Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

# Monthly Investment Update
## March 2020

Contents:


## Performance Update

**Stock markets in the last week of February experienced one of their steepest weekly declines since the financial crisis in 2008. The FTSE 100 fell -8.99%*, leading to losses in the portfolios of between -2.57% and -7.61%.**

As at the end of the month, coronavirus had infected 85,000 people in 53 countries, having been largely confined to China previously. This rapid spread caused global stock markets to sell off across the board with the majority falling below their trend lines. The question now that concerns investors, is whether the coronavirus will be a catalyst for serious economic contraction and a global recession.

The reaction of central banks and governments is now extremely important as we saw America's central bank, on the last day of the month, announce that it was considering cutting interest rates. This has caused stock markets to bounce somewhat. The Italian government has said that it would inject Euro 3.6 billion into the economy and Hong Kong has announced "helicopter money". This means that every resident over the age of 18 will be given the equivalent of £1,000. Watch out for more announcements like this.

As stock markets have broken below trend, the amount of cash in the trend following portfolios has increased automatically. This will hopefully protect those portfolios from suffering significant losses if stock markets continue to fall.

The lower risk portfolios have a significant amount invested in bonds due to the fact that most bonds are above trend. This has helped to reduce the losses on these portfolios as bonds generally performed well last month.

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 | -2.57 | -4.22 | 5.64 |
| Cautious | -3.89 | -4.94 | 0.71 |
| Balanced | -5.40 | -6.23 | 0.80 |
| Adventurous | -6.66 | -6.10 | 2.77 |
| Dynamic Equity | -7.61 | -6.16 | 5.01 |
| Income Generating | -6.86 | -2.28 | 2.89 |
| Fourth Industrial Revolution | -5.16 | -0.37 | 7.56 |
| Retirement Investment Solution 1 | -4.91 | -4.83 | 3.32 |
| Retirement Investment Solution 2 | -5.38 | -5.09 | 3.40 |
| Retirement Investment Solution 3 | -5.82 | -5.32 | 3.48 |

Please note that these figures do not include the platform or Watson Moore's fees.
All figures are sourced from Financial Express to 29.02.2020.

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

Most equity markets moved below trend, whilst every bond market is now above trend.

## Cautious, Balanced and Adventurous portfolios

Risk has been reduced within these portfolios over the last two months as we have significantly reduced exposure to equities. Within the Cautious and Balanced portfolios we reduced exposure to US, European, Japanese, Global, UK equities. In addition, exposure to property and infrastructure companies was reduced. The Adventurous portfolio reduced exposure to US, European, Japanese and North American equities.

On the bond side we now have the maximum possible exposure in the Cautious, Balanced and Adventurous portfolios, as overseas corporate bonds broke above trend.

We are now at a stage in which stock markets are no longer in upward trends and susceptible to further extreme volatility – both upwards and downwards. Conversely lower risk assets are increasing in value and the portfolios now have a high allocation to bonds and gold. This should help protect the portfolios if we experience further falls in global stock markets.

## 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. UK smaller companies were replaced with global equities this month. The portfolios benefitting from holding an overweight allocation to US equities and gold miners as they are both continuing to outperform.

## Foundation portfolio

Similar changes were made to this portfolio as we did to the Cautious portfolio and risk has been reduced significantly.

## Income Generating portfolio

There is a large allocation to UK equities within the portfolio and, with the FTSE 100 falling 8.89% last month, the portfolio was affected negatively.

The portfolio now yields 3.88%. By investing in income producing assets the portfolio is better equipped when we are faced with a downturn in the stock market. This is because, as stock markets fall, the income that is generated from the underlying companies increases as a percentage of their value. Eventually this income yield becomes very attractive and buyers' step in thus cushioning the falls.

## Fourth Industrial Revolution portfolio

The portfolio did not fall as much as equity markets. This was largely due to the fact that the portfolio invests in biotech and healthcare companies which have somewhat benefitted from the battle against the coronavirus. For example, the AXA Framlington Biotech fund only fell 0.28% this month. Technology companies might also benefit if a large number of the working population are forced to stay at home, as the amount of time spent online will increase.

## Retirement Investment Solutions

Exposure to equities was significantly reduced but on Bonds we are now fully invested. This means that if stock markets continue to fall then the portfolios should be somewhat protected.

