Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

# Monthly Investment Update
## February 2020

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## Performance Update

**January saw stock markets give up some of their recent gains with the FTSE 100 falling -3.35%*. However, our portfolios performed relatively well, with the portfolios ranging by between -0.95% and +0.80%.**

The UK has finally left Europe. The UK has low inflation, low interest rates and low unemployment. By historic standards this is a really stable economy and with growth relatively low, it allows the UK Government to borrow in order to boost the economy.

The US stock market was one of the best performers globally in January, as stocks such as Tesla, Amazon, Microsoft, Alphabet and Apple rallied. This helped our portfolios as we are overweight US equities.

The Coronavirus is somewhat of an unknown and caused equity markets to fall in the second half of the month. No one believes the data coming out of China as they state that the number of deaths is in the low hundreds, yet there are reports that morgues are running 24/7. Could this be the catalyst that causes the next global recession?

The UK kept interest rates unchanged despite investors believing that they would cut them. The Bank of England believes that the UK economy could have a 'Brexit Bounce' and therefore does not need further rate cuts. Despite this, UK Bonds performed well due to fears that the Coronavirus will spread globally and therefore investors moved money into safer havens such as bonds.

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 | 0.80 | -1.70 | 8.24 |
| Cautious | -0.02 | -2.39 | 4.48 |
| Balanced | -0.21 | -2.89 | 6.55 |
| Adventurous | 0.18 | -1.44 | 10.10 |
| Dynamic Equity | 0.04 | -0.42 | 16.02 |
| Income Generating | -0.95 | 2.36 | 12.01 |
| Fourth Industrial Revolution | 0.91 | 0.27 | 18.05 |
| Retirement Investment Solution 1 | 0.19 | -1.08 | 8.86 |
| Retirement Investment Solution 2 | 0.14 | -1.01 | 9.79 |
| Retirement Investment Solution 3 | 0.10 | -0.95 | 10.66 |

Please note that these figures do not include the platform or Watson Moore's fees.
*All figures are sourced from Financial Express to 31.01.2020.

## 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 | x | Commodities | x |
| 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 | ✓ |
| Global Infrastructure | ✓ | Overseas Corporate Bonds | x |

UK Gilts, UK Index Linked Bonds and Emerging Market Bonds moved above trend, whilst Emerging market equities and UK larger companies fell below trend over the month.

## Cautious, Balanced and Adventurous portfolios

Exposure to larger UK equities was reduced in the Cautious and Balanced portfolios as they fell below trend. The Balanced portfolio also saw exposure decrease to Emerging Market equites. No equity changes were made to the Adventurous portfolio.

On the Bond side, exposure to UK Gilts, UK Inflation Linked bonds and emerging market bonds was increased in the Cautious portfolio.

We are now at a stage in which stock markets are beginning to become concerned about the Coronavirus and they have started to fall back a little, with some breaking below their trends. Conversely lower risk assets are increasing in value and the portfolios now have a higher allocation to bonds and gold.

## 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. US, European, UK smaller companies, technology and gold miners remain the regions and asset classes with the strongest momentum, so no changes were made.

## Foundation portfolio

Similar changes were made to this portfolio as we did to the Cautious portfolio. The Foundation portfolio remains our most diversified portfolio and benefitted this month from an increase in the value of bonds.

## Income Generating portfolio

The portfolio benefitted from the "**Boris Brexit Bounce**" in December, but January saw a sharp fall in UK equities, with the portfolio falling 0.95%. There is a large allocation to UK equities within the portfolio and, with the FTSE 100 falling 3.35% last month, the portfolio gave up some of December's gains.

The portfolio yields 3.91% and investors in the portfolio have the option to take the income or have it reinvested. If they are taking an income, then the income is paid monthly. This income will vary quite considerably as different funds pay their income in different months. We have found that December and January have few funds paying out their income, but February will see a higher amount being paid.

