GIBRALTAR ASSET MANAGEMENT
STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - June 2016

FTSE 100	**6,115**	S&P 500	2,096
Resistance	6,330	Gold	$1,274
Support	6,070	GBP/EUR	1.2670
VIX	17%	GBP/USD	1.4255

Introduction:

A year ago, most equity indices were up for the year, and investors were surely anticipating a positive year for stocks. That happy time seems like ancient history, given the harrowing corrections experienced in August-September 2015 and January-February 2016. Investors are now extremely skittish and prone to exit the market at the first whiff of selling. Despite being in the seasonally weaker part of the year, we think bullish factors outweigh bearish factors at this juncture of the market and economic cycles. Therefore, we are minded to disregard the calendar this summer.

Economics:

Activity in the UK services sector remains "*frustratingly weak*" despite recovering last month from a three-year low. Alongside feeble readings in manufacturing and construction, the latest data indicates that the UK economy may expand by just 0.2% this quarter. That compares with 0.4% growth in the first three months of the year and marks the weakest level since 2012. This is certainly partly due to uncertainty surrounding the forthcoming EU Referendum, which is weighing on investment and hiring, with the Bank of England and other institutions warning that leaving the bloc would further damage the economy.

Growth in the European economy remaining subdued in May, suggesting that the continent's recovery is still struggling to get out of "*low gear*". The Eurozone saw a composite PMI reading of 53.1, just marginally better than the 53 reading seen in April. Such a lacklustre performance in the second quarter points to an ongoing lack of growth momentum, which in turn raises the prospect of policymakers seeking new ways to stimulate growth.

The US created just 38,000 new jobs in May and nearly half a million people dropped out of the labour force. The increase in hiring was the smallest since the fall of 2010. More than half of the nation's major industries eliminated jobs last month, the first time that's happened in several years. In another bad sign, temp employment fell by 21,000 and it's down 64,000 so far this year. The drop off in temporary work in 2016 is the sharpest of the seven-year-old recovery and might be a sign that hiring is likely to remain soft. Temp hiring usually increases when the economy is strong, with many of those workers eventually getting hired full time. The poor May jobs report and clear slowdown in hiring could force the Fed to delay plans to raise interest rates in either June or July. The central bank had been poised to raise rates soon amid a raft of other evidence suggesting the economy continues to grow at a modest pace.

Market Commentary (cont)

Technical Analysis:

The technical outlook has worsened with the RSI dipping below 50% and the FTSE 100 falling below all three major moving averages. However, this could be a blip caused by opinion polls surrounding the EU referendum. With the Remain campaign still odds-on to win, these negatives could quickly become reversed. We see technical analysis playing second fiddle to the outcome of such an important political event.

"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. Considering the FTSE 100 fell both during the first 5 days and the month as a whole, 2016 is forecast to be a negative year for the stock markets,.

June ☹

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%. June is historically the 2nd worst performing month, rising just 38% of all the time, with an average return of -1%. The market has only risen once in the last eight years in June and the market falls can be quite large – the FTSE has fallen over 3% in June in eight years since 1982.

Second Quarter ☺

The FTSE 100 has risen 19 of the 32 years in the second quarter between 1984 and 2015, posting an average gain of 0.9%.

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. Some investors, therefore, tend to reduce exposure to the stock market from May. 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.

Fourth-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. Since 1948, the UK market has risen 14 times out of 17 (82%) in US election years, with a rather extraordinary average annual return in those years of 33%. Generally, the UK market tends to rise in the few weeks leading up to the election.

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Market Commentary (cont)

Seasonality (cont):

Chinese New Year – Year of the Monkey 🙂

Chinese calendar revolves around a 12 year cycle where each year is associated with an animal (rat, ox, tiger, rabbit, dragon, snake, horse, sheep, 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 monkey, an average year of the Chinese zodiac historically for equities, with positive returns averaging 7.3% for the S&P 500.

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 6th year is one of the weaker years, having been positive in 12 of the 21 decades (57%), rising on average 1.6%.

