GIBRALTAR ASSET MANAGEMENT
STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - December 2014

FTSE 100	**6,722**	S&P 500	2,067
Resistance	6,840	Gold	$1,157
Support	6,195	GBP/EUR	1.2575
VIX	13%	GBP/USD	1.5634

Introduction:

Last month, we remained overweight on the stock market, noting that November was historically a good month for equities as well as being the start of the strongest half of the year. Technically, the market was also quietly bullish with the RSI at 61% - a nice level for a continuing uptrend in the market.

The market rose 2.7% to 6,722. Unfortunately, our recommendation in BHP performed poorly falling 6.7% mainly due to the fall in iron ore. However, we believe the fall in the oil price will provide some comfort for the stock going forward and would use this as a buying opportunity.

Economics:

Figures released on Friday revealed that unemployment in the 18-country Eurozone is stuck at 11.5%. In Italy the jobless count has risen to 13.2% (its highest since 1977), while in Greece and Spain, a quarter of the working population is out of work. Inflation in the Eurozone was just 0.3% in November, putting added pressure on the ECB to step up its stimulus campaign. Most analysts expect this ultralow inflation to prompt the ECB to purchase large amounts of government bonds in early 2015 to raise the money supply and further depress borrowing costs, following a route taken by central banks in the U.S., U.K. and Japan. Commerzbank economists said Friday they expect Eurozone inflation to hit zero by January. Analysts at Citi expect the ECB to launch a government bond programme on 22nd January. This will be a major positive for European equities.

The US economy was far stronger than initially thought in the 3rd quarter – with GDP being revised up from 3.5% to 3.9%, as strong consumer spending and business investment helped the economy to post its strongest six months of growth in more than a decade. This brisk economic growth is another reason to expect the FED to begin normalising interest rates sooner than expected next year, perhaps as early as March.

Strong consumer and government spending drove UK growth up by 0.7% in the 3rd quarter. This follows growth of 0.9% in the 2nd quarter, making it the fastest growing economy in the G7 this year. Household

Market Commentary (cont)

Economics (cont):

inflation and an ongoing supermarket price war helped to boost household incomes and support consumption. The UK has now expanded for seven consecutive quarters. However, a Treasury spokesman has warned against complacency saying the UK was "*not immune to weakness in the Euro area and instability in global markets*".

Technical Analysis:

Last month, we noted that the bull market was still intact and with the RSI lying at 61%, the FTSE was poised to continue its upward trend between now and year end, barring any geopolitical shocks. The market subsequently rose 2.7%. Whilst fundamentally bullish, technically the market looks overbought with the RSI at 71% and the index towards the upper Bollinger band. Strong seasonal factors, however, should push the market towards its recent highs north of 6,800.

"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>December</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%.

December is the best month of the year for shares. Since 1984, the FTSE 100 has increased 86% of the time on average by 2.5% in December. Indeed, it has only fallen a total of 4 times in those 28 years.

<u>November - April</u>

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.

<u>Second-Year U.S. Presidential Cycle</u>

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.

Market Commentary (cont)

Seasonality (cont):

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:

"Share prices follow the theorem: hope divided by fear minus greed" – Dominic Lawson

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 remains overweight. December is historically the best month of the year for equities (rising on average 2.5%, 86% of the time). Technically, the market is overbought but we remain positive on stocks.

The US bull market looks particularly tired now in its 68th month (versus the 50-year average of 54 months) with valuations particularly full. We still retain our preference for European equities, noting that JP Morgan Cazonove has just upgraded the Eurozone from Underweight to Overweight, based on the following rationale:

1-The Eurozone stock market has lagged the US by 22% so far this year in USD terms and is now trading at a lower price relative than the one recorded at the point of peak stress in 2012, when a Eurozone breakup was almost the base case.

2-The price of Eurozone stocks has now moved to the cheap side of fair value.

3-Eurozone M3 (a measure of money supply) has been picking up since April and it tends to lead economic activity. Lending is improving following positive bank stress tests (which finance 3/4 of all loans in Europe).

Market Commentary (cont)

Market Outlook (cont):

4-The ECB balance sheet could expand 35% from here, which is not negligible and will be hugely positive for equity markets.

5-The falling Euro is a tailwind for growth, for exporters and for earnings. A 10% move lower in the trade-weighted Euro should boost growth by 1% over a two to three year period.

European exporters should particularly benefit (which is why we have been favouring German equities) along with sectors that have significant revenue exposure to the continent and are the most likely to benefit from improving domestic activity. Such sectors include Financials (Soc Gen & Allianz), Industrials (Siemens), Materials (Lanxess), Autos (Volkswagen Pref, BMW & Daimler), Transport (Airbus) and Consumer Discretionary (LVMH & Adidas).

