Watson Moore's Monthly Investment Update

July 2019

Contents:

PERFORMANCE UPDATE

- **Global stock markets rallied in June, helping our portfolios grow by between 2.39% and 5.16%.**

- Every main asset class that we monitor is above trend, which has resulted in our portfolios accepting more risk. This risk is being rewarded.

- Over the last year we have seen the FTSE 100 fall significantly and then recover, managing a gain of 1.84%.

- Trump's trade war with China softened as he announced that they were restarting talks, and tariffs would not rise. This happened in the last weekend of June and helps set the background for positive returns in July. We believe that he will do his best to manipulate the US stock market higher in the run up to his election in November 2020.

- 'Boris' looks set to become the next Prime Minister (as long as he doesn't say anything stupid!). Both he and Hunt are making plans to mitigate the effects of a 'no-deal' by announcing plans to stimulate the UK economy if a 'no-deal indeed happens. Sterling remains weak as a result and this is helping increase returns from our overseas holdings.

- The performance of the portfolios over the last month, 6 months, and one year is shown below:

Portfolio	Performance % 1 month	Performance % 6 months	Performance % 1 year
Foundation	2.76	7.98	4.44
Cautious	2.84	4.46	0.08
Balanced	3.41	6.11	0.47
Adventurous	3.95	7.98	0.66
Dynamic Equity	4.38	15.44	6.76
Income Generating	2.39	10.38	4.77
Third Industrial Revolution	5.16	19.36	7.70
Retirement Investment Solution 1	3.34	7.07	1.99
Retirement Investment Solution 2	3.50	8.14	2.50
Retirement Investment Solution 3	3.65	9.16	2.98

Please note that these figures do not include the 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

Every main asset class that we monitor is above trend. This is the first time in a long while that we have recorded this, and as a result our trend following portfolios have been increasing equity exposure over the last few months. This additional risk is being rewarded as the short-term returns that we have experienced have been good. So why is every asset class above trend and will this continue?

Whilst it is difficult to pinpoint one specific reason, we believe that Trump is the main factor as he is possibly manipulating markets before his election in November 2020. 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 its performance through his actions, and we have begun to see him do this. His biggest problem towards the end of 2018 was that interest rates were expected to increase significantly, and this caused markets to fall. Suddenly (and after his lambasting of the Federal Reserve via Twitter), we saw the Federal Reserve (FED) change track and call that the next change in interest rates would be downwards. This was one of the biggest U-turns in history. The reason given by the FED was that global trade had started to turn downwards and the chances of a recession in the US had increased. This was mainly due to the trade war that Trump had started.

Then, just as he got what he wanted from the FED, he announced at the G20 summit that he was restarting trade talks with China and not raising tariffs. This resulted in stock markets globally going up over 1% on the first trading day of July. We feel that as we get closer to November 2020, Trump will make further positive trade announcements and hope to push stock markets higher.

So, not only have equities gone above trend, bonds have also gone above trend due to the expectation that interest rates will be cut. Whilst a Trade Deal with China should result in equities going up even more, we do feel that if this happens, there will be another change in direction in expectations in interest rates. Due to this we are very reluctant to invest too much in bonds as we expect low long-term returns from them. For example, the yield on the German 10-year bond is now minus 0.331%. This means that if you buy them now and keep for the next 10 years you will lose 0.331% per annum.

Whilst the recent good returns from bonds has surprised just about everyone, there has to be a point at which they snap back, and significant losses are made. We therefore consider bonds now to be a much higher risk of returning negative returns over the next 5-10 years than they have ever been in their history. We therefore do not want to have too much money invested in them and we have a plan to reduce exposure when they start to fall in value i.e. when they break below the trend line.

Cautious, Balanced and Adventurous portfolios

The main investment philosophy that the portfolios utilise is trend following. This means that you invest more in the asset classes that are going up and reduce exposure when they are below trend. For the first time in a long while, all of the selected equity asset classes are above trend and we increased exposure to the UK and Japan within the Cautious and Balanced portfolios. In addition, exposure to emerging markets was increased in the Balanced portfolio. The Adventurous portfolio was already fully invested in equities.

