Gibraltar Asset Management

STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - May 2024

FTSE 100	**8,213**	S&P 500	5,127
Resistance	8,250	Gold	$2,323
Support	7,820	GBP/EUR	1.1690
VIX	14%	GBP/USD	1.2488

Introduction:

Good feelings tend to fade away fast when confronted with discomfiting reality. Following hot jobs and inflation data, investors were confronted with stumbling stocks and surging Treasury yields though mid-April. In addition to pressuring stocks, the rise in yields boosted the VIX to multi-month highs and caused a recalibration of expected Fed policy moves. However, the market has swiftly recovered suggesting that investors are anticipating the beginning of rate cuts, rather than dreading rate hikes as they had been doing for more than two years.

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 equalweight. The stock market has had a big run, with several major indices reaching all-time highs. But we feel the equity markets look priced for perfection and looking vulnerable.

Of course, falling inflation and lower interest rates are good for valuations, and stocks are not expensive, trading in line with the trailing five-year market P/E average. But we have now entered what is historically the weakest half of the year. The Halloween Effect, as it is known in the US, tends to see investors reduce their exposure to the stock market from May. And May itself is the third weakest month of the year, rising just 50% of all time, with an average return of -0.1%.

The lagged effects of higher rates are dragging on consumer and business spending and confidence. Recession appears increasingly unlikely, but remains a risk. The stock market has had a big run, partly because corporate earnings have started to rebound from a year of negative comparisons. While equity valuations appear inexpensive, stocks will appear pricey if earnings fail to grow as anticipated and/or inflation or interest rates start ticking higher. Any of those factors would result in elevated valuations and increase the risk of a selloff. Another key risk is that the central banks may have raised interest rates too far and too fast, and may be too slow to begin reducing rates.

Where the market goes from here will be influenced by external events. The major geopolitical event of 2023 - the war between Israel and Hamas - has continued into 2024. The recent deaths of several Iranian

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Market Outlook (cont):

commanders could potentially broaden the war into a larger regional conflict. Well after the end of China's zero-tolerance pandemic lockdown, the world's second-largest economy has experienced just tepid economic recovery. Meanwhile, the war in Ukraine grinds on, hurting economic growth in Eastern Europe.

In conclusion, we expect the markets to continue trading near all-time highs in 2024 but see more risks to the downside.

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Recommended Investment:

L&G Cyber Security ETF

Every passing day seems to bring news of another high-profile cyberattack. Meanwhile, terms such as ransomware and spear-phishing are no longer the preserve of technical specialists - public awareness of the many different forms of cyberattack has never been greater.

Does this mean the cyber security industry has now reached a saturation point? In a word, no. Despite the vast sums that are spent on cyber security every year - an estimated $160 billion in 2023 (and expected to grow at a compound annual growth rate of 14%) - it's estimated the industry penetration rate is currently no more than 10%. This should perhaps come as no surprise, given that the cyber security landscape constantly evolves, as both attackers and defenders race to deploy the latest technologies and stay ahead of the other side.

Artificial intelligence (AI) has become a hotly discussed topic in the mainstream press, raising hopes of increased labour productivity but also leading to fears around data privacy and misinformation. In the cyber security space, AI is similarly double-edged.

From the cyber attacker's perspective, generative AI can be used to develop attack capabilities. An example is bespoke phishing email content, aiming to target the weakest link in the cyber security chain: the end user. We have also seen the emergence of hacker-friendly generative AI chatbots such as FraudGPT and WormGPT, which are specifically designed to enable *"even those with minimal technical"* skills to launch sophisticated cyber attacks.

AI also provides cyber security providers with new ways to identify potential attacks, enabling them to be stopped before they cause harm. One example is the screening of potentially harmful email. Historically, this has been done by identifying and blocking specific email addresses, domains or email contents. While this allows known attacks to be blocked, these features are constantly being changed. AI-powered screening technology is instead able to identify the underlying characteristics of emails (such as requests for identifiable information) to flag potentially dangerous content even when it originates from a source not previously blacklisted.

AI provides a useful reminder of how new technologies can radically shift the cyber security landscape. But this is just one example among many showing how the cyber attack surface has expanded in recent years. Let's not forget than just four years ago the market was disrupted by the pandemic, leading to a transformative shift to remote working and the rise in demand for cloud protection services.

We recommend investors obtain exposure to this theme via the L&G Cyber Security ETF. This low-cost exchange traded fund trades on the LSE in GBP (ISPY.L) & USD (USPY.L) Holding a basket of stocks that are actively engaged in providing cyber security technology and services, the fund has returned 168% since its launch in 2015. The fund is invested in a diversified portfolio of 40 cybersecurity stocks, including technology titans such as Juniper Networks, CrowdStrike, Broadcom, Darktrace & Cisco Systems. Buying individual tech stocks is inherently risky so buying a fund reduces the stock specific risk. With an excellent performance record, strong growth potential and a reasonable TER of 0.69%, we rate the fund a **strong buy.**

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Post of the Month:

"US stocks now account for 60% of the FTSE All-World index, with the American market roughly ten times the size of its closest rival, Japan. Soberingly, US dominance is so assured that the market capitalisation of Microsoft alone is almost the same as the entire UK market"

But it wasn't always like this. At the turn of the 20th century, the UK market dominated, with US market capitalisation far closer to French or German levels. Over the proceeding 125 years, strong economic performance, large IPO volumes and substantial returns saw the US stock market soar. No other market can rival this long-term accomplishment - and nor are rivals likely to do so in the near future.

