Watson Moore's Monthly Investment Update

November 2019

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PERFORMANCE UPDATE

- **Most asset classes suffered falls last month with the FTSE 100 falling 1.87%, MSCI World 2.32%, Overseas Government Bonds 5.00%, Gold 3.16% and UK Government Bonds 1.96%. This led to the portfolios falling between 0.45% and 2.81%.**

- Sterling rallied over the month as the fear of a "no deal" receded, gaining 5.3% against the US Dollar. This meant that our overseas holdings fell when converted back to Sterling. A rising Sterling also provides a headwind to the FTSE 100 as over 70% of its earnings are overseas.

- The Conservatives look likely to win the election on the 12th December, but whether they achieve a majority or not is almost 50/50 in what looks like being a very difficult election to predict.

- The US lowered interest rates again by 0.25%, taking the range to between 1.5% and 1.75%. However, it has indicated that it may pause rate cuts from here. There are still over $13 trillion worth of bonds that trade on negative yields.

- There is so much negativity in the investment world, yet the main US stock market has hit a new record high. This could mean that there is still a lot of cash on the side-line waiting to be invested. How long will it be before positivity returns and this cash gets invested again, pushing stock markets even higher? We believe that a China/US Trade deal would be the catalyst to push stock markets significantly higher from here.

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

Portfolio	Performance % 1 month	Performance % 6 months	Performance % 1 year
Foundation	-2.81	3.98	6.33
Cautious	-2.36	1.82	1.36
Balanced	-2.55	2.33	2.70
Adventurous	-2.53	3.17	3.42
Dynamic Equity	-2.50	3.64	9.38
Income Generating	-1.05	1.57	7.21
Fourth Industrial Revolution	-0.45	-0.23	10.17
Retirement Investment Solution 1	-2.30	3.37	4.80
Retirement Investment Solution 2	-2.32	3.35	5.31
Retirement Investment Solution 3	-2.34	3.33	5.79

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	x
UK Equity	x	Commodities	✓
Europe ex UK Equity	✓	UK Corporate Bonds	✓
US Equity	✓	UK Corporate Bonds (Short dated)	✓
Japan Equity	✓	UK Index Linked Bonds	✓
Pacific Equity	x	Global Bonds	✓
Gold	✓	UK Gilts	✓
Global Property	✓	Emerging Market Bonds	x
		Overseas Corporate Bonds	✓

Large UK companies, Pacific equities and Emerging Markets (both equities and bonds) fell below trend over the month.

Cautious, Balanced and Adventurous portfolios

For the Cautious portfolio we sold large UK companies, Pacific equities and Emerging Market bonds as they all fell below trend. For the Balanced portfolio we sold Emerging Market equities in addition to the Cautious portfolio and due to Sterling appreciating, we moved the bond holdings from Overseas Government bonds to UK gilts. UK inflation linked gilts were also sold and replaced by UK corporate bonds. For the Adventurous portfolio we sold out of Pacific equities but remain invested in the US, Property, North America, Technology and Gold Miners. We also sold UK Inflation Linked bonds and purchased the strongest bond class which was UK Government bonds.

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 as the best performing asset classes remain so.

Foundation portfolio

We reduced exposure to Pacific and UK equities as well as Emerging Market bonds. Whilst this portfolio has performed well over the last year, its high exposure to bonds caused it to be our worst performing portfolio this month. If bonds continue to fall, then exposure will reduce significantly and thus help protect the portfolio.

Income Generating portfolio

No changes were made to the Income Generating portfolio. The portfolio has a large weighting in UK equities due to the high level of dividends that UK companies are paying. We do believe that UK equities are considerably undervalued, and the level of income offered from the FTSE 100 is extremely high. Smaller UK equities performed very well last month because Boris has reduced the risk of a “no deal”. We have written about why the FTSE 250 is outperforming the FTSE 100 recently in the “Asset Class Review”. The Income Generating portfolio has increased the amount it holds in smaller UK companies over the last 6 months.

We do believe that UK equities could achieve significant gains due to the high level of income being offered which will entice overseas investors once Brexit is finalised. The portfolio overall is paying a yield of 3.88%.

Fourth Industrial Revolution portfolio

The Fourth Industrial portfolio will always be more volatile than our other portfolios. It is our best performing portfolio over the last year but our worst performing one over the last 6 months. This month we saw biotech rise significantly which helped the portfolio. Biotech has been one of the more volatile parts to the portfolio and been underperforming due to the uncertainty surrounding the US healthcare system.

Retirement Investment Solutions

We sold large UK companies, Pacific equities and Emerging Markets (equities and bonds) as they all fell below trend. The Retirement Investment Solutions are invested in not only a trend following portfolio, but the Foundation and Dynamic Equity portfolios as well.