In addition to trend following on equities, we also invest in defensive equity funds. We have decided to take advantage of the higher than normal dividend yields on UK companies by switching out of the Edinburgh Investment Trust to the 7IM UK Value fund in the Adventurous portfolio. In the Cautious portfolio the same fund was changed into the 7IM fund as well as the Vanguard FTSE 100 fund.

The Balanced and Adventurous portfolios reversed last months change and moved out of inflation linked gilts and into overseas corporate bonds. This is because these two portfolios invest in the best performing bond funds and due to the recent changes in expectations of interest rates, bond asset classes are moving much more than normal. This has led to more changes than normal in this asset class.

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. There were no changes this month and the current momentum asset classes are US, Pacific and North American equities as well as property, healthcare and technology sectors. The UK equity exposure has also been changed from the Edinburgh Investment Trust to the 7IM UK Value fund. The investment process for the 7IM fund looks to find undervalued UK companies, with strong fundamentals and potential for earnings growth. We believe that this fund will produce better long-term returns than the Edinburgh Investment Trust as there are many undervalued UK companies as a result of overseas investors not wanting to invest in them due to the fear of Brexit. When Brexit is resolved then money may come flooding back into them.

Foundation portfolio

All of the selected equity asset classes are above trend and we increased exposure to the UK and Japan. In addition, commodities also broke above trend and we increased exposure.

Income Generating portfolio

No changes were made. The 6-month performance of this portfolio is particularly strong at over 10%. This is mainly due to the fact that interest rates globally are expected to fall and therefore investors are valuing asset classes that are paying relatively high levels of income.

Third Industrial Revolution portfolio

No changes were made this month. This continues to be our best performing portfolio and it increased by over 5% this month.

Retirement Investment Solutions

The trend following part of these portfolios invested in the UK, emerging markets, Japan and smaller global equities this month as the trends all turned positive. The Retirement Investment Solutions are invested in not only a trend following portfolio, but the Foundation and Dynamic Equity portfolios as well.

Summary

June saw all our monitored equity markets move above trend and exposure was increased. Bonds are also increasing in value and this is helping our lower risk portfolios.

ASSET CLASS REVIEW

This section will give you an insight into our current thinking, and below are some charts that look interesting. With global stock markets recovering from their losses in May, we look at how the main developed equity markets have performed over the last year, and whether this recovery will continue.

FTSE 100 – bouncing off the trend line

Over the last year the FTSE 100 has experienced much volatility and we remain below the all-time high at just over 7800. After recovering from the dramatic break below the trend line towards the end of last year, we suffered another fall in May. However, this time the market bounced off the red trend line which is positive:

S&P 500 bounces off the trend line as well

Similarly to the FTSE 100, the main US stock market (S&P 500) has just bounced off the red trend line as well. In addition, it has recovered to a new all-time high and this is extremely positive as stock markets can attract more money once the headlines are positive:

Europe displays a similar positive pattern

Despite Europe lagging other global stock markets recently, it has acted similarly to other markets and bounced off the red trend line. Again, this is very positive as it shows commonality between the main markets:

China recovering after a downward trend throughout 2018

By looking at the 5-year chart, we can see how much the Chinese stock market was affected last year by the trade wars, as it fell continuously. Since the start of this year it has rebounded and, like other markets, remained above the trend last month. Again, this is positive news:

In Summary

Major global stock markets have displayed much commonality over the last few months. They all experienced falls in May but have subsequently bounced off their trend lines. This is extremely positive as we have seen buyers' step in and take advantage of the dip. Whilst 2018 saw global markets experience two sharp falls and therefore a loss of consistency, 2019 is displaying a more normal pattern of small falls followed by a recovery. If the recovery leads to new highs in more markets, then a more consistent uptrend will emerge.

