GIBRALTAR ASSET MANAGEMENT
STOCKBROKERS & INVESTMENT MANAGERS

Market Commentary - October 2024

FTSE 100	**8,280**	S&P 500	5,751
Resistance	8,335	Gold	**$2,651**
Support	8,000	GBP/EUR	1.1930
VIX	19%	GBP/USD	1.3080

Introduction:

If one were to ask the average investor to name the leading S&P 500 sector this year, Information Technology might very well be the most-common answer. But that answer would be wrong, as the Utilities sector is leading the pack. Utilities typically tend to do well in periods of declining interest rates, when higher-yielding equities become attractive. Utilities in the US have other positive in their favour - strong investment in new power capacity to support the growing power needs of data centres in support of the AI revolution. We believe investors will continue to favour Utilities as the Fed's rate-cutting cycle plays out.

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. The stock market had some very jittery phases in July, August, and September. The US election is looming, there has been a second attempt on former President Trump's life, and polls suggest an election outcome that is too close to call.

The measure of market volatility, the VIX, is currently at its long-term average of 19. The VIX briefly spiked to the mid- 30s in August following a weak July jobs report in the US. Keep in mind that this fear gauge spent nearly all of the late-2020 through mid-2024 period below 12.

Recession fears also are likely contributing to the VIX spike. But one key "*recession indicator*" has unwound. The yield curve is no longer inverted (where 2-year gilts yield more than 10-year gilts). An inversion signals an economy out of joint, as rational investors should not be willing to accept lower returns on long-dated gilts than on short-dated gilts. Today, the two-year yields 3.9% and the 10-year yields 4.1%. We do not expect the yield to "*re-invert*" now that the BoE has started its rate-cutting cycle. Amid the uncertainty and recession fears, bulls have one mantra: the era of rate cuts has begun.

The BoE cut the base by 25 basis points on 1st August, its first rate cut in more in more than four years. That last cut in 2020 occurred amid the turbulence and extraordinary circumstances of the global COVID-19 pandemic. Normally, the BoE cuts rates when growth is slowing and the economy is at risk of slipping into recession. This time, the BoE has started its rate-cutting cycle at a time when GDP is growing, companies are reporting solid earnings growth, the workforce is close to full employment, and annual wage

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Market Outlook (cont):

growth is higher than annual inflation growth.

We have now entered the strongest quarter of the year. During Q4, the FTSE 100 has risen 30 of the 40 years (75%) between 1984 and 2023, posting an average gain of 3.4%. History is not a reliable indicator of future performance; but it is often a good indicator. We believe that bearish capitulation to the bullish reality along with FOMO (fear of missing out) should drive further gains.

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Recommended Investment:

Treasury Gilts

Bonds issued by the UK government, known as gilts, are back on the radar of investors due to their attractive yields in a falling interest rate environment. We feel this is a no-brainer for investors looking to lock in reasonable returns without the counterparty risk. But to start with, let's take a step back and explain what a gilt is, and how they work in practice.

What is a gilt?

The word 'gilt' is short for 'gilt-edged securities', which is what they were originally named because the first certificates issued by the British Government to bondholders had gilded edges. A "*conventional*" gilt (the most common type of gilt, the rest being "*index-linked*") is a liability of the government under which it guarantees to pay the holder a fixed cash payment (coupon) every six months until the maturity date, at which point the holder receives the final coupon payment and the return of the principal. The coupon rate usually reflects the market interest rate at the time when the gilt is first issued. Consequently, there is a wide range of coupon rates available in the market at any one time, reflecting how interest rates on borrowing have fluctuated in the past.

Risk

Gilts are seen as having zero "*counterparty risk*" because investors are almost guaranteed to get their money back. The UK Government has not once defaulted on its debt since it began issuing gilts in 1694 when King William III raised £1.2 million to fund a war with France. The government can always raise taxes or issue more gilts to pay bank its bondholders. However, there is still "*market risk*" to consider. Though less volatile than shares, gilt prices can dramatically change as views about interest rate prospects change. A coupon fixed at 3% may look generous when the market interest rate is 2% but will look decidedly unattractive should market interest rates rise to 5%. Prices in the gilt market will adjust to reflect that. Thus, despite their risk-free image, gilts (particularly longer-dated gilts) can fall dramatically in an environment of rising rates.