## Fourth Industrial Revolution portfolio

Technology companies such as Facebook, Alphabet, Microsoft and Amazon surged higher in January and this helped lift the portfolio by 0.91%. We must expect this portfolio to have periods when it moves significantly higher, but also periods when it falls sharply.

## Retirement Investment Solutions

Exposure to larger UK equities and Emerging markets was reduced but on the Bond side, UK Gilts, UK Inflation Linked bonds and emerging market bond exposure was all increased.

The Retirement Investment Solutions have returned between 8-11% 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. However, if we continue to see global equity markets fall, then the amount invested in cash and bonds will increase and help protect the portfolios from further losses.

## Summary of Portfolios

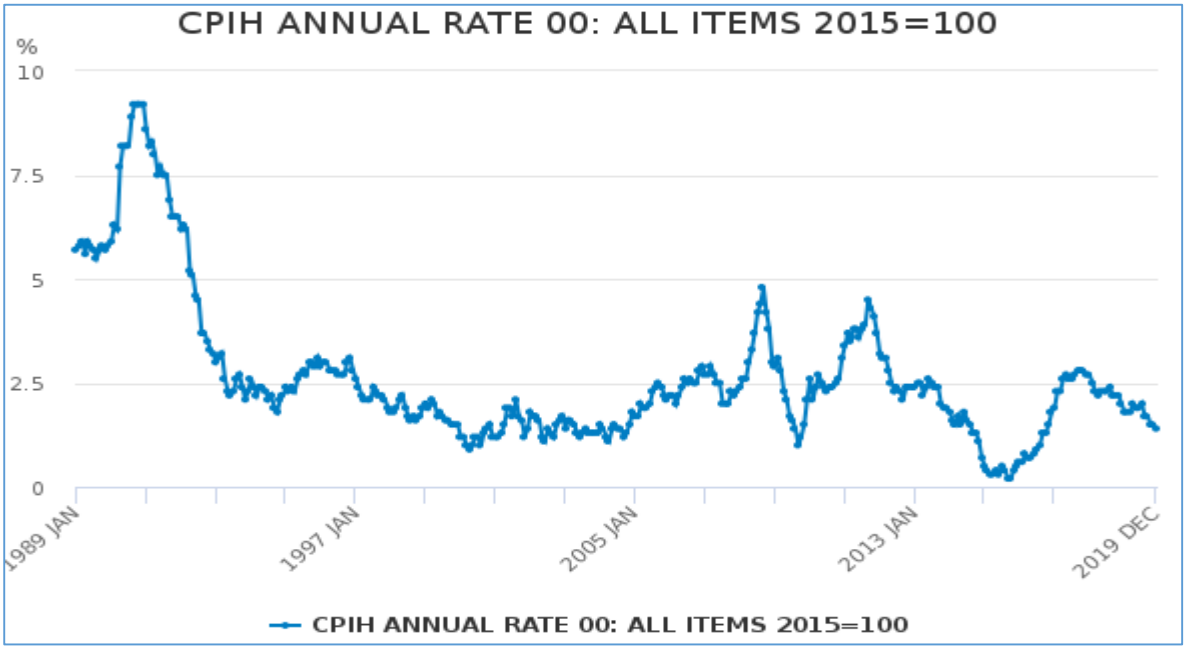
The Coronavirus is the reason why equity markets fell towards the end of the month, and why we have seen some equity markets break below trend and some bond markets go above trend. We simply do not know what the full effect of the virus is since we cannot trust any of the official statistics coming out of China. Reports say that 5 million, out of the population of 11 million, fled the city of Wuhan before it was locked down, and that mortuaries around the area are working 24/7. Yet the official death toll is in the low hundreds. The incubation period of the virus is two weeks and there are estimates that over 100,000 people are already infected. This will affect the Chinese economy and it will also have a knock on affect to the wider global economy. For example, Amazon sells a large part of its goods that are sourced from China, and if its factories are in lock down, then the global supply chain will start to cause problems for many big global companies such as Amazon. We therefore expect much volatility over the next few weeks as we learn more about this virus.