According to the latest OECD forecasts, the US economy will grow 2.1% this year, far outstripping Japan (at 1%) and the UK (0.7%). This should be good news for US shares: research from Schroders shows that US earnings per share growth has an extremely high correlation to domestic GDP growth. In theory, buoyant US growth will only entrench the gulf between the size of the US market and its rivals.

But developed markets are not the only contenders. Although US economic growth looks enviable from a UK perspective, it is sluggish compared with many emerging markets. Forecasts suggest that the Indian economy will grow by 6.2% this year, and China will grow by 4.7%. Estimates from Goldman Sachs now imply that China will overtake the US as the world's largest economy by 2035, with India bumping the US out of second place by 2075. This raises an obvious question: if the US economy finds itself third in the global economic league table, could the market eventually follow suit?

Goldman's economists expect emerging markets to gain a bigger share of global equity market capitalisation as their economies expand. According to their analysis, India will see the biggest increase in global market share thanks to its rapid economic and population growth, with China experiencing more headwinds from an ageing population. Overall, Goldman forecasts suggest that emerging market's share of global equity market capitalisation will double between now and 2075 to account for 55% of the total. Even so, the US will remain the single biggest equity market.

But there are precedents for big changes in index composition. Between 1949 and 1959, Japan's *"economic miracle"* saw a real return on equities of over 1,500%. Stocks continued to rise for a further 30 years, leaving the Japanese equity market the largest in the world. By the 1990s, it had a 45% weighting in the world market, against just 29% for the US. Then the bubble burst. Between 1990 to 2023, Japan was the worst performing stock market.

Looking backwards reminds us that past performance doesn't guarantee future performance - and could even leave investors vulnerable to unhelpful biases. In 1900, the Russian stock market made up 6% of world capitalisation, making it the fifth biggest market in the world. This didn't stop investors from going on to lose everything when assets were expropriated in 1917.

The US market, on the other hand, has performed handsomely over the past 124 years, generating an annualised real return of 6.5%. Yet only focusing on periods of strong performance opens us up to survivorship and success biases, where investors can gain a misleading view of future equity returns. Although US market dominance looks secure, history tells us how quickly fortunes can reverse.

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Quote of the Month:

"We don't prognosticate macroeconomic factors, we're looking at our companies from a bottom-up perspective on their long-run prospects of returning" - Mellody Hobson

It's very difficult to predict when the next recession or stock market crash will come, so many of the best investors don't even try. Instead, look for good companies with the strength to make it through the occasional challenging economic environment.

Economics:

The Organisation for Economic Co-operation and Development (OECD) predicts UK GDP will rise by 1% in 2025, below G7 nations Canada, France, Germany, Italy, Japan and the US. The organisation blames the after-effects of a succession of interest rate rises in the UK for the lethargic performance. It also warns that some elements of inflation remain high and that uncertainty over when the Bank of England might start lowering interest rates might be putting people off from investing. The OECD predicts that tax receipts in the UK will *"keep rising to historic highs"* to around 37% of GDP. Inflation - which measures the pace of price rises - has slowed significantly from a 40-year high reached in October 2022 to 3.2% in April. Interest rates have been held at 5.25% since last September. The OECD expects the Bank to start cutting borrowing costs from this autumn. The think tank predicts that interest rates could fall to 3.75% by the end of next year.

Price rises in the euro area held steady at 2.4% in April, while the economy returned to growth in the first quarter. It is the seventh straight month the headline rate has been below 3%, despite a slight rebound in the rate in December due to energy prices. GDP meanwhile rose by 0.3% over the first three months of the year, slightly better than consensus economist expectations. GDP for the fourth quarter of 2023 was revised from no growth to a 0.1% contraction, which means that the eurozone was in a technical recession in the second half of last year. Market expectation is mounting for the ECB to start cutting interest rates at its next monetary policy meeting on the 6th of June. Money market pricing currently indicates a 70% probability of a cut.

US job growth slowed considerably last month, with just 175,000 positions added in April. The slower than expected gains - April's tally is the lowest since October of last year - come as the Federal Reserve has sought to cool demand to tame high inflation. Economists have anticipated the labour market would see a gradual slowdown due to the pressure of high interest rates. Although April's jobs numbers are sharply cooler than the upwardly revised 315,000 gains notched in March, they're in line with what was seen pre-pandemic and the neutral rate of job growth to keep pace with population gains. In the decade before the pandemic (which also was the nation's longest-ever period of employment expansion), monthly job gains averaged 183,000. Meanwhile, the unemployment rate ticked higher to 3.9%. April marks the 27th consecutive month that the jobless rate has held under 4%, matching a streak last seen in the late 1960s.

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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.*

May

May is 10th in the ranking of monthly performance, rising 50% of all the years in May, with an average return of -0.1%. In an average month, the market tends to trade fairly flat for the first two weeks, and then prices drift lower in the second half of the month.

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.*

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Investment Calendar:

8th May	New Moon (markets tend to reach a high point around this time)
9th May	MPC Meeting
17th May	Options Expiry Day
23rd May	Full Moon (markets tend to reach a low point around this time)

Technical Analysis:

The FTSE 100 has broken through all resistance levels to reach all-time highs. The RSI is overbought at 70%. The ADX reading of 29 indicates the market is in a strong trend and that trend is obviously up. However, the market does appear overextended to us. We have now entered the historically weakest half of the year and May itself is the third weakest month of the year. We suggest traders go short of the market, targeting the 20-day moving average lying at 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 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).

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