Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update
March 2021

Contents:

Performance Update

The portfolios had a mixed month with the Cautious, Balanced, Adventurous and Income Generating portfolios all producing positive returns of between 0.19% and 0.39%. However, the other portfolios suffered losses.

Equity markets suffered large falls towards the end of February, with the Nasdaq index (predominantly US technology companies) falling 3.5% in one day, which was the worst day for technology stocks since October 2020. This contributed to a fall of 2.88% in the Fourth Industrial Revolution portfolio.

We now appear to be at a crucial time for investment markets as good news does not always mean that stock markets will go up. The news headlines are extremely positive as the vaccination programme appears to be working, virus rates and deaths are falling in the UK and we now have a road map for reopening the UK economy. However, fears that the economy will run "too hot" with inflation and interest rates rising too quickly, caused a wobble in the upward trajectory of stock markets.

Yields on US Government bonds spiked to over 1.5%, which caused bonds to fall significantly. This yield is one of the most important numbers for financial markets as it represents the "risk-free" rate as lending money to the US Government is considered the safest investment in the world. As the risk-free rate rises, then it makes other investments less attractive, hence equity markets falling and growth companies such as technology companies falling more.

We all know deep down that inflation is the only realistic way out of the mountain of debt that has recently been created to fund the fight against COVID-19. If inflation remains between 2-4%, then stock markets should not be overly concerned, but we are likely to see more volatility if inflation starts to creep much higher.

Gold had a difficult month as well, but other commodities are making strong gains.

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	-0.89	2.29	3.68
Cautious	0.19	4.04	5.73
Balanced	0.21	4.95	8.38
Adventurous	0.19	4.77	9.01
Dynamic Equity	-0.93	2.80	16.25
Income Generating	0.39	7.34	1.85
Fourth Industrial Revolution	-2.88	13.46	44.86
Retirement Investment Solution 1	-0.42	3.24	7.89
Retirement Investment Solution 2	-0.49	3.16	9.12
Retirement Investment Solution 3	-0.56	3.08	10.27

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 28.02.2021.

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	x
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

Last month emerging market bonds, UK Gilts and UK Inflation-Linked Bonds fell below trend and then subsequently suffered significant losses. This month, UK corporate bonds fell below trend.

Cautious, Balanced and Adventurous portfolios

Surprisingly, the healthcare sector fell below trend and therefore the Cautious and Balanced portfolios exited the position. Every other equity position remains above trend, though. The Adventurous portfolio moved out of gold mining and European smaller companies and into Japan and smaller US companies. This mirrored the change in the Dynamic Equity portfolio and the "momentum" investment philosophy we use.

With corporate bonds falling below trend, we continued to reduce the portfolios' allocation to this asset class. By reducing our exposure to bonds over the last 3 months, we have been able to protect the portfolios from some of the significant falls in bond markets that we have just experienced. This is another example of how trend following can help protect our client's wealth.

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 switched the exposure to smaller companies from Europe to the US. This meant that we only invested in European smaller companies for a month and had to exit the position at a small loss. This will happen from time-to-time when following a momentum strategy. We also exited gold miners as they have suffered along with the price of gold and replaced this with some exposure to Japan. Following a long period in which we made few changes to the portfolio, we are undertaking a rotation out of those previous leaders and into what we hope will be new ones.

Foundation portfolio

Similarly to our other portfolios, exposure to bonds decreased, with corporate bonds falling below trend. This portfolio will always be our most diversified portfolio due to its continual exposure to bonds, commodities, property, infrastructure and equities. Bond exposure currently stands at 24.5%, with the lowest it can move to being 19%. Last year, our bond allocation was at 44%, so you can see how exposure can significantly move depending on the investment conditions. Commodities were added to the portfolio in order to help diversify even further. This asset class is on a strong upward trend after many years of falling.

Income Generating portfolio

This portfolio continues to recover and was the best performing portfolio in February. The portfolio has exposure to dividend paying UK companies and they performed extremely well, with the holding in the Man GLG Income fund growing by 4.46%.

Fourth Industrial Revolution portfolio

The companies that make up this portfolio are generally categorised as "growth" companies. This means that investors accept that profits will be small in the short-term but expect that longer-term profits and returns will be significant. As the "risk-free" rate that you can obtain from US Government bonds increases, it means that the value placed on growth reduces. This is because you could simply earn 1.5% per annum right now, rather than taking the risk of investing in a company that *could* earn a lot of money, but also go bankrupt, at a later date. We therefore saw a loss of 2.88% last month for the portfolio as clean energy and cyber security, in particular, were hit due to rising bond yields.

