Watson Moore's Monthly Investment Update

April 2019

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PERFORMANCE UPDATE

- **Global stock markets continue to advance with many more moving above their trend lines. Our portfolios grew by between +0.57% and +3.29%.**
- President Trump has been cleared of conspiring with Russia to swing the election and will face no charges. This means that there is more stability in US politics which helped US markets push higher.
- Unemployment in the UK fell to just 3.9% which is the lowest level since 1975. The total number of people in work also rose to an all-time high of 32.7 million. At the same time wages rose by 3.4%, well ahead of inflation. However, Brexit news is hitting our headlines and the strength of the UK economy is being brushed aside.
- The US Federal Reserve warned that the economy had slowed and said it would not raise interest rates this year. Stock markets have reacted more to the news that interest rates will be lower for longer than the fact that the economy is not doing as well as expected. We have therefore seen stock markets go up in March.
- Equity exposure was increased in most of the portfolios as more markets broke above trend.
- The performance of the portfolios over the last month and year is shown below:

Portfolio	Performance % 1 month	Performance % 1 year
Foundation	1.74	3.18
Cautious	0.57	--2.39
Balanced	0.86	-1.24
Adventurous	1.66	0.81
Dynamic Equity	3.29	10.64
Income Generating	1.68	5.48
Third Industrial Revolution	2.93	11.02
Retirement Investment Solution 1	1.61	0.98
Retirement Investment Solution 2	1.84	2.12
Retirement Investment Solution 3	2.05	3.21

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

The news flow has been poor over the last month, mostly with the doom and gloom surrounding Brexit negotiations. However, the US Federal Reserve also warned that the US economy has slowed. In addition, a gauge tracking Germany's manufacturing sector slipped to its lowest level in six-and-a-half years. This has caused the yield curve in the US to look like it is closer to inverting. When the yield curve inverts, it means people think that interest rates will be lower in the future than they are now, which implies that a recession is coming (because that is typically the reason for rates falling).

Therefore, Central Banks globally have changed their minds about raising interest rates and this has in turn kept stock markets strong and many more have broken above the trend line. It is the classic case of bad news being good news. The uncertainty surrounding Brexit has also caused Sterling to fall a little bit over the month which is helpful for our overseas holdings.

Whilst it is easy to read the news headlines and become very pessimistic, we must also realise that bad news sells and therefore good news does not hit the headlines as much. Therefore, we must balance out the negative with the positive and on the positive side the following is happening:

- We are 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.
- UK unemployment is the lowest for 25 years.
- Many stock markets are now above trend.
- Interest rates globally are unlikely to rise this year, so a "Bond" crash looks like it will be delayed.
- Trump is making progress with China.

Cautious, Balanced and Adventurous portfolios

Exposure to equities was significantly increased as more markets moved above trend. The Cautious portfolio saw an increase of 6% as the US and World went above trend. The Balanced portfolio saw an increase of 7.5% as it is invested in Emerging Markets as well. In addition, we have increased the exposure to UK equities in the two portfolios by purchasing the 7IM UK Value fund. The investment process for this fund looks to find undervalued UK companies, with strong fundamentals and potential for earnings growth. 2.5% was invested in each portfolio into the fund.

In the Adventurous portfolio, exposure was increased to equities as US, Healthcare and Technology all went above trend. 5% was added to each market.

The two trend following funds which are in each portfolio also increased exposure to equities. It is worth noting that they also increased exposure to UK and European equities which went above trend on the dates that they were looked at within these funds.

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. The only change this month was that small US companies were replaced with Pacific equities, which have been performing strongly recently.

Foundation portfolio

The Foundation portfolio increased its exposure to US and World equities as they moved above trend.

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.

Retirement Investment Solution portfolios

The trend following part of these portfolios invested in US, World and Emerging Market equities this month. The Retirement Investment Solution portfolios are invested in not only a trend following portfolio, but the Foundation and Dynamic Equity portfolios as well.