## Summary of Portfolios

Stock markets in the last week of February experienced one of their steepest weekly declines since the financial crisis in 2008. The FTSE 100 fell -8.99%*, wiping out the gains made following the "Boris Bounce" and the main US stock market (S&P 500) fell by more than 10%. To put this into perspective, since the Second World War, there have been four previous 10% falls in the S&P 500 in a single week: the October 1987 crash, the April 2000 bursting of the TMT (technology, media and telecoms) bubble, the September 2001 terrorist attacks and the October 2008 Lehman's bust.

Where markets go from here is anybody's guess. We can read about all the bad predictions and they may come true. There are also a lot of conspiracy theorists looking at why the outbreak of coronavirus started in Wuhan, just 300 yards from the first Chinese high level viral disease research centres that opened only two years ago. Coincidence? However, the optimist would be looking at the following:

- A vaccine could be produced shortly and when Trump hinted about this in India, markets reacted very positively. However, there wasn't a lot of evidence to back up his comments which is why they fell again. We do know that there are companies working hard on a vaccine now.
- It is believed that the virus doesn't like heat and thus the summer months should put a stop to it spreading.
- Governments and central banks will react by cutting interest rates and loosen monetary conditions in order to stimulate the economy.
- Trump wants the economy to be doing well in the run up to the election and China also now has more reasons to do trade deals with the US. Perhaps we will see a temporary removal of all trade tariffs.

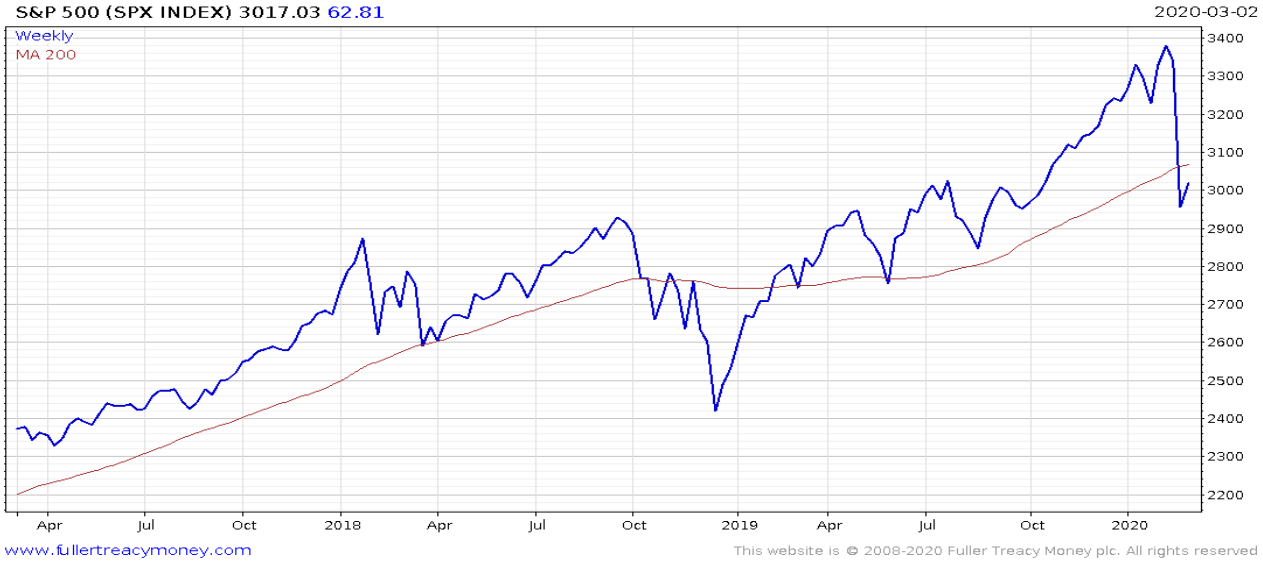
The coronavirus is a huge unknown and until we have more data, then we must expect volatility in markets – this could mean large daily gains or losses.

# 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 stock markets experiencing some of their steepest ever falls in the last week of February, we look at what damage has occurred in some of the world's biggest and most important markets.

