Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update
May 2021

Contents:

Performance Update

The portfolios had a great month, as stock markets continued their strong upward trends. The portfolios all grew by between 2.17% and 4.72%, with the higher risk portfolios outperforming.

The uneven rollout of the vaccine is causing problems in the less wealthy regions, with India struggling to contain the virus. This has led to emerging markets underperforming developed markets. However, the vaccine rollout has been so successful in the UK, USA and now Europe, that there is much optimism that the global economy will have one of its strongest ever rebounds. It won't be long until the developed nations start seriously helping those countries with a low rollout of vaccines. For example, the UK has given 75 doses of vaccine per 100 residents (a large number the population have now had 2 doses), whereas African countries such as Nigeria have had only 0.6. This inequality is not good for all of us.

Every major global stock market that we monitor is continuing to perform above trend and our portfolios have the maximum allowable invested in equities. This is why they have performed so well recently. Conversely, most bond markets are below trend, and we are extremely underweight bonds.

The price of most commodities is increasing significantly, with copper up 44% over the last 6 months, energy up 57% and corn up 71%. Inflation figures are going to be very high over the next year as the recovery takes hold. The debate is whether inflation will continue to run high or if it is just a short-term anomaly due to the Covid recovery.

Fears that the economy will run "too hot" with inflation, and that interest rates will rise too quickly, have not taken hold yet, but we believe that over the next year stock market volatility will return due to the uncertainty surrounding this. Therefore, we must expect corrections of 10% or more, from time-to-time. This volatility will also extend into bond markets, and we could see every asset class fall at once. For now, we are riding the upward trend in equity markets.

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	2.17	6.58	9.62
Cautious	2.22	9.99	12.01
Balanced	2.77	12.69	15.60
Adventurous	3.11	14.77	17.67
Dynamic Equity	3.84	13.87	22.95
Income Generating	2.58	17.42	18.66
Fourth Industrial Revolution	4.72	18.16	41.96
Retirement Investment Solution 1	2.73	10.50	14.13
Retirement Investment Solution 2	2.91	11.07	15.43
Retirement Investment Solution 3	3.07	11.59	16.65

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 30.04.2021.

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

There were no changes this month and we continue this year's theme of equities generally following an upward trend and bonds falling below trend.

Cautious, Balanced and Adventurous portfolios

There were no changes to the Cautious and Balanced portfolios and they both benefitted from having every equity position above trend. Bonds recovered a little from last month's falls, but we have little exposure to this asset class at the moment. The Adventurous portfolio exited its position in Indian equities and moved into smaller European companies. While Indian equities remain above trend, they have paused in their advance and so fell down on the momentum scale. This mirrored the change in the Dynamic Equity portfolio and the "momentum" investment philosophy we use.

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 from India to European smaller companies. This meant that we only invested in India for a month. This will happen from time-to-time when following a momentum strategy. 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. At the moment, the new leaders appear to be smaller companies.

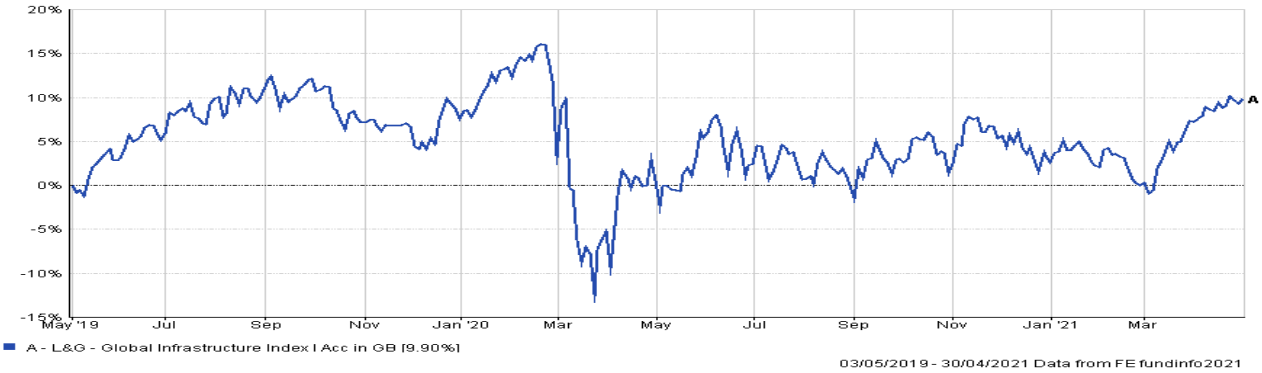
Foundation portfolio

There were no changes to this portfolio, and we benefitted from last month's increase to healthcare and infrastructure companies. We remain underweight bonds, and they recovered somewhat from last month's falls. The portfolio continues to provide steady returns and exactly what it was designed to achieve. It is extremely diversified and will always invest some money in bonds, equities, infrastructure, property and commodities.

The exposure to commodities performed extremely well with the commodity fund rising 7.91% and the gold fund rising 3.68%. Commodities appear to be "cheap" and on a strong upward trend – exactly what we like!

Income Generating portfolio

This portfolio has been one of our best performing portfolios over the last 6 months as we have benefitted from the recovery made by income-producing companies. The portfolio had been holding 10% in cash as we waited for opportunities to present themselves. Last month we deployed the cash and invested 5% into the L&G Global Infrastructure fund. This is yielding 2.3% and after Biden's announcement you can see how the fund began to move higher:



We also invested 5% into the Nomura Global Dynamic Bond fund. While bonds are on a downward trend, this fund is very strategic, and this has allowed the fund manager to benefit. It is expected to produce a long-term income of between 3-5%.

