Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update
January 2021

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Performance Update

The 'Santa Rally' was evident again with global stock markets continuing to build on their November gains. The FTSE 100 and S&P 500 rose 3.28% and 1.38% respectively. With equities rising, our portfolios also rose between 1.33% and 6.16%.

We finally reached a Brexit deal and this helped remove much of the uncertainty that the UK had faced. Despite the deal, UK stock markets did not rally as much as expected, although the gain from the FTSE 100 this year, was greater than the average 'Santa Rally' over the last 20 years. The risk for UK investors after the deal was that Sterling would jump higher and this would have provided a strong headwind for returns from our overseas investments. While Sterling did rise slightly against the Euro, the US Dollar was very weak, which enabled Sterling to increase from $1.27 in September, to nearly $1.37 at the end of December.

While the UK deals with a new more transmissible variant of the virus, global stock markets do not appear to be overly worried. This is because they are forward-looking and can see the progress being made with vaccinations (Israel has already vaccinated over 10% of its population) and therefore the reopening of the global economy does not seem to be far off.

The US passed its second biggest economic rescue package. A further package is likely to be unveiled once Biden becomes President. This additional stimulus should ensure a strong economic growth rate this year and next and helped stock markets move higher.

Every major stock market remains on an upward trend and our portfolios are benefitting. We must also remember that those companies that have survived this year, are likely to have implemented cost savings and may also face less competition due to some companies not surviving. Therefore, some companies may see significant increases in profitability.

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	1.33	4.06	3.72
Cautious	1.58	5.02	2.09
Balanced	1.90	6.94	2.53
Adventurous	1.93	6.83	2.00
Dynamic Equity	2.13	9.68	9.09
Income Generating	1.90	8.84	-6.03
Fourth Industrial Revolution	6.16	19.04	41.03
Retirement Investment Solution 1	1.70	5.97	3.68
Retirement Investment Solution 2	1.76	6.53	4.38
Retirement Investment Solution 3	1.83	7.05	5.03

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 31.12.2020.

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

Infrastructure and overseas corporate bonds moved below trend, whilst UK Gilts and index linked bonds moved above.

Cautious, Balanced and Adventurous portfolios

Every equity market remains above trend and the portfolios benefitted from the "Santa Rally" as we had maximum exposure to equities. As stock markets have recovered since their lows in March 2020, we have seen the three portfolios increase their exposure to equities after being heavily in cash in February, March and April. We are pleased that they all produced positive returns in 2020 whilst protecting wealth if stock markets had fallen further after their initial crash. Exposure to bonds was increased this month in the Cautious and Balanced portfolios. We expect that bonds may fall in the medium term as inflation rises and the pressure on central banks to have to raise interest rates in the longer-term increases. Therefore exposure may decrease again over time.

Dynamic Equity portfolio

The momentum philosophy that forms the core of this portfolio attempts to invest more money in those stock markets that are experiencing the strongest growth (or the lowest losses). This month healthcare was replaced by emerging markets as we now have some strong performance in the Chinese, Indian and Russian stock markets. Gold miners recovered significantly and still remain high up on the momentum scale. After Novembers significant fall, they were at risk of being removed.

Foundation portfolio

Every equity market remains above trend. However, global infrastructure and overseas corporate bonds moved below trend and exposure was reduced. UK Gilts and inflation linked bonds reversed last months negative trend and exposure was increased. This portfolio will always be extremely well diversified. The portfolio gained 3.72% in 2020 which we are pleased about. The diversification certainly helped in the difficult times as the exposure to bonds helped offset the losses in equities. During the latter part of 2020, the exposure to equities ensured that the portfolio recovered and posted a positive overall annual gain.

Income Generating portfolio

Smaller UK companies grew significantly in December as the Brexit deal removed much uncertainty. The best performing fund was the Unicorn UK Income fund which rose 5.52%. However, the Brexit deal also caused Sterling to rise and this proved to be a headwind for our overseas equity holdings, although the majority of them did grow over the month. Since the lows hit in March, the portfolio has grown by nearly 25% and clawed back a lot of the losses experienced in February and March. As the global economy recovers into 2021 and the vaccinations open up society again, we expect this portfolio to continue its recovery.

Fourth Industrial Revolution portfolio

The Herald Investment Trust (invests in small UK technology companies) was the best performing fund within this portfolio, growing an incredible 18.03%. The Brexit deal has given investors confidence again to buy into smaller UK technology companies and maybe these will be the main winners from the deal. Whilst the UK does not have any big global technology companies, we do have leaders in various fields. In November we initiated a position in the iShares Global Clean Energy fund and were rewarded as this grew by 16.67%. Cyber security also grew by double digit figures. The portfolio grew in 2020 by over 40% and we have not seen any portfolio in the UK grow by more than this.

