GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - November 2015

FTSE 100	**6,361**	S&P 500	2,079
Resistance	6,668	Gold	**$1,139**
Support	6,200	GBP/EUR	1.4063
VIX	15%	GBP/USD	1.5484

Introduction:

Global equity indices have clawed back the bulk of the summer's losses and now look in much better shape. What has historically been the more profitable half of the year starts now.

Economics:

The UK economy slowed in the third quarter, in what could be an early sign of how a stumbling Chinese economy is denting growth prospects across the globe. According to government statisticians, GDP expanded 0.5% between July and September, an annualised rate of 2%. This is slower than the second quarter's 0.7% growth and undershoots most economic forecasts, including the Bank of England's, which were predicting a 0.6% rate. The slowdown was concentrated in manufacturing, where sluggish global demand, coupled with a strong pound, sapped demand for British-made goods.

Mario Draghi will be pleased to see that the Eurozone clambered out of deflation this month, but it only takes a little pressure off the region's central bank. Last week, the ECB chief hinted that more stimulus could be needed soon, as inflation remained sharply off course. The ECB's most likely next move is to announce an extension in December of the duration of its QE programme to last through to March 2017. European unemployment may be at a six-year low but at 9.3%, it is still far too high – almost twice the levels in the UK and the US.

US economic growth cooled in the third quarter despite a pick-up in consumer spending as a glut in inventory led to businesses cutting back on restocking warehouses. GDP increased at a 1.5% annual rate, a significant drop from the 3.9% seen in Q2. Although the headline number was weaker than expected, the fundamentals were actually quite good. Demand from US consumers and businesses remains solid, as does demand for US-produced goods and services, both domestically and from abroad. The big drag from inventories will quickly fade, and growth should pick back up in the fourth quarter. The GDP figures add little to the debate over whether the FED will raise rates at its next meeting in December. As far as the Fed is concerned, the next two employment and inflation reports will have a bigger impact on whether to hike interest rates in December or wait until early next year. It's a close call but, on balance, it now looks like the Fed will end up delaying until 2016.

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Market Commentary (cont)

Technical Analysis:

The market has enjoyed a good bounce following the recent market turbulence, though has recently come off its high. Trading at the 20-day moving average, the market has reverted to its mean and the RSI has fallen from way above the 50% level to 49%. This suggests that the market has run out of steam and it will take some time before getting back above the 200-day moving average.

"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 2015 is likely to be a positive year if the past is anything to go by.

November 🙂

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 47% of the time, with an average return of -1%.

Since 1984 the FTSE 100 has risen 57% of the time in November, with an average return of 0.7%, making it the 6th best month of the year.

Fourth Quarter 🙂

The FTSE 100 has risen 23 of the 31 years between 1984 and 2014, posting an average gain of 3.8%

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.

Market Commentary (cont)

Seasonality (cont):

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%.

<u>Market's Decennial Cycle</u>

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:

"If you have trouble imagining a 20% loss in the stock market, you shouldn't be in stocks" – John Bogle

Investing in the stock market requires a long-term time horizon. Markets can do absolutely anything over the short term. In our experience, no one can predict anything over such a timescale. What we do know is that the stock market has beaten returns from cash over every 5-year period going back to 1900. That is why we always recommend a time horizon of no less than 5 years for investors looking to buy equities.

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. We continue to believe that equities will perform better into year end on stabilisation in China/EM sentiment, as well as supportive Q4 seasonals. November is historically a good time for equities (rising on average 0.7%, 57% of the time). It is also the start of the strongest half of the year.

Within individual markets, we are constructive on US equities, but they do tend to outperform mainly in down markets and this is not the direction we expect heading towards year end. We believe the China/EM worry has been overplayed and this is being reflected in relative equity performance. For example, eurozone small caps are strongly outperforming US small caps this year - by 12% in USD. This is a good sign for risk-on assets.

We are particularly bullish on the Eurozone. PMIs are resilient, credit is starting to flow more freely, the ECB is posed to reinforce its support and the market is lower that it was six months ago - a good combination to support a rally in the stock market. Fundamentally, this will be the first year since 2008 where Eurozone earnings are going to handsomely beat US earnings. Finally, the policy differential between

Market Commentary (cont)

Market Outlook (cont):

the two regions, as expressed in the likely forward path of the central bank's balance sheets as a share of GDP, is clear. Look for Eurozone to rebound vs the US.

Emerging markets also appear to be a contrarian call. The bearish narrative on their medium-term prospects is fully consensus these days and their equities only account for a 10% allocation in global equity portfolios. This is far below their economic value – 39% of global GDP, 85% of global population and 40% of global revenues. We also think that the drivers behind the commodity and emerging market rebound have not exhausted yet. Valuations of Miners and Energy remain at decades' lows and investors are still short both sectors. Emerging markets have seen inflows for two weeks now, but that follows months of massive outflows. Furthermore, Fed tightening has more than likely been pushed out to Q1 2016, enlarging the window of opportunity of this tactical call. Emerging markets are trading on a 11x P/E multiple, offering a 29% discount to developed markets. In summary, we believe that the rebound in emerging markets vs. developed markets, which started in mid-August, has further to run.