HOLIDAY MONEY

As many of you may know, Sterling has fallen significantly since our decision to leave the European Union back in June 2016. For those of us looking to enjoy a holiday, this has had a knock-on effect in that the cost of buying our holiday money has risen. It's now more important than ever to look at your options in order to make sure you are not forking out unnecessarily before you even begin enjoying your time away.

One option available to us now is to reduce the cost of our overseas transactions by opening an account with one of the new 'challenger' banks. Examples of these include Monzo and Revolut.

What do we typically pay when we use our debit or credit card abroad?

It's safe to say that the high street banks probably enjoy it when we go abroad as they can charge for the overseas transactions that we make. And in this modern age of contactless technology and paying on your smartphone, wouldn't it be far more convenient to be able to make more card transactions without having to worry about accidentally incurring lots of fees?

Whilst each bank's charges vary, typically you will pay the following when you make a card transaction abroad:

- A non-Sterling transaction fee – This typically could be a fee of around 3% of each transaction that you make. It's calculated each time you use your card abroad and is designed to cover the cost to the bank of having to calculate and apply the relevant conversion rate applicable at the time, given these fluctuate on a daily basis.

- A 'spread' between the rate you buy, and the rate you sell, currency – This 'spread' refers to the difference in what you have to pay to buy a foreign currency and what you make back from selling a foreign currency back into Sterling. For example, on the 1st July 2019 the Euro exchange rate at one of the leading banks was 1.0661 to buy Euros and 1.2185 to sell Euros. This means if you were going away and wanted £1,000 in Euros, you would get €1,066. If you then returned this immediately, you would only get back £874.85.

So, what is a Challenger bank?

Wikipedia provides a useful definition of a Challenger bank, as quoted below:

"Challenger banks are small, recently-created retail banks in the United Kingdom that compete directly with the longer-established banks in the country, sometimes by specialising in areas underserved by the 'big four' banks (Barclays, HSBC, Lloyds Banking Group, and Royal Bank of Scotland Group). The banks distinguish themselves from the historic banks by modern financial technology practices, such as online-only operations"

A new way to spend money abroad

So, as mentioned towards the end of the Wikipedia quote above, these Challenger banks tend to be very tech-savvy, offering comprehensive digital services and banking app facilities. They can help reduce the cost of your holiday money as you simply deposit Sterling into your account with them and convert/use it in the currency of your choice. They exchange the money at the interbank rate (also known as the 'middle' rate) which means there are no charges or spreads in doing so.

Thus, returning to our previous example, £1,000 would buy you €1,016 and could be changed back to £1,000 straight away (assuming the exchange rates hadn't changed). You also get a debit card, so it is easy to spend your money at most retailers, bars and restaurants abroad. Remember to elect to pay in the local currency when you're paying and NOT to pay in Sterling if offered.

The two major leaders we have looked at on this are Monzo and Revolut, and the above descriptions are based largely on their services. (Revolut is not yet a bank but has applied for a banking licence). There are other similar challenger banks but these two have been used by us and clients.

In Summary

The Challenger banks, such as Revolut and Monzo in particular, are British start-up firms. They are trying to attract as many customers as they can in a short space of time, and whilst they are effectively losing money in the short term by offering these exchange rates to their customers, their business plan means that they will soon start offering other products and, given that they don't have the same expensive infrastructure as the big banks, they should be able to undercut them on most of these products. These banks will assist you in reducing the cost of your holiday.

FINAL COMMENT

Last month we wrote in our summary:

'Trump is engaging in trade wars, but we do feel that with the election less than 18 months away, he will want to see the US stock market rise significantly before then. This means that we are likely to see some announcements of trade deals shortly.'

Since then we have seen equity markets rise and Trump announcing that he would be recommencing trade talks with the Chinese. We therefore have a catalyst for further growth in stock markets.

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

Tel: 01708 250624

Email: chrismoore@watsonmooreifa.com

www.watsonmooreifa.com