Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update
January 2020

Contents:

Performance Update

We experienced a Santa Rally with the FTSE 100 rising 2.78%* in December. However, Sterling strengthened, and this proved to be a headwind for our overseas investments. This led to the portfolios growing by between 0.20%* and 2.60%* and by between 5.49%* and 24.94%* during 2019.

Boris Johnson won a decisive 80 seat majority – the biggest majority since 1987. Meanwhile, at 44%, the party's share of the vote is the highest since 1979, when Margaret Thatcher became prime minister.

This led to a rally in UK equities with the FTSE 100 rising 2.78%* and the FTSE 250 by 5.15%*. The UK is now investable again as the risk of a non-business friendly Corbyn government has been removed.

Britain will now leave the European Union (EU) on 31st January and enter a "transitional period" during which a new deal with the EU will be negotiated. Sterling rallied on the election news but then gave up some of the gains as the government formally ruled out any extension to the end of year deadline for the new trade deal to be implemented. This has created some concern that a "hard" Brexit is still on the cards.

Overseas equity markets also advanced on the announcement of a "phase one" trade deal between America and China. However, Sterling rose from $1.297 to $1.325 against the Dollar and this reduced returns from our overseas investments, with the S&P 500 (main US stock market) only growing by 0.43%* when converted to Sterling.

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	0.20	1.10	9.17
Cautious	0.57	1.12	5.49
Balanced	0.48	1.45	7.57
Adventurous	1.40	3.31	11.56
Dynamic Equity	1.86	4.88	21.07
Income Generating	2.60	5.85	16.83
Fourth Industrial Revolution	0.78	4.88	24.94
Retirement Investment Solution 1	0.72	2.86	10.13
Retirement Investment Solution 2	0.90	3.16	11.56
Retirement Investment Solution 3	1.06	3.44	12.91

Please note that these figures do not include the platform or Watson Moore's fees.
*All figures are sourced from Financial Express to 31.12.2019.

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	✓
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	x
Global Property	✓	Emerging Market Bonds	x
Global Infrastructure	✓	Overseas Corporate Bonds	x

Emerging market equities and global infrastructure moved above trend, whilst UK Gilts and overseas corporate bonds fell below trend over the month.

Cautious, Balanced and Adventurous portfolios

We continued to increase exposure to smaller UK companies due to the increase in stability in the UK's political situation. The exposure to the FTSE 250 now stands at 7.5% for all three portfolios. The FTSE 250 is now one of the best performing asset classes and therefore is high up on our momentum scale. In order to fund this, we reduced exposure to the Finsbury Growth & Income fund as well as the 7IM UK Value fund as they are not performing as well in the short term. Global infrastructure moved above trend so we increased exposure and, in the Adventurous portfolio only, we increased exposure to emerging market equities as they broke above trend. Part of our exposure to US equities was hedged. This is because Sterling is rising and we want to reduce the risk of having too much money invested in overseas assets which fall when Sterling goes up. Finally, UK Gilts and overseas corporate bonds both fell below trend so we reduced exposure. Exposure to bonds has been reduced significantly over the last few months.

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 we increased exposure in the FTSE 250 as the asset class is high up on our momentum scale. We reduced exposure to the Finsbury Growth & Income fund correspondingly. Finally part of our exposure to US equities was hedged, this is because Sterling is rising and we want to reduce the risk of having too much money invested in overseas assets which fall when Sterling goes up.

Foundation portfolio

Similar changes were made to this portfolio as we did to the Balanced and Cautious portfolios. Exposure to the FTSE 250, global infrastructure and hedged US equities was increased, whilst exposure to UK Gilts and overseas corporate bonds was decreased. Bonds have been falling in value over the last few months which is why the Foundation portfolio has been lagging the other portfolios. However, over the last year it has still grown by over 9%.

Income Generating portfolio

The portfolio benefitted significantly from the "**Boris Brexit Bounce**" and it was our best performing portfolio this month, rising by 2.6%. Over the last 6 months we have benefitted from shifting the portfolio so that it has:

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

This month we fully sold out of UK commercial property following the announcement by M&G that it would suspend their property fund due to a large amount of money being withdrawn from it. This is to protect investors as it allows them time to sell properties at close to market value in order to raise the cash to pay for the redemptions. We believe that investors are nervous about Brexit and the impact it will have on the UK economy, in particular retail. Therefore they have been reducing exposure. Over the last year the Income Generating portfolio has indeed reduced exposure and has now removed it completely. This may just be a temporary measure but one that we feel is necessary as we do not want our selected property fund to be suspended. We therefore sold out of the Janus Henderson UK Property fund. The fund has grown by 17% over the last three years so has helped the portfolio.

