Market Commentary - January 2015

FTSE 100	**6,566**	S&P 500	2,059
Resistance	6,740	Gold	$1,190
Support	6,180	GBP/EUR	1.2773
VIX	17.8%	GBP/USD	1.5329

Introduction:

Last month, we remained overweight on the stock market, noting that December was historically the best month of the year.

Unusually for this time of the year, the market fell 2.3%. However, there was some Christmas cheer for investors as the market arrested a 8.5% decline, which left the FTSE 100 at one stage at 6,147. Our recommendation, the Premier Oil 5% 11/12/20 bond, rose 7%.

Economics:

European data continues to deteriorate with Eurozone manufacturing output on course for its worst performance since the recovery began in autumn 2013. Eurozone inflation also slipped to 0.3%, far off the ECB's price-stability target of just below 2% and economists expect the single currency zone to have sunk into outright deflation in December with a fall of 0.1%, with the fall in the oil price being the major factor. Deflation as a result of oil prices is not the problem - it is a good thing for the real economy. It is the weak state of demand that is the problem and the ECB President has just raised expectations that he will turn to the printing presses to fight it, sending the Euro to its lowest level against the USD in 4 1/2 years. We expect a QE programme to be unleashed as early as the 22nd of January.

The British pound is also falling, reaching a 16-month low against the USD as reports showed growth in manufacturing and the housing market slowed, spurring bets the Bank of England will refrain from raising interest rates. Some economists are suggesting that UK growth may have peaked, supporting the view that sterling will probably weaken further against the USD as the US economy outperforms. It is now forecast that the BoE will not start raising interest rates until the 4th quarter of the year.

Thankfully, the powerhouse of the world's economy, the US, is motoring ahead. The IMF believes that economic growth is likely to be a full percentage point higher than last year with a stronger housing market and business investment suggesting the rebound is becoming more sustainable. Of course, this means that the FED will have to raise its interest rates, probably in mid-2015, in order to contain inflationary pressures. Though this will undoubted be accompanied by some degree of market turbulence, we see this as a positive.

Market Commentary (cont)

Technical Analysis:

Last month, we noted that the market looked overbought with the RSI at 71% and the index towards the upper Bollinger band. Despite our bullish stance on the fundamentals, the market fell 2.3% to 6,566 though perhaps the strong seasonal factors arrested the decline, which was 8.5% at one point. Looking forward, the RSI, at 52%, has unwound its overbought level. Rising from the recent low to above 50%, the RSI is mildly bullish. However, with the ADX at 21% and with the FTSE lying roughly at the 20 & 50 day moving averages, we see little movement from here in either direction.

"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*

January 😊

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%.

January is 9th in the ranking of monthly performance, rising 57% of all the years in January, with an average return of 0.4%.

First Quarter 😊

The FTSE 100 has risen 20 of the 31 years between 1984 and 2014, posting an average gain of 2.3%.

November - April 😊

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.

Third-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 Goat 😊

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 goat, the strongest year of the Chinese zodiac historically for equities, with positive returns averaging ~18%.

Market Commentary (cont)

Seasonality (cont):

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 5th year has been positive in 14 of the 21 decades, rising on average 6.2%. This makes it the best performing year for stocks.

Quote of the Month:

"How many millionaires do you know who have become wealthy by investing in savings accounts? I rest my case – Robert G. Allen

Though investing in a savings account is a sure bet, your gains will be minimal given the extremely low interest rates. But don't forgo one completely. A savings account is a reliable place for an emergency fund (we recommend 3-6 months salary), whereas a market investment is not.

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 equalweight. January is historically not a month to get overly excited about, generally rising 57% of the time with an average return of just 0.4%. Bearing in mind that the market has enjoyed a good bounce from its mid-December low of 6,147 and that technically the market is not poised to move much in either direction, we feel that the market is in a no-mans land in the short-term.

Having said that, we are constructive on equities for the year ahead. JP Morgan Cazenove is particularly bullish for the following reasons:

1) Liquidity is not going away. G4 central bank balance sheet as a share of GDP is likely to continue expanding. Money supply is accelerating in the Eurozone and the region's credit cycle appears to be bottoming out.

