Gibraltar Asset Management

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - September 2016

FTSE 100	**6,894**	S&P 500	2,179
Resistance	7,100	Gold	**$1,326**
Support	6,260	GBP/EUR	1.1918
VIX	12%	GBP/USD	1.3294

Introduction:

After the summer lull, things get exciting again for investors in September in what is historically the worst performing month of the year, falling on average 1%, 55% of the time. It is even worse for the mid-caps with the FTSE 100 historically outperforming the FTSE 250 by 0.7%. We re-iterate that markets never go up in a straight line and a short-term pullback would indeed be healthy for the markets before its traditional strong finish to the year.

Economics:

Another day, another piece of news that suggests the economy is coping with the result of the Brexit vote much better than expected. The latest health check of manufacturing suggests that the record plunge suffered in July was a kneejerk response to the result of the referendum. All the lost ground was made up in August – and then some. The closely watched Markit/Cips report recorded the joint biggest monthly increase in industry's performance in the 25-year history of the purchasing managers' index (PMI), taking it to its highest level since last October. Manufacturers are being helped by the fall in the value of the pound as well as benefitting from policy decisions including Theresa May's swift coronation and the stimulus provided by the Bank of England.

Economic confidence in the eurozone fell sharply in August, hitting its lowest level since March and suggesting that Britain's vote to leave the EU may be starting to hit sentiment across the bloc. The European Commission's economic sentiment index fell from 104.5 in July to 103.5. This accompanied a sharp deterioration in the Commission's business climate index, which tumbled from 0.38 in July to 0.02 in August, its lowest level since October 2013. The large amount of political uncertainty hanging over a number of EU countries is likely to be weighing on sentiment. Examples include Italy's constitutional referendum due in November, on which Prime Minister Matteo Renzi has staked his political future, and Spain's political stalemate, which has resulted in almost nine months without a government.

Good, but not too good. That is the verdict from economists after the US Labor Department reported on Friday that in August employers added 151,000 jobs with the unemployment rate remaining unchanged at 4.9%. It was a solid performance that keeps the economy on track, but not strong enough to push the Federal Reserve to raise its benchmark interest rate when policy makers meet this month. However, a broader measure of unemployment that includes discouraged and underemployed workers is nearly twice that figure. Jonas Prising, CEO of recruiter ManpowerGroup, agreed that low participation rates were troubling, despite the improving labour market. *"It may look like full employment,"* he said, *"but it's not full employment."*

Market Commentary (cont)

Technical Analysis:

We still feel that the market is hugely overstretched at current levels and highly susceptible to a pullback. The FTSE 100 is now 631 points above its 200-day moving average and that is not sustainable in the short-term. The RSI is also in bearish territory at 48%, suggesting the bears are taking back control. We see support at 6,260 and heavy resistance at the 7,100 level, its 2015 high.

"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,.

September ☹

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. After the summer lull, things get exciting again for investors in September in what is historically the worst performing month of the year, falling on average 1%, 55% of the time. It is even worse for the mid-caps with the FTSE 100 historically outperforming the FTSE 250 by 0.7%.

Third Quarter ☺

The FTSE 100 has risen 20 of the 33 years in the third quarter between 1984 and 2015, posting an average gain of 1%.

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.

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:

"Trees don't grow to the sky." - Anonymous

There is an old saying often repeated amongst the investment crowd, *"Trees don't grow to the sky."* It is a warning that stock prices don't continue to increase forever. Eventually they will fall. Or, the saying you may be more familiar with, *"What goes up, must come down."*

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 underweight. Seasonally, September is the worst month of the year for stocks, falling on average 1%. After strong recent stock market gains following the Brexit vote, we would be hesitant about putting new money to work at these levels.

Widely regarded as the *"most hated"* bull market in history, the wave of disdain is, however, just another wall of worry for the bull to climb. And soon, decisions about liking or trusting this rally leg will become moot. Sometime late in September or early in October, the stock market reaches its "*event horizon,*" beyond which the countervailing tendency of the prior nine months is sucked in and succumbs to the prevailing tendency. In short, if the market is bullish through nine months, it gets extremely bullish in the final three months.

Gibraltar Asset Management

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary (cont)

Market Outlook (cont):

As of today, year-to-date capital appreciation on the FTSE 100 has reached 10.4%. Assuming the stock market can maintain a high-single-digit gain through to the end of the year, bearish money managers will need to change their investing strategy and go aggressively long, or risk delivering even-deeper under-performance to unhappy clients. While much can intervene between now and Year End, including one of the more-dramatic and polarizing presidential elections in memory, we expect stocks to maintain their bullish tone. Let's just get September out of the way first.

