is a leading global company in the Indian film entertainment industry, which co-produces, acquires and distributes Indian language films.

The Group has aggregated rights to over 2,300 films including recent and classic titles that span different genres and budgets. The Group's distribution capabilities enable it to target a majority of the 1.2bn people in India as well as to non-Indian customers in 50 counties around the world who view Indian films that are subtitled or overdubbed in local languages.

It has also released over 220 new films over the last three years, including many big budget and Tamil language films. The Group's typical annual slate of films is comprised of high or medium budget films in the popular comedy and romance genres, supported by lower budget films.

Whilst the issue is unrated, the bonds are senior unsecured, ranking ahead of ordinary shareholders. The terms and conditions of the Bonds contain a number of covenants, including a limitation on debt that seeks to restrict the Group's ability to incur additional debt. There is also a negative pledge where Eros International Plc will not create a security interest over any of their assets to secure any debt without equally and at the same time securing the bonds.

The bonds have been issued on the Order Book for Retail Bonds and trade on the London Stock Exchange with a minimum subscription size of £2,000 and £100 thereafter. The company aims to raise £100m from the bond issue, with the money being used to repay other borrowings.

Investors should feel confident buying the bonds. Eros's net debt stood at $126m at the end of June, or 22% of its equity, so it isn't drowning in debt by any means. It simply wishes to diversify its sources of funding. The company has made consistent profits over the last five years. Its constant-currency sales rose 15% in Q2, while its adjusted full-year cash profits leapt 43% to $80m last year. That reflects strong demand for Indian films worldwide. The nature of its business makes the bond a good diversifier away from other financial assets as it is an uncorrelated asset class. The closing date of the offer period is the 9th of October; however, similar to previous new issues, we believe this could close early with the bonds trading higher upon listing in the secondary market.

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Market Commentary (cont)

Investment Calendar:

1st October	4th strongest market day
2nd October	ECB Meeting
3rd October	Nonfarm payroll report
8th October	Full moon (markets tend to reach a low point around this time)
9th October	MPC interest rate announcement at 12 noon
15th October	ECB Meeting
17th October	Options Expiry Day
22nd October	10th weakest market day
23rd October	New Moon (markets tend to reach tops around this time)
29th October	FED Meeting
31st October	5th 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 thin 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)
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.

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