Retirement Investment Solutions

Our healthcare exposure was removed and in line with our other portfolios, we reduced our exposure to bonds. Our Retirement Investment Solutions are made up of three portfolios and include the Dynamic Equity, Foundation and Multi-Asset Trend Following portfolio. Each of these portfolios have different strategies and risk levels, which ensures that the Solutions are diversified, not only by asset allocation, but by investment philosophy. We were very pleased at how this ensured losses were relatively low during the "Covid crash", while also managing to participate in a lot of the recovery.

Summary of Portfolios

Last month we highlighted the risk around inflation and interest rates and at the end of February we experienced the first real concerns as bonds and equities began to fall. Last month we wrote:

"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."

We do believe that from time-to-time over the next few years, inflationary concerns will cause stock markets to wobble, but they will remain on their upward trajectory. Stock markets usually perform well as long as inflation remains between 2-4%. The current expectation in the US is that inflation will be 2.2% in the long term which is ideal. We therefore continue to have economic conditions that support equities, namely low interest rates, goldilocks inflation and central banks/governments continuing to support the economy.

Asset Class Review

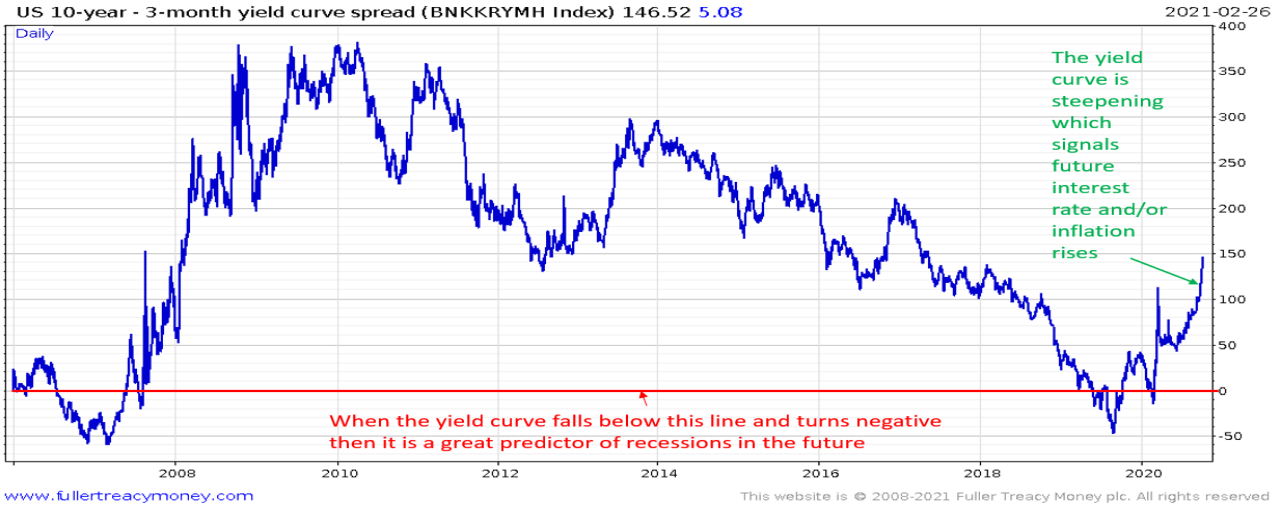
This section will give you an insight into our current thinking and we have included some charts that we believe look interesting. This month we look at bond yields, inflation and sterling.

Inflation is coming

Last year we were concerned about deflation and a global depression. However, Central Banks have done, and will do, whatever it takes to avoid this and create inflation instead. We are now seeing the price of most commodities move higher and the chart below shows how the average price of a basket of commodities has broken out to a new medium term high. Inflation is coming, and this is the best way of reducing the real value of debt each year. If wages and prices go up, then the tax paid through VAT and income tax also increases. Therefore, inflation is also a great way to reduce Government debt. The US is expecting inflation to be around 2.2% per annum in the medium term.

Yield Curve steepening – signs of a strengthening economy

The yield curve is the difference between the interest rate (yield) on a longer-term bond and that of a shorter-term bond. The chart below shows the difference between what yield you can achieve by lending money to the US Government over 10 years and 3 months. The higher the value, the better the indication that longer-term interest rates will rise. At the moment, the US Central Bank (FED) is keeping short-term interest rates low, but the market is predicting that due to the global economy strengthening (as well as inflationary pressure), that interest rates will have to go up. This is great news for banks as they borrow at short-term rates and lend long-term, so the wider the difference, the bigger their profits are, This in turn allows them to lend more into the economy.



Mortgage rates going up?

The chart below shows the yield you can receive when lending money to the UK Government for 10 years. It indicates that longer-term interest rates, and therefore fixed-term mortgages, will be going up. As you can see, they have bounced back to pre-Covid levels and the trend is rising sharply higher. If your mortgage deal is coming to an end, then now maybe a good time to fix it for a long period.