Tweet of the Month:

"*Oil prices have fallen 25-30% from their June highs. We see this as a positive for equities as it equates to a tax cut for most of the world*"

JP Morgan Cazenove believes that oil prices will fall further to the low $70's in Q1 2015 and, crucially, will remain at current levels through 2015 and 2016, expecting no rebound at all. They see the following implications in this:

1) Lower inflation ahead, potentially negative in some countries

Though the knee-jerk reaction will likely be intensifying deflationary concerns, policy makers should look through this. Subdued inflation can almost fully be explained by the lower oil price. The deflationary scare should fade as G-4 wage growth is running at 1.6% and house prices are growing at a 3.2% annual pace. Liquidity conditions remain largely supportive – M3 is accelerating in the Eurozone and US credit growth is picking up.

2) Positive impact on the economy

The sharp fall in oil and other commodity prices is a welcome development for final demand, as it boosts real disposable incomes and purchasing power. Many may see the falling oil price as a "*risk-off*" indicator, a signal that demand is weakening. However, the key driver of lower oil prices appears to be the spike in supply. This contrasts with 2001 and 2008, when poor oil demand drove the downside. Historically, a sharp fall in oil prices tended not to be a precursor to a slowdown in activity, on the contrary.

Regionally, Eurozone stock markets and, in particular Germany, stand to benefit due to a relatively favourable sector composition of the index. Sectors to focus on include consumer facing cyclicals such as Transport, Airlines, Autos, Retail and Travel & Leisure. Such consumer stocks include Easyjet, Daimler, BMW etc. We would not sell energy stocks at these levels. Valuations are cheap and seasonality is typically positive in H1.

Market Commentary (cont)

Trader's Corner:

Quarterly Sector Strategy

The following sectors 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 fourth quarter (1988p, 20.9x P/E, 2.8% yield). 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 tends to increase slightly in the first two weeks of the month, but then rises strongly in the final two weeks. Indeed, this is the strongest two-week period in the whole year. *Going long the market via a CFD on 15th December would be best to capture this move.*

Strongest Weeks

The week starting the 15th of December is the 3rd strongest week of the year, rising 76% of the time, posting an average gain of 0.8%. The week starting the 22nd of December is the 4th strongest week of the year, rising 76% of the time, posting an average gain of 1%. The week starting the 29th of December is the 6th strongest week of the year, rising 69% of the time, posting an average gain of 1.2%. *Going long the market via a CFD would be best to capture these moves.*

Strongest Days

The 16th of December is the 10th strongest day of the year, rising 75% of the time, posting an average gain of 0.6%. The 23rd of December is the 2nd strongest day of the year, rising 80% of the time, posting an average gain of 0.4%. The 24th of December is the strongest day of the year, rising 81% of the time, posting an average gain of 0.2%. *Going long the market via a CFD would be best to capture these moves.*

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Market Commentary (cont)

Trading Corner (cont):

Option of the Month
Sell Royal Dutch Shell 'B' February 2000 puts @ 35p

Strike price at multi-year lows, supported by a 5.3% dividend yield and trading on a P/E ratio of just 9.3x. Premium equates to an annualised yield of 10.2%.

Click here to view our guide to the Traded Options Market.

Recommended Investment:

Premier Oil 5% 11/12/20
Following the 30% fall in the price of crude, the oil sector has obviously taking a hammering. This month, we are recommending a bond that has fallen 17%, which we feel represents good value at this level.

Premier Oil is an international oil & exploration company headquartered in London with a market capitalisation of ~£1bn. Founded 79 years ago in Scotland, the company today pursues a strategy of low-risk development of existing discovered reserves whilst maintaining shareholder leverage to material exploration upside, which forms just 25% of the business.

Since 2005 when the current management was installed, the company has gone from being an explorer to being a producer, which has pushed production up from 30,000 bpd to 60,000 bpd. Current production comes from 20 producing assets in the UK (North Sea), Pakistan, Vietnam and Indonesia. Thus, the company is protected to a significant extent from 'event' risk. Because of the quality of the assets, the Group's existing producing fields generate significant cash flow even at low oil and gas prices. For example, their cost of production ranges from sub $10 per barrel in Pakistan, which is on-shore, to about $50 from their Norwegian fields. They therefore have good room to manoeuvre. And their technology for offshore production is improving too through the use of floating tankers, which are cheaper to construct, operate (they offload straight onto tankers) and decommission.

The Group also has a portfolio of discovered fields in the development phase in the UK, Norway, Vietnam, Indonesia and the Falkland Islands. The Group is targeting future production rates in excess of 100,000 barrels of oil equivalent per day. As at 31st December 2013, the Group had a reserves and contingent resource base of 800m barrels of oil. The average remaining life span of the fields that are currently producing is 13 years.

Premier oil has large tax losses/allowances of approaching $2.3bn, following a takeover of a loss making company, so it is unlikely any tax will have to be paid in the UK for 5 years. The company has been profitable for the last 5 years.

Whilst the issue is unrated, the bonds rank pari passu with the company's bank debt, which is a major plus. There is also a negative pledge whereby Premier Oil will not create a security interest over any of their assets without equally and at the same time securing the bonds.