Summary of Portfolios

Sterling rising is a threat to our wealth as we invest money in overseas assets. In addition, the FTSE 100 has over 70% of its earnings from overseas and therefore when this is converted back, the profit in pounds falls. A rising Sterling is therefore a headwind for the FTSE 100 as well as global equities. This does not mean that the FTSE 100 will fall, or that overseas stock markets will not produce positive returns when converted back into Sterling, but it does mean we need to be aware of this additional risk. If Sterling continues to advance, then the trend following portfolios are likely to increase their cash positions.

Whilst there is so much to worry about in the investment markets at the moment, few have noticed that the main US stock market has hit an all-time high. This is extremely positive especially when so many people are negative. This is because with the negative headlines, many investors have been holding cash and waiting for stock markets to crash. When they see markets going up higher, there is a lot of cash that could be invested as they do not want to miss out as this in turn pushes markets even higher. The catalyst for a rally in stock markets is very clear - Trump wants a deal with China before the election in November 2020 so that he can tell the electorate how much the stock market has gone up under his Presidency. If he doesn't strike a deal with China, then the chance of a recession occurring before the election increases. If the American economy is struggling in the run up to the election, it is unlikely that he will get re-elected. October saw progress in this trade deal. Our portfolios are currently therefore accepting more risk than normal as most stock markets are on a positive trend.

ASSET CLASS REVIEW

This section will give you an insight into our current thinking, and below are some charts that look interesting.

Sterling jumps and returns to the 3-year range

The chance of a 'no deal', and the uncertainty surrounding it, has receded over the last few months. Despite the uncertainty that the General Election brings, Sterling is a good measure of how investors view the UK. A rising Sterling means that investors are generally bullish about the UK, and a falling Sterling means that they are concerned. The chart below shows how Sterling crashed after the Brexit vote but then trended sideways over the last 3 years. There was a sharp break down in the Summer as the chances of a 'no deal' grew, but since Boris has renegotiated Theresa May's deal, Sterling has risen sharply:

A rising Sterling will prove to be a headwind for our holdings in overseas equities as well as the FTSE 100 which has the majority of its earnings from overseas.

FTSE 100 v FTSE 250

The chart below shows how the FTSE 100 (the UK's largest 100 companies) have performed against the FTSE 250 (the UK's next largest companies). Whilst they have both returned a similar amount over the last 2 years, the FTSE 250 has recently been rising compared to the FTSE 100 which has been falling. This is mainly because the FTSE 250 is more UK-centric than the FTSE 100 and a conclusion to Brexit is likely to boost the UK economy and therefore the companies that are more UK-centric. The FTSE 100 could be hampered if Sterling rises as over 70% of its earnings are in foreign currency, the value of which would be reduced when converted back:

US interest rates are cut, which helps bonds

The chart below shows the yield (income) that you could receive by investing in US Government bonds. Over the last year this has fallen significantly and thus pushed up the price of bonds. They are now at a level in which investors are saying that they are the next asset class to pop and you could lose a significant amount of money if you invested in them today. The start of October saw the yield rise and bonds fall in value. However, the US cut interest rates towards the end of October causing the yield to fall again slightly. We are possibly at a stage in which yields stay in the same range for a long time before eventually recovering.

The US stock market hits a new all-time high

We have been discussing in these updates about how Trump needs to do a deal with China so that he has the best chance of getting re-elected. October saw some good progress and the main US stock market hit a new all-time high. If a deal is concluded, we expect a significant advance from here.

VALUE MAKES A COMEBACK?

What is value investing?

All investors are looking for value, but value investing simply means buying something that is cheap, or a more technical definition is "stocks with low price/earnings (p/e) ratios". The opposite of value investing is growth/momentum investing, which involves buying the companies that have gone up significantly already, in the hope that they will continue to grow in the future. Companies such as Amazon and Facebook are great examples of this as you are buying into the hope that they will continue to grow their profits in the future.