2) Global GDP growth is expected in deliver 3.8% in 2015 and the fortunes of the Eurozone are set to turn following a disappointing 2014.

3) Relative valuations continue to favour equities vs other asset classes.

4) Fed tightening will not derail equities, as rate hikes will commence only if the economy allows it.

JP Morgan Cazenove continues to believe that the Eurozone will outperform the US as earnings between

Market Commentary (cont)

Market Outlook (cont):

the two regions should start converging. European stocks are trading on P/E multiples not seen since the height of the Eurozone crisis. A lower oil price should also benefit consumer facing cyclical sectors, such as Transport, Airlines, Autos, Retail and Travel & Leisure.

Tweet of the Month:

During the month, we reflected upon what 2015 may bring for equities. Here we look in detail at what the investment community has to say. The IMF sees global GDP growth accelerating to 3.8% in 2015 (from 3.3% in 2014) and we feel again that there is risk in equities to the upside.

FTSE 100 Y/E Target = 7,200 (9.7% upside)

City strategists are predicting the FTSE 100 will finally hit a new peak next year, despite worries about the UK general election. Morgan Stanley has a December 2015 target for the FTSE 100 of 7,200 but believes the UK will lag behind other markets due to 1) weaker 2015 estimated EPS growth (4% vs 10% in Europe); 2) average valuations; 3) FX headwinds from the pound and USD, and; 4) political risk surrounding the general election. Citi is more bullish with a 7,700 target on the grounds that a global pick-up in M&A will drive an additional re-rating.

Citi's top UK picks for 2015 are Associated British Foods, Aggreko, AstraZeneca, Barclays, BG Group, BHP Biliton, Carphone Warehouse, CRH, Experion, IAG, Pearson, Schroders, Shire, Travis Perkins & Vodafone.

Eurostoxx 600 Y/E Target = 400 (17.3% upside)

Citi has a Y/E target of 400 for the Eurostoxx 400 based on four pillars: 1) aggressive liquidity actions from the ECB; 2) ECB Quantitative Easing; 3) improving European earnings trends with 10-15% earnings growth in 2015E and a weaker euro, and; 4) rising demand for equity from capital allocators. Whilst European equities are neither cheap nor expensive on absolute valuation metrics, stocks have never been so cheap vs government or corporate bond yields. This relative attraction of equities remains super strong.

Citi's top European picks for 2015 are Akzo Nobel, Allianz, AXA, Caixabank, Continental, Danone, Intesa Sanpaolo, Kering, Renault, Roche & UBS.

S&P 500 Y/E Target = 2,275 (10.5% upside)

Morgan Stanley has a Y/E target of 2,275 on the basis that the US is in the middle of a long expansion, one that may last until 2020. Economic factors such as consumer confidence, financial obligations, and delinquencies are all improving, The strong US Dollar suggests that investors should gear their portfolios towards domestic growth stories.

Argus Research Company's top picks for 2015 are Nike, Williams Sonoma Inc, Hain Celestial Group Inc, EOG Resources Inc, American Tower Corp, Morgan Stanley, Quintiles Transnational Holdings Inc, Stryker Corp, General Electric Co, IHS Inc, Micron Technology Inc, PPG Industries Inc, American Electric Power Inc, and CenterPoint Energy Inc.

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	Food & Drug Retailers
2nd	Electricity	Construction & Materials
3rd	Life Insurance	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, Life Insurance 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 Weir in the first quarter (1883p, 13.4x P/E, 2.6% yield, 21% potential upside to average broker price 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 has a tendency to climb during the first few days of the year (the Santa Claus Rally officially finishes on the 5th of January) as the euphoria of December spills over the New Year. However, this excitement then starts to wane and the market falls for the next two weeks. Indeed, the second week of January is the weakest week for the market in the whole year, rising on average just 37% of the time with an average loss of 0.5%. Canny traders should then look to capitalise from the resultant upswing, which takes place in the final week of the month (the year's 7th strongest week, rising on average 1%, 67% of the time).

