Watson Moore's Monthly Investment Update

March 2019

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PERFORMANCE UPDATE

- **On the positive side some stock markets rose last month, but we also saw some bonds fall. In addition, Sterling appreciated which proved to be a headwind for the returns on our overseas holdings. Our portfolios ranged between -0.29% and +4.08%.**

- Trump announced that he will postpone an increase in tariffs on $200 billion of Chinese goods which helped Emerging Markets rise.

- On this news, and after falling by 20% last year, copper prices jumped to their highest level in 8 months over optimism that global growth will benefit significantly from a trade deal. This optimism could in turn push up stock markets.

- Postponing Article 50 is now back on the list of possibilities and this helped boost Sterling. However, a stronger Sterling is a headwind, not only to our overseas holdings, but also the FTSE 100 as 70% of its earnings are overseas.

- Risk was increased in the portfolios as some markets broke above trend. The majority are still below trend but close to moving above trend in Sterling terms.

- The performance of the portfolios over the last month and year is shown below:

Portfolio	Performance % 1 month	Performance % 1 year
Foundation	-0.18	-0.18
Cautious	-0.29	-5.24
Balanced	-0.01	-5.04
Adventurous	0.00	-4.32
Dynamic Equity	2.07	3.22
Income Generating	1.34	0.98
Third Industrial Revolution	4.08	3.80
Retirement Investment Solution 1	0.20	-2.97
Retirement Investment Solution 2	0.47	-2.30
Retirement Investment Solution 3	0.72	-1.66

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

Trend Following Signals

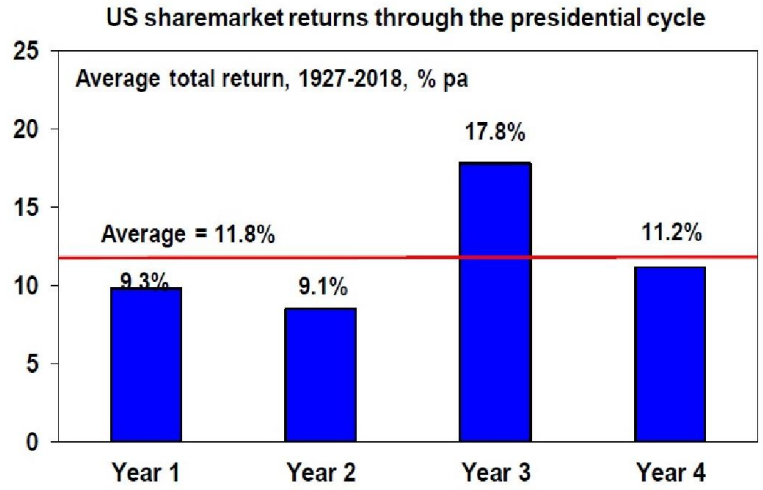
The table below shows whether the asset class is either in a positive trend (✓) or a negative trend (✗). The portfolios will have more exposure to those asset classes in a positive trend and less (if any) to those in a negative trend. These are the main asset classes we monitor:

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

Whilst we still have much bad news around, we are seeing markets recover as the bad news is improving somewhat. One of the biggest contributing factors to the improvement is Trump. He wants to go down in history as one of the greatest ever American Presidents and one of his stated measures is the performance of the US stock market during his tenure. He also knows that he can significantly influence the performance of it through his actions and we have begun to see him do this as he has postponed the increase in Chinese trade tariffs set for the 1st March. He has said that there has been 'substantial progress' in trade talks. The US might also drop the charges against the technology company Huawei as part of a trade deal. In return, China could agree to buy large amounts of US products, such as soybeans. Chinese stock markets have surged as a result and the portfolios may further increase exposure to emerging markets at the next rebalance.

We are also in Trump's third year of his Presidency and returns from the third year have been historically the best and nearly double that of the worst:



Source: Bloomberg, AMP Capital

We believe that this third-year anomaly is because a President does his best to ensure the economy is in good shape for his re-election year. Therefore, we could see an end to the trade war shortly and markets move higher. Our trend-following investment philosophy will be able to take advantage of this as it will keep increasing equity exposure if the upward trend in the third year persists.

