Watson Moore's Monthly Investment Update

January 2018

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PERFORMANCE UPDATE

- The Santa Rally was at full throttle this year, with the FTSE 100 racing ahead with a 5.03% gain in December. This was by far the best-performing major stock market with Europe growing by 0.12% and the US by 1.12%. Many global stock markets are hitting new all-time highs as the global economy continues to perform well.

- **The portfolios benefited from the Santa Rally and experienced returns of between 0.74% and 1.59%. Returns over the year have been strong and range between 4.98% and 21.81% with our higher risk portfolios performing the best.**

- We enter 2018 with most stock markets on upward trends and the global economy performing well.

- Generally higher-risk funds are beginning to outperform but we also saw a bounce this month in defensive income producing equities which is why the Income Generating portfolio performed the best.

- The performance of the portfolios over the last month and year is shown below:

Portfolio	Performance % 1 month	Performance % 1 year
Foundation	0.88	4.98
Cautious	0.74	7.02
Balanced	1.02	8.75
Adventurous	1.17	11.76
Dynamic Equity	1.35	12.89
Income Generating	1.59	7.27
Third Industrial Revolution	1.55	21.81
Retirement Investment Solution 1	0.80	6.13
Retirement Investment Solution 2	0.87	6.96
Retirement Investment Solution 3	0.93	7.75

Please note that these figures do not include the platform's, or our, 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	✓
UK Equity	✓	Commodities	✓
Europe ex UK Equity	✓	UK Corporate Bonds	✓
US Equity	✓	UK Corporate Bonds (Short dated)	✓
Japan Equity	✓	UK Index Linked Bonds	✓
Pacific Equity	✓	Global Bonds	✓
Gold	×	UK Gilts	✓
Global Property	×	Emerging Market Bonds	×
		Overseas Corporate Bonds	×

Summary of Portfolios

The FTSE 100 hit a record high in December and many of the major global stock markets are also at or near all-time highs. The global economy continues to support equity markets and we have almost the perfect scenario in which interest rates and unemployment are low, but inflation is also not rising (except in the UK due to Brexit).

Further gains were made in US stock markets as Trump's tax cuts were pushed through and this should support equity markets during 2018. Whilst Trump may not be everyone's 'cup of tea' he certainly has helped ensure stock markets grow and thus our wealth.

2017 saw most equity markets grow but we saw vast differences between the leaders and laggards. Whilst the FTSE 100 grew by 11.95% (5.03% of which was in December) the best-performing stock market was China, which grew by 41.93% and the worst-performing one was Russia which fell 3.07%.

Bonds outperformed cash and remained mostly above trend in 2017, with UK gilts growing by 1.50% and inflation-linked bonds by 1.87%.

Overall, the portfolios performed well in 2017 and, with global stock markets on strong upward trends, 2018 looks like it could be another good year.

Cautious Portfolio

The Cautious portfolio increased exposure to UK and Pacific equities as both asset classes moved into upward trends. Gilts also went above trend and exposure was increase to 2.5% of the portfolio. We decreased the exposure in the two market neutral funds by a corresponding amount. During 2017 positive returns were experienced in 8 out of the 12 months with the largest monthly loss being only 1.72%. This is the lowest we have experienced since we started our portfolios and signifies that investment markets remain calm.

Balanced Portfolio

Similar changes as the Cautious portfolio were made to the equity funds. In addition, the momentum in bond funds has shifted so UK shorter dated corporate bonds have replaced the M&G Floating Rate Note fund. We expect that as interest rates rise we may experience much more volatility in our bond funds and thus momentum might change quite regularly.

Adventurous Portfolio

Similar changes as the Balanced portfolio were made to the bond funds. In addition, momentum in the equity funds meant that the iShares World Index fund was replaced by the iShares Mid Cap UK Equity fund. This is because UK smaller companies are performing very well.

Dynamic Equity Portfolio

The Dynamic Equity portfolio made the same equity change as the Adventurous risk portfolio. 2017 saw the portfolio outperform the FTSE 100 which we are pleased about. We are beginning to see higher-risk markets outperform, which would be good news for the Dynamic Equity portfolio if the trend continues in 2018.

Foundation Portfolio

The portfolio significantly outperformed against its benchmark over the year, achieving a return of 4.98%. The Foundation portfolio is our most diverse portfolio as it will always invests in an asset class even if it is on a downward trend. We use trend following to simply increase and decrease the exposure rather than remove it completely. Therefore, this month's exposure was increased back up to 3% in the Fidelity Index UK and Fidelity Index Pacific ex Japan funds. Commodities and UK gilts were also increase to 5%.

Income Generating portfolio

As stock markets move higher and get more expensive, investors who have cash feel that they must invest it in equities so as not to miss out on future growth. Instead of investing in the higher risk assets that maybe have grown the most, they tend to purchase more defensive income producing stocks. The reason is that they feel that this will give them a bit more protection if stock markets subsequently experience a stock market crash. December may have been the first month that we experienced this and this led to the Income Generating portfolio growing the most at 1.59%.

The "Third Industrial Revolution" portfolio

The biotech part of the portfolio grew by 4.30% over the month, reversing the previous month's losses. The portfolio is up an impressive 21.81% over the last year as stocks linked to the exponential growth of technology continue to perform well. This is nearly double the performance of the FTSE 100.

Retirement Investment Solutions

The Retirement Investment Solutions range are designed specifically for those clients who are taking an income in retirement or who may do so in the short term. The portfolios apply a trend following strategy and should not only outperform a typical buy and hold portfolio over the longer term but with significantly lower volatility. The portfolios will hold significant amounts in cash during difficult investment periods and whilst they share a similar investment philosophy as our Cautious, Balanced and Adventurous portfolios, they should fall less during the bad times.

