Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update
December 2019

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Performance Update

Most asset classes rose last month with the FTSE 100 rising 1.81%. This led to the portfolios growing by between 0.66% and 5.21%.

Sterling did not give back any of October's rally, nor did it move any higher with the news that the chances of a Conservative majority increased. This is good news for our portfolios as a rising Sterling provides a headwind to returns from our overseas investments. Perhaps markets are now looking at what happens after the Brexit deal is struck and are yet to form an opinion about whether the UK can indeed agree new trade deals.

The Conservatives look likely to win the election on the 12th December and, according to leading bookmakers, the chances of a majority have increased from 50% to 66%.

US equities remain one of the best performing asset classes, but UK smaller companies have rallied and are now very high on the momentum scale. This has led to an increase in some of the portfolios' exposure to UK smaller companies.

Equity markets continue to move higher with some of the main developed markets looking like they could break through their medium-term ceilings and rally.

The performance of the portfolios over the last month, 6 months and 1 year is shown below:

Portfolio	Performance % 1 month	Performance % 6 months	Performance % 1 year
Foundation	0.66	3.68	7.27
Cautious	0.93	3.26	2.29
Balanced	1.48	4.34	3.88
Adventurous	1.74	5.90	4.44
Dynamic Equity	2.28	7.47	10.47
Income Generating	2.60	5.63	9.84
Fourth Industrial Revolution	5.21	9.42	13.83
Retirement Investment Solution 1	1.49	5.53	6.10
Retirement Investment Solution 2	1.62	5.82	6.60
Retirement Investment Solution 3	1.75	6.09	7.06

Please note that these figures do not include the platform or Watson Moore's fees. All figures are sourced from Financial Express.

Trend Following Signals

The table below shows whether the asset class is either in a positive trend (✓) or a negative trend (x). 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		Trend Signal
Global Equity	✓	Emerging Market Equity	x
UK Equity	✓	Commodities	x
Europe ex UK Equity	✓	UK Corporate Bonds	✓
US Equity	✓	UK Corporate Bonds (Short dated)	✓
Japan Equity	✓	UK Index Linked Bonds	x
Pacific Equity	x	Global Bonds	✓
Gold	✓	UK Gilts	✓
Global Property	✓	Emerging Market Bonds	x
		Overseas Corporate Bonds	✓

Large UK companies moved above trend, whilst UK Index Linked Gilts fell below trend over the month.

Cautious, Balanced and Adventurous portfolios

For the Cautious and Balanced portfolios we bought back into large UK companies as they moved back above trend. For all three portfolios we increased exposure to smaller UK companies as they are now high up on the momentum scale and should do well if we see more stability in the UK's political situation. We also switched infrastructure exposure from global to the UK in the Cautious portfolio. This helps reduce our overall currency risk as a stronger Sterling will provide a headwind to our overseas investments. Finally, UK inflation linked bonds fell below trend and we sold out of them within the Cautious portfolio.

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. This month exposure increased in UK smaller companies and European equities as they both moved high up on our momentum scale. Pacific equities and global property were sold.

Foundation portfolio

We increased exposure to smaller and larger UK companies, switched infrastructure exposure from global to the UK and reduced exposure to UK inflation linked bonds. The Foundation portfolio is our most diverse portfolio and due to this, holds more money in bonds. Bonds have performed very well over the last year but have started to underperform against other asset classes. This is why the performance of the portfolio has been good over the last year but was why the portfolio lagged others this month.

Income Generating portfolio

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.

Therefore, one of the main risks to our wealth is that a Brexit deal is achieved after the election and Sterling responds positively. Some journalists have begun to refer this as the "**Boris Brexit Bounce"**. There are ways to mitigate this risk and we have been implementing this over the last six months. The ways to help mitigate it are relatively simple and they are:

- Invest more money in smaller UK companies.
- Invest money into funds that hold overseas assets but hedge them back into Sterling.
- Invest in UK infrastructure funds that should benefit from the Boris Brexit Bounce.

In November, we reduced exposure to overseas equities by 7.5% and reinvested into smaller UK companies. In addition, we switched our holding in the JP Morgan US Equity Income fund to the hedged share class. This means the performance of the fund is now not affected by currency. We already have enough invested in UK infrastructure so did not add to it. The portfolio was our second best performing one last month.

Fourth Industrial Revolution portfolio

The Fourth Industrial portfolio will always be more volatile than our other portfolios. It rose 5.21% last month and was our best performing portfolio. This month we saw biotech rise over 10% which helped the portfolio. Biotech has been one of the more volatile parts to the portfolio and had been underperforming due to the uncertainty surrounding the US healthcare system. It is however recovering.

Retirement Investment Solutions

We bought back into large UK companies, but sold UK inflation linked bonds and global infrastructure as they 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

We are potentially experiencing a period in which UK smaller companies and possibly European equities, begin to outperform. The portfolios have increased exposure in both of these asset classes. In addition, we have tried to take advantage of the potential Boris Brexit Bounce and look forward to an interesting month!

Asset Class Review

This section will give you an insight into our current thinking and we have included some charts that we believe look interesting. With global stock markets rising, we look at which markets are close to their medium-term highs and might break significantly higher.

