Watson Moore's Monthly Investment Update

August 2018

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PERFORMANCE UPDATE

- **The portfolios performed well in July, more than recovering the losses from the previous month. They showed gains ranging from 0.69% to 2.26% as the FTSE 100 recovered 1.52%.**
- The summer months typically are the weaker months for stock market returns, leading to the saying "sell in May and go away." However, the portfolios have shown gains ranging from 2.13% to 7.85% so far this summer.
- European Equities recovered significantly as Donald Trump called a "trade war truce" with the European Union. However, Chinese stocks continued to fall as the threat of an all-out trade war with the US increased.
- The Bank of England increased rates, as many expected, but this did not help the pound which fell over the month. However, this helped produce positive returns on our overseas holdings and shows why a "bad" Brexit may be good news for our wealth. However, UK Government Bonds fell due to the increase in rates.
- Technology stocks have been the stock market leaders but the shock announcement by Facebook that it won't grow as much in the future caused the stock to fall 20% and lose investors $120 billion!
- The performance of the portfolios over the last month and year is shown below:

Portfolio	Performance % 1 month	Performance % 1 year
Foundation	0.69	1.43
Cautious	1.02	0.56
Balanced	1.14	2.76
Adventurous	1.46	5.45
Dynamic Equity	2.26	11.28
Income Generating	1.75	2.43
Third Industrial Revolution	2.04	19.73
Retirement Investment Solution 1	1.05	1.34
Retirement Investment Solution 2	1.22	2.57
Retirement Investment Solution 3	1.38	3.74

Please note that these figures do not include the Standard Life platform or Watson Moore's fees.

Trend Following Signals

The table below shows whether the asset class is either in a positive trend (✓) or a negative trend (✗). The portfolios will have more exposure to those asset classes in a positive trend and less (if any) to those in a negative trend. These are the main asset classes we monitor:

Asset Class	Trend Signal	Asset Class	Trend Signal
Global Equity	✓	**Emerging Market Equity**	✗
UK Equity	✓	**Commodities**	✓
Europe ex UK Equity	✓	**UK Corporate Bonds**	✓
US Equity	✓	**UK Corporate Bonds (Short dated)**	✗
Japan Equity	✓	**UK Index Linked Bonds**	✓
Pacific Equity	✓	**Global Bonds**	✗
Gold	✗	**UK Gilts**	✓
Global Property	✓	**Emerging Market Bonds**	✓
		Overseas Corporate Bonds	✓

Summary of Portfolios

July saw good gains for our portfolios as equities rose. The portfolios continue to be overweight US equities as they are high on the momentum scale and continue to outperform. A lot of the outperformance is down to technology stocks such as Facebook, Amazon, Apple and Google (Alphabet). Apple has just become the world's first public company to be valued at over $1 trillion (£767 billion). The latest jump in the share price was due to the company announcing better than expected quarterly results and, over the last two years alone, the share price has nearly doubled. Normally it is only smaller companies that can appreciate in price this quickly.

In contrast, Facebook announced slower growth and this resulted in the largest one-day loss in market value by any US company in history. Despite Facebook's performance, the wider US stock market continues to move ahead, which is very positive as sometimes a fall in one of the companies that has led the market higher, like Facebook, can cause a wider sell off as investors conclude that these stocks are now overvalued.

Going forward, August and September have been volatile months in most stock markets over the past few decades. Although the number of winning months is slightly greater than losing months, those losses have been steep at times. For example, the FTSE 100 lost over 6% in August 2013 and 2015. With the holidays in full swing, trading volumes can be light which can cause greater volatility and some commentators have blamed 'less experienced' traders left in charge of trading desks. Today, a lot of trading is controlled by algorithms rather than live traders and many of these may use similar rules to accentuate moves. August has also been a weak month for the pound against the dollar, though that would help our US holdings.