Retirement Investment Solutions

Exposure to equities was at the maximum amount last month and this has benefitted the Retirement Investment Solutions as all 3 experienced good gains. Exposure to global infrastructure was reduced though as it has been performing badly. The Retirement Investment Solutions all have exposure to the Dynamic Equity portfolio, and this has helped boost returns. Again we are delighted that the three portfolios have all posted positive returns during 2020, whilst increasing cash during the difficult period in February, March and April.

Summary of Portfolios

November saw good news in terms of the vaccine and probably the best US election result possible, while the conclusion of Brexit at the end of the year provided some stability to the UK economy. This 'good news' has enabled stock markets to move significantly higher, with returns in December positive, but not quite as strongly positive as November. December's good news was somewhat tempered by the resurgence of a new, more transmissible strain of the virus. We must remember, though, that stock markets focus on the profits companies will make over the longer term and so if the economy remains subdued for a few extra months, it shouldn't affect longer term profits.

Asset Class Review

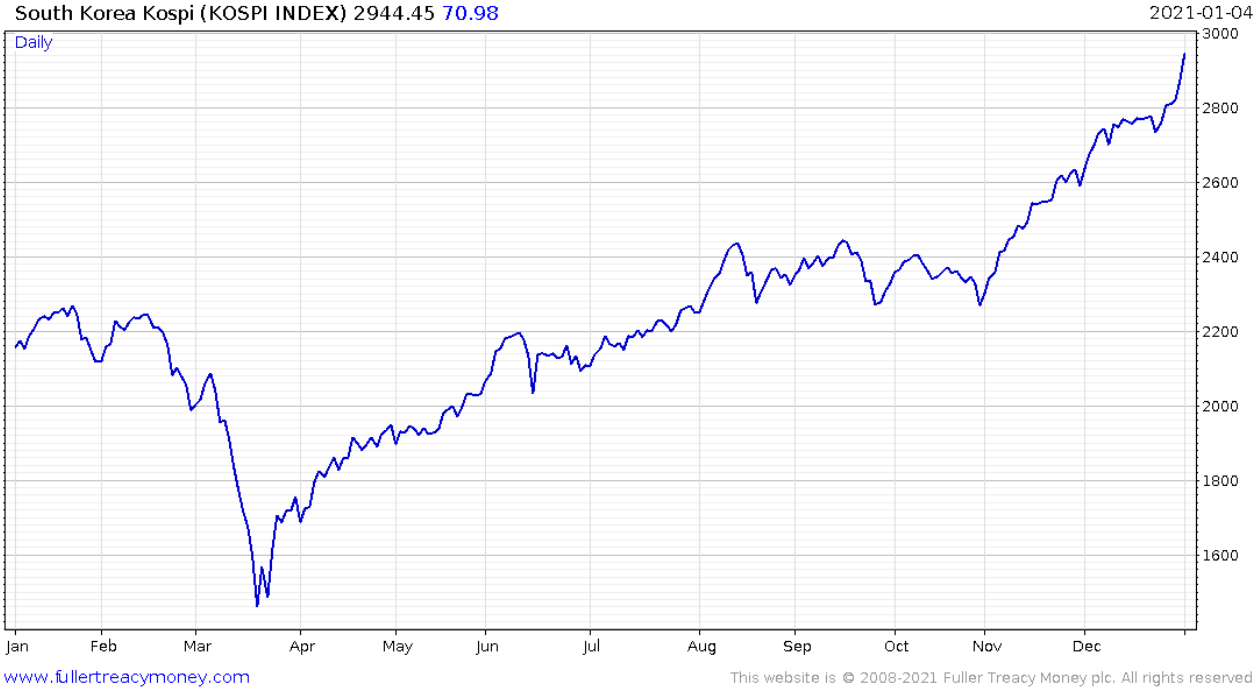
This section will give you an insight into our current thinking and we have included some charts that we believe look interesting.

UK Smaller Companies– the Brexit deal effect?

UK Smaller Companies started to move higher after Trump lost the election in November. They have also begun to trend higher again as we made progress and finally signed, the Brexit deal. Commentators were expecting a more significant jump in the markets, but the revelation of a new virus strain may have delayed this jump higher. Smaller UK companies should benefit significantly from this more stable environment and they are certainly cheap when compared to the rest of the world:

Korea – a star performer in 2020

The Korean stock market (Kospi Index) rose 41% last year and was the star performer, largely down to the fact that Korean companies have benefitted from the increase in demand for computer chips, electric car batteries and biopharmaceutical goods. In comparison, the FTSE 100 fell nearly 15%:



Inflation ahead?