Fourth Industrial Revolution portfolio

After a slow few months, this portfolio rebounded with a gain of 4.72% as technology companies performed strongly. The best performing fund was the Herald Investment Trust which rose 9.37%. This invests in smaller UK (mainly technology) companies and is now up 228% over the last 5 years. Clean energy was the only poorly performing fund as it fell 4.22% over the month.

Retirement Investment Solutions

No changes were made to the trend following part of these solutions. 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 that this strategy meant that losses during the "Covid crash" were relatively low, but that we were still able to participate in a lot of the recovery. Last month saw strong gains in all 3 solutions.

Summary of Portfolios

When there are thousands of people on the street and parliament buildings are under siege, politicians tend to wake up to the public mood. The harrowing experience many elderly politicians experienced in the USA during the Capitol riot, is likely to inform their decision-making going forward. That's true regardless of whether they are aware of it or not. Giving the people what they want, which is more money, is going to be high on the list of priorities. They really don't have a choice. They have to spend. The only question is how much and what will spending focus on. This is one of the main reasons that global stock markets are on strong upward trends as Governments everywhere are increasing the supply of money. In the short to medium term, we see the additional money printing, as well as the good news on the vaccination numbers, ensuring that stock markets continue to trend higher.

However, there are two longer-term hurdles that need to be overcome and these could derail the upward trend in stock markets. The first is inflation and we are seeing the prices of many commodities move significantly higher. If inflation is maintained at below 4%, then this could be exactly what is needed as it will reduce the real value of debt each year. However, if it moves higher than this, then interest rates will have to rise, and this would be problematic if the debt hasn't been reduced. Secondly, taxes will need to rise in order to pay off the debts and if corporation taxes rise too much, then stock markets could fall.

Currently, we continue to have economic conditions that support equities, namely low interest rates, Goldilocks inflation, pent-up consumer demand 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.

Smallest UK companies- breaking higher

The FTSE AIM 100 index is made up of some of the smallest listed UK companies, such as Asos, Boohoo, Abcam and Fevertree Drinks. They are a great representation as to how the UK economy is doing as more of their earnings are based in the UK. You can see how the index fell by nearly 40% early last year before recovering. You can also see how Brexit fears stopped the uptrend in October 2018. The end of 2020 saw it surge much higher before pausing, and we are now seeing the next break higher, which indicates that the UK economy is in good shape.

US – surges higher

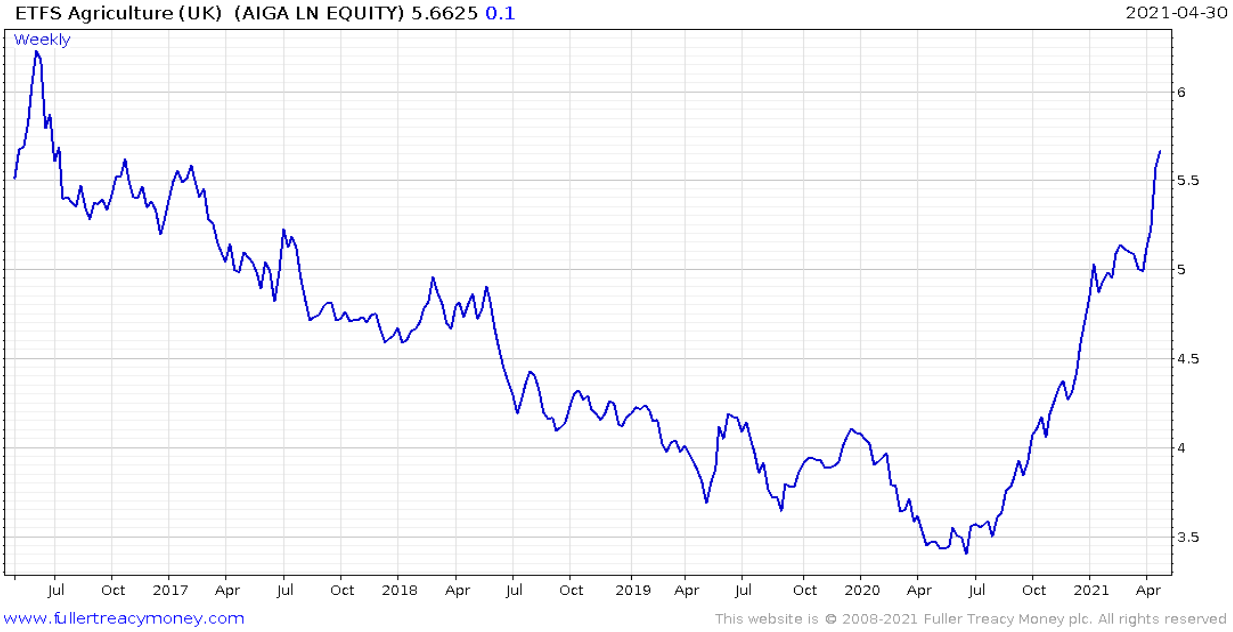
Last month we wrote that "*The 4000 level on the S&P 500, is being discussed as a potential barrier for this market and one that will act as a ceiling. If it breaks above this level shortly, then we can expect it to advance much higher. Round numbers tend to act as ceilings and floors*". As you can see it easily broke the 4000 level and has moved much higher. This is very positive.

India - devastating news but stock market holds firm

The news coming out of India is devastating, with the healthcare system totally overwhelmed by the new wave of Covid infections and deaths. Despite this news, the stock market is still up 37.05% over the last year, even though its upward trend has paused over the last few months. This shows that the major stock markets are linked more to global growth than the news within individual countries.

Food Inflation – significantly going up

We have been discussing how inflation is imminent with all the extra money that has been printed. The chart below shows how a basket of agricultural products such as wheat, soyabeans and barley have surged higher over the last few months. This is another piece of evidence