# 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 UK having finally left the European Union, we look at how the UK economy is doing from a long-term perspective.

## UK Inflation – historically low

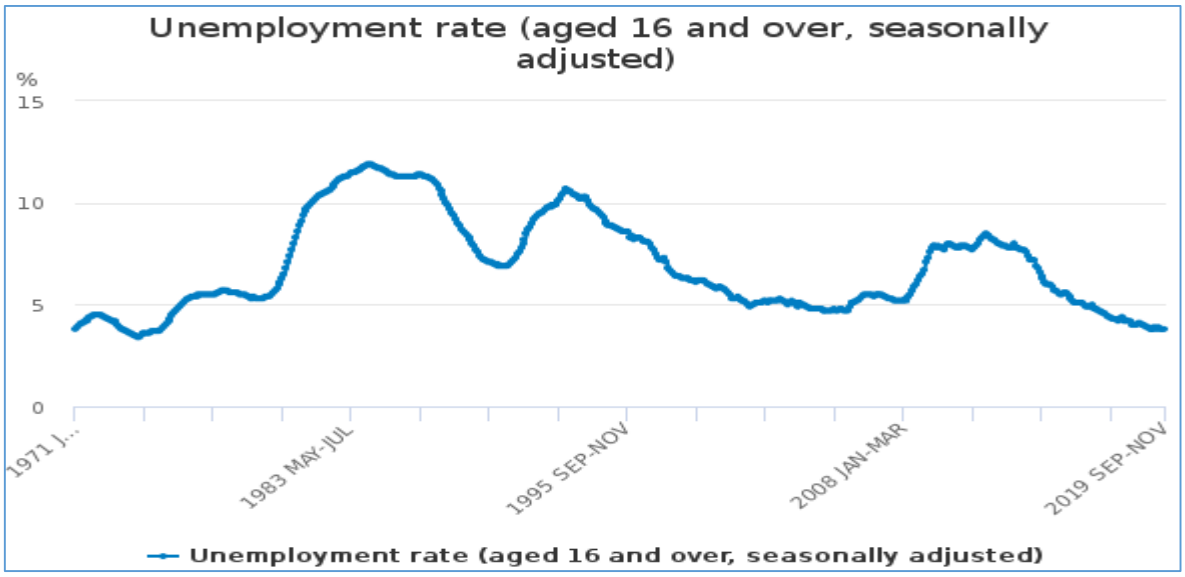
The latest consumer price inflation rate came in at 1.4%*, and you can see how this is low by historic standards:




*Source: Office for National Statistics

## UK Unemployment rate – historically low

According to the Office for National Statistics, the UK's unemployment rate is just 3.8%* which is at historic lows. They also estimate that the employment rate is at a record high of 76.3%* (up 0.6% over the year) and this is largely down to a record number of women in employment, partly as a result of recent changes to the State Pension age:




*Source: Office for National Statistics

## Interest Rates – at record lows

Despite the Bank of England not reducing interest rates last month when they were expected to, we are at historic record lows for rates. The rate the Government can borrow at is also at record lows, with the 10-year yield on UK Government Bonds at just 0.542%. This could mean the Conservative Government will borrow more and embark on huge infrastructure spending due to the borrowing rate being so low.


## The UK Economy – still growing but not too hot

With low levels of unemployment, low inflation and low interest rates, one would expect that one of these measures would change i.e. low unemployment usually causes higher inflation. However, what is keeping all this together is that economic growth (measured by Gross Domestic Product growth) has been very modest. The economy is growing at just 1.1%* year on year and the Bank of England would normally expect to see growth rates above 2% by now.


*Source: Office for National Statistics

## Summary

We have low inflation, low interest rates and low unemployment. By historic standards the economy is very stable and with economic growth relatively low, it allows the UK Government to borrow in order to boost the economy. By comparison to other periods the UK is in a great position to prosper.