Running Yield

The coupon is fixed for the life of a gilt when it is first issued but the yield will change as gilt prices change. Bond prices and bond yields have an inverse relationship, so when gilt prices rise, yields fall and vice versa. The running yield, which shows how much will be distributed annually as income, is calculated by dividing the coupon by the price, and multiplying by 100. For example, a bond issued at 100% ("par") with a 5% coupon, has a yield of 5%. However, if the price rises to 120%, the coupon is still 5%, but the yield falls to 4.2%. In general, the longer you agree to lend your money for, the better yield you will be offered. That is because you as the lender are taking on more risk by tying up your money for longer.

Gross Redemption Yield

The gross redemption yield ("GRY") is the total return (including the capital gain or loss) that the investor will receive from buying the gilt and holding it to maturity. For example, if you paid 100% to buy the 4.5% Treasury Gilt 07/09/2034 in September 2024 and held it to maturity, your capital gain/loss would be zero and, therefore, your GRY would be the annual coupon earned (4.5%). However, if you paid only 90%, you would make a capital gain of 10 points, in addition to receiving the annual coupon of 4.5%, giving a GRY of 5.5%. Conversely, if you had paid 110% and held it to maturity, you would make a capital loss of 10 points, still receiving the annual coupon of 4.5%, giving a GRY of 3.5%.

Recommended Investment (cont):

Treasury Gilts

CGT Exempt

For UK investors, it is interesting to note that capital gains from selling a gilt or when it matures are not subject to capital gains tax. Meanwhile, income received from gilts is taxed just like any savings income. As a result, investors paying a marginal tax rate of 40 or 45% should purchase gilts with low coupons and trading significantly below par as most of the total return is when the gilt matures at par, meaning that the capital gains tax savings are significant.

Trading Gilts

Gilts trade on the London Stock Exchange (T+1) with tight spreads and no minimum investment. You can purchase gilts through your local stockbroker. Due to their traditionally low returns, GAM charges 0.1% on short-dated gilts (up to 1 year maturity) and 0.25% on others (subject to a £45 minimum).

We are currently recommending long-dated gilts, as the direction of travel for interest rates from these elevated levels is down. We believe this due to a combination of falling inflation and the economy requiring increased stimulus. For investors looking for income, the Treasury Gilt 4% 2060 is the obvious choice. Investors looking to make tax-free capital gains may wish to buy the Treasury Gilt 0.5% 2061 instead.

Gilt	Running Yield	GRY
Treasury Gilt 4.0% 22/01/2060	4.5%	4.6%
Treasury Gilt 0.5% 22/10/2061	1.7%	4.3%

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Post of the Month:

"More interest rate cuts mean more volatility for investors in the short term. Although it feels like we are on a bumpy road, it could ultimately lead us to a more normal investment environment"

Lower interest rates were supposed to mean a more favourable backdrop for stock markets. In theory, falling interest rates will boost the economy, lifting earnings - and share prices, too. Growth stocks should be particularly well placed, as falling borrowing costs mean a lower discount rate is applied to future earnings. Yet the gyrations of the past few months must have felt anything but benign for investors.

Back in August, a disappointing US labour market release stoked fears of a US recession and triggered a substantial equity market correction. Japan found itself in the eye of the storm as 'carry trades' came under pressure and the Japanese banking index plummeted. This saw the US stock market volatility index make its third sharpest jump on record, behind only the collapse of Lehman Brothers and 2020's pandemic panic.

This episode illustrated just how easily the impact of lower interest rates can be offset by jitters about economic growth. Economists at the Bank for International Settlements believe that markets today have become "*hypersensitive*" to unemployment and growth-related news surprises, leaving them quick to revise their expectations about how far - and fast - interest rates will be cut.

And this isn't the only thing that investors have to contend with over the final quarter of the year. The US election is looming, and volatility tends to rise 25% between July and November of a presidential election year. Tensions in the Middle East and ongoing conflict in Ukraine only add to the sense of volatility.

For investors, this could leave non-cyclical stocks looking attractive. Utilities in particular are an attractive hedge as "*tortoise*" stocks start to catch up with the "*hares*". Although markets stabilised after August's sell-off, fast-growing tech stocks were badly hit and haven't recovered to the same extent. Technology's market cap share in the S&P 500 had dipped from 50% at the start of the year to 45% today.

