Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update
February 2021

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Performance Update

After strong gains in November and December, global stock markets fell in January with the FTSE 100 and S&P 500 falling 0.79% and 1.46% respectively. This led to small losses in our portfolios between 0.25% and 0.97%. The one outlier was the Fourth Industrial Revolution portfolio which gained 1.22%.

Despite small losses in January, every major stock market has remained on an upward trend and our portfolios have benefitted over the last 6 months. It is difficult to give an exact reason why stock markets fell in January, but sometimes they need to pause and give up some of their previous gains before moving higher again – it's that simple!

The current lockdown appears to be working and the virus rates are falling in the UK. We must remember that short-term news (riots at the Whitehouse, new strains of the virus and supply problems in respect of the Pfizer vaccine in Europe), does not really affect global stock markets as they are forward-looking and can see the progress being made with vaccinations and therefore the reopening of the global economy.

The liquidity that has ben pumped into the global economy is now starting to form "bubbles" in some less liquid asset classes, such as Bitcoin. The same liquidity has helped to move stock markets significantly higher over the last 6 months and the additional stimulus that is being promised by the Biden administration should help stock markets continue their upward trend.

Identifying which asset classes are in "bubbles" will be extremely important going forward and most of this Investment Update has been devoted to this.

Bonds fell in January and have been moving above and below trend over the last few months. Longer term we do not feel there is much value in bonds as yields are so low.

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	-0.97	3.47	1.89
Cautious	-0.69	4.83	1.41
Balanced	-0.46	6.49	2.27
Adventurous	-0.25	6.18	1.56
Dynamic Equity	-0.58	8.11	8.41
Income Generating	-0.48	8.88	-5.50
Fourth Industrial Revolution	1.22	20.54	41.46
Retirement Investment Solution 1	-0.43	5.56	3.05
Retirement Investment Solution 2	-0.44	5.96	3.78
Retirement Investment Solution 3	-0.46	6.33	4.45

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 31.01.2021.

Trend Following Signals

The table below shows whether the asset class is 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	x
Pacific Equity	✓	Global Bonds	✓
Gold	x	UK Gilts	x
Global Property	✓	Emerging Market Bonds	x
Global Infrastructure	x	Overseas Corporate Bonds	x

While all the equity markets remain above trend, we are experiencing some weakness in bond markets, with emerging market bonds, UK Gilts and UK Inflation Linked bonds all falling below trend.

Cautious, Balanced and Adventurous portfolios

Every equity market remains above trend, so no changes were made to the equity positions, except for the Adventurous portfolio, which moved out of a global equity position and into European smaller companies. This mirrored the change in the Dynamic Equity portfolio and the "momentum" investment philosophy we use. The major changes we have made to the portfolios over the last few months have been to the bond allocation. 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. This month, we saw UK bonds, as well as emerging market bonds, fall below trend and so we removed exposure to them. The Cautious portfolio now has four bond positions in cash instead of being invested – this aims to protect the portfolio if we experience further falls from bonds. In the Adventurous and Balanced portfolios bond exposure was moved away from UK Government bonds to corporate bonds.

Dynamic Equity portfolio

The momentum philosophy that is core to this portfolio, aims to invest more money in those stock markets that are experiencing the strongest growth (or the lowest losses). This month we initiated a position in European smaller companies to replace a general global stock market position. We are beginning to see a rotation out of those previous leaders (healthcare, US Equities) into newer ones (emerging markets and smaller companies).

Foundation portfolio

In a similar vein to the Cautious portfolio, exposure to bonds decreased with three more bond funds falling below trend. This portfolio will always be our most diversified portfolio due to its continual exposure to bonds, gold, property, infrastructure and equities.

Income Generating portfolio

The fall in bonds and equities meant that the portfolio suffered some losses, but only by 0.48%. This has been our second-best performing portfolio over the last 6 months, growing by 8.88%. As the global economy begins to recover in 2021 and the vaccination programs take effect enabling society to re-open again, we expect this portfolio to continue its recovery.