# The Boris Majority

With Boris Johnson winning a decisive 80 seat majority (the biggest majority since 1987) and 44% of the vote (the highest since 1979, when Margaret Thatcher became prime minister), we look at what Boris is likely to do with this majority.

## Left, Right, Centre

With such a large majority he has the opportunity to lower taxes dramatically, thus reduce the size of the Government and empower the people with more money to spend. This is the Conservative ideology. However, with the Labour party in disarray, Boris is viewing this as an opportunity to stay in power for two terms (10 years) rather than just one. The best way to do this is to occupy the centre ground, so that when the new Labour leader is chosen, they are likely to be forced to more extreme policies of higher taxes and spending i.e. more like Corbyn. Therefore, we do not expect large tax cuts initially and instead, could perhaps see an increase in taxation in some areas (e.g. the removal of higher rate pension tax relief). Therefore if you are a higher rate taxpayer, consider making a pension contribution before April 5th.

## A Pivot to the North

The new catchphrase of Boris Johnson's government is 'levelling up'. This is a signal to voters who deserted the Labour party for the Conservatives in December's general election, that there will be a decisive shift of state-guided investment in favour of their regions, chiefly in northern England and the Midlands. 'Levelling up' is a political project as much as an economic one. The Prime Minister is planning to invest £100bn over five years on roads, rail and other infrastructure projects, notably in so-called red wall constituencies that once voted Labour, but supported the Tories at the election. This is all aimed at retaining power at Westminster throughout the 2020s.

## Infrastructure spending

You only have to look at Boris's London Mayor legacy and (in a period dominated by London riots, a financial crash and redundant water cannons) he is often remembered for Boris Island, Boris Bikes and the Boris Bridge. Two of them didn't receive a green light, but we do know that he loves an infrastructure project! And with the rate at which the Government can borrow at record lows, Conservative insiders have already said that it would be "rude not to spend at these levels of interest". Therefore, expect a huge infrastructure agenda and the possibility that HS2 will continue. In order to capitalise on this, we have money invested in a UK infrastructure fund.

## The UK to embrace Technology

Boris decided that the potential risk to national security posed by Huawei was outweighed by the estimated £126 billion boost to the economy by allowing it to be part of our 5G network. His compromise is to impose a cap of 35% of non-core equipment to be built by Huawei, and to work with the US to find new trusted suppliers to replace them. Overall this statement shows Boris's commitment to technology and he believes that technology will help solve our problems. The UK has some of the most generous tax breaks to encourage investment in UK start-up companies (many of them technology related) such as EIS and Venture Capital Trusts. We expect these tax reliefs to remain and possibly increase. If you want more information on how to invest in them then please contact us.

## "Weirdos" Takeover

Dominic Cummings, Boris's chief adviser, has asked for "weirdos and misfits with odd skills" to apply for new jobs within the Government. This is part of his plan to shake up central government and to date they have received 35,000 applications! Whilst this is great headline news, it does show that the Government is keen to embrace change and perhaps bold enough to deliver it.

## In Summary

The large majority has enabled Boris to make significant changes to the UK. However, the changes may be different to what one would expect from a conservative government and we may see Government Debt increasing due to huge infrastructure spending as well as taxes remaining neutral or possibly even going up. The one thing we do know is that the next year is going to be interesting in politics within the UK.

## Final Comment

Trump's trade deal and the 'Boris Bounce' have helped our portfolios, but the uncertainty surrounding the Coronavirus has caused stock markets to give up some of their recent gains. This uncertainty will also cause much volatility over the next few weeks as we find out exactly what is happening in China. It may also lead to China agreeing more deals with Trump in order to boost its economy in the short term and nullify the negative economic effects of the virus.

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

**Tel: 01708 250624**

**Email: chrismoore@watsonmooreifa.com**

**www.watsonmooreifa.com**