Tweet of the Month:

"If a company is busting a gut to pay a very high yield and that's all it can do, then it may very well be a value trap"

Research from investment manager Schroders has shown just how difficult it has become to find leading UK shares (FTSE 350) that offer a high yield coupled with a good level of dividend cover.

The median cover for the highest-yielding half (2.6% and over) of the UK's leading shares currently stands at just 1.9 times. Meanwhile, the highest-yielding quarter (3.7% and over) of leading shares have a flimsy median cover of 1.6 times. At the other end of the spectrum, the lowest-yielding quarter (2% and below) of shares offer a more reassuring median cover of three times.

A high yield with low cover can be a dangerous combination for obvious reasons. In order to rank stocks for possible investment, it would be nice to have a single measure that combines the two pieces of data – dividend yield and dividend cover.

A ranking methodology outlined by hedge fund manager Joel Greenblatt in his investment classic, *The Little Book That Beats The Market*, offers a great way to try to answer this question. The Greenblatt method - he used it for his earnings-focused magic formula - is to add a company's dividend yield and dividend cover together to produce a combined ranking.

We have ran this formula through the FTSE 350, adding the following parameters:

1-Dividend yield of at least 4%

2-Dividend cover of at least 2 times

Also, it is important to consider the potential upside/downside to a company. If a company yields 5% but has 10% downside to the average broker target, there is not much point. Therefore, we have obtained the

Market Commentary (cont)

Tweet of the Month (cont):

upside/downside to the average broker price target and added that to the Greenblatt formula and ranked them by the highest total.

Name	Price (£)	Yield	Dividend cover	Greenblatt	Up/Down	Total
Anglo American PLC	5.33	8.9%	2.0	10.9	39.7%	48.6
Weir Group PLC	10.55	4.3%	2.9	7.2	37.9%	42.2
Aviva PLC	4.86	4.5%	2.8	7.3	22.7%	27.2
Foxtons Group PLC	1.99	5.4%	2.4	7.8	19.5%	24.9
Halfords Group PLC	4.35	4.0%	3.0	7.0	20.6%	24.6
Morgan Adv Mat PLC	2.80	4.1%	2.2	6.3	20.4%	24.5
Vedanta Res PLC	4.97	8.2%	30.4	38.6	13.6%	21.9
Smiths Group PLC	9.68	4.3%	2.1	6.4	17.2%	21.6
UBM PLC	5.13	4.2%	2.2	6.4	14.8%	19.0
Vodafone Group PLC	2.14	5.3%	2.0	7.3	13.5%	18.8
Tullett Prebon PLC	3.52	4.8%	2.3	7.1	12.0%	16.9
Vesuvius PLC	3.60	4.6%	2.3	6.9	10.0%	14.6
Computacenter PLC	7.55	7.6%	2.5	10.1	7.0%	14.6
Fidessa Group PLC	19.93	4.4%	2.0	6.4	9.0%	13.4
BP PLC	3.82	6.7%	2.1	8.8	5.4%	12.1
Marston's PLC	1.62	4.4%	2.2	6.6	6.9%	11.3
Direct Line Ins PLC	3.94	11.1%	2.2	13.3	0.2%	11.2
esure Group PLC	2.65	5.5%	2.0	7.5	5.5%	10.9
Jupiter Fund Mgmt	4.51	5.4%	2.1	7.5	5.1%	10.5
Intermediate Cap Grp	5.68	4.1%	2.3	6.4	4.6%	8.7
Imperial Tobacco Grp	35.06	4.0%	3.8	7.8	4.0%	8.1
Card Factory PLC	3.64	6.2%	2.1	8.3	0.6%	6.8
Hansteen Holdings	1.22	4.2%	3.4	7.6	1.5%	5.7

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, 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 Britvic Plc in the fourth quarter (700p, 14.8x P/E, 3.3% yield, ~17% 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 tends to rise in the first three days before then falling back. It has a tendency to increase quite strongly over the final seven trading days of the month. *Going long the market via a CFD on 20th November would be best to capture this move.*

Gold Strength

Gold tends to enjoy good gains in November rising 60% of the time since 1986 with an average gain of ~1.3%.

Seasonality of GBP/USD

On 15th August 1971, President Nixon announced that the US was ending the convertibility of the US dollar to gold and this led to the end of the Bretton Woods system and fixed-rate currencies, such as sterling, became free-floating. Since then, November has statistically been a weak month for GBP/USD, falling on average almost 1.5%. *Going short GBP/USD via a CFD would be best to capture this move. Alternatively, buying a share that derives the majority of its earnings in USD and that historically performs strongly in November is an option e.g. Shire Plc.*

Weakest Weeks

The 30th of November is the 8th weakest week of the year, falling 68% of the time, posting an average loss of 0.5%. *Going short the market via a CFD would be best to capture this move.*

Market Commentary (cont)

Trader's Corner (cont):

Weakest Days

The 19th of November is the 7th weakest day of the year, falling 68% of the time, posting an average loss of 0.5%. *Going short the market via a CFD would be best to capture this move.*

Option of the Month

Sell BaE Systems December 420 puts at 4p

Strike price at one-year lows. Stock has a 4.8% yield and 19% potential upside to the average broker price target. *Click here to view our guide to the Traded Options Market.*

Recommended Investment:

Equities

With base rates remaining stubbornly at 0.5%, we have been surprised by the pullback in preference shares over the last few months. Even if interest rates are set to rise in the near future, we think the new "normal" will be far from what was the norm in the past and therefore these shares, with their high coupons, are a good choice for those investors looking for income.

A hybrid of an ordinary share and a bond, preference shares stand in front of (i.e. are preferred to) ordinary shares in the queue for cash when a company is wound up, but behind all forms of company debt. They are also preferred to ordinary shares for dividend payments; indeed, no ordinary dividend can be paid until all dividends due to preferred holders have been paid. Their main features are:

Issuance

Issued mostly by banks and insurance companies (and their predecessors), preference shares pay a fixed dividend, net of tax, twice a year. Many preference shares are also cumulative, meaning if the company misses a payment, the dividend rolls up and has to be paid in full, including any arrears, before the company can resume paying dividends on its ordinary shares.

Tax benefits

As the dividends are paid out of taxed corporate profits they are classified as "franked investment income". This is beneficial for UK tax payers as they pay a fixed interest rate net while bonds pay a fixed interest rate gross.

Disadvantages

A takeover might result in reasonable terms being offered for the preference capital, or in them being left alone, but this is something of a grey area. They could be repaid at par, but this is unlikely. Their problem lies in the fact that you don't receive the growth element of ordinary shares nor the additional security of a corporate bond.

Market Commentary (cont)

Recommended Investment (cont):

Undated

Most preference shares are irredeemable, though some can be redeemed either at the market price at any time or at a pre-set price (usually par value) on a specific date (known as callable prefs). Like undated gilts, the prices of preference shares tend to be more sensitive to movements in interest rates than shares with a fixed redemption date. Yields are mainly affected by the perceived standing of the company in terms of financial robustness rather than the fact whether they are callable or cumulative.

Dealing

Preference shares are dealt for standard T+3 settlement, with a dirty price. This means that the accrued interest is included in the price, unlike with bonds. Stamp duty is payable on purchases.

Anomalies

Callable stocks can be less volatile than irredeemable prefs close to the date at which redemption may happen, yet do not tend to have lower yields. Cumulative preference shares tend not to have noticeably lower yields than non-cumulative ones, despite the greater likelihood – although no absolute uncertainty - of the dividend payment being made in full. Yields are mainly affected by the perceived standing of the company in terms of financial robustness.

Our recommended preference shares at this time are:

1) General Accident 7 7/8% Cumulative at 139.5p
General Accident is a wholly-owned subsidiary of Aviva Plc, a FTSE 100 company. The General Accident preference shares do not carry a credit rating. However, Aviva Plc is 'A' rated by S&P and comparable subordinated Aviva debt carry an investment grade BBB+ credit rating. 6.4% yield.

2) Ecclesiastical Insurance 8.625% Non-Cumulative at 138p
Founded in 1887 to insure the Anglican church, Ecclesiastical is the UK's leading church insurer. BBB rated. 6.3% yield.

3) Standard Chartered 8.625% Non-Cumulative at 121.75p
Standard Chartered is a British multinational banking and financial services company with 90% of its profits derived from emerging markets. BB+rated. 6.7% yield.

4) Lloyds 9.25% Non-Cumulative at 140p
One of the UK's "Big Four" clearing banks. BB rated. 6.6% yield.

Market Commentary (cont)

Investment Calendar:

November is a busy month for mid-caps, with 62 companies from the FTSE 350 making announcements.

5th November	MPC interest rate announcement at 12 noon
	ECB Meeting
6th November	Nonfarm payroll report
11th November	New moon (markets tend to reach tops around this time)
18th November	ECB Governing Council Meeting
19th November	7th Weakest Market Day
25th November	Full moon (markets tend to reach a low point around this time)
30th November	8th Weakest Market Week

Chart Legend:

— — — —	20 day moving average	(signifies the short-term direction of the security. prices tend to gyrate around their 20 day m/a)
——	50 day moving average	(signifies the medium-term direction of the security)
——	200 day moving average	(signifies the long-term direction of the security - whether it is in a bull or bear market)
——	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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