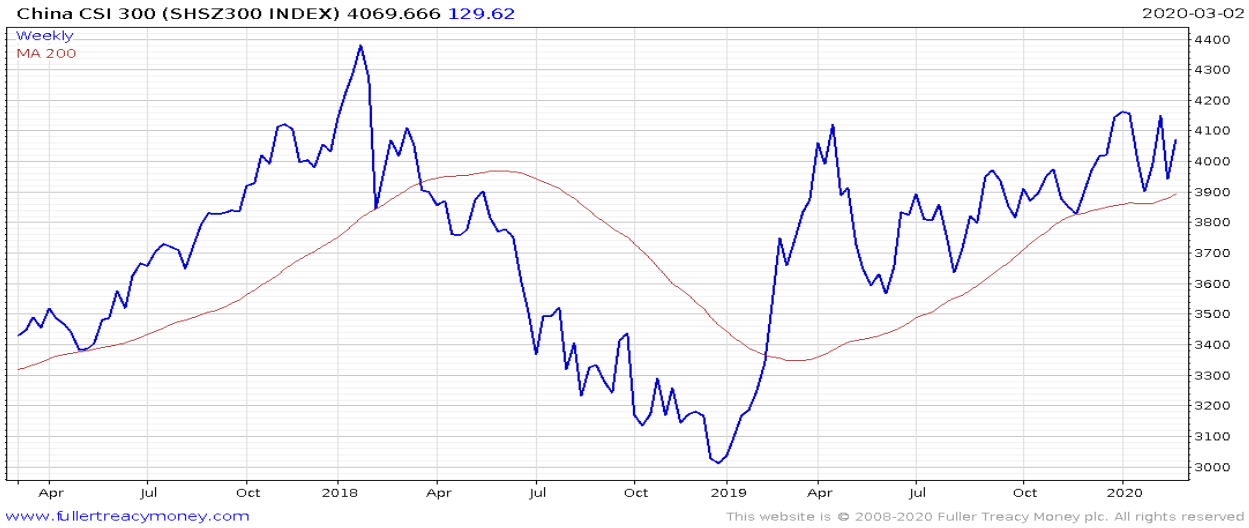
## S&P 500 - broken below trend

The blue line is the main US stock market (S&P 500) and the red line is its trend line. As you can see, it fell below the trend line last month. You can also see how the market bounced back from a similar-sized fall in late 2018 and we wait to see whether this is a more prolonged downturn or if we will experience the same bounce as previously:



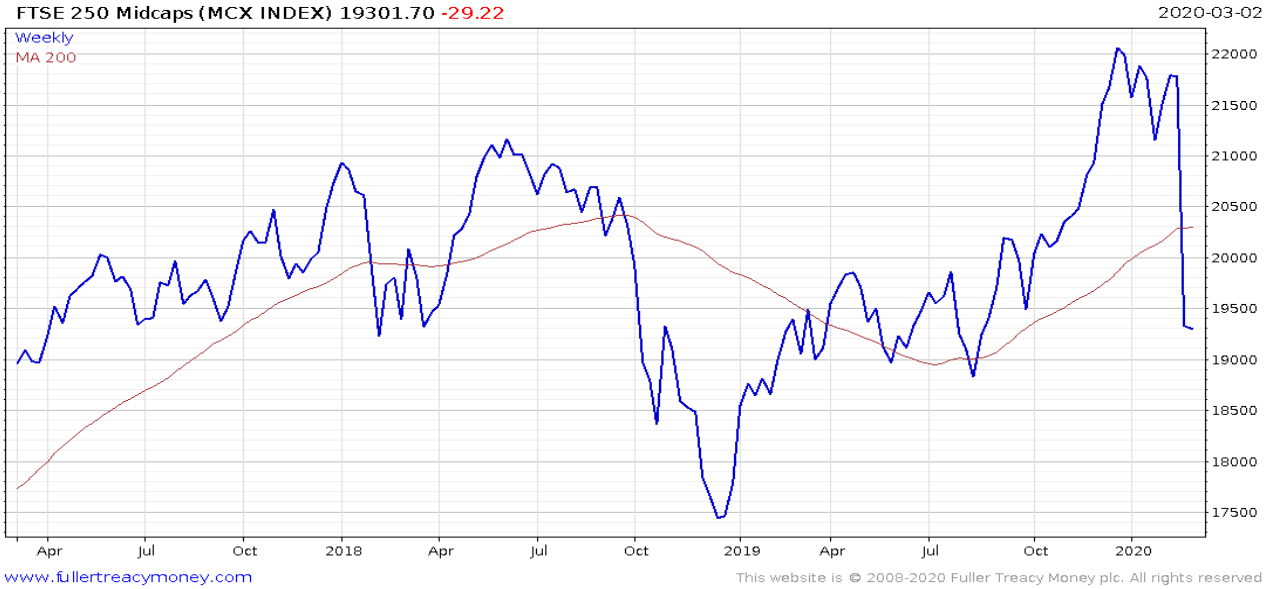

## Chinese stock markets – not hit as hard and above trend

Rather surprisingly, Chinese stock markets have not been hit as hard. This is due to the fact that they weren't at record highs and the fact that the government has begun to loosen monetary conditions thus stimulating the economy:



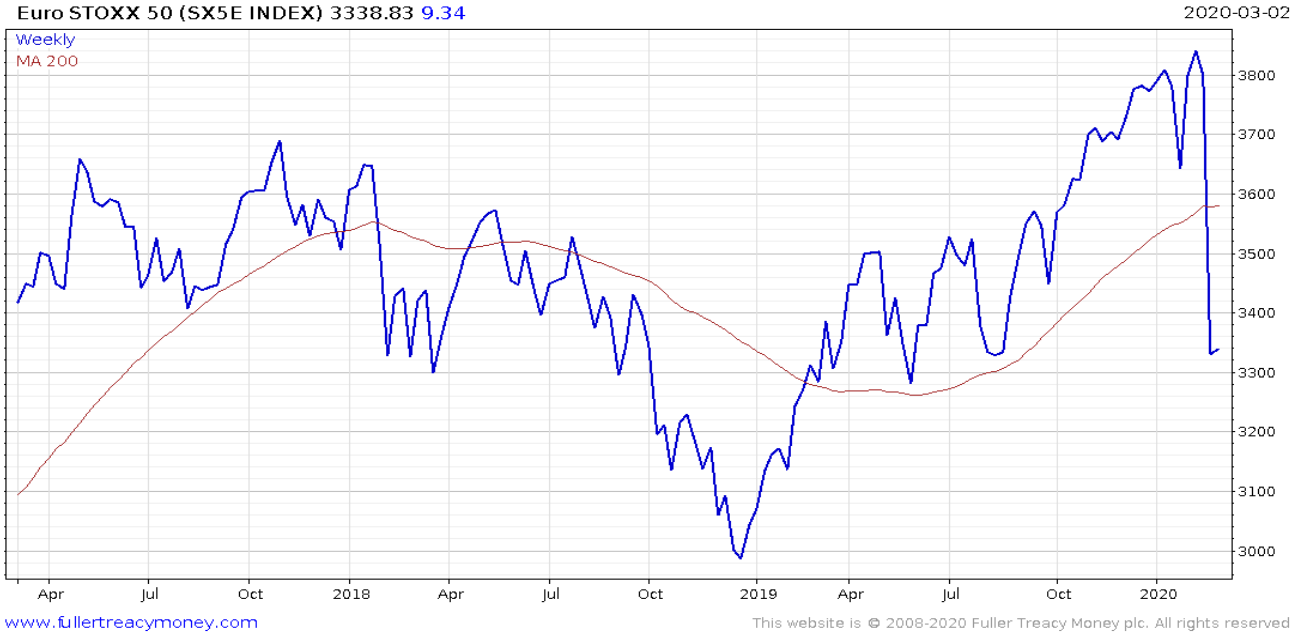
## UK stock markets - given up the Boris Brexit Bounce

The FTSE 250 is a stock market that measures the value of medium-sized UK companies. As you can see, it rallied towards the end of last year but has since given up those gains dramatically and fallen below the trend line:




## Europe – a similar pattern to the FTSE 250

Italy appears to have been the European country that has been hit the hardest by the coronavirus and you can see how the main European stock market has fallen below trend after trending significantly higher in 2019:




## Summary

The falls in the last week of February have been dramatic and broken the consistent uptrend in many global equity markets. As a result most of our portfolios are taking less risk than previously.

# Glittering Gold

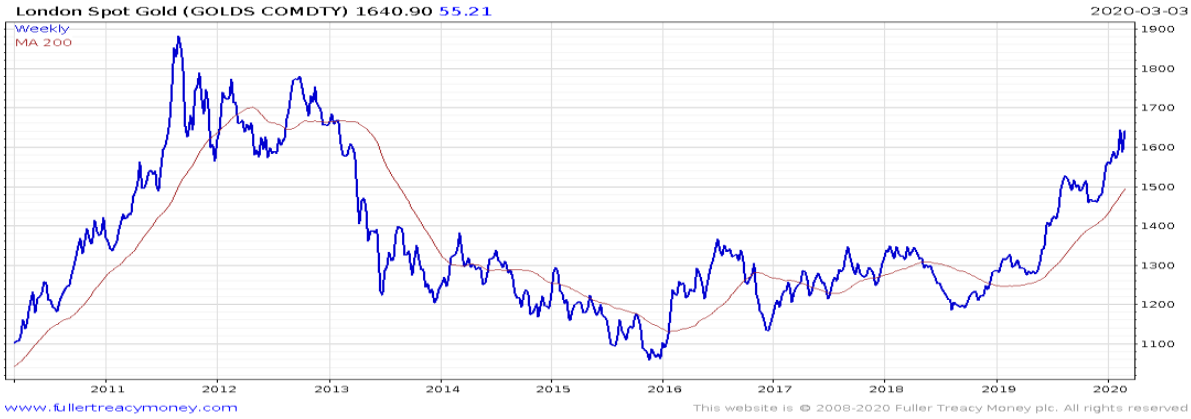
Gold is respected throughout the world for its value and rich history, which has been interwoven into cultures for thousands of years. Coins containing gold appeared around 800 B.C., and the first pure gold coins were struck during the reign of King Croesus of Lydia about 300 years later.