Trading at 83.50, the bonds are currently yielding 6% with a GRY of 8.6%. We feel this is too attractive to miss and recommend investors to buy.

Market Commentary (cont)

Investment Calendar:

4th December	MPC interest rate announcement at 12 noon
	ECB Meeting
5th December	Nonfarm Payroll Report
6th December	Full moon (markets tend to reach a low point around this time)
10th December	FTSE 100 Quarterly Review
15th December	3rd Strongest Market Week
16th December	10th Strongest Market Day
18th December	FED & ECB Meetings
19th December	Options Expiry Day
22nd December	New Moon (markets tend to reach tops around this time)
	4th Strongest Market Week
23rd December	2nd Strongest Market Day
24th December	Strongest Market Day
	Christmas Eve (LSE closes early at 12.30pm)
25th December	Christmas Day (LSE closed)
26th December	Boxing Day (LSE closed)
29th December	6th Strongest Market Week
31st December	New Year's Eve (LSE closes early at 12.30pm)

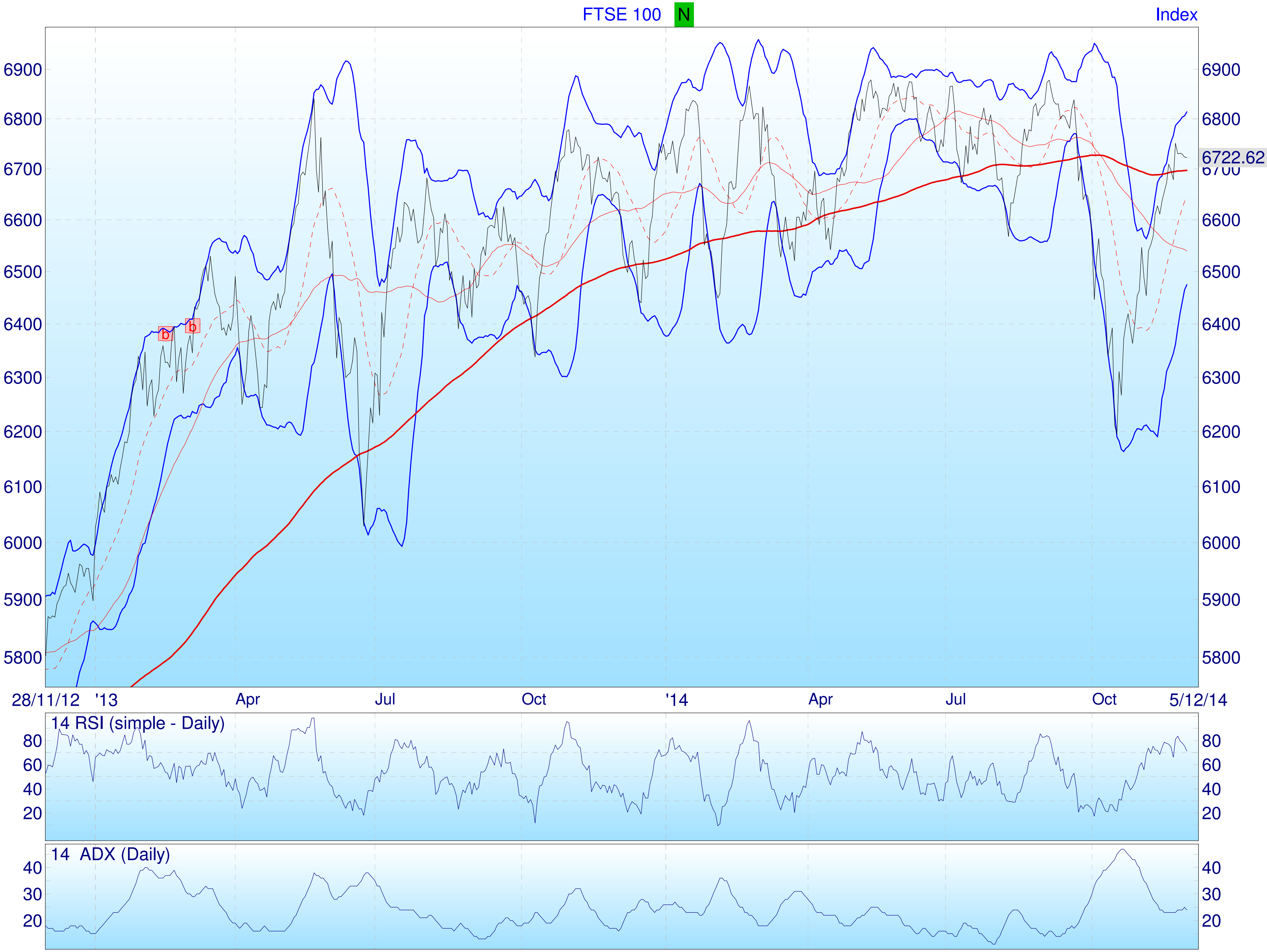
Chart Legend:

(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)
(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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