Cautious, Balanced and Adventurous portfolios

There were no changes to the Adventurous portfolio, but exposure was increased to pacific equities in the Cautious and Balanced portfolios as they moved above trend. In bonds only the Cautious portfolio reduced exposure as overseas corporate bonds and UK inflation linked bonds fell below trend. The changes were:

Fund	Cautious	Balanced	Adventurous
Fidelity Index Pacific	+3.0%	+2.5%	
iShares Index Linked Gilts	-2.5%		
iShares Overseas Corporate Bonds	-2.5%		

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 to the portfolio with the strongest markets still global property, US equities, healthcare, technology and gold miners.

Foundation portfolio

The Foundation portfolio increased its exposure to pacific equities as they moved above trend. Exposure was decreased in UK inflation linked bonds and overseas corporate bonds.

Income Generating portfolio

No changes were made, and the portfolio is benefitting from the recent changes made over the last few months.

Third Industrial Revolution portfolio

No changes were made this month and the portfolio was our strongest perfoming one, rising by 4.08% in February.

Retirement Investment Solution portfolios

The trend following part of these portfolios invested in pacific equities this month but sold out of UK inflation linked bonds and overseas corporate bonds. The Retirement Investment Solution portfolios are invested in not only a trend following portfolio, but the Foundation and Dynamic Equity portfolios as well.

Summary

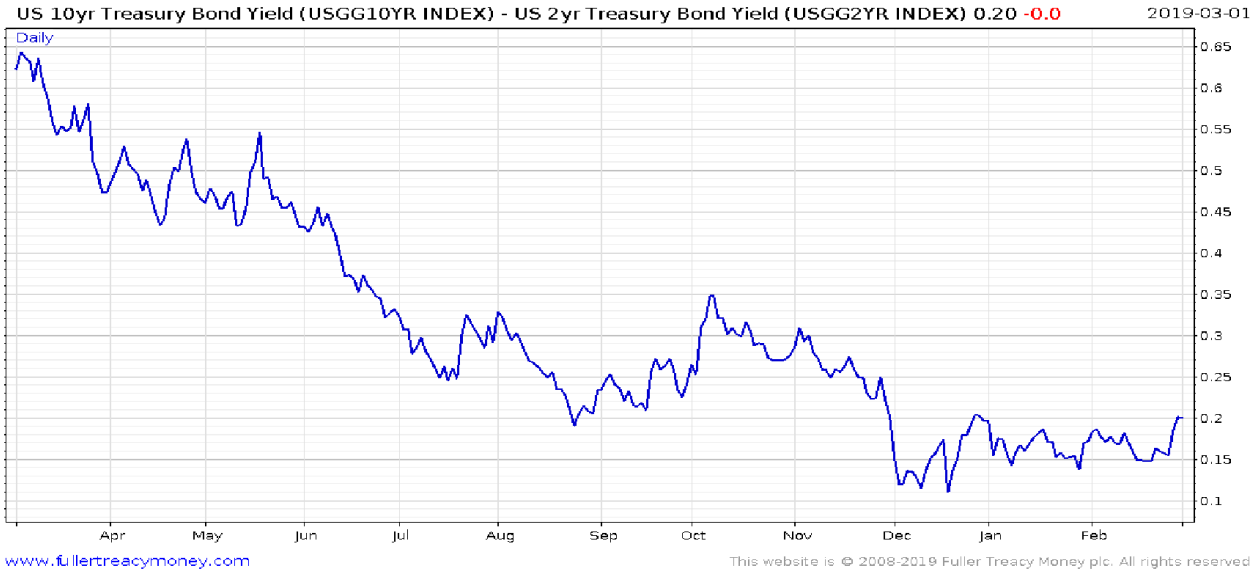
We saw a small recovery in global stock markets in February, but the majority remain below trend. Pacific equities moved above trend and exposure was increased within some of our portfolios.

ASSET CLASS REVIEW

This section will give you an insight into our current thinking, and we have attached some charts that look interesting.