Fourth Industrial Revolution portfolio

This portfolio bucked the trend growing by 1.22% and the annual return remained at over 40%. In November, we initiated a position in the iShares Global Clean Energy fund and were again rewarded as this grew by 6.04% over the month. Cyber security was the next best performer, rising 2.28%. Clean energy has been one of the main beneficiaries of Biden being elected and has been the best performing sector in our portfolio over the last 3 months. We believe that this trend will continue and therefore the amount invested in clean energy increased to 5%. In addition, we initiated a position in the L&G Battery Value-Chain ETF. The problem with producing our future energy from wind and solar, is that we need to store it when the sun doesn't shine, and the wind doesn't blow. Batteries are the answer, and we believe that this sector will continue to produce strong gains. In addition, electric cars will eventually be the only cars on the road and breakthroughs in battery range and the speed of charging will ensure that some battery manufacturers will perform exceptionally well.

Retirement Investment Solutions

We have continued to maintain our maximum exposure in equities, but as with the Cautious and Foundation portfolios we have reduced the exposure to bonds. The Retirement Investment Solutions are all exposed to the Dynamic Equity portfolio and this has helped boost returns. As a result, there is now more exposure to European smaller companies this month.

Summary of Portfolios

Currently, nothing is dramatically unsettling markets despite the dangerous mutation of coronavirus, the Democrats control of the Senate and rioters storming congress. We now appear to be at the start of a "bubble" phase in equity markets. This can be borne out by the exponential rise in Tesla and Bitcoin as retail investors throw money into assets just because they are going up. If we are correct and equities are at this stage, then returns from the portfolios could be extremely strong over the next few months and years.

The biggest indicator that suggests the start of a strong period of returns was that the markets were positive when Trump was going to win the election (lower taxes and less red tape). They remained positive at the suggestion there might be a split Government (because Biden wouldn't be able to spend too much) and they are still positive now that Biden controls both houses (more money will get printed). The narrative is very clear – it doesn't matter what the story is the markets will see the positive in it.

This is, therefore, a good time to be riding the wave of optimism, while remaining cautious about when the bubble will pop. So, what will pop the bubble? Inflationary costs are rising. If you look at the price of Soybeans and other agricultural commodities, you can see the sharp reversal of the downward trend. We have the catalyst for a significant recovery in global economies now the vaccine is being rolled out. Eventually this will lead to inflation and the deflationary effects that technology has had over the last 10 years will not be able to stop the inflationary wave. Central banks will do everything in their power to keep interest rates low, even by yield control policies. The yield on 10-year treasuries is already rising, but still remains low. This is not the time to be overly invested in bonds, unless you believe that we will get a further set back in the fight against Covid-19. However, it is also a time in which significant returns can be made by investing in those asset classes that are moving higher – currently mainly equities.

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. This month we look at three investments that we do not specifically invest in, but that are in "bubble" territory. We also look at the previous technology bubble and where we are now by comparison.

Bitcoin – the first bubble to develop

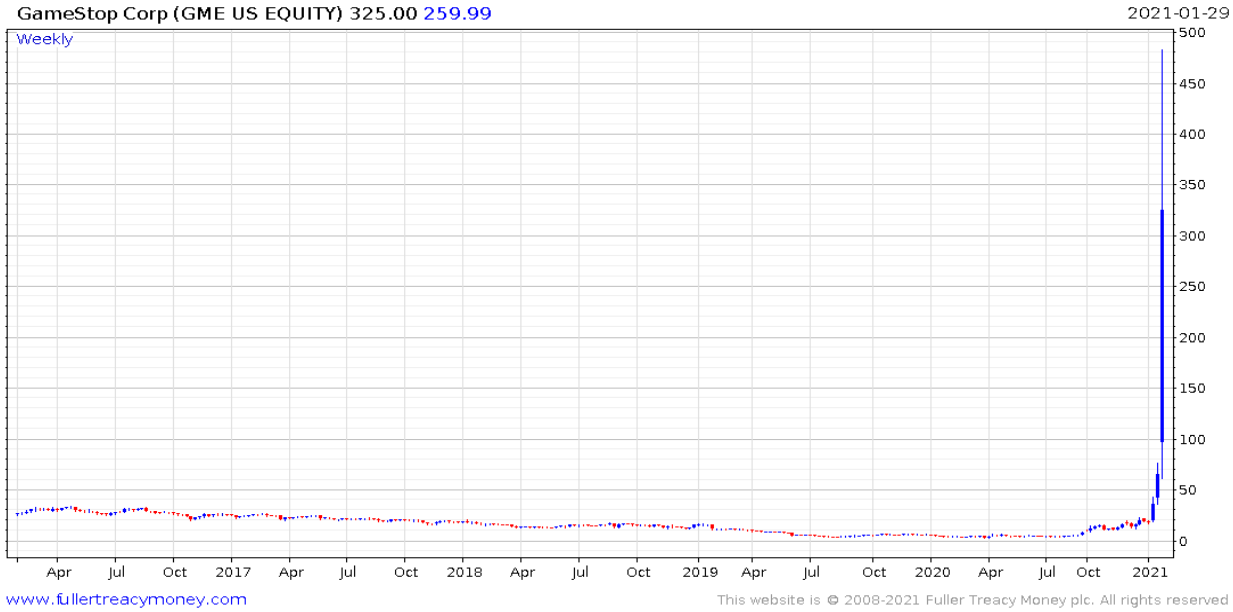
Bitcoin first hit the news in 2017 when it formed a bubble and popped. Many small retail investors were sucked in and either made, or lost, a lot of money. This recent bubble has moved significantly higher, but has it popped? Bitcoin could be the new global reserve currency, or it could just be a short-term fad that ends up consigned to the history books.