Cautious, Balanced and Adventurous Portfolios

The portfolios increased their exposure to European Equities as bigger and smaller European companies moved back above trend. In Bonds we are seeing much more volatility. This month both Floating Rate Notes and Emerging Market Bonds broke above trend and therefore exposure was increased. UK Gilts slipped down the momentum scale and therefore exposure was decreased in the Balanced and Adventurous portfolios. Exposure was reduced to cash and the market neutral funds with the main changes being:

Fund	Cautious	Balanced	Adventurous
L&G Emerging Markets Bond	+2.5%		
Fidelity Index Europe	+2.0%	+2.0%	
iShares UK Gilts		-5.0%	-2.5%
M&G Global Floating Rate Notes	+2.5%	+5.0%	+2.5%
Lazard European Smaller Companies			+5.0%

Dynamic Equity Portfolio

The momentum philosophy that forms the core of this portfolio attempts to invest more money in those markets that are experiencing the strongest growth. No changes were made this month. The portfolio is overweight US equities as they continue to be ranked high on the momentum scale.

Foundation Portfolio

The Foundation portfolio increased its exposure to European Equities and Emerging Market Bonds as they broke above trend. Exposure was reduced to cash and the market neutral funds.

Income Generating portfolio

Defensive equities, which forms the core of this portfolio, have been underperforming. However, this month they started to outperform. Investors buy defensive stocks for a couple of reasons. One is that they pay higher dividends. The other is simply that they're starting to turn more defensive on the stock market. It may be that some investors are beginning to show concern about the potential trade wars and are starting to hedge their bets by moving their money into the more defensive higher dividend paying companies.

Third Industrial Revolution portfolio

It was another great month with the portfolio returning 2.04%, keeping the one year return at over 19%. Biotech performed extremely well with the AXA Framlington Biotech fund growing by 5.26%. On the negative side the Cyber Security fund fell 1.29%. This shows the benefits of having a diversified portfolio which invests in different sectors within the Industrial Revolution.

Retirement Investment Solution portfolios

The trend following part of these portfolios increased its exposure to European Equities and Emerging Market Bonds as they broke above trend. Exposure was reduced to cash. The Retirement Investment Solutions portfolios are invested in not only a trend following portfolio, but the Foundation and Dynamic Equity portfolios as well.

Summary

After most stock markets fell below trend in February and March, we are now in a position in which most are now above trend again. Exposure to equities within the trend following portfolios has thus increased. Bonds are also mainly above trend but with interest rates rising we expect that many bond asset classes will be more volatile than normal and could move above and below trend quite regularly. We will thus increase exposure to cash when they are below trend and if we experience a “bond crash” then hopefully the portfolios will be protected from this.

ASSET CLASS REVIEW

This section will give you an insight into our current thinking as we attach some charts that look interesting. This month we focus on which markets have been volatile but effectively not moved much over the last year.

Brazil – a high 50% above its low

Brazil has been one of the most volatile stock markets in the world. The index is currently at the same level it was a year ago. However, the journey in between has been eventful with it reaching a high of 2,400 and a low of 1,600:

Brazil has suffered from a horrendous bout of scandal, violence and economic destruction. There are even calls for a military coup to restore order as the country has lost faith in its politicians. However, there is some hope that the elections in October will stabilise the country. These are the reasons for such a volatile time in the stock market. Please see the article on "high risk equals high returns?" below, for our strategy on trading volatile markets.

Emerging Markets - 20% rise followed by a 20% fall

Similar to Brazil, other emerging markets have also been volatile due to the fact that they have been struggling with the implications of Trump's trade war.

Europe - gone nowhere and very correlated to Trump

With the US imposing tariffs on European goods, but then lifting some of them, European stocks have been affected significantly. Overall, they have not moved much during the year, but some of the world's leading companies have fluctuated significantly due to Trump:

Sterling - strong then weak

The chart below shows how sterling had increased in value due to the fact that it appeared Brexit negotiations were going well. However, the recent problems within the Conservative government have caused sterling to fall against the dollar as the concern is that we will get a 'no deal'. Sterling against the dollar is back to where it was a year ago, albeit in a volatile way:

In Summary

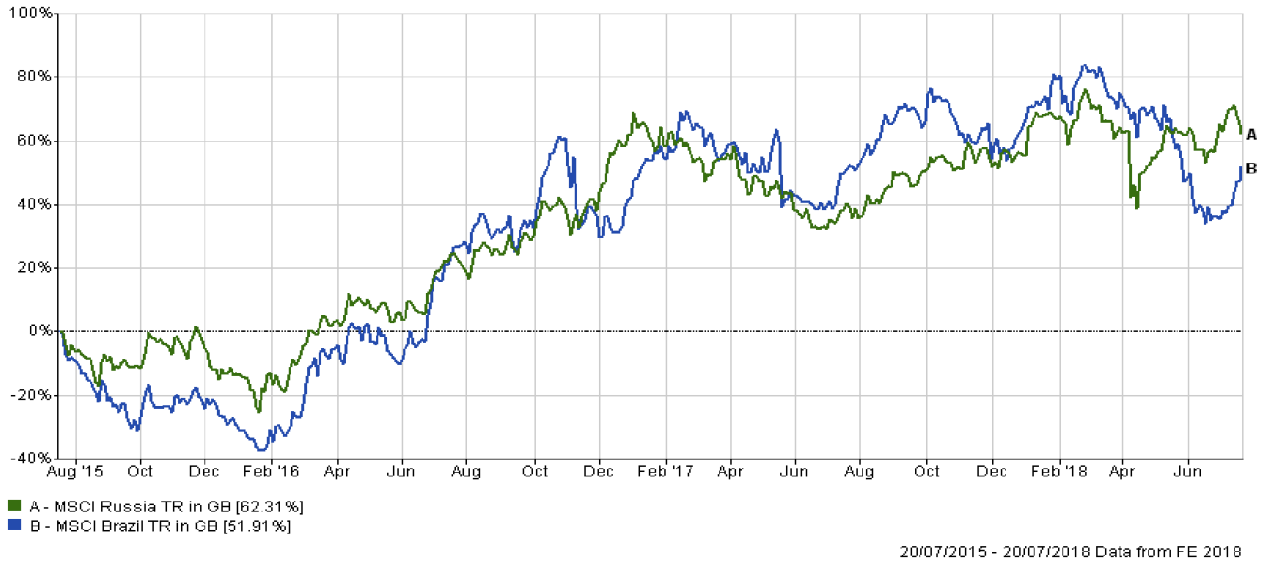
Over the last year we have seen many markets act in a volatile way. This has mainly been driven by the uncertainty surrounding Brexit and "Trumpomacy." It has been difficult to invest in volatile markets as upward trends have turned into negative trends quite rapidly. In the article below we discuss how trend following can assist when investing in higher-risk more volatile markets.

HIGH RISK EQUALS HIGH RETURNS?

Last month we looked at the returns from the stock market World Cup with the winning country being the one that enjoyed the highest market return for the duration of the competition. The winner was Brazil, whose main index returned **6.2%**, narrowly edging out Russia. What surprised us most was the difference between the winning country and the losing one as Argentina fell 13.1% in the same time.

These countries are classified as emerging markets and investing in their stock markets is obviously high risk, which led us to look at one of the main theories of the investment industry – 'the higher the risk you take then the higher the potential long-term returns will be.' If you had invested 10 years ago in both markets then you would not have made any money (these returns do not include charges):

However, if you invested 3 years ago then you would be extremely happy:



What we can see is that by adopting a 'buy and hold' approach to higher-risk markets, you can lose significant amounts of money as well as make significant gains. We do not believe that a 'buy and hold' approach to volatile markets is a good long-term investment strategy, as higher-risk markets are difficult to predict and very volatile. We feel that a better investment approach to 'buy and hold' is to use trend following to help identify the best time to invest in these riskier markets as trend following will hopefully reduce the chances of staying invested during the bad periods but also let you participate in rising markets. As you know, trend following forms an important part of our portfolios and currently Russia is on an upward trend whereas Brazil is not (however it is close to turning into an upward trend).

FINAL COMMENT

Stock markets grew over the month and there are now more in positive trends than negative trends. However, there are many markets that have been trading almost sideways for a long period but in a volatile way. During these periods some stock markets can experience significant losses and the best way to avoid these is to have an investment philosophy such as trend following as it will will hopefully reduce the chances of staying invested during the bad periods but also let you participate in rising markets.

The most positive news over the month was that the decline in Facebook did not spill over and cause markets to fall. Sometimes the best performing companies can also lead the whole market lower and the good news at Apple probably ensured that the contagion did not spread.

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