This summer's volatility was not the first and will certainly not be the last turbulence in the markets. Although rate cuts should ultimately create a favourable environment for risk assets, it won't be a smooth ride. This summer's market moves are perhaps part of the bigger picture that has seen the inevitable withdrawal symptoms that markets suffer as they transition away from the extraordinary period of exceptionally low interest rates and ample liquidity that has prevailed for so long.

If market expectations are anything to go by, interest rates will fall to around 3% by the end of 2025 in the US, and around 3.5% in the UK - a substantial drop, but still a long way from zero.

But there could be a silver lining. If rates do settle to around 3%, central banks will have plenty of scope to cut further should conditions worsen in the future. This means less need to turn to 'unconventional' tools such as quantitative easing if the economy starts to stutter. Although it feels like we are on a bumpy road, it could ultimately lead us to a more normal investment environment.

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Quote of the Month:

"The biggest risk of all is not taking one" - Mellody Hobson

There is a direct tradeoff between risk and returns. If investors stick to low-risk assets like money market funds and cash deposits, then they run a high risk of low long-term returns. Returns may be satisfactory at the moment (the AAA-rated Insight ILF Liquidity Fund is currently returning 4.8%) but the direction of travel for interest rates is down so this rate of return will not remain for very long.

Economics:

The UK's GDP grew by slightly less than originally estimated in the second quarter of this year (0.5% vs 0.6%), but overall the UK economic outlook has improved considerably since January. This is largely the result of inflation being back to target, interest rates starting to come down and greater political stability post-election. The Bank of England has forecast growth will slow to 0.3% in the third quarter of 2024 but said there were signs that its first interest rate cut in August and the expectation of more cuts, plus lower inflation, would boost growth later in the year. And according to the OECD, the UK has risen in the rankings of a group of wealthy nations to have the joint-second highest economic growth for this year. The economy is now expected to grow by 1.1%, the same rate as Canada and France, but behind the US.

The year-on-year eurozone inflation rate for September came in at 1.8%, dropping below the ECB's 2% target. The ECB slashed interest rates to 3.50% in September and has also hinted that another cut could be coming in the near future. The ECB's doves have a very strong case now to go to the Governing Council meeting in a few weeks' time and say: 'Let's get moving'. When officials meet, they are going to have to face up to advanced disinflation, a crumbling economic recovery, and consumer confidence in a trough. In France, a rising tax burden has further weakened the investment climate, with the budget deficit expected to surpass 5.5%. Germany's labour market is also feeling the strain, with unemployment over 6% and expected to climb, alongside a GDP contraction and a declining IFO Business Index - clear indicators of recession. The ECB's rate cuts appear to be a desperate measure to control the situation, but in our view, they won't be enough to address the deeper economic issues now at play in the European Union.

US job growth surged in September, blowing past expectations and providing solid reassurance for the ongoing stability of the labour market. Employers added an estimated 254,000 jobs, a much higher tally than August's monthly total and it smashed economists' expectations for a 140,000-job gain. The unemployment rate meanwhile dropped to 4.1% from 4.2%. "*We had a bounce-back from what were relatively sluggish numbers in July and August,*" said Brian Bethune, economist and professor at Boston College. "*So it looks like we're still on track. The economy is expanding and we have a very high probability of achieving a soft landing (of reining in high inflation without triggering a recession).*"

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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.*

October

Despite its reputation for volatility (since 1984, seven of the ten largest one-day falls in the market have occurred in the month of October), for the most part the market posts a positive return - rising 0.2% on average 68% of the time. This strength may not be unconnected with the fact that the strong six-month period of the year starts at the end of October (part of the Sell in May Effect) and investors may be anticipating this by increasing their weighting in equities during October.

Fourth Quarter

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

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:

2nd October	New Moon (markets tend to reach a high point around this time)
17th October	ECB Meeting
17th October	Full Moon (markets tend to reach a low point around this time)
18th October	Options Expiry Day

Technical Analysis:

Barring an October-style stock market crash, we do not see the stock market poised for any major moves in either direction at this time. The market moved just 72 points over the three months to the end of September, not unexpected given the typically quiet summer months. The RSI is neutral at 50%, whilst the VIX has settled at its long-term average of 19%. The ADX, at only 11, is signalling the market is completely lacking in direction. That means we look for the Bollinger bands for direction. We see support at the lower Bollinger band lying at 8,200 and resistance at the upper Bollinger band lying at 8,335. Any breakdown would see strong support at the psychologically-important 8,000 level.