Summary

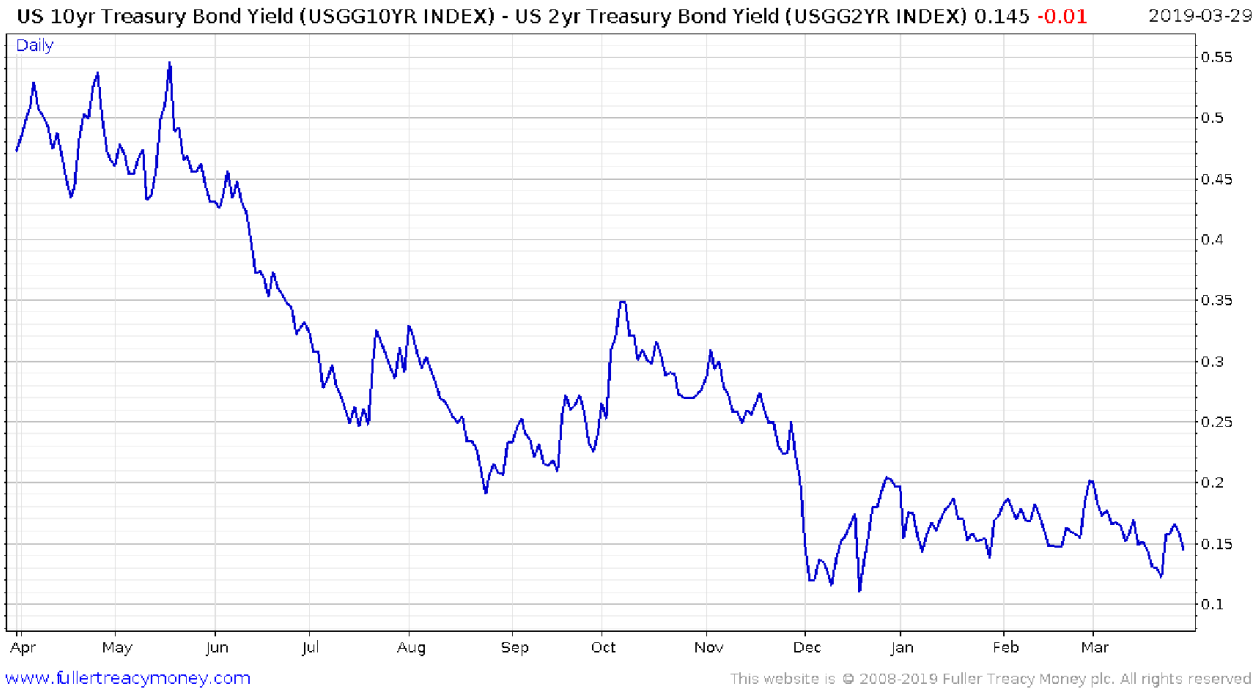
Equity exposure is significantly increasing within our portfolios as more markets are moving above trend.

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 becomes a threat again.

Just when we thought that the yield curve was improving, the US Federal Reserve announced that interest rates would not rise in 2019. Analysts also expect that the next change could even be a reduction. Last month we explained why the yield curve is important and, to sum it up, if the blue line goes below zero it can signal a global recession within two years. You can see that it had risen by the beginning of March but fell again during March:



MSCI World moves above trend

Exposure to equities within the portfolios is increasing as markets move back above trend. The chart below is of the MSCI World index which measures the performance of the world's major companies. You can see how we have experienced a V shaped fall and recovery:

Pacific equities continue to rise

Last month we invested in Pacific equities as they had gone above trend. We can see that they have continued to rise subsequently:

Emerging market equities have broken above trend as well

Emerging markets have also broken above trend. The chart below demonstrates how a long downward trend now appears to be broken:

In Summary

Stock markets continue their recovery and more have now broken above trend. This is in turn increasing the exposure to equities within the portfolios.

SPOTLIGHT ON THE FIDELITY INDEX EMERGING MARKET 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 China, Korea (South), Taiwan, India and Brazil. There are no fund managers deciding which companies to purchase as the fund simply tracks the MSCI Emerging Markets 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 0.20% per annum.

What has the performance been like?

The fund was launched in 2014 and has grown by 8.58% per annum since, this is despite it falling over the last year. We can also track the performance of the index that it tracks over a much longer period and since 2001, the index has grown by 467%. However, it is also extremely volatile and can fall significantly - which it did in between June and October 2008. During this period the index fell over 50%:

It is therefore very important to ensure that you invest in this fund at the correct times, which trend following assists with.

What is special about this fund?

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

Will it continue to perform well?

Emerging markets have a tendency to be much more volatile than other markets. However, they also have long periods of moving sideways before exploding higher or lower. We are currently seeing them recover after suffering losses in 2018. Much of this is down to Trump's trade war with China and if it is resolved then the fund should perform extremely well and we could see significant gains over the next year.

Summary

The Fidelity Index Emerging Markets 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

We must remember that the media exists on promoting bad news and whilst we are all probably tired of the current negotiations surrounding Brexit, there are many good news stories that we need to look at in order to understand why stock markets are now generally trending higher. As stock markets have begun their recovery process and break above trend, our Trend Following portfolios have increased exposure to them. This will continue as more and more markets begin to break into upward trends.

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