The three portfolios have produced steady returns between 6.13% and 7.75% over the last year.

ASSET CLASS REVIEW

This section will give you an insight into our current thinking and we have attached some charts that look interesting. Last month we focused on asset class booms and busts and this month we are looking at the best- and worst-performing investments of 2017.

Bitcoin – Up 1,262%

Bitcoin looks like the biggest speculative bubble of our lifetimes. If it isn't, then we are witnessing the birth of a new global currency that cannot be manipulated by any government and, due to the fact that there will only be 21 million Bitcoins ever issued, the scarcity is creating a growing demand. This demand saw the price rise by 1,262% in 2017:

Whilst we have seen an incredible rise, the chart above does look very similar to last month's boom and bust charts and we could see the price tumble from here. If anyone is interested in buying Bitcoin then the feedback we have received is that registering it is quite a laborious process and you are limited to investing just £750 per week. We are also hearing rumours that some of the early speculators are now trying to cash in their profits but have not yet received their money after 3 weeks of trying.

China and India – up 41.93% and 26.74% respectively

Emerging markets are beginning to perform well, with China and India leading the pack. As you can see, returns since January 2008 were flat until they started to accelerate higher in the middle of 2016:

European Smaller Companies – up 25.85%

Whilst Europe has experienced problems over the last few years, 2017 saw the European economy improve and this led to strong gains in their smaller companies. Our portfolios gained exposure to European smaller companies mainly via the Lazard European Smaller Companies fund which is outperforming:

Russia – Down 3.07%

The Russian economy suffered as it is very reliant on the oil price which fell significantly in the first half of the year but then subsequently recovered:

Debenhams – Down 33.79%

Will 2018 be the demise of the old-fashioned retailer with shops like Debenhams going the same way as Woolworths?

In Summary

Whilst we have seen strong returns in most stock markets, there are always winners and losers. Applying a momentum filter, in which you invest more money in the assets that have gone up the most over the last 12 months, is the best way of enhancing returns and hopefully avoiding those assets that are on a long-term decline.

DON'T BUY A CAR NOW

There are currently more than a billion vehicles on the road worldwide, 38 million of them registered in the UK. The overwhelming majority run on petrol or diesel.

But the world is changing.

Manufacturers are investing heavily in developing both hybrid and pure electric models to help meet tightening emissions standards. In the UK, where toxic air is at illegal levels in most urban areas, sales of diesel vehicles have plummeted by 30% in the last year while sales of electric cars have soared by 37%. At current rates, sales of electric cars could outstrip diesel cars as early as May 2019.

The biggest cost of owning a car is the depreciation. It is well known that a car depreciates significantly once it rolls off the forecourt, but each year the average depreciation is a further 15-20%. Therefore, even if you are a shrewd shopper and purchase a car for £20,000, a year after it has been driven off the forecourt the value could fall £4,000 after you have owned it for 1 year, £3,200 the next year and £2,560 in the third year. These figures are based on selling the car on to another driver, but in the future this assumption needs to be challenged.

The Government has announced the ban on selling new petrol and diesel cars from 2040, but it is likely that the market will change significantly before this date and electric cars will be the vehicle of choice from 2019. Although electric cars are already cheaper to run, the average driver is still reluctant to purchase one due to the limited distance they can go between charges, the time it takes to charge, and the lack of availability of 'cool' electric cars. But they are improving rapidly, and it won't be long before they are 'cool'. So, if you buy a diesel or petrol car now, do you think you will be able to sell it in five years' time? They could be virtually worthless.

So, should you buy an electric car now?

No!!! The exponential growth of technology will ensure that it won't be too long before there is a range of 'cool' electric vehicles that can go over 1,000 miles between charges and that fully charge before you can drink a cup of coffee. Therefore, if you buy an electric car with a range of under 200 miles, do you think anyone will buy it from you in three years' time? Therefore, a new electric car could depreciate even more than a new diesel car.

Driverless Cars

Then, finally, driverless cars will take over our roads - probably in the next 10 years - and you may no longer need to own a car as you will simply jump into a driverless car at your convenience.

Our Advice

Before you buy a new car now, think about how you would feel if it was virtually worthless in five years' time. Perhaps you should consider keeping your existing car now or leasing one.

Our Investment Advice

The car industry is going through a rapid technological change and therefore we know that there will be winners and losers. Big names such as Ford, BMW and Honda may not survive if they don't embrace the change and become technological leaders. Existing technology companies such as Google, Uber and Panasonic may become the leading transportation companies in the future. By understanding the possible impact of these changes we can build and adjust our investment philosophy to take advantage of the changes. We believe that a simple 'momentum' overlay will ensure that you have more of your wealth in the winners and less in the losers.

FINAL COMMENT

2017 saw global stock markets move significantly higher and our portfolios benefited. We enter 2018 in a very positive mood, with most global stock markets in a strong upward trend and the global economy in a very favourable position. Our objective is to continue to try and invest more money in those asset classes going up the most and avoid those assets classes that suffer significant losses.

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

Tel: 01708 250624

Email: chrismoore@watsonmooreifa.com

www.watsonmooreifa.com

The past is not necessarily a guide to future performance. The value of any investments can go down as well as up and you may not get back the full amount invested. Taxation is subject to change and you may have to pay tax on any gains. The Watson Moore portfolios are unlikely to exactly mirror our clients' portfolios due to the timing of the initial investment and the speed of response to our fund switch recommendations as well as the effect of charges. The figures above therefore assume a client invested on the launch day and have responded immediately to our recommendations. As from the middle of 2016, the portfolios have been run on a discretionary basis by our sister company WM Capital Management. All figures and charts are provided by Financial Express.