Tesla - is this a bubble or the insurmountable leader in the future of transportation (or both)?

The world's most valuable car company has made its founder, Elon Musk, the world's richest person. Will Tesla become the global leader in electric self-driving taxis or is it a company that has been built solely on other companies paying it for carbon credits i.e., other car companies that have built petrol and diesel cars have had to give Tesla money to offset the carbon emission. We believe that we are in bubble territory, but also that it could still be a leader in the future of transportation.

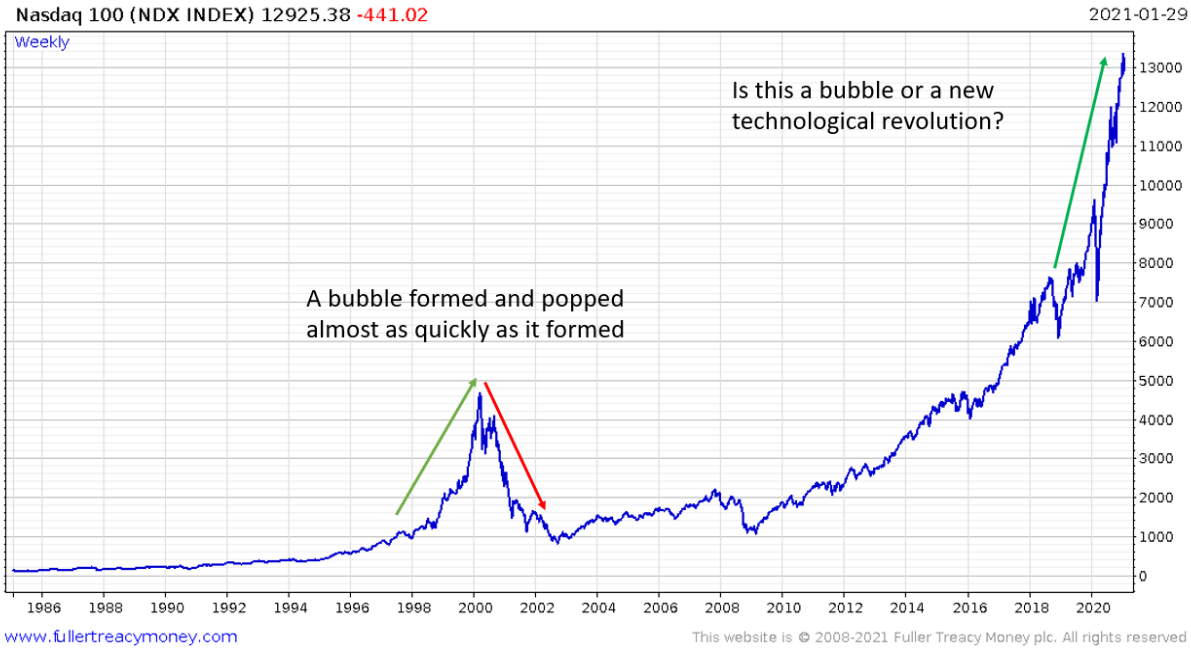
Gamestop - 1,625% return in January!

This company sells computer games at retail stores and has been the most traded stock over the last few weeks, causing a battle between hedge funds and small investors. What is happening here is so important that we dedicate the next section (the 'Gamestonk' bubble) to explain it.