The inverted yield curve is less of a threat

The chart below is important as it can signal a global recession within two years. In fact, the US yield curve has inverted before each recession in the past 50 years. It offered a false signal just once in that time. The chart shows the difference between US 10-year Treasury Bond yields and 2-year Treasury Bond yields. US Treasuries are Bonds issued by the US Government and the yield is a measure of the annualised return an investor can expect to receive for holding the Bond until it matures. In normal circumstances you expect to receive a higher return for holding the Bond for a longer period. However, on rare occasions the yields in the short term are higher than long-term yields (this is called an inversion). When the blue line in the chart goes below zero then it is 'inverted'. You can see that it was heading close to zero but has now bounced a little which has helped global stock markets:



A 'no deal' Brexit is now less of a threat

The chart below is the exchange rate for the US Dollar against Sterling. The higher it goes the stronger Sterling becomes. As you can see it has begun to edge higher, which is indicating that we are going to get a softer Brexit and closer ties to the EU. Removing the uncertainty of a 'no deal' would be viewed as short term positive for businesses but if Sterling continues to move higher, it reduces the returns on our overseas holdings.

Is Trump making friends in China?

The trade war with China has certainly affected stock markets over the last year. However, a US deal with China is becoming a closer possibility and this has led to the Chinese stock market significantly improving this year:

The FTSE 100 has not yet broken above trend due to a rising Sterling

Over 70% of the revenue from the FTSE 100 is derived from overseas and thus if Sterling rises, this reduces the value of that revenue in Sterling terms. This in turn provides a headwind to the FTSE 100 and you can see how it has still not broken above the red trend line:

In Summary

The bad news that caused the last stock market correction appears to be getting slightly better and this is helping stock markets recover somewhat with China the most to benefit. One of the biggest current threats to our wealth is Sterling rising, which reduces returns on our overseas holdings as well as the FTSE 100.

SPOTLIGHT ON THE FIDELITY INDEX PACIFIC EX JAPAN FUND

What does the fund invest in?

Some of the portfolios have just invested in this fund as they have broken above trend. The fund invests predominantly in the Australian and Hong Kong stock markets. There are no fund managers deciding which companies to purchase as the fund simply tracks the MSCI Pacific ex Japan index, which means that it will invest in most of the companies in this region. Since there are no fund managers, the cost is much lower at just 0.13% per annum.

What has the performance been like?

Over the last two years the fund has been as volatile as the FTSE 100 but since its short-term lows seen last October, the fund has grown by over 10%:

Over the last year it has nearly doubled the return of the FTSE 100. However, it is also much more volatile and can fall significantly - which it did in 1997/98. During this period the index fell over 50% whilst the FTSE 100 achieved a positive return. It is therefore very important to ensure that you invest in this fund at the correct times.

What is special about this fund?

The fund is a low-cost way of investing in higher-risk equity markets, and it is outperforming over the last year against its sector average.

Will it continue to perform well?

Whilst it is impossible to predict future returns, we do know that the asset classes going up the fastest tend to outperform going forward. The fund is currently one of the strongest “momentum” markets (i.e. going up the fastest relative to other stock markets), so we can conclude that there is a strong chance that this fund will continue to outperform. However, if we do see a ‘wobble’ in the global economy, it is likely that this fund will fall more than others since the Australian economy has a high dependency on exporting its basic resources such as copper and steel, the prices of which tend to fall in a slowing economy.

Summary

The Fidelity Index Pacific ex Japan fund is an excellent and low-cost way of accessing higher-risk equities. The long-term performance of this index is excellent, but there are times when it rises and falls significantly. Therefore, it is very important to time the investment into this fund, and we use a process called “trend following” to help to try and ensure that we maximise returns and avoid the significant falls.

FINAL COMMENT

In our trend following portfolios, the main objective is to try and minimise losses once we have experienced the first significant stock market falls. This is the reason why we have more cash in these portfolios and less invested in equities. As stock markets begin their recovery process and break above trend, we are increasing exposure to them. This will continue as more and more markets begin to break into upward trends.

Whilst there is still much bad news around, the fact that Trump wants to be remembered as a great President could indeed be the catalyst for higher stock market prices over the rest of the year.

Watson Moore Independent Financial Advisers Limited
54 Station Road
Upminster
Essex
RM14 2TU

Tel: 01708 250624

Email: chrismoore@watsonmooreifa.com

www.watsonmooreifa.com