The US - Once it broke the ceiling it moved much higher

Stock markets tend to form patterns that keep repeating. One important pattern is a period in which stock markets continually look like they will move to a new high, but just as they approach the previous high, they fall back. They almost look as though there is a ceiling that is holding them back and the pattern involves them ranging sideways for a significant period. However, once the ceiling is broken they then move significantly higher. We have recently seen the main US market (S&P 500) break above the ceiling and then move in an almost straight line higher, so now we are looking to see if there are other stock markets that could follow this pattern.

UK Equities – Close to the high seen in June 2018

The FTSE 250 has recently started to move higher and looks like it is set to test the 2018 ceiling. The removal of the political uncertainty in the UK could be the catalyst for it to break through this ceiling and surge higher:

Europe - Close to the 2015 high

Europe is by far the biggest victim of the long-running trade dispute between the US and China, with the German economy hardly growing at all. This is because it has been reliant on growing through exports which have fallen significantly. However, the stock market is beginning to move higher and if we get some good news on the trade dispute, this could be the catalyst it needs to break the ceiling:

Japan - Testing its ceiling again

The chart below is the Japanese stock market over the last 20 years. The market broke the previous ceiling and then moved significantly higher. The previous ceiling has acted as a floor and we now approach the new one:

Summary

Once a market breaks through its ceiling, it tends to surge higher before another ceiling is created. The US market broke through its ceiling and we now have other major markets testing theirs. If they break through them then we could experience a period of extremely positive returns.

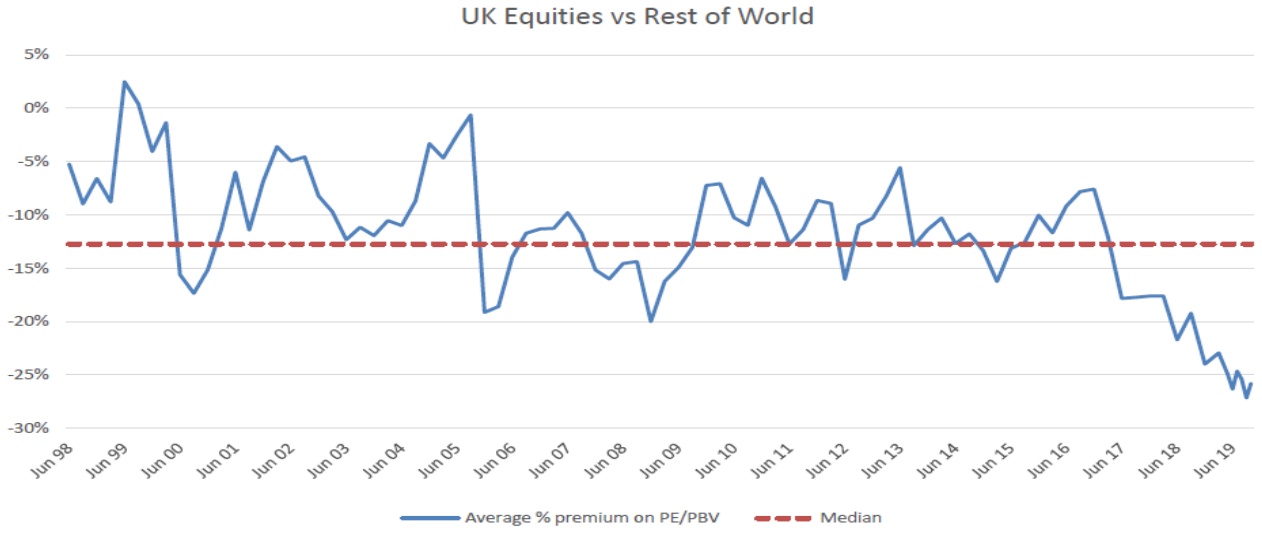
The Boris Brexit Bounce (BBB)

What is the "BBB"?

With the election looming, the bookies' most probable outcome is that the Conservatives win by a majority and form the next government without the need of the support of any coalition. It is then likely that a deal will be signed to leave the EU by the 31st January 2020. Commentators are now forecasting that the UK will experience a Boris Brexit Bounce (BBB) after this, due to the fact that businesses (and investors), who have delayed making decisions amid the political uncertainty, will begin to invest in the UK again. On top of this, the Conservatives are likely to cut taxes and try to fan the feel-good factor.

UK equities undervalued

The chart below, which has been produced by Bloomberg, shows that UK Equities are at a 27% discount to other developed markets:



Even if UK equities have historically been at a discount, these are now extreme levels and you can now see how UK stock markets could simply revert back to normal. This would mean that they could outperform by 15%. In addition, we have started to see smaller UK equities (green line) begin to bounce and outperform bigger UK companies (blue line):

How are the portfolios positioned to benefit?

We have recently increased exposure to the smaller UK companies within some of the portfolios due to the fact that they are high on the momentum scale.

FINAL COMMENT

During this period of uncertainty, stock markets have continued to trend higher. While it may appear to be all doom and gloom on the news front, stock markets tend to move higher as the news flow improves. While the Brexit vote continues to split the UK, investment markets appreciate the removal of future uncertainty and if we do get a Conservative majority then it is likely to be good for the UK economy and stock markets. In addition, the news coming out of the trade deal talks is slightly improving and we are more positive that a deal (even if it is temporary) will occur shortly. This has helped many stock markets move to their previous medium-term highs and, if the news flow continues to improve, we expect most of them to reach new medium-term highs.

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