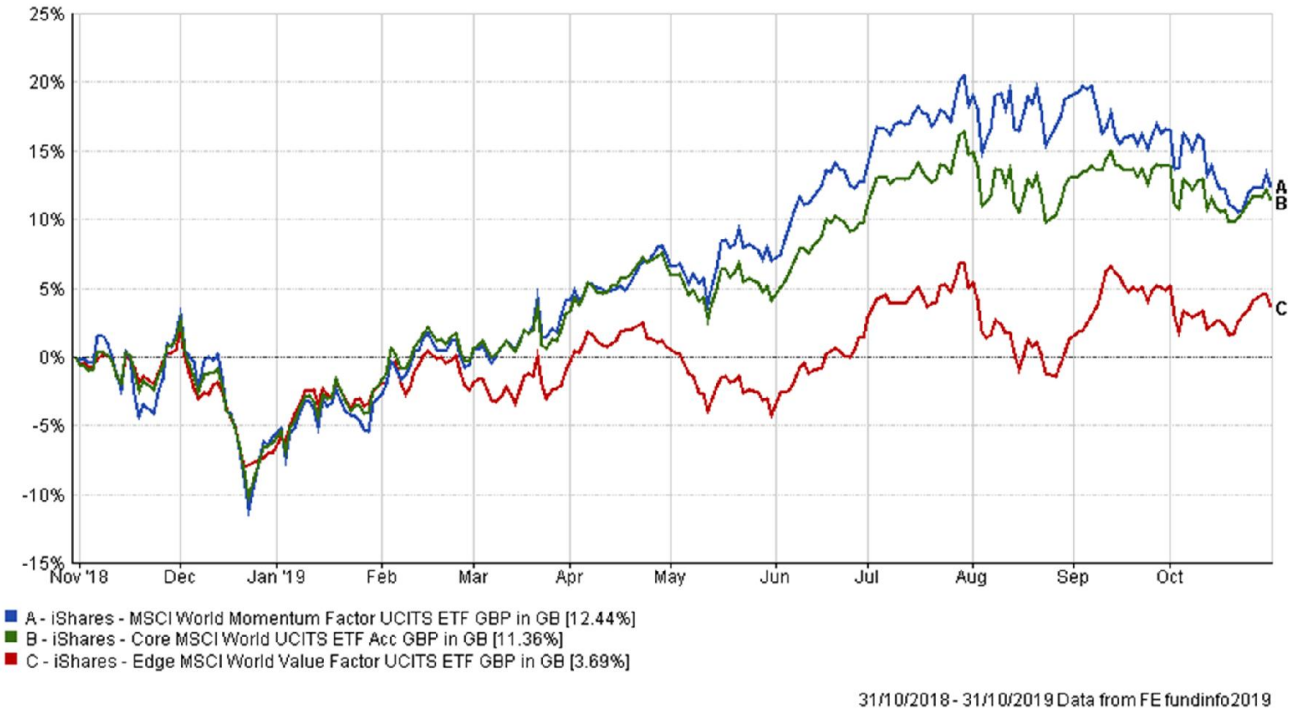
A good example of a UK value stock is British American Tobacco (BAT). The cigarette industry is currently going through enormous change in which the Western world is moving away from tobacco and replacing this with vaping. BAT's share price has halved over the last 2.5 years, but it is still paying a dividend yield of 7.4%. If BAT is able to successfully navigate the problems in their industry and continue with their dividend, then this looks like a bargain. They could of course continue to struggle, cut their dividend and see the share price fall even further.

Does value investing work?

Some of the best investors in the world (including Warren Buffett) have made their fortunes from value investing. However, over the last 10 years, the MSCI World Value index has underperformed the MSCI World index by 17.8%, whereas the MSCI World Momentum index has outperformed the MSCI World index by 35.1%. We believe that the reason for the underperformance in value investing has largely been due to the exponential growth of technology in our lives, which has caused disruption in many industries. You only need to look at how Amazon has disrupted the high street for evidence. Therefore, certain companies that became attractive to value investors, then failed to adapt to the new environment and fell even more, with some like Kodak, Blockbusters and now Thomas Cook going out of business. Consequently, even if you hold only a few companies that go bust, you underperform the index significantly.

What is the future for value investing?

The chart below shows how value investing (red line) has underperformed the index (green line) and momentum investing (blue line) over the last year:



However, you can see that since the middle of August value investing has increased by 4.60% and momentum investing has fallen by 3.45%. We could therefore be at a turning point. Investors who want to invest new monies into the stock market look for bargains rather than invest in the companies that have gone up the most, due to the fact that they feel as if they have missed out on the growth stocks but not the value stocks. We then have an outperformance in value.

FINAL COMMENT

The renegotiated Brexit deal ensured that Sterling rose significantly as the chance of a “no deal” receded. Whilst this is good news when we go on overseas holidays, it reduces the value of our overseas assets as well as providing a headwind to the FTSE 100. A rising Sterling is therefore one of the main risks to our wealth currently, although a Brexit deal would remove much uncertainty and possibly lead to money flowing into UK markets.

Balancing this though is the fact that we believe Trump wants a deal with China in order to assist him in being re-elected President. This will push stock markets higher, and help the global economy avoid a recession. We would not be surprised if this happens sooner than later and progress has been made recently.

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