The January Effect

This describes the tendency of small-cap stocks to outperform large-cap stocks in January. The FTSE Small Cap has outperformed the FTSE 100 by an average of 2.7% in January since 2000, underperforming the market just 3 times. *One way to play this would be to buy the iShares MSCI UK Small Cap ETF whilst simultaneously going short the FTSE 100 via a CFD.*

Outperformance of FTSE 250 vs. the FTSE 100

The FTSE 250 tends to outperform the FTSE 100 in the first 3 months of the year as well as in August. In the more troublesome months of September (the year's worst performing historical year) and October (the year's most volatile month), the reverse applies. *The obvious way to play this trend is the go long the FTSE 250 and short the FTSE 100 via CFDs from 1st January to the 31st of March.*

Market Commentary (cont)

Trader's Corner (cont):

Strongest Weeks
The week starting the 26th of January is the 7th strongest market week, rising 67% of the time since 1984, by an average of 1%. *Going long the market via a CFD would be best to capture this move.*

Weakest Weeks
The week starting the 5th of January is the weakest market week, rising just 37% of the time with an average loss of 0.3%. The week starting the 12th of January is the 6th weakest market week, rising just 43% of the time with an average loss of 0.5%.*Going short the market via a CFD would be best to capture these moves.*

Strongest Days
The 26th of January is the 9th strongest day of the year, rising 80% of the time, posting an average gain of 0.7%. *Going long the market via a CFD would be best to capture this move.*

Weakest Days
The 7th of January is the 8th weakest day of the year, rising just 32% of the time, posting an average loss of 0.4%. The 20th of January is the 10th weakest day of the year, rising 33% of the time, posting an average loss of 0.2%.*Going short the market via a CFD would be best to capture these moves.*

Option of the Month
Sell HSBC February 580 puts @ 6.25p

Strike price at two-year lows, supported by a 5.3% dividend yield and trading on a P/E ratio of just 10.2x. One of Hargreaves Lansdown's top picks for 2015. Premium equates to an annualised yield of 6.5%.

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

Recommended Investment:

Carador Income Fund (CIFU.L) 90.5cts, 11% yield
Investment trusts have historically outperformed unit trusts for a variety of reasons - the ability to use gearing, lower investment management fees and the simple advantage of managing a closed-ended portfolio in that it encourages long-term decision making as the fund manager doesn't have to hold cash to meet redemptions. This month's recommendation happens to be the best performing investment trust over the five years to September 2014.

The Carador Income Fund trades on the LSE and aims to provide attractive & stable returns with low volatility compared with equity markets. This is handy in these markets where the FTSE 100 has posted two double-digit slumps in the last three months alone.

The fund invests in loans (on a senior secured basis) to US and European companies via a diversified portfolio of senior notes of CLOs. As the underlying loans are short-term in nature, rising US interest rates (expected mid-2015) will be a big boost to returns. The company currently pays a dividend of 2.5cts a quarter, which equates to a yield of 11% a year. As the fund is based in USD, there is an FX risk for European investors. However, most analysts are bullish on the dollar as their economy is improving the most, interest rates are set to rise and, against sterling, the UK has elections in 2015 which will increase the market's nervousness in the pound. We believe that the yield of 11% is more than enough to compensate.

Market Commentary (cont)

Investment Calendar:

1st January	New Year's Day (LSE closed)
2nd January	Nonfarm payroll report
5th January	Weakest Market Week
	Full moon (markets tend to reach a low point around this time)
7th January	8th Weakest Market Day
8th January	MPC interest rate announcement at 12 noon
	ECB Meeting
12th January	6th Weakest Market Week
16th January	Options Expiry Day
19th January	Martin Luther King Jr. Day, USA (NYSE Closed)
20th January	10th Weakest Market Day
	New Moon (markets tend to reach tops around this time)
22nd January	ECB Meeting
26th January	9th Strongest Market Day
	7th Strongest Market Week
27th January	Two-day FOMC meeting starts

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)
thin 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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