The dot-com bubble

Global stock markets crashed between 2000-03 as the dot-com bubble burst. The Nasdaq 100 is a technology laden US stock market, and we can see how the bubble popped and how it took until 2017 to return to its previous high. Since then, we have seen it move much higher as the pandemic has exponentially increased the importance of technology in our lives.



In Summary

With all the additional money being injected into the economy, it is inevitable that bubbles will form as this extra money has to go somewhere. Currently, the bubbles are forming in less liquid assets that should not affect our wealth if they pop. We believe that all this liquidity will continue to move stock markets higher and there are no signs as yet that governments are about to withdraw liquidity from the economy.

The “Gamestonk” Bubble

Shares of video game retailer GameStop soared 1,625% in January. The company sells video games at physical locations around the world and has been struggling to survive as the pandemic has forced it to close many stores during lockdown, while other retailers are going bankrupt. Yet this company has been the focus of worldwide attention from investors and has started a new phenomenon called “Gamestonk”.

What has happened?

GameStop and a number of other companies, (including Nokia and cinema chain AMC), have been subjected to hedge fund “short sellers” who bet that the share prices of these companies would fall. Up until January, the hedge funds had been successful. However, the shares of these companies rallied as a result of a co-ordinated buy from private investors who had collaborated through a chatroom on the Reddit social media site. These investors intended to drive up the share price of these small, less liquid companies, in turn forcing the hedge funds to have to cover their losses by buying shares, thereby forcing up the price even further. GameStop’s share price at the end of January was $325 against what analysts believe is a fair price of $13 – clearly a big bubble has formed.

What is causing the “Gamestonk” Bubble?

In a nutshell, it’s the fault of the global pandemic, as trillions of dollars have been pumped into the global economy. For example, every American was given a cheque for $1,200 and this money is getting invested. The online “mob”, who are generally working from home and have time on their hands, are now looking at other opportunities, with silver next on the list. Therefore, two ingredients - a mob and liquidity - have developed out of the pandemic, and this has started to cause the formation of bubbles. Elon Musk, the founder of Tesla and now richest man in the world, has now begun to throw his weight into the arena by tweeting which stocks to buy - he has termed it “Gamestonk”.

Should we be worried?

At the moment we don’t think so. “Gamestonk” bubbles have only formed in relatively small, individual companies and the losers have been two hedge funds which, if they went bust, should not cause long lasting damage to the global economy. The share price of Tesla and the value of Bitcoin gives the appearance that they are in bubbles, but if they both fell then they are unlikely to cause other markets to crash.

What about the dot-com crash in 2000-2003?

Back in 2000, any company related to technology and the internet (known as the dot-com companies) saw their share prices surge higher. Many of these companies were based on some great ideas but back then there wasn’t the infrastructure in place for them to make money. For example, we still had dial-up internet and few people trusted paying money online. The Nasdaq 100 housed many of these technology companies and you can see from the chart below, how they surged higher, before crashing. This time around, the Nasdaq 100 is indeed advancing quickly, but we are in the midst of what we term the “Fourth Industrial Revolution”, in which these technology companies are making lots of money by helping to improve our lives. This is clearly very different to the year 2000.

Summary

It is clear that bubbles are beginning to form, but in asset classes that are not big enough to cause a stock market crash. We do believe that we have the ingredients for further bubbles to develop and it is at this stage where investors can make a lot of money by simply investing in equities. This is highlighted by the fact that every main stock market is on an upward trend.

Final Comment

As Governments and Central Banks have injected more and more money into the economy, this has had the effect of pushing up the prices of many asset classes and has ultimately helped our wealth recover from the "crash" in February and March last year. We do not see this cycle ending any time soon and further stimulus packages will be announced by the Biden administration, while interest rates will be kept low.

We therefore have all the ingredients for the formation of "bubbles", and they have begun to appear in the less liquid asset classes. We do not think that this is a concern at the moment and returns from the main asset classes that we invest in could be extremely good over the next few months and years, as more and more money is printed and finds its way into stock markets. As per last month we remain bullish for the following reasons:

- The roll-out of vaccinations will help to reopen the global economy and once the vulnerable are vaccinated, more confidence should return.
- The US looks set to extend and increase additional fiscal stimulus packages (money printing) under the Biden administration.
- 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.

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