The chart below shows the price of a basket of agricultural goods such as soybeans, corn, wheat, sugar and coffee. As you can see, it has been trending lower for years and thereby helping keep a lid on inflation. However, recently this trend has changed and we have seen a sharp increase. If this increase continues, then we must expect the price of our food to increase and therefore, there will be inflationary pressures. Other commodities such as copper are also increasing in price:

Emerging Markets - continuing the upward trend

Emerging markets have continued their strong upward trend. China accounts for over 40% of the emerging market index and 6 of the top 10 companies. While it may have been the source of Covid-19, it was also the fastest country to overcome it, allowing the economy to rebound much more quickly than some others:

In Summary

The 'Santa Rally' helped stock markets to push higher and we are now seeing some strong returns from emerging markets. With all the additional money that is being injected into the economy, it is inevitable that inflation will increase at some stage. We are beginning to see commodity prices move higher. Some inflation is definitely needed as this will reduce the value of Government debt over time.

The Future of Shopping

Virtual reality, augmented reality and 3D printing are converging with artificial intelligence, drones and 5G and are set to transform shopping this decade. Let's look at what shopping may look like in 2029…

Shopping in 2029

Your friend has just invited you to an upmarket restaurant tonight and you have nothing to wear. 10 years ago you would have had to drive to the shops to buy some clothes but, as you recently had your body scanned, you now put on your virtual reality headset and talk to your artificially intelligent personal shopper. You tell your personal shopper what clothes you would like and are then transported to a virtual clothing store which has access to every designer in the world. You then tell your personal shopper where you are going, who you are going with and your budget. As the shopper knows your tastes and everything you have purchased over the last 3 years, it starts to dress models that look exactly like you, with what it thinks you will like. After trying on 100 different styles (in ten minutes), you select the look that you want for the night. That's it! The personal shopper pays the bill and your new clothes are sent to a 3D printing warehouse which is 50 miles from your home. You have paid extra for a three hour delivery so that the you get priority printing. Your drone books its air route and drops the package off in the secure parcel box on your driveway, in time for your night out.

As your body has been scanned, you don't have to worry about whether the clothes will fit as they are exactly tailored to you. Your shoes are designed to your feet and therefore do not need to be worn in and will not rub if you have slightly differently shaped feet. And the bonus is that this outfit costs half as much as what you were paying 10 years ago, as the costs of inventory, shop rents and middlemen have been taken out. If this all seems far fetched then you may be interested to know that all of the aforementioned technology has already been invented and is in use.

Which companies will benefit from this change?

The current shopping winner is Amazon, which saw its share price grow by 71% last year and nearly 600% over the last 5 years. Its drone company will begin to deliver packages shortly and the Amazon Echo Dot (Alexa) is beginning to gather data on you in order to build an artificially intelligent personal shopper. However, Amazon is also a middle man and makes the majority of its money by taking a cut of the revenue when you buy something online from a retailer. Therefore it may not be the long-term winner and the real winners could be existing brands like Nike, individual clothes designers, new drone companies, 3D printing manufacturers, virtual reality companies and the cyber security that keeps all this safe.

How can we make money from this?

It is difficult to predict which individual companies will be winners as some of them have probably have not yet been set up. However, picking the winners can be made a simpler process the application of a momentum screen to our investment philosophy. This screen identifies those companies that are increasing the most – the winners – and simply invests more money in them. Therefore, if Amazon continues its current trajectory, you will be invested in it. The chart below shows the performance of global companies, as represented by the MSCI World index (red line), increasing by 290% over the last 20 years. However, if we were to overlay the momentum screen and had invested in those companies that were going up the most during this time, then the return would be 556%!

Summary

Shopping is just one industry that will change dramatically this decade. The technology to revolutionise this industry has already been invented and the best way to ensure that more of your money is invested in the 'winners' is to apply a momentum screen.

Final Comment

2020 year was extremely volatile for stock markets and we all had to overcome the challenges that Covid-19 brought with it. However, the doom and gloom appears to be lifting, especially within stock markets, as they have begun to trend higher once again. While the UK deals with a new variant of the virus, stock markets are not overly worried due to the following:

- The roll-out of vaccinations will help to reopen the global economy and once the vulnerable are vaccinated, more confidence should return. Although the virus infection rates are increasing, it is expected to be a short-term problem that will be resolved through vaccination and increased herd immunity.
- The US has passed a new fiscal stimulus package (money printing) and this could be increased and extended once Joe Biden becomes President.
- The savings rate has been extremely high during lockdown for those who have remained employed, so this could be a catalyst for a surge in spending in the economy.
- The Brexit deal has removed much uncertainty.
- Those companies that have survived this year are likely to have implemented cost savings and may find less competition due to some companies not surviving. Therefore, the profitability of some companies could increase significantly.
- Interest rates are likely to remain low for a long time to encourage a small increase in inflation. This would allow companies to borrow and invest for growth and if inflation does not go out of control, would allow them to raise prices and thus profits.

All of the above have been contributing factors enabling every main global stock market to move above trend - this momentum looks set to continue.

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