"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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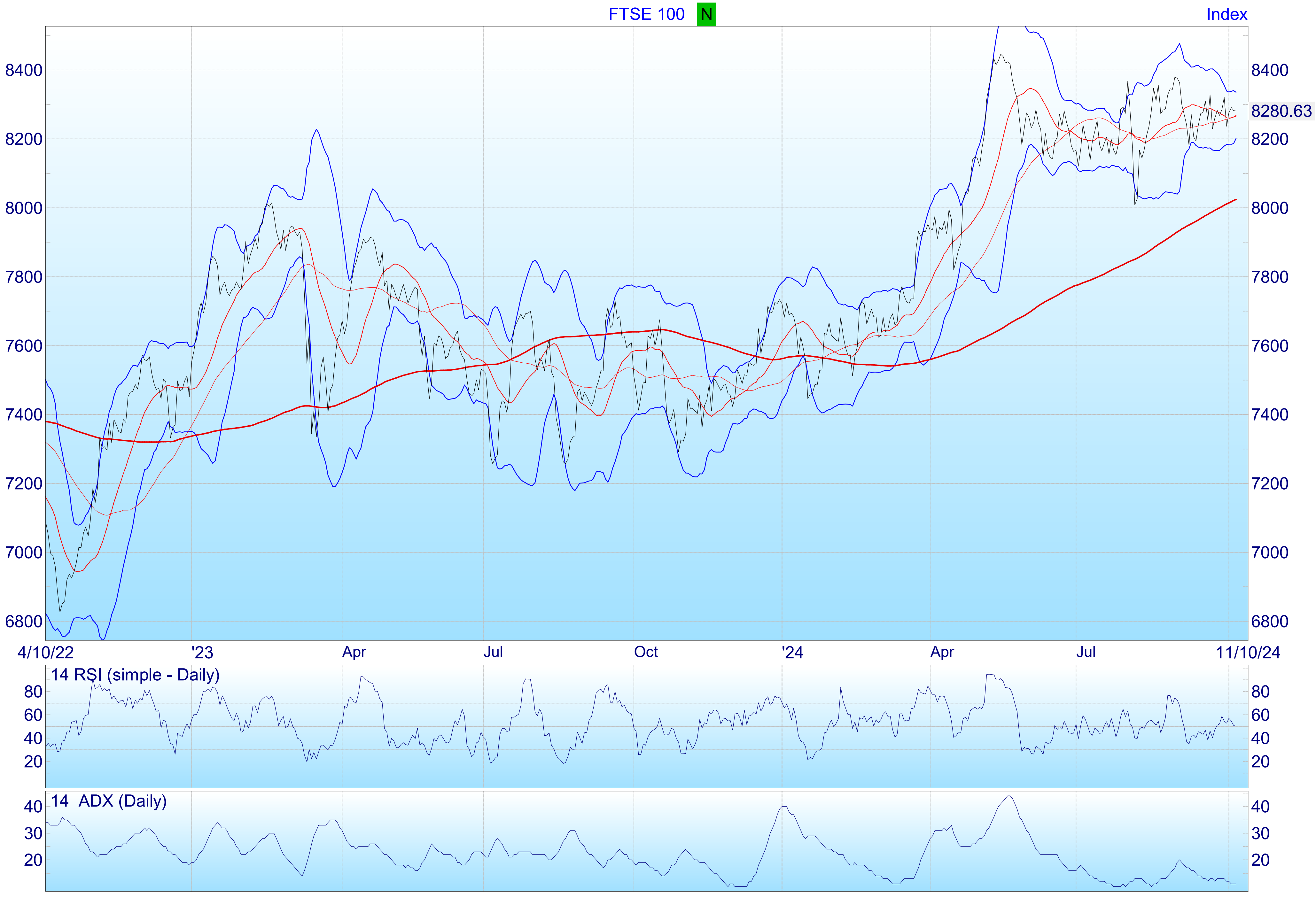
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