Gibraltar Asset Management
STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - December 2024

FTSE 100	**8,308**	S&P 500	6,090
Resistance	8,400	Gold	$2,647
Support	8,160	GBP/EUR	1.2086
VIX	13%	GBP/USD	1.2761

Introduction:

As we approach the end of 2024, we are seeing two conflicting forces at work. Investment managers that are beating their benchmark are lightening up on their equity exposure and starting to plan for 2025. Meanwhile, those who were behind going into December have little time to catch up and are buying momentum stocks to increase their risk exposure. Interestingly, company directors are remaining on the sidelines, seemingly content to observe the action without any major participation. As new all-time highs are being printed on a regular basis, we can't fault these corporate insiders for not jumping in to buy at the latest top, but are pleased that they have not been dumping shares either in a manner that would suggest a correction is imminent.

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 at overweight. Even with the broad market at all-time highs, we believe stocks can continue to rise from here. Along with lower inflation and higher earnings, lower rates support our positive view of equity valuations.

In the short-term, there will be a strong technical pull into year-end as bears likely capitulate. Indeed, the technical condition of the stock market is very bullish. Of course, *"everyone"* on Wall Street knows this - and whether you're a fundamental or technical analyst, it's difficult to support a bearish case. Unless you're a *"perma-bear"* of course.

Historically, December is the FTSE 100's best-performing month, rising 2.3% on average, 80% of the time. Interestingly, the stock market rallied in November and December of 2016 and 2020 post the US presidential election, and the *"Trump Bump"* is currently providing a tailwind to equity markets.

This year, no equity sector has really been left behind with practically every investment style participating in the year-to-date gains. Markets with good breadth are more durable and better positioned to withstand adverse news than thin and narrowly led markets. A key risk to valuations would be earnings growth failing to meet the market's targets and inflation or interest rates ticking higher. Either of those factors would result in elevated valuations but represent just modest risks currently.

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Recommended Investment:

iShares World Momentum Factor ETF

Perhaps the strongest deviation from the textbook theory of market efficiency is the success of momentum investing. The strategy seeks to exploit an often-overlooked aspect of markets, which is their short-term inefficiency. While stocks eventually follow earnings over the long haul, over shorter time horizons they are affected by all manner of reactions, overreactions, emotions, fads and fears. We know markets are inefficient because its participants - that's us - are inefficient.

The reasons why momentum investing works are rooted in behavioural finance, market inefficiency, and investor psychology.

<u>1. Behavioural Finance</u>

i-Herding Behaviour. Investors often follow the crowd, buying stocks that are already rising, which can push prices higher.

ii-Anchoring and Underreaction. Investors often cling too strongly to their prior beliefs about a stock and therefore do not respond sufficiently to new information. When they see a company announce good news, they think it a flash in the pan from an otherwise average company and so don't bid up its price sufficiently, causing it instead to drift up as reality gradually dawns.

iii-Overconfidence. Overconfident investors may push trends further by overestimating their ability to identify *"winners."*

<u>2. Market Inefficiency</u>

Information about a company or asset doesn't reach all investors simultaneously, leading to delayed price adjustments.

<u>3. Investor Psychology</u>

Investors may chase performance, buying into assets that have recently done well and selling those that haven't. This self-reinforcing behaviour extends price trends.

Good returns on momentum strategies were first spotted in US stocks by finance professors Jegadeesh and Titman in 1993. They found that a momentum strategy of buying US stocks with the highest returns over the past 3 to 12 months produced an average excess return of about 12% annually from 1965 to 1989. Similar momentum strategies have been successful in international markets, such as Europe, Asia, and emerging markets, often generating annualised excess returns of 8%–10%.

Buying individual stocks and regularly rebalancing can be, however, too much trouble for many investors who do not want to monitor individual stock price movements and end up with a potentially undiversified, by sector, portfolio. One easy way of obtaining exposure to this theme is to purchase the iShares World Momentum Factor ETF (IWFM.L). This is a low-cost Exchange Traded Fund, that trades in sterling (IWMO.L trades in USD & IS3R.DE trades in EUR), that seeks to reflect the return of the MSCI World Momentum Index. The constituents of this index are selected using a similar strategy of identifying equities that have experienced price increases over the past 6 and past 12 months with the assumption that increases will continue in the future. With a TER of just 0.25% and a 5-year return of +83%, we rate the fund a strong buy. Furthermore, as it is regularly rebalanced, we feel it can be bought at any stage of the market cycle.

Post of the Month:

"The argument in favour of tariffs is that having a large trade deficit is bad. The logic being that if a country is importing lots of goods from abroad, that means it must also be exporting jobs to foreigners. However, evidence shows they are just a symptom of growth"

The simplicity of the argument for tariffs is compelling. It is why Donald Trump made it such an important part of his campaign messaging. Just before the election, he told supporters he would *"bring the companies back"*, promising them *"we're going to protect those companies with strong tariffs because I'm a believer in tariffs"*.

Under this logic you would expect there to be some positive correlation between the trade deficit and unemployment. In other words, as the trade deficit increases, unemployment would be expected to rise because more jobs were being exported. The problem for the protectionist argument is that the opposite is true. Most of the time when the trade deficit decreases, unemployment tends to rise. For example, during the Great Recession, US bank lending stopped, consumer spending collapsed and the monthly trade deficit more than halved. In the same period, the unemployment rate doubled to more than 10%.

The relationship between strong economic growth, low unemployment and a large trade deficit has been on clear display in the last two years. At the height of the Covid pandemic, the US unemployment rate peaked at 14.8%. The government responded by handing out stimulus cheques while the Fed cut interest rates. As a result, the economy boomed, the trade deficit doubled, and unemployment dropped below 4%.

Industrial workers in the 'Rust Belt' states would argue these aren't the 'right kind of jobs'; the sort of high-paying factory jobs their fathers had. This is true. Since 1970, the percentage of the US employed in the service sector has risen from 60% to more than 80%. However, to truly make US manufacturing internationally competitive again, the government would have to diminish the standard of living for the rest of the country.

The Republicans complained about subsidies for the green energy industry, but tariffs are just another form of interventionism. Like any other form of fiscal policy, it is a way of funnelling money from one group in society to another. A sort of crony capitalism that favours one sector over another.

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Quote of the Month:

"If you go for a home run on every pitch, you're also going to strike out a lot. I try never to leave myself too exposed even if it means sometimes settling for a triple, a double or even on rare occasions, a single" - Donald Trump

The finer rules of baseball are more than likely lost on most of us but the sentiment is clear and directly transferable to stock market investing. Diversification, bonds, defensive stocks, low-beta investments. They all have their place in any portfolio.

Economics:

The UK economy is set to grow 1.4% next year - twice as fast as its European counterparts according to investment bank ING. Much of the UK's growth will be driven by the £40bn of additional spending announced in Chancellor Rachel Reeves' October Budget, which the bank predicts will play out through higher public sector wages and employment. The Eurozone, meanwhile, will contract early next year, with political upheaval in France and Germany weighing on the continent's prospects. The ING analysts cautioned that Germany and France's reliance on manufacturing and goods also leaves them more exposed to the tariffs being trumpeted by Donald Trump, while the UK's service-dominant economy - though still vulnerable - is less likely to be in the President-elect's crosshairs.

A political vacuum in France and Germany, the EU's two biggest and most influential players, spells trouble for an already ailing European economy. The French Parliament has voted no confidence in the Prime Minister, making Michel Barnier the shortest-serving head of government under the Fifth Republic. President Emmanuel Macron will now be under pressure to appoint a replacement – and is even facing calls to resign himself. The political dispute which tipped Barnier over the edge, the 2025 annual budget, suggests it will now be even harder to address the country's economic woes. With a deficit of 6.2% of GDP, France already has the worst budget imbalance in the eurozone. And Berlin is facing political troubles of its own. The ruling three-party coalition collapsed in November, following disagreements on fiscal policy between socialist leader Olaf Scholz and his liberal finance minister Christian Lindner. Meanwhile, Donald Trump's campaign pledge to impose 10% tariffs on European goods will pose a further headache - imposing both a direct economic cost on EU exporters, and a tough choice for national leaders as to how to retaliate. The threat of Russian aggression, and possible US retreat from NATO, will also mean Europe needs to reach into their pockets to invest in their military.

Bank of America has projected the US economy will grow at an annualised rate of 2.4% in 2025. This comes despite uncertainties surrounding the economic policies of President-elect Donald Trump, including campaign promises of tariffs on imported goods, tax cuts for corporations, and curbs on immigration, which economists have viewed as inflationary. However, the US is best prepared to weather any economic storm that follows Trump's agenda. *"We like to say that the US imports a lot of stuff, but it doesn't import recessions,"* Aditya Bhave, senior US economist at Bank of America, said. *"It only exports recessions."* Recent domestic growth trends have been *"remarkable,"* in Bhave's view, and the proof is in the data. Consumer confidence is at its highest level in 18 months. US economic output hasn't been this strong since April 2022. Retail sales topped estimates for the month of October, the unemployment rate continues to hover at around 4%, and inflation has moderated despite its bumpy path down to 2%.

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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. *Judging by the first 5 days, 2024 is likely to be a negative year for the stock markets.*

December

December is the FTSE 100's best performing month since 1984, rising 2.3% on average, 80% of the time. In an average month, the market tends to increase slightly in the first two weeks, but then rises strongly in the final two weeks. Indeed, this is the strongest two-week period in the whole year, with the three strongest days of the year all occurring in this period.

Fourth Quarter

The FTSE 100 has risen 30 of the 40 years (75%) between 1984 and 2023, posting an average gain of 3.4%.

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.

Fourth-Year US 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 Dragon

The 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, rooster, 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 dog. The worst performing animals have been the rooster and snake. *The Year of the Dragon is believed to foster growth, progress, and abundance. For investors in Chinese stocks, that would be a most welcome break from the past few years.*

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Investment Calendar:

1st December	New Moon (markets tend to reach a high point around this time)
12th December	ECB Meeting
15th December	Full Moon (markets tend to reach a low point around this time)
17th December	FED Meeting
19th December	MPC Meeting
20th December	Options Expiry Day

Technical Analysis:

Last month we wrote *"We are bullish on the stock market at these levels. Following a +200 point pullback from its October highs, the FTSE 100 looks good value as we head towards year end, traditionally the strongest part of the year for equities…"* In the event, the market rose 129 points (1.6%). With the FTSE 100 at elevated levels, the short-term direction from here is far more difficult to predict. The RSI, at 71%, is signifying the market is overbought, the FTSE is a whopping 148 points above its 200-day moving average and is hovering around a quadruple top. Having said this, betting against the markets making further gains heading towards year end would be a very dangerous game. This is, after all, the strongest two-week period in the whole year, with the three strongest days of the year all occurring in this period.

"The illusion of randomness gradually disappears as the skill in chart reading improves" – John Murphy

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 thin line)	50 day moving average	(signifies the medium-term direction of the security)
(red thick line)	200 day moving average	(signifies the long-term direction of the security - whether it is in a bull or bear market)
(blue line)		(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. ending markets Bollinger Bands work best (sell at upper band, buy at lower band).

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