GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - June 2024

FTSE 100	**8,245**	S&P 500	5,346
Resistance	8,440	Gold	$2,297
Support	8,000	GBP/EUR	1.1770
VIX	12%	GBP/USD	1.2723

Introduction:

The FTSE 100 has been left out of the *"AI mania"* gripping global markets, but the UK's blue-chip index made new record highs in May and is up 7% for the year. London's bias towards *"old economy"* sectors such as raw materials and banking have held it back in recent years, but that weakness has turned into a strength. Commodities are real assets and thus look attractive in a time of persistent inflation, while higher-for-longer interest rates will boost bank profits. The prolonged uncertainty following the 2016 Brexit referendum prompted investors to attach a higher risk premium to UK equities. Yet calmer political waters in Britain (there is little difference between Labour and the Conservatives on macroeconomics) mean that the Brexit risk premium now looks to have disappeared. Meanwhile, UK stocks are paying twice the dividend available in many comparable markets, but continue to trade near a record-low discount.

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. The Wall Street narrative is that inflation is in retreat, the economy is strong, and people are employed. But the average consumer is weary and wallet-constrained after two years of inflation. And high interest rates are a further impediment to large-ticket and discretionary purchases.

Despite these and other challenges, the bull has pressed on. Historically, bull markets have successfully climbed walls of worry, many more formidable than the current one. But investors need to remain confident this bull still has legs. Positively, IPO prices are not exploding higher and the Nasdaq has not doubled in price over the past year. In any rallying market, the two biggest risks are concentration and complacency. The fact that the S&P 500 is running neck and neck with the Nasdaq in 2024, not trailing deeply as it did during 2023, shows that breadth at least has returned to the market.

But the arrival of warm weather has historically brought a meaningful slow-down in the stock market. In any year, stock-market gains tend to be concentrated in the early month and the later months. That often leaves the June-September period dead in the water, or with feeble gains at best. In fact, June is the 2nd worst performing month, rising just 45% of all the years in June, with an average return of -0.4%.

Market Commentary

Market Outlook (cont):

The stock market has risen 7% year-to-date, a performance equivalent to an *"average"* year. No year in the market is really average, of course; while the mean gain since 1980 is about 7%, the market rarely delivers exactly that gain in any single year. Bigger-than-average wins, interspersed with bigger-than-average losses, are the norm. What will we get this year? The stock market's advance is broader than it has been in many years; that provides a bit of downside protection. However, we are remaining extra cautious amid the crosscurrents of an unusual and unpredictable year.

GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary

Recommended Investment:

Caledonia Investments

Caledonia Investments started out as a shipping company in the nineteenth century with the Cayzer family developing it into the world's largest cargo carrying line. It became an investment trust in 2003 and trades on the London Stock Exchange (CLDN.L). The trust is self-managed, run by a 20-strong team, with the objectives of growing both capital and income over the long run while doing so in a risk conscious manner.

With a market capitalisation of £3bn, the trust is a member of the FTSE 250 and aims to outperform inflation by 3%-6% over the medium to long term, and the FTSE All-Share index over 10 years. It does this by taking a long-term *"buy and hold"* approach to investing across three key investment pools:

i-Public Companies (~40% of portfolio)

This consists of a global portfolio of around 30 high quality companies across two strategies - Capital and Income. The Capital portfolio has a preference for US companies (such as Microsoft, Oracle and Watsco) and the Income portfolio is smaller and more UK-focussed, with holdings including Diageo, National Grid and Unilever. The target return is 10% p.a. on the Capital portfolio and 7% p.a. on the Income portfolio.

ii-Private Capital (~30% of portfolio)

This consists of direct investments where the trust works in partnership with 6-8 UK mid-market companies to drive value through business improvement. The target return is 14% per annum.

iii-Funds (~30% of portfolio)

This allocation consists of >70 private equity funds managed by >40 fund managers focussing on North American mid-market companies (~60%) and an Asian growth portfolio investing in new economy sectors (~40%). The target return is 12.5% per annum.

The fund trades at a 34% discount to NAV, largely due to investor scepticism towards private market valuations. This is unwarranted in our view (especially vs the peer group's 20% average discount), given that the trust holds 32% in publicly listed equity and it recently sold its majority stake in wealth manager 7IM at a +32% uplift to its carrying value.

