Gibraltar Asset Management Stock Market Commentary

"Stock Markets Seeking Direction After a Hot Summer"

GIBRALTAR ASSET MANAGEMENT LIMITED
STOCKBROKERS & INVESTMENT MANAGERS

The stock market obliterated the "sell in May" maxim this summer. Anyone who "went away" missed out on some large gains. These gains came amid unprecedented economic pain, high unemployment, and rising COVID-19 cases. Looking past those massive challenges, investors focused on strengthening economic data, growing receptivity to wearing masks and maintaining social distancing, and steady progress on leading vaccine candidates. In a strange year, the stock market and economy are exiting summer with Brexit negotiations and US presidential electioneering firmly on the front pages. With the chances of a Brexit deal estimated to be as low as 30% and Joe Biden leading in the polls, it would not be surprising to see the stock market find direction one way or the other.

by Mark Maloney, Managing Director, Gibraltar Asset Management Limited

Market Outlook

Our allocation to the stock market remains at equalweight. Whilst the typical pattern for stocks is to continue what they are doing into year-end, only more so, there are some visible storms on the horizon, not least Brexit and the US presidential election.

The stock market in 2020 has had to climb out of a 30%-plus hole dug in March. The fact that any stock market is positive at all is either a tribute to investor naivete, or an acknowledgment of the remarkable advances in science that have several vaccines on the cusp of readiness. Perhaps it is a bit of both.

The rise in stocks is both impressive and concerning. It is impressive because it shows that investors have focused on the underlying economic data, which has been solid, rather than on the headlines.

It is concerning because the pandemic is still raging, and because it has damaged most areas of the economy.

Recent economic data does not reflect an economy aided by government stimulus that has now partly gone away. This is bound to impact the spending power of out-of-work consumers until a new relief package is crafted. Infection rates are also spiking. Small businesses, with less of a cash cushion than larger companies, have expressed concern that this could roll back economic reopenings. Many small business owners are barely hanging on and might not survive a second round of stay-at-home restrictions.

The all-important US stock market has returned to all-time highs, pushing their benchmark index about 12% above fair value. On a positive note, stocks rarely trade right at fair value. Since 1960, on average, the S&P 500 has traded 0.2% above fair value, but the standard deviation to the mean is 17%. That indicates the S&P 500 can comfortably trade between 17% undervalued and 17% overvalued without raising alarms. Therefore, at current levels, the market has some room to the upside before valuation becomes more of a concern. Investors are obviously optimistic that companies have seen the worst of the COVID-19 impact on earnings, and that the outlook will improve.

Given the current overvalued level of the market, however, any disappointments could be painful.

Recommended Investment
GCP Asset Backed Income Fund Ltd

GCP Asset Backed is a Jersey-incorporated investment trust whose shares are traded on the main market of the London Stock Exchange (GABI.L).

The Company's objective is to provide shareholders with regular, growing distributions and modest capital appreciation over the long term through investment in a diversified portfolio of loans secured against physical assets (94%) or cash flows (6%) across a range of sectors predominantly in the UK. The Investment Manager focuses on the following sectors that are integral to society:

i-Property (45%)
The fund invests in bridging and development loans as well as co-living accommodation, an attractive new asset class. Co-living is a modern form of communal living in which residents get a private bedroom in a furnished home with shared common areas. Co-living is popular in major cities as a means of affordable living for students, workers, digital nomads, or individuals relocating.

ii-Social Infrastructure (38%)
This sector includes assets such as student accommodation, housing for vulnerable adults, homes for the elderly, nurseries and urban regeneration.

iii-Energy & Infrastructure (11%)
The Investment Manager seeks out opportunities that have a strong sustainability angle, whilst providing capital protection. They typically include assets that produce or manage energy and/or process waste.

iv-Asset Finance (6%)
The Investment Manager invests in a number of new areas in this sector, including the financing of football transfer fees and royalties where there are strong contractual protections in place.

At 30 June 2020, the Company was exposed to a diversified portfolio of partially inflation and/or interest rate protected investments comprising 44 loans with a valuation of £428 million, weight-adjusted average annualised interest rate of 8.1% and an average maturity of six years.

Despite the challenges posed during the coronavirus, the Company received all expected interest and principal on time and in full, as well as generating significant fees from early loan repayments.

The Investment Manager remains confident that the Company's defensive and diverse portfolio of assets will continue to perform well and offer shareholders both strong downside protection and an attractive yield even in current markets.

The fund's shares are currently trading at a 6% discount to NAV, having traded at a premium for most of its life since launch in October 2015. We believe the fund could see its discount narrow, particularly given the ability to repurchase its shares. The company pays a quarterly dividend, the last declared being 1.55p, which is fully covered by earnings. Based on the current share price, that equates to a 6.6% yield. Buy.

Please be aware that the value of your investments may fall as well as rise and your capital is at risk. Income from the investment may fluctuate in value in money terms.

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