GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - July 2024

FTSE 100	**8,203**	S&P 500	5,567
Resistance	8,290	Gold	$2,371
Support	8,000	GBP/EUR	1.1827
VIX	13%	GBP/USD	1.2815

Introduction:

Stock markets have logged gains at mid-year that would be acceptable for a full year. But recent sentiment among investors has been held hostage by interest-rate obsession, with peaks for stocks on days when the data suggests a cut is needed and valleys on days when rates seem destined to stay high. Indeed, the one-month charts for the major indices are roller coaster in nature. Retail investor surveys show a neutral attitude towards stocks. That's fuel for higher stock prices, but we need a catalyst or two to get investors off the sidelines. To paraphrase William Shakespeare, it seems *"neither a buyer nor a seller be"* is the quote of the day.

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 equalweight. With major indices hitting all-time highs, the presumption is that market sentiment is as hot as the temperatures in Southern Iberia. Economic data is arguing otherwise. Both industrial and particularly consumer data show that inflation and high interest rates are wearing on spending and activity. One well-known economist suggested that *"it's time to stop obsessing about inflation, which increasingly looks like yesterday's problem, and start worrying about the possibility of recession as the economy's strength finally begins to erode under the strains of high interest rates. So yes, I think the Fed should start cutting rates, and soon."*

History has shown that markets carrying double-digit appreciation into mid-year tend to finish the year with above-average gains. For the 16 years between 1980 and 2023 in which the S&P 500 has been up more than 10% at mid-year, the average full-year gain has been 23.3%, or more than twice the market's 10% average gain. Yet this advance seems oddly fragile, predicated as it seems to be on the perception that the Fed will soon begin cutting rates.

The stock market is showing better breadth than in 2023. But growth sectors are now pulling away from the broad market, in an echo of last year. Right now, it's Nvidia's world, and everyone else is just living in it. Until the AI spell is broken, market participation is likely to remain narrow - contributing to the unease that continues to characterise this otherwise healthy stock market advance. We would like to see investors take profits in AI names, reallocate winnings, and enable improvement in sector breadth.

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Market Outlook (cont):

That would be a highly encouraging sign as the traditionally slower summer months progress.

It's not all doom and gloom of course. The upcoming earnings season is likely to be the best in at least two years. Accelerating earnings growth is preventing the market from stretching into deep overvaluation territory even as stocks repeatedly hit new highs. And notably, recent inflation data finally showed improvement from recently stalled levels. The US economy continues to chug along, albeit below the levels of 2022-23. Unemployment remains low, and wages are growing faster than inflation.

In summary, accelerating earnings growth along with lower inflation and interest rates are keeping stock valuations reasonable, even as the market repeatedly makes new highs. But we are firmly in the weakest half of the year and without any catalysts on the horizon to get investors off the sidelines, we see limited potential for stock market gains in the months ahead.

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Recommended Investment:

Patria Private Equity Trust

Patria Private Equity Trust is an investment trust listed on the London Stock Exchange (PPET.L) that provides investors with access to a portfolio of private equity funds and companies, highly diversified by country and industry sector.

Investing in private equity has historically been difficult for retail investors. Private equity firms typically have investment minimums of over EUR5,000,000. Individual investors face a complex regulatory environment when investing. Daily liquidity is not available in open-ended funds. And the best funds are often oversubscribed and closed to new investors. PPET makes investing in private equity available to all types and sizes of investors in a fund that has daily liquidity.

The trust invests primarily in private equity funds based in Europe (75%) with a smaller exposure to North America (25%). The private equity managers selected are experienced at transforming private companies through active management, away from the glare of listed markets, to turn them into attractive market leaders that can then be sold in a typical four to five-year investment cycle. The cash proceeds from these exits are returned to PPET and the investment cycle starts again in a continuous flow. The investment portfolio is valued at £1.2bn and comprises 80 private equity funds gaining exposure to over 700 underlying companies.

In addition, the fund invests up to 25% of assets in co-investments, which are direct investments into private companies alongside private equity managers. These currently comprise 26 individual private companies making up ~20% of the portfolio. This allocation brings the potential for outsized returns, lower fees, greater exposure to particularly attractive assets and the opportunity to put more capital to work.

PPET has a strong long-term performance record, returning 11% per annum since its inception in 2001 and has outperformed its Private Equity peer group and the FTSE All-Share Index over the last three, five and ten years. The trust also has an attractive dividend yield of 3.1% making it suitable to income investors. The fund has a low management fee of 0.95% with no performance fee.

The shares of PPET are currently trading at a 29% discount to NAV. We believe that this is hard to justify given the fund's long-term performance record, the quality of its investment portfolio and its attractive dividend yield. Therefore, the current share price represents an attractive entry point.

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Post of the Month:

"Yield curves usually slope upwards. Because of the risks they incur, investors are normally compensated with higher returns when they lock away money over the longer term. This means that there is usually a positive gap between the yields on ten-year and two-year government bonds"

But when the curve inverts, this 'spread' turns negative: suddenly, the yield investors earn on short-term bonds exceeds the yield on long-term bonds. This, historically, is a pretty reliable recession indicator. Indeed, research shows that inversions have preceded every US recession since 1955. The New York Fed even uses the slope of the yield curve to calculate the probability of a recession in the US in 12 months' time. Ominously, this probability currently sits at over 50%. Prior to the 2020s, the last time the odds were this high was in the 1980s - when a deep contraction duly followed.