The fund has outperformed against its peers and its index over three, five and ten years, delivering a 10% annualised return over the last decade. Moreover, it has delivered on its target to outperform inflation by 3%-6% over the medium and longer term. In our view, this long-term track record is testament to the trust's long-term investment approach, which is driven by its family office structure and the Cayzer family's 48% ownership.

The trust sits atop the Association of Investment Companies' dividend hero table with 57 consecutive years of dividend growth. Currently at 2%, the yield is less than spectacular, but the income is inflation-linked. The TER is 0.81%.

Investors in search of a trust with a long-term approach (10-15 years), a unique strategy, a low correlation to equities, lower volatility and growing dividends will find a lot to like in Caledonia. The discount to NAV is the cherry on top, providing a chance to boost investment returns once interest rates start to fall, which should provide a valuation boost to small caps and private equity alike.

Market Commentary

Post of the Month:

"After months of speculation, we finally have a date: the UK will head to the polls on 4th July. Given an autumn election was widely expected, the decision caught markets (and even fellow politicians) off-guard"

A closer look at the economic data helps to explain why the UK's prime minister decided on the quick campaign. Hours before Rishi Sunak's announcement, data showed that UK inflation had fallen to within a whisker of the 2% inflation target. Since one of Sunak's key pledges was to 'halve inflation', the latest figures were on the face of it a good news story for the government.

But at the same time, April public finance figures revealed that the fiscal year has got off to a shaky start. Borrowing came in above the Office for Budget Responsibility's forecasts, while stagnant economic growth and slowing wage growth are expected to drag on tax receipts over the months ahead. The 20-year gilt yield (used for long-run forecasts) also rose from 4.4% at the time of the Spring Budget to 4.8%, reducing wriggle room further. This all left the chancellor, Jeremy Hunt, with less 'headroom' for possible tax cuts in a fiscal event later on in the year. So how will the election affect the financial markets?

<u>The economy</u>

Both the Conservative and Labour parties have pledged to bind themselves by fiscal rules to limit borrowing and debt. As a result, the overall stance of fiscal policy will end up very similar whoever wins in July. There is, however, still room for nuance between the two parties. Labour might prove more successful at increasing homebuilding, while the Conservative party could regulate artificial intelligence (AI) with a lighter touch, resulting in a greater productivity boost. Either way, the UK's economic growth rate will likely accelerate in the years ahead due to the benefits from AI rather than government reforms.

There is also scope for a new government to bolster confidence in the UK economy. Household saving behaviour has still not returned to normal after the pandemic, and households saved around £54bn more last year than they would have done at 2019 rates. If a change of government boosts confidence enough to encourage spending and investment, we could see a positive impact on GDP.

<u>Interest rates</u>

Since the election result isn't expected to alter the path of fiscal policy, it should have minimal bearing on direction of interest rates. Nor should there be a political one: the Bank of England's (BoE) independence is long-held and supported by both major parties.

Crucially, a June interest rate cut was already effectively ruled out before the election date was announced. The latest headline inflation figures came in higher than expected, while services inflation was significantly above the BoE's forecasts. Following the inflation data, traders slashed the likelihood of a June rate cut from 50% to 15%. Luke Bartholomew, senior economist at Abrdn, expects a first rate cut in August, adding that the decision *"will turn not on politics but the behaviour of inflation and wage growth data over coming months"*.

<u>The markets</u>

Economists at ING said that *"UK investors have become accustomed to political drama over the past few years, and we're inclined to think that July's election shouldn't be particularly volatile for markets"*. But since the *"mini"* Budget, gilt markets remain sensitive to any signs of fiscal *"indiscipline"*. If the political parties do not offer plausible plans for public spending cuts or engage in a 'race to the bottom' on tax cuts, we could see elevated gilt yields - even as interest rates are cut.

Market Commentary

Post of the Month (cont):

History tells us that the UK stock market tends to welcome new prime ministers. Since 1962 the FTSE All-Share has recorded a double-digit percentage gain in the first year after an election when a new candidate takes over. The effect is even stronger when there is a change of government.

Sterling

For now, polling data suggests a 20-point lead for the Labour party, and analysts at ING expect 'noise' in FX markets as new Labour policies are announced. Yet they do not expect the election to have a meaningful impact on the exchange rate, with changes in US and UK interest rates driving movements this year. They added that *"as we don't see the BoE changing its policy plans due to the election, the overall implications for sterling should be limited"*.

GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary

Quote of the Month:

"If there is one common theme to the vast range of the world's financial crises, it is that excessive debt accumulation, whether by the government, banks, corporations, or consumers, often poses greater systemic risks than it seems during a boom" - Carmen Reinhart

Beware of debts that seem sensible during periods of prosperity. When a crisis comes, individuals, companies, and even governments that ran up debts during the boom usually suffer the most.

Economics:

The British Chambers of Commerce has upgraded its outlook for the UK economy, but warned long-term growth was likely to be subdued. The business group said that following a stronger start to the year, the UK economy was now on track to grow 0.8% this year and by 1% in 2025. That compares to expectations for growth of 0.5% in 2024 and 07% in 2025 in its last Quarterly Economic Forecast. But it also noted that long-term growth was *"unlikely to be strong"* and left its 2026 forecast unchanged at 1%. It continued: *"The overall profile remains flat, as a poor outlook for exports acts as a drag anchor and high interest rates continue to limit investment."* The BCC expects consumer price inflation - currently at 2.3% - to dip below the Bank of England's 2% target this year before rising again to 2.3% in the fourth quarter. It expects inflation to end 2025 at 2.1% and 2026 at 2.2%.

The European Central Bank (ECB) announced a cut in its main interest rate from an all-time high of 4% to 3.75% at its recent meeting. The move was widely anticipated but will nevertheless come as a relief to consumers and businesses on the continent. The ECB has stolen a march on the Bank of England and Federal Reserve who are both potentially still a few months away from cutting - and will breathe life into an economy that desperately needs some form of stimulus. Katherine Neiss, chief European economist at investment firm PGIM said she was *"reasonably confident"* that the ECB would cut rates further over the summer or autumn, resulting in eurozone rates that were at 3.5% or lower by the end of the year. *"Growth is encouragingly recovering from the recession that the euro area went through towards the end of last year, but it's still sluggish. That factor, combined with slowing inflation and easing wage growth, would justify another rate cut"*, she said.

A better-than-expected jobs report on Friday displayed the resilient strength of the US economy, even after years of high interest rates and stubborn inflation. Employers hired 272,000 workers last month, blowing past economist expectations of 190,000. The hiring exceeded the average number of jobs added each month over the previous year, and it accelerated notably from the 175,000 jobs added in April. The blockbuster report defies the nation's flagging economic growth. GDP slowed significantly at the outset of this year, suggesting that the prolonged policy of high interest rates had weighed on business investment and economic activity. In theory, high interest rates depress consumer demand and slow price increases. Inflation has fallen significantly from a peak of 9.1%, but it remains more than a percentage point higher than the Fed's target rate of 2%. The jobs report complicates the Fed's forthcoming decision on a possible interest rate cut. The Fed risks a rebound of inflation if it cuts interest rates too quickly, since stronger consumer demand could lead to an acceleration of price increases.

GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary

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.*

June

June is the 2nd worst performing month, rising just 45% of all the years in June, with an average return of -0.4%. There is only one month since 1984 where the market has an average return of below zero - the month of September. In an average June the market starts strong, hitting its month high on the second or third trading day, but prices then drift down steadily for the rest of the month, although the market ends the month on a positive note - the last trading day is the second strongest in the year.

Second Quarter

The FTSE 100 has risen 25 of the 40 years (63%) between 1984 and 2023, posting an average gain of 1.3%.

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.*

GIBRALTAR ASSET MANAGEMENT

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary

Investment Calendar:

6th June	New Moon (markets tend to reach a high point around this time)
11th June	FED Meeting
20th June	ECB Meeting
21st June	Options Expiry Day
22nd June	Full Moon (markets tend to reach a low point around this time)

Technical Analysis:

Our call to go short last month did not turn out as planned but the FTSE 100 only rose 32 points (0.4%). With the RSI at 31, the market has unwound its overbought level and, positively, is trading below the 20-day MA now lying at 8,340 (95 points higher). Having said that, we are now firmly in the weakest half of the year. June is the 2nd worst performing month, rising just 45% of all the years in June, with an average return of -0.4%. And with European and UK elections around the corner, the possibility of far right or socialist political advances could make for a volatile market where the risk would be certainly to the downside. We again suggest traders go short of the market, targeting the psychologically-important level of 8,000.

"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 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)		(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).

Printout from Alpha Terminal - 07/06/2024 18:00