Quote of the Month:

"Our job is to find a few intelligent things to do, not to keep up with every damn thing in the world." - Charlie Munger

It is not possible to keep up with every trend/theme in the world. Select a diversified portfolio of twenty stocks instead and you not only keep 'company risk' down to its theoretical lowest level but you will also have a manageable portfolio of stocks to follow.

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 equalweight. June is historically the 2nd worst performing month, rising just 38% of all the time, with an average return of -1%. With the market at elevated levels (P/E multiples have re-rated substantially), now is not the time to chase the rally. However, we would not sell either.

We believe that equities can benefit from economic data and trends that indicate that:

1) core US GDP is growing at 2%
2) interest rates will remain low on a historical basis through 2016
3) corporate profits can surprise on the upside, given the economic growth outlook and expectations for a stable dollar

Market Commentary (cont)

Market Outlook (cont):

As currencies and commodity prices stabilize later in 2016 and into 2017, the environment should become more favourable for growth. Research House Argus is looking for high single to low double-digit annual growth in the second half of the year, with the strongest growth in Q4. Altogether, they look for 6% EPS growth for 2016 and 10% EPS growth for 2017.

In the short-term, we also see a vote to remain in the EU on the 23rd of June as a catalyst for a relief rally across the major stock markets.

Tweet of the Month:

"*A vote to stay in the EU could see sterling rise sharply*"

The Bank of England warned last week that if we vote to leave the European Union on 23rd June, sterling is "*likely to fall, perhaps sharply*". This echoed a prediction by The National Institute of Economic and Social Research (NIESR) a few days earlier that the pound could fall by 20% in the event of a Brexit. Such warnings, however, have an alternative reading - that if we vote to remain in the EU, sterling could rise a lot. This is simply because the risk of a big fall in the pound should be weighing on the currency now, so if that risk disappears, sterling should rise.

We can roughly quantify this. We should think of sterling in the same way we should think of equities - as bets on different possible future states of the world. Their prices at any point in time should therefore be equal to the probability-weighted average of their prices in those different scenarios.

We know the probabilities. The odds against Brexit are around 9/4, implying there's a 30% chance of it. NIESR's estimate of a 20% drop in sterling implies that, in this event, sterling would be around €1.02. Given the current rate of €1.27, this implies that a vote to remain would push sterling up to €1.38. This is because €1.27 = (0.3 x €1.02) + (0.7 x €1.38). This is a rise of just over 8%. We should expect a similar move against other currencies.

This would take the pound back to its levels of last autumn. Obviously, if NIESR is too pessimistic about the fate of sterling in the event of Brexit, its rise in the event of a remain vote would be smaller.

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	Banks
2nd	Personal Goods	Construction & Materials
3rd	Technology Hardware & Equipment	Industrial Transportation
4th	Chemicals	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, Personal Goods from 1st April to 30th June, Technology Hardware & Equipment from 1st July to 30th September and Chemicals 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 Ted Baker Plc in the second quarter (2329p, 21x P/E, 2.4% yield, ~35% 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.

Ramadan

Observed by more than 1.5bn Muslims around the world, Ramadan involves abstinence from eating and drinking, as well as a strict control of desires.

What has this got to do with investing you might think? Research published by Ahmad Etebari of the University of New Hampshire, Jedrzej Bialkowski of New Zealand's University of Canterbury and Tomasz Wisniewski of the University of Leicester examined stock returns between 1989 and 2007 from 14 Muslim-majority countries and found that monthly annualised stock dollar-denominated returns during Ramadan averaged 38.1%, compared to a monthly average of 4.2% during the other 11 months of the Islamic calendar. Surprisingly, stock market returns also exhibited less volatility compared to the rest of the year.

The benefits of Ramadan-type fasting are well known. It can promote both the physical and mental well-being of individuals. It detoxifies the body, makes people less tense and anxious and may also induce mild states of euphoria. Thus, Ramadan is an event capable of influencing the moods and decisions of its adherents.

The report concludes that the Ramadan effect can best be explained by a change in investor psychology. Ramadan is a religious month that affects almost every aspect of Muslim's lives. Besides fasting and prayers, Ramadan promotes heightened social awareness and a closer relationship with 'Allah' and with fellow Muslims around the world. As a fundamental shared experience, Ramadan brings about a sense of solidarity among Muslims, enhances their satisfaction with life and encourages optimistic beliefs. This optimism affects investor sentiment and decisions, leading to the increases in stock markets.

