Gibraltar Asset Management Stock Market Commentary

GIBRALTAR ASSET MANAGEMENT LIMITED
STOCKBROKERS & INVESTMENT MANAGERS

'Quietly Optimistic for the year ahead'

We wish all our clients and readers a very Happy New Year and all the best for 2019. Last year was one in which all stock market maxims went out of the window. A strong January is supposed to foretell a good year. Stock levels at the nine-month mark were indicative of a better-than-average fourth quarter, only to plunge at a rate not seen since 1931 when we were in the throes of the Great Depression. Not to mention "Sell in May and go away", which turned into "Buy the summer, because autumn will be a bummer". Contributors to the sudden collapse in market direction include tariff wars, rising interest rates, a US government shutdown, weaker energy demand and Brexit. Despite these challenges, we are quietly optimistic and shall continue to make the bullish case as we see it.

by **Mark Maloney**, Managing Director, Gibraltar Asset Management Limited

Market Outlook

Our allocation to the stock market remains at overweight. The equity market remains volatile as investors rethink economic and corporate profit expectations for 2019. This has raised the risk profile of equities and led to unprecedented volatility. The S&P 500 had a startling 65 trading days in 2018 with a 1% or greater move, compared to only 10 such days in 2017.

On balance, while we agree that the current environment carries above-average risks, most of these risks are not new. And we believe the global economy, though potentially slowing, will remain on an upward trajectory. Equally vital to the stock market's health, we think that corporate earnings growth is largely intact, driven by a consumer benefitting from low interest rates and record low levels of unemployment. If those two things are true, and stocks are >10% off their peak, then it follows that valuations must be more attractive than they have been in some time. Indeed, we believe valuations are more compelling than they have been in years. Investors speak of the 10-year bull market, but it has been anything but a straight line. Multiple events have challenged the market and, thereby in our view, given it renewed vitality. In many ways, the current environment is similar to 2011 and 2015, years in which fierce and concentrated selling was followed by above-average recovery years. We do not believe we are in the throes of a classic bear market.

The three indicators of a bear market - negative GDP growth, declining earnings and inflated valuations - are not present. Investors, having cleared their tax losses into year-end, now get to start with a fresh sheet of paper - and they will see plenty of formerly expensive stocks selling at deep discounts, with their fundamentals intact.

Additionally, through all the panic selling and institutional programme trading that took the stock markets lower, business insiders (corporate executives & directors) have remained positive, snapping up shares in a voracious manner to send strong signals that this correction is indeed an opportunity.

Whilst mindful of the shape of the yield curve (an inverted yield curve typically precedes recessions), we do not see a recession on the horizon. Even if the yield curve did invert, it often takes a year or longer for the economy to turn (and the inversion also occasionally sends false alarms). We also note the change in tone from the Fed (recently suggesting a pause in interest rate hikes due to the flattening yield curve), indicating they too are keenly aware of its implications.

Finally, progress is being made between the US and China to reach an amicable agreement following threats of trade wars that are wreaking unforeseen havoc. In a world in which global trade has been woven into the collective fabric, nations are having to relearn the wisdom of Benjamin Franklin when he said that we must hang together, *"or surely we will hang alone"*.

Recommended Investment

The North American Income Trust plc

The USA is the engine that drives the world's GDP and its stock market is the largest in the world, accounting for over 40% of the world's stock market capitalisation. Obtaining exposure can, however, be difficult for overseas shareholders, with investors having to complete complex US tax forms and often pay very high rates of withholding tax.

North American Income Trust (NAIT.L) is an investment trust that trades on the London Stock Exchange in sterling. As such it is very simple to purchase through a stockbroker and can be bought and sold throughout the trading day. Its objective is to provide investors with above average dividend income and long term capital growth through active management of a portfolio consisting predominantly of US equities. The trust has delivered strong performance under the management of Fran Radano and Ralph Bassett of Aberdeen Standard Investments, having risen >90% over the last five years. The managers construct the portfolio with an emphasis on quality and value, targeting cash generative companies that are able to reinvest in their businesses as well as paying dividends. It is the quarterly dividends that we find particularly attractive. The trust currently yields 3.1%, more than 1.5x that of the index. The dividend is also growing at 8% a year, supported by growing revenue reserves (equivalent to >60% of the latest full year dividend).

The portfolio consists of over 40 equities, containing such blue-chip names as Chevron, Cisco, Proctor & Gamble, Pfizer and DowDuPont. In addition, the trust is able to write covered calls and put options as a means of both supplementing income (~20% of income) and managing the portfolio in terms of exiting or adding positions at target prices.

One feature of investment trusts is that they can trade at a discount or premium to NAV. Currently, the trust is trading at a 3% discount vs its 12-month average discount of 6%. In our opinion, downside discount risk is limited to an extent by the Board's commitment to consider share buybacks when the discount exceeds 5% for a significant period.

The fund is unhedged so in addition to USD investors, sterling investors looking to protect themselves from a further devaluation in the pound may wish to purchase a small allocation.

In summary, we believe this to be a well-managed fund with a good dividend yield providing exposure to the world's largest stock market. Buy.

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