Tweet of the Month:

"A remarkable 76% of all the FTSE 100 index gains in a month come from the first six and the last six calendar days"

By calculating the daily mean return for each day in the trading year, it is possible to calculate the cumulative performance of the FTSE 100 in a month based on each day's average gain/loss.

This exercise has been carried out over the period 1984-2015 and the result is that in an average month, the FTSE 100 rises to the 5th of the month, then falls back until the 12th. It then increases again briefly to the 18th, before falling back and then finally bottoming on the 23rd, before rising quite strongly from there to the end of the month.

The outcome of this analysis is that short-term traders are best being long the market from the 23rd to the 5th calendar day and short the market from the 6th to the 22nd calendar day.

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 Laird Plc in the third quarter (305p, 13.2x P/E, 4.1% yield, ~10.5% 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

The market tends to gently drift lower for the first three weeks before rebounding slightly in the final week. *Going short the market via a CFD at the beginning of the month before switching to long on 26th September would be best to capture this move.*

Weakest Weeks

The week starting 19th September is the 2nd weakest week of the year, falling 61% of the time, posting an average loss of 0.5%. *Going short the market via a CFD would be best to capture this move.*

Weakest Days

The 9th of September is the 3rd weakest day of the year, falling 73% of the time, posting an average loss of 0.3%. The 23rd of September is the 10th weakest day of the year, falling 68% of the time, posting an average loss of 0.3%. *Going short via a CFD would be best to capture these moves.*

Option of the Month

Sell Sky November 800 puts at 16.5p

Strike price at a 2-year low. Stock is yielding 4.0% and has 25% potential upside to the average broker price target. *Click here to view our guide to the Traded Options Market.*

Market Commentary (cont)

Recommended Investment:

Sky Plc 860p, 14.5 x P/E, 4% yield

Sky Plc, formerly British Sky Broadcasting Group Plc is a well-known entertainment company serving approximately 21 million customers across five countries: Italy, Germany, Austria, the United Kingdom and Ireland.

Its recent reported results have been impressive. European and Premier League football, hit dramas such as Game of Thrones and new devices and services are all boosting customer numbers (up 800,000 year-on-year) and product sales across the board. Strong demand, combined with a tight grip on costs, propelled operating profits up 12% to £1.56bn in the 12 months to June 2016.

Constant-currency sales climbed 7% in the UK as the group launched new services such as Sky Cinema - a digital film library that releases a new movie every day. The UK is, however, an increasingly mature market. The big growth potential lies overseas, and Sky are confident that they can roll-out expansion in Italy, Germany & Austria in the same way that they have in the UK. If Sky is successful, the rewards will be vast. At present, UK customers pay an average of £47 per month each, while those on the continent pay around 15% less. On this front Sky is making good progress. Better programming and Bundesliga coverage helped the German and Austrian business to deliver its maiden operating profit. And the Italian segment grew its customer base for the first time in five years, as football fans tuned into Italy's football matches during Euro 2016.

Looking forward, Sky plans to launch their brand into the UK mobile market and will launch a VR app later this year. Revenue growth of 5-7% is targeted, and the focus on controlling costs is set to continue. The current synergy target from the integration of Sky Deutschland and Sky Italia of £200m by 2017 has been extended to £400m by 2020. Separately, Sky will carry out a cost reduction programme of 2-3% of sales, or over £300m in 2017, to help offset the step up in Premier League costs.

We feel that the recent share price underperformance offers an attractive entry point at current levels. **Yielding 4%**, they trade on a forward P/E ratio of 14.5x, which is slightly below their long-run average. Investment Bank Exane BNP Paribas believes that Sky can deliver sustainable mid-single digit organic revenue growth for the medium term through a combination of pricing power and innovation. They have upgraded the stock to buy with a 1075p price target, suggesting **25% potential upside.**

Market Commentary (cont)

Investment Calendar:

1st September	New Moon (markets tend to reach tops around this time)
2nd September	Nonfarm payroll report
5th September	Labour Day (NYSE closed)
8th September	ECB Meeting
9th September	3rd Weakest Market Day of the Year
15th September	MPC interest rate announcement at 12 noon
16th September	Options Expiry Day
	Full Moon (markets tend to reach a low point around this time)
19th September	2nd Weakest Week of the Year
21st September	FOMC Meeting
23rd September	10th Weakest Market Day of the Year

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.

Gibraltar Asset Management Limited
One Irish Place, PO Box 166, Gibraltar
Telephone: +350 200 75181 Website: www.gam.gi


FTSE 100
Index
7000
6894.6
6800
6600
6400
6200
6000
5800
5600
2/9/14
Oct
'15
Apr
Jul
Oct
'16
Apr
Jul
9/9/16
14 RSI (simple - Daily)
80
60
40
20
14 ADX (Daily)
40
20