With the proceeds we have bought two lower risk funds that have been growing in a slow but steady way. The iShares Corporate Bond Index fund yields 2.25% and the M&G Global Floating Rate High Yield fund yields 3.5%.

Fourth Industrial Revolution portfolio

Last year was an exceptional year for the portfolio as it rose 24.94%. The main investment themes within the portfolio are technology, biotech, robotics and cyber security. The majority of these companies are based in the US and they account for nearly 60% of the portfolio. Japan is one of the leaders in Robotics and accounts for just over 8%. Unfortunately, the UK accounts for less than 2% of the portfolio, despite being leaders in financial technology. Many of the UK's best technology companies are private and not yet investable but with two of the worlds best Universities, we believe that it won't be long before the UK produces some great companies that we can invest in. Due to the high overseas exposure, we must be wary that this portfolio will suffer if Sterling rises.

Retirement Investment Solutions

Emerging market equities and global infrastructure moved above trend so we increased exposure. UK Gilts and overseas corporate bonds both fell below trend so we reduced exposure. Exposure to bonds has been reduced significantly over the last few months.

We now have all but one equity market above trend, as well as property, infrastructure and gold above trend. However, only 3 out of the 7 bond funds are above trend, meaning that instead of investing in these bond funds, we have moved the money into cash.

The Retirement Investment Solutions have returned between 10-13% over the last year, which we are very pleased about. They are designed to capture uptrends but also reduce risk significantly in the downtrends. 2019 was a year that really assisted the portfolios as we were able to capture most of the uptrends in equity markets..

Summary of Portfolios

We are potentially experiencing a period in which most global equity markets are above trend. Therefore the portfolios have a higher than normal allocation to equities, in particular UK smaller companies as they are one of the best performing asset classes. However, bonds are beginning to fall and have been a drag on the performance of our lower risk portfolios. Exposure has been reduced over the last couple of months as they have been falling below trend.

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 the Conservatives winning a large majority, we look at how this has affected the UK and Europe. .

Sterling - rallies on the election news but fails to break through the ceiling

The pound staged its biggest rally in almost three years after the election, as markets welcomed the greater certainty over Brexit. This took the pound to the top of the medium term range and just when it looked like it was going to break through the ceiling and move much higher, it began to fall. This was due to the fact that Boris signalled that he will seek to pass legislation that could cause a "cliff-edge" Brexit at the end of the year. This has increased the chances of what is termed a "hard Brexit" and caused investors to worry once again.

UK Equities – the FTSE 100 moves higher but still in the range

The FTSE 100 bounced on the news but remains stuck in the same range that it has been in for the last 2 years. A stronger Sterling provides a headwind to the FTSE 100 as over 70% of earnings are generated overseas. When Sterling rises then the value of the revenue falls when converted back into pounds.

UK Equities – the FTSE 250 breaks through the ceiling

Last month we looked at how the FTSE 250 had started to move higher and looked like it was set to test the 2018 ceiling. We wrote "The removal of the political uncertainty in the UK could be the catalyst for it to break through this ceiling and surge higher". This was achieved and the index moved to new all-time highs as investors began to feel more confident about the UK economy:

Europe – approaching the 2015 high

It is also worth looking at how Europe has been performing as clarity over a trade deal with the UK should also benefit its economy. Europe has also been one of the biggest victims of the long-running trade dispute between the US and China. This has meant that the stock market has been unable to break through the previous high. However, December saw some progress on the US/China trade deal as well as more clarity on Brexit. This has helped lift the stock market above 3700 and close to the medium term high. Some more good news should provide the catalyst for the market to break through the ceiling and move much higher:

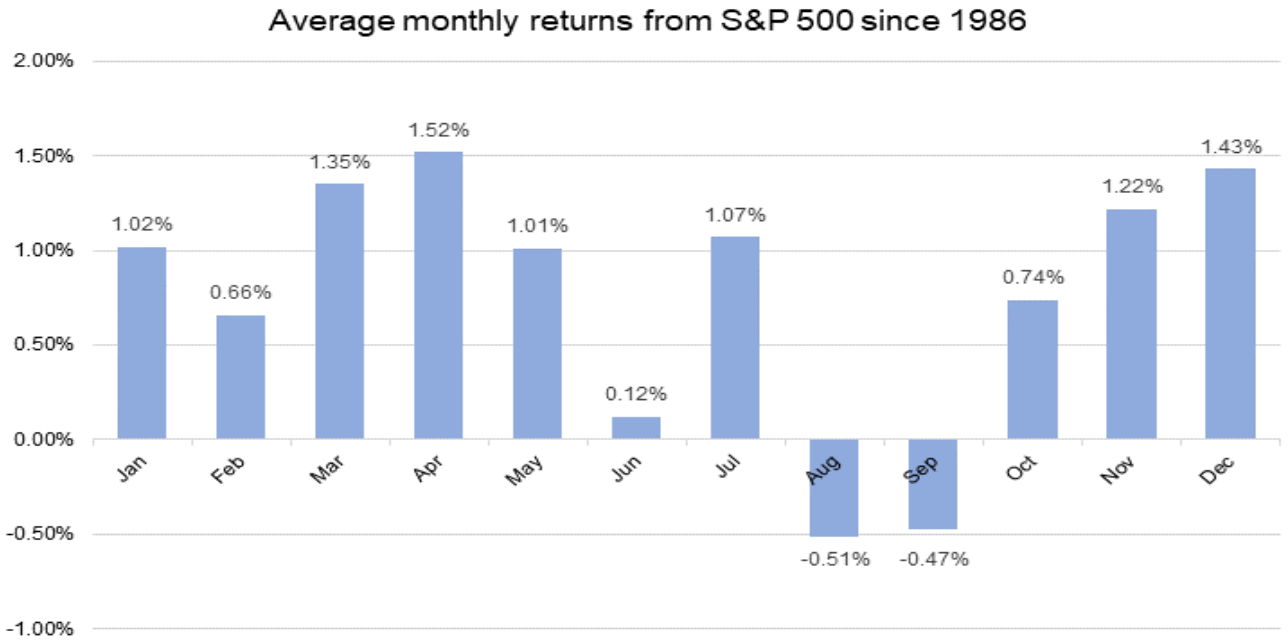
Summary

Confidence has begun to return to the UK, but until the trade deal with Europe is completed, we must expect more uncertainty in the currency markets. However, if progress is made then we should expect the FTSE 250 to move significantly higher again.

The Santa Rally Returns

As the name implies, a 'Santa Rally' is the term for when stock markets post positive results in the run up to Christmas and the New Year. This year the rally returned, with the FTSE 100 growing by 2.67%* and the S&P 500 (main US stock market) by 2.86%* in December. However, the previous year saw the FTSE 100 fall 3.61%* and the S&P 500 by 9.18%*. From 1986 to today, the FTSE made an average gain of 0.71%* in the last month of the year and has only fallen 5 times.

It isn't just the FTSE 100 that has benefited from a Santa Rally, as most global stock markets have similar seasonal statistics. The chart below shows the average monthly return for each calendar month from S&P 500 and you can see the effects of the Santa Rally, with December being the second-best performing month:



Source: Financial Express

Quite why this phenomenon should occur is unclear, and in truth there are probably several factors behind each individual rally. But a few of the major theories on why markets rally in December include:

- Seasonal goodwill among investors, who are more willing to buy around Christmas.
- Markets rising on lower volumes over the holiday period.
- Fund managers rebalancing their portfolios before the end of the year.
- People investing their Christmas bonuses.

Interestingly, there is no agreement about when the Santa Rally period really starts, with different sources offering conflicting answers. Does it last the whole of December? Or just the week before Christmas? Or something in between? One source, however, found that the biggest rises in indices typically occur from the 14th – 16th December. This year we experienced a fall in the first few days but strong returns until mid-December.

By looking at historical monthly returns, we can also see that the strong returns continue until May, with the best historical month for the S&P 500 actually being April. The best return for the FTSE 100 is actually January, growing by 1.97%* on average.

Whatever the reasons behind these statistics, we know that we are currently in the period during which returns have historically been the highest.

**All figures have been produced by Financial Express and are available upon request. The figures exclude dividends.*

Final Comment

The election outcome has been very good for our wealth, albeit that Sterling advancing has dampened down returns from our non-hedged overseas assets, which still account for a significant portion of the portfolios. However, global stock markets have moved higher and by a greater percentage than the increase in Sterling. In addition to the news from the UK, there was another very important message that was tweeted by Donald Trump last month:

"Getting VERY close to a BIG DEAL with China. They want it, and so do we!"

This tweet helped lift global stock markets and we have been writing in our Investment Update that Trump's deal with China will be the catalyst for a rally in stock markets. The 'phase one' deal is likely to be signed shortly and this is likely to lead to more deals this year. We therefore have the catalyst for the next move higher in global markets.

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

Tel: 01708 250624

Email: chrismoore@watsonmooreifa.com

www.watsonmooreifa.com

Authorised & Regulated by the Financial Conduct Authority