Sterling rising – the British economy is strengthening relative to others?

The chart below shows the value of sterling against a basket of other currencies. You can see how it significantly fell after the "Brexit" vote and then ranged sideways, with 76 being the ceiling. We have now approached the ceiling again, which signals that global investors are now more bullish about the UK economy. A break above 76 will be significant and could lead to sterling moving back to pre-Brexit levels. If this happens, then it will be good news for our 2022 overseas holidays!

In Summary

After decades of falling interest rates and Government bond yields, we have seen a bounce higher to pre-Covid levels. What is even more interesting, is the huge change from deflationary fears to inflationary fears and this signals that the global economy is recovering. We could, therefore, be in for a very good time in which we see interest rates rise (but not too much) and the price of most asset classes that we invest in move higher.

Emerging Markets Update

Emerging markets have begun to outperform other regions and we are spotlighting the fund that we use to gain exposure to them – the Fidelity Index Emerging Markets Fund.

What does the fund invest in?

The fund invests predominantly in China (39.9%), South Korea (13.3%), Taiwan (13.3%), India (8.9%) and Brazil (4.6%). There are no fund managers deciding which companies to purchase as the fund simply tracks the MSCI Emerging Markets index, which means that it will invest in most of the companies in this region. Since there are no fund managers, the cost is much lower at just 0.20% per annum.

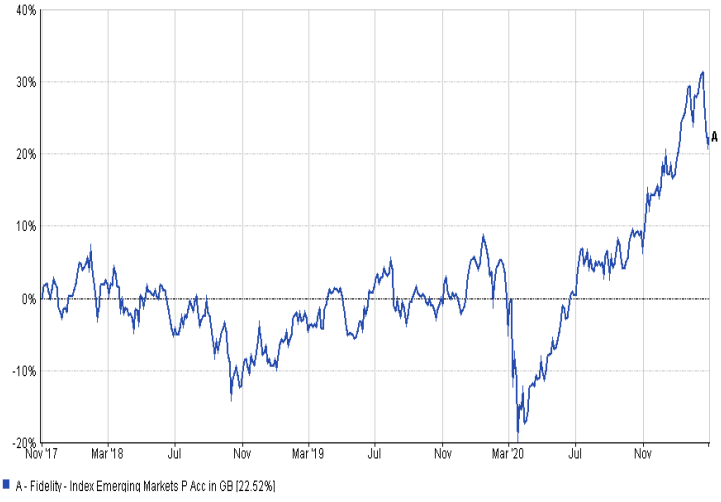
What has the performance been like?

The fund was launched in 2014 and has grown by 9.88% per annum since. We can also track the performance of the index that it tracks over a much longer period and since 2001, the index has grown by 9.78% per annum. However, it is also extremely volatile and can fall significantly - which it did between June and October 2008. During this period the index fell over 50%:

It is therefore very important to ensure that you invest in this fund at the correct times, which trend following assists with. Trend following would have helped you avoid most of the losses experienced above.

Will it continue to perform well?

Emerging markets have a tendency to be much more volatile than other markets. However, they also have long periods of moving sideways before exploding higher or lower. From November 2017 to March 2020, we saw them move sideways, and much of this was down to Trump's trade war with China. Like every stock market they fell significantly during the "Covid crash", but the recovery since has been very strong as China seems to have been the country that has recovered the quickest. We must also be very wary that nearly 40% is invested in China and within a communist economy.



Summary

The Fidelity Index Emerging Markets fund is an excellent and low-cost way of accessing higher-risk equities. The long-term performance of this index is excellent, but there are times when it rises and falls significantly. Therefore, it is very important to time the investment into this fund, and we use a process called "trend following" to help to try and ensure that we maximise returns and avoid the significant falls.

Final Comment

We are in a clear, upward trend in equity markets, but from time-to-time they will have "wobbles" like those we experienced towards the end of last month. This "wobble" was more about good news rather than bad news. The good news is that the global economy looks set to strengthen significantly as interest rates remain low and Governments have continued to support their economies. However, investors are now beginning to worry about inflation and whether interest rates will have to rise sooner than previously expected in order to try to put a lid on the inflationary pressures.

Bond prices, therefore, fell in February as a result of the expectation that interest rates will go up. We do not think that this is a concern now 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. We remain bullish for the following reasons:

- The roll-out of vaccinations will help to reopen the global economy (the UK is well ahead of other countries).
- The US looks set to pass a $1.9 trillion package shortly, which is enormous. We expect 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 other companies not surviving. Therefore, the profitability of some of these 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 therefore profits.

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

Tel: 01708 250624

Email: chrismoore@watsonmooreifa.com

www.watsonmooreifa.com