Throughout the centuries, people have continued to hold gold for various reasons. However, gold is one of those marmite investments that some people love, and some people hate. Those that are gold fans believe that you should invest 10% of your portfolio in gold. They point out the fact that gold adds diversification to a portfolio as it is not correlated to the stock markets. In fact, the 1970s were great for gold but terrible for stock markets; the 80s and 90s were great for stocks but terrible for gold. In 2008 stock markets crashed whereas gold did well, growing by over 40% in sterling terms. Currently some investment commentators are promoting gold as a hedge against economic collapse. They are saying that Governments have created so much debt that currencies and economies will crash, and the best medium of monetary value will be gold.

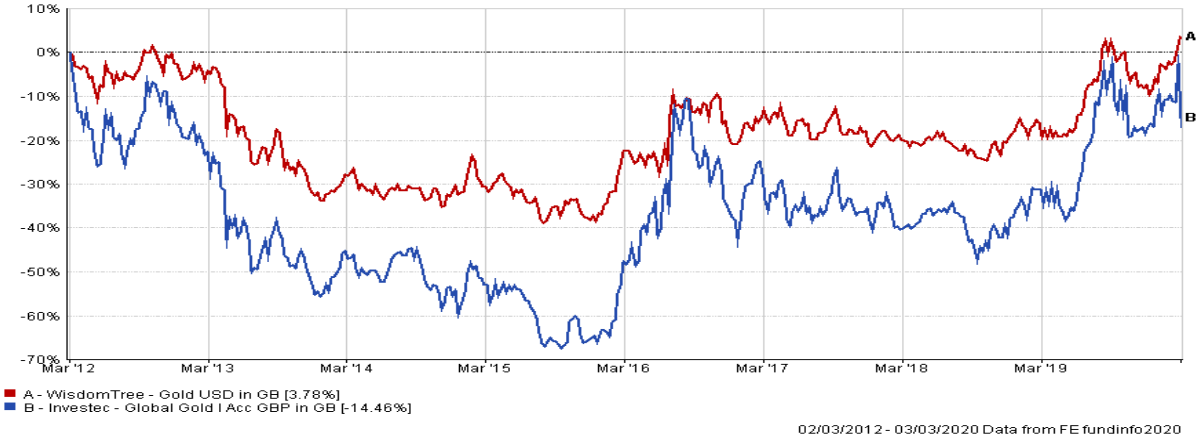
Those that don't believe in holding gold point to the fact that it doesn't create a dividend, the long-term returns have been low when compared to stock markets, and it is only worth what the next person will pay for it and therefore prone to booms and busts.

## How do we invest in gold?

Gold's volatility is evident in the chart below which saw it grow from under $900 in 2009 to nearly $1900 in 2011, before falling back to $1100 in 2015. It is now clearly on an uptrend and racing to the previous high:




We have therefore seen clear upward and downward trends over the last 10 years and, due to this, gold is a good asset class to enact trend following on. As the price of gold is now above trend, we have exposure to it within our portfolios. In addition, the higher risk portfolios are currently invested in a gold mining shares fund (Investec Global Gold) as the price of gold miners tends to be correlated to gold. However, gold miners tend to rise and fall significantly more, which is why we only invest our higher risk portfolios in them. You can see how the performance of the Investec fund (blue line) tracks the price of gold (red line) but in a much more volatile way:




Gold is a great asset class for our investment philosophy as it is prone to booms and busts and therefore trend following works very well on it. We may be about to see gold continue its uptrend and test its all-time high.

## Final Comment

The global spread of coronavirus and the huge uncertainty from the fact that we do not know much about the virus, has caused investors to panic and sell out of global equities. This has caused most stock markets to fall below trend and our portfolios have significantly increased their cash positions. Where markets go from here depends on the virus, as well as how central banks react.

Bonds and gold have benefitted from the falls in global stock markets and we are invested in these asset classes as they were above their trend lines prior to the stock markets falling.

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