GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - February 2024

FTSE 100	**7,615**	S&P 500	4,958
Resistance	7,730	Gold	$2,024
Support	7,440	GBP/EUR	1.1711
VIX	14%	GBP/USD	1.2590

Introduction:

The *"Energizer Bunny"* stock market seems to have a lot of juice left, as the major US indices power to new all-time highs. Each day and each week, the market goes up and the rubber band is stretched further and further. Since the low of 27th October, the S&P 500 has soared almost 20%. Generally, gains like these occur during the early stages of a bull market. The 14-week RSI (a momentum indicator) hit 72% in late January, indicating the market is overbought. Just because we are overbought though does not necessarily mean stocks are approaching a top. In most cases, the market eventually pauses only to continue moving higher.

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 moves to overweight. 2024 seemed to get off on the wrong foot with the FTSE 100 falling over the first five trading days of the year. Some investors fear that this sets up the market for a down year (known as the "January Effect"). We prefer to focus on the fundamentals rather than stock market superstitions.

While we never argue with price action (the most important element for a technician), 2024 has reverted to the major theme of 2023, when gains in the major US indices were from a concentrated area of the market (the AI boom). The Street is divided as to whether the AI-driven *"Magnificent Seven"* can remain magnificent in 2024. Bears point out that the valuations of these stocks are stretched (at more than twice the broad market average). Bulls respond that margins and growth rates for these stocks are also two-times or more the market average. Given that the age of generative AI has only just started, we believe these names and other perceived AI winners (such as AI-adopting companies) could lead the market over the next several years. For some, this feels like a repeat of the late 1990s, when the Technology sector was the only place to be. The difference this time around is that the mega-cap tech stocks leading the market higher are well-established, money-making machines.

Meanwhile, falling inflation and lower interest rates are good for valuations, and stocks are looking increasingly attractive. The S&P 500 is trading on a 18.5-times forward P/E multiple, a 7% discount to the trailing five-year average of 20. Oil-production cuts by Russia and Saudi Arabia briefly led to a surge in

Market Outlook (cont):

energy prices, but that trend has now reversed. The supply/demand equation looks to favour supply over the next two years. West Texas Intermediate crude oil is forecast to average $80 in 2024, in line with the 2023 average and down from $95 per barrel in 2022. This is good for consumers. And though the yield curve was inverted for all of 2023, we expect investors to push short-term interest rates lower and long-term rates higher over time, eventually returning the yield curve to its normal upward slope. This is good for stocks.

On the negative side, the major geo-political event of 2023 - the war between Israel and Hamas - has continued into 2024 and could potentially broaden into a larger regional conflict. Other geo-political challenges include the end of China's zero-tolerance pandemic lockdown, which has resulted in just tepid recovery in the world's second-largest economy, as well as the war in Ukraine. Despite these and other challenges, the global macro-environment appears moderately positive for equities.

We expect the global economy to continue expanding in 2024, remaining on a narrow growth path but only a wrong turn or two away from recession. The consumer has carried the economy during the post-pandemic transition phase, and improving consumer confidence reflects high levels of employment and wages running ahead of inflation. We anticipate that an expanding economy, growing earnings, and declining inflation and interest rates can offset recession risks and geo-political uncertainty, resulting in the major indices establishing new all-time highs in 2024.

Market Commentary

Recommended Investment:

Chesnara

An anagram of Chesnara is *"earn cash"*, fitting for a company that offers one of the most generous dividend yields on the stock market - 9%.

Chesnara specialises in buying up and running off the unwanted life insurance books of larger insurance companies, and then runs them down in an orderly way. The company bedded in a number of acquisitions last year including Conservatrix in the Netherlands, plus a protection book from Canada Life in the UK. The company administers ~1 million life and pension policies for their policyholders; 308,000 in the UK, 304,000 in Sweden and 404,000 in the Netherlands.

Like certain types of marine life, the company cannot afford to stand still, but it is being helped by a boom in the pension transfers market creating a capital hunger that Chesnara, with its Solvency II ratio of 205% (well above its 140-160% target), can satisfy by buying up the smaller portfolios that big insurers no longer want. This is particularly opportune at a time when the cost of capital is high. The surplus implied by its 205% ratio is around £345m, giving the company large firepower for acquisitions.

In addition to creating value through acquisitions, the company also seeks to maximise the value from existing business (through the efficient management of existing customers and financial resources to optimise long-term cash flow), creating value from synergies, and the writing of new business.

Chesnara is not a flashy or high-profile business, but its income record - 19 years of continuous dividend rises and counting, is almost unique. With a price at approximately 70% of its forecast Economic Value, Chesnara seems undervalued. And with a solid dividend yield supported by a strong solvency ratio, we rate Chesnara a buy not just for yield but also for value and indeed the company could become a bid target for a larger player.

Market Commentary

Post of the Month:

"Deciding how much you can afford to withdraw from your pot is one of those questions financial planners spend hours on. And now they suggest the 4% rule no longer works"

The often cited 'safe' level of drawdown is 4%. You can start by taking 4% of your pot in the first year of retirement, and then increase the withdrawals by inflation each year thereafter. If you manage to grow your pot by 4% a year plus inflation, your pot then remains more or less untouched in nominal terms.

Gary Smith, partner in financial planning at Evelyn Partners, says that achieving this now looks trickier than it used to. *"The favourable assumptions around inflation and investment growth that prevailed 30 years ago when this rule first gained traction might no longer apply,"* he says. Market volatility and the likelihood that inflation stays above pre-pandemic levels for a while means that 3% is *"probably a safer bet"* when it comes to establishing an indicative drawdown rule. *"The volatile market conditions and inflation levels of the last few years have given some savers with defined contribution pots a bit of a wake-up call as to how long their savings might last,"* Smith adds.

In a sense, the rule was perhaps always too simplistic. There are a few alternative ways to think about your drawdown rate.

Using the 4% starting amount, you would withdraw the same actual sum along with an inflationary increase, regardless of how your investments are performing. This is great for maintaining your lifestyle, but riskier for preserving your pot in the long run. Alternatively, you could just withdraw 4% of the value of your pot each year. This is more likely to protect your capital in the long term, but also means that you will have less money if your assets underperform. A combination of the above works as a nice middle ground. The idea is to take a little more in good years and a bit less in bad years. This strategy is sometimes referred to as 'dynamic spending' and is advocated by the likes of Vanguard.

Another option is relying on the income that is generated naturally by your portfolio. Doug Brodie, founder of retirement planning firm Chancery Lane, favours using investment trusts to create a portfolio that is both diversified and generates a steady stream of income, which typically grows year on year and matches the amount you need for your day-to-day life.

However you approach drawdown, a rule of thumb can only go so far. What's more, the level of drawdown is not all that matters. If high inflation means that you will need to withdraw more to be able to afford the same lifestyle, volatility means that the point when you withdraw is also a key consideration. Avoid cashing in your investments when markets are down; returns are asymmetrical, so it will take much more growth for the pot to go back to where it started. Instead, you should keep about six months' worth of cash to protect yourself from market volatility in drawdown.

Market Commentary

Quote of the Month:

"I am always prepared to do the right thing regardless of what other people think" - Bill Ackman

In the high-stakes world of investing, it's easy to get swept up in the opinions and actions of others. But Bill Ackman's quote reminds us that, as investors, we must be willing to stand our ground and make decisions based on our own convictions, even if it means going against the grain.

Economics:

The Bank of England left interest rates on hold for the fourth time in a row, as the UK economy teeters on the brink of recession. Despite a slight uptick in December, when the headline rate of inflation came in at 4%, inflation in the UK has generally come in much lower than predicted by the Bank over the last few months. In November, the Bank predicted inflation would be 4.6% by the end of 2023. Officials at the Bank have so far cautioned that it is *"too early"* to talk about cutting rates, but the progress on inflation has prompted markets to ramp up bets that the Bank will start lowering interest rates in the first half of the year. By the end of 2024, markets think the Bank Rate will stand at 4%. Although the Bank is unlikely to cut rates as fast as markets hope, most experts think rate-setters will drop any mention of hiking rates further.

Europe's economy has avoided ending 2023 in a recession by the narrowest of margins. GDP across the 20 countries that use the euro was flat in Q4. In Q3 GDP had dipped 0.1%. Overall, the data is *"no reason to celebrate,"* according to Christoph Weil, a senior economist at Commerzbank. *"This does not really change the picture. The massive tightening of monetary policy brought economic growth to a standstill in the summer. It is unlikely that the economy will emerge from this weak phase before the spring".* Persistently high inflation makes it unlikely the ECB will lower its key interest rates before the summer. Jack Allen-Reynolds, a eurozone economist at Capital Economics, takes a similarly gloomy view of Europe's prospects. *"The region dodged a technical recession. This is just semantics though. The big picture is that eurozone GDP has been flat since Q3 2022 when gas prices surged and the ECB started raising interest rates,"* he wrote in a note. He expects the eurozone economy to *"flatline"* in the first half of 2024 *"as the effects of past monetary tightening continue to feed through and fiscal policy becomes more restrictive".*

The hot US employment market is creating a positive feedback loop in the American economy according to White House economist Jared Bernstein. Bernstein argues that the blow-out January jobs report *"tells an unequivocal story of a very strong jobs market",* highlighting how unemployment has remained below 4% for the 24th month in a row. The strength in the job market is powering a *"virtuous cycle"* in the economy, Bernstein said, noting that consumer spending makes up 70% of GDP. The thinking is that as long as consumers have jobs, and paycheques are beating inflation, Americans can keep shopping. And that in turn should create new jobs, and so on. Still, some economists worry the January jobs report paints a picture of a job market that is too hot - a concern that could prevent the Federal Reserve from cutting interest rates anytime soon.

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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.*

February

Since 1984 the average month return of the FTSE 100 Index in February has been 0.6%, making it the 5th strongest month of the year. In an average February shares tend to rise strongly on the first trading day, then trade flat for a couple of weeks, before gaining strongly in the middle of the month and finally drifting off slightly to month end.

First Quarter

The FTSE 100 has risen 27 of the 40 years (68%) between 1984 and 2023, posting an average gain of 1.3%.

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 February	BoE Meeting
9th February	New Moon (markets tend to reach a high point around this time)
16th January	Options Expiry Day
21st February	ECB Meeting
24th February	Full Moon (markets tend to reach a low point around this time)

Technical Analysis:

Last month, we recommended that traders go short following extremely overbought RSI readings. In the event the FTSE 100 fell as much as 248 points but recovered strongly to close just 83 points down. The RSI has since unwound its overbought reading and is now sitting at 53, a bullish level considering it has risen from below 50. The ADX at 23, is suggesting the market is trending and we therefore see the market looking to push forward to 7,730 (its recent high). Any break of the 200-day would see the market likely test the recent low of 7,440.

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

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)
	(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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