Market Commentary (cont)

Trader's Corner (cont):

The implications of this study were obvious. Investors seeking fast profits in the Muslim world should try to profit from the Ramadan fast, buying shares prior to the start of Ramadan and selling them at the end of the holy month or preferably after Eid al-Fitr (the 3 day celebration that follows Ramadan). Buying an ETF such as the iShares MSCI GCC Ex-Saudi Arabia ETF on the 5th of June and selling on the 7th of July would be the best way to capture this move.

Seasonal Tendency

In an average month, the market starts strong, hitting its month high on the second or third trading day, but prices then drift down steadily for the rest of the month. *Going short the market via a CFD after the third business day would be the best way to capture this move.*

Weakest Weeks

The week starting 20th June is the 4th weakest week of the year, falling 59% of the time, posting an average loss of 0.6%. *Going short the market via a CFD would be best to capture this move.*

Option of the Month

Sell Royal Dutch Shell B November 1250 puts at 12p

Strike price at an 8-year low. Stock is yielding 6.5% and has 8.7% potential upside to the average broker price target. With the oil price recovery in full swing, we think it is unlikely that the stock will drop 30% from current levels. *Click here to view our guide to the Traded Options Market.*

Recommended Investment:

ITV - 206p, 12x P/E, 7.8% yield

Pubs, takeaways and gambling companies will be hoping for a pick-up in sales this summer as Brits celebrate three months of world-class sporting events.

Broadcaster ITV is also set for a recovery in advertising revenue as a result, bolstered by its role as an official broadcaster of the European Championships. ITV's coverage of the last major football tournament, 2014's World Cup, delivered on a target of driving a 13% rise in advertising revenue for its duration. This was despite England's worst performance at a World Cup for decades.

It is worth noting that the company's destiny is not determined by the short-term variations in advertising - any boost from the football is merely a bonus. Net advertising revenue now makes up just 55% of group revenue. Nevertheless, ITV remains the most effective way advertisers can reach millions of potential customers. Recent trading performance has been good with the company seeing its underlying profit rise 18% to £843m for the full year to 31st December 2015, and total revenues climbing 14% to £3.3bn.

The company has a strong programme slate for 2016, with 50 hours more drama on top of the major sporting tournaments. Last March, it acquired Talpa, the Dutch firm which makes talent show The Voice for £355m. The move will see the hit show move from the BBC to ITV next year. The company produces 7,000 hours of programming annually and 53% of its revenues are now outside the UK, with programmes such as Downton Abbey, Aquarius, Texas Rising, Jekyll & Hyde, Mr Selfridge and Come Dine With Me selling particularly well. ITV is committed to expanding internationally and growing its higher-margin businesses.

Market Commentary (cont)

Recommended Investment: (cont)

The company also has strategic value in a consolidating industry with many in the City believing that ITV is ripe for a takeover. US cable giant Liberty Global has a 9.9% stake in the firm and is seen as a potential bidder, while rival Comcast is also thought to be interested. Already, ITV is the largest independent production house in the USA.

The broadcaster has seen its share price fall by 25% year-to-date with management citing Brexit fears as affecting the advertising market. We feel this fall is overdone. Trading on 12x next year's earnings, the company is priced at a 25% discount to peers. With a strong balance sheet and good prospects for dividend growth (ITV has paid special dividends for the last 3 years and is currently yielding 7.8% assuming this is continued) the company is attractively valued. Along with the 36% potential upside to the average broker price target, we rate the shares a **strong buy.**

Market Commentary (cont)

Investment Calendar:

1st June	FTSE 100 Quarterly Review
2nd June	ECB Meeting
3rd June	US Nonfarm payroll report
5th June	New Moon (markets tend to reach tops around this time)
6th June	Ramadan (until 5th July)
14th June	Two-day FOMC meeting starts
16th June	MPC interest rate announcement at 12 noon
17th June	Options Expiry Day
20th June	Full Moon (markets tend to reach a low point around this time)
22rd June	ECB Meeting

Chart Legend:

(dashed red 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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