But although yield curves have a lot to say about whether a recession will materialise, they don't give us much of a steer on when. Research finds that a US yield curve inversion can precede a recession by anything from six months to two years. And today, the wait is becoming increasingly lengthy, and perhaps increasingly disconcerting. The US yield curve has now been inverted since July 2022 – the longest inversion in history. This, clearly, is a long time to wait for the yield curve to be proved 'right'.

There could be several reasons for this delay. Excess savings have been unusually high this cycle, meaning that consumers haven't been as exposed to tighter credit conditions as they usually are. What's more, the Fed has staged a number of interventions, such as the emergency liquidity provision after the collapse of Silicon Valley Bank, meaning that the impact of the regional banking crisis was far more contained than it might have been in previous decades. Meanwhile, the demand side of the economy has bounced back strongly from the pandemic disruption, which has further supported growth and made this cycle unique. High inflation has muddied the waters further. At the start of 2023, the US policy rate was 4.5-4.75%, while inflation was at 6.4%, leaving 'real' (inflation adjusted) interest rates firmly negative.

In normal cycles, real and nominal yield curves tend to move in sync. This time, although the nominal yield curve inverted in 2022, the real curve only flipped in January this year. And recessions occur more predictably after the real curve inverts – typically 12 months afterwards, but sometimes as little as seven.

Whilst other leading indicators have their uses, the yield curve is slightly different: it doesn't only reflect economic conditions, it influences them, too. When the yield curve is inverted, it makes sense for investors to keep more of their money at the short end of the curve, and not lend long term. If rational investors aren't compensated for taking on more risk, they will refuse to do so. Eventually, this can weigh the economy down: investors aren't incentivised to take risk, encouraging more defensive behaviour.

This means that analysts aren't just reading the economic tea leaves. An inverted yield curve can tell us that a recession is coming because it makes one more likely.

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Quote of the Month:

"It's not whether you're right or wrong that's important, but how much money you make when you're right and how much you lose when you're wrong" - *George Soros*

Too many investors become obsessed with being right, even when the gains are small. Winning big and cutting your losses when you're wrong are more important than being right.

Economics:

Britain's economy pulled out of recession at a faster pace than previously thought (0.7% vs 0.6%) in the first three months of this year but the broader economic backdrop remains fragile. Real household disposable income - a measure of living standards - was 0.6% lower per head in the first quarter of 2024 than it was in the final quarter of 2019, the time of Britain's last national election and just before the COVID-19 pandemic. *"Income growth over the parliament so far has been worse than in any other since the 1950s, and the third worst in post-Edwardian Britain,"* said Adam Corlett, principal economist at the Resolution Foundation. Britain's economy has struggled since its last election, hurt not just by the pandemic - which dealt a lasting blow to the labour force - but also by a surge in inflation after Russia's invasion of Ukraine and post-Brexit trade frictions.

Inflation in the 20-nation eurozone crept lower to 2.5% in June, but remained stuck above the level favoured by the European Central Bank, which is in no hurry to add more rate cuts after a first tentative reduction in its benchmark rate. The ECB's caution in making sure inflation is under control comes as the Federal Reserve holds off on cutting rates from current highs. The central banks don't want to belatedly discover that inflation is more stubborn than they thought and reverse course - a mistake that would make inflation harder to wring out of the economy and would dent their credibility into the bargain. The European economy has slogged through quarter after quarter of near-zero growth, with a modest upturn of 0.3% in the first three months of this year. Recent indicators such as S&P Global's purchasing managers' index indicate that factory activity in the eurozone is contracting.

The US economy added 206,000 jobs in June, a modest decline from the revised 218,000 jobs added in May. June's unemployment rate edged up to 4.1%, marking the first time in over two years that it has surpassed 4%. This 0.1% increase from May indicates a gradual easing in labour market conditions. These employment figures, alongside upcoming inflation data, will be pivotal for the Federal Reserve's assessment of economic health and its interest rate strategy. The Fed maintained interest rates at a two-decade high of around 5.3% last month as it strives to bring inflation down to its 2% target. In May, inflation stood at 3.4%, significantly lower than its June 2022 peak of 9.1% but still above the Fed's goal. Minutes from the Fed's last meeting indicated a cautious approach, with officials awaiting *"additional favourable data"* before considering rate cuts.

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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.*

July

July has risen on average 58% of all the years since 1984, with an average return of 0.9%. So, after a usually disappointing May and June, shares tend to perform a bit better this month. In an average July, the start of the month tends to be strong - the first week of the month is among the top ten strongest weeks in the year. After that, the market has a propensity to drift lower for a couple of weeks until finishing strongly in the final week.

Third Quarter

The FTSE 100 has risen 25 of the 40 years (63%) between 1984 and 2023, posting an average gain of 0.6%.

Sell in May and go away; don't come back till St Leger Day

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:

5th July	New Moon (markets tend to reach a high point around this time)
18th July	ECB Meeting
19th July	Options Expiry Day
21st July	Full Moon (markets tend to reach a low point around this time)
30th July	FED Meeting

Technical Analysis:

We continue to be wary of the stock market at current levels. The market is down just 42 points since last month but was down 121 points at one stage, with the removal of political uncertainty giving the market a last-minute boost. Whilst the RSI is positive at 56%, the market is trendless (the ADX is just 15%) and we could see large bouts of volatility on thin market trading over the summer months. Upside appears to be capped at the upper Bollinger band (8,290), whilst the natural support level of 8,000 is over 200 points away. We are in the weakest half of the year and French elections continue to make the markets jittery. We again suggest traders go short of the market, targeting 8,000. Any breakdown below this psychologically-important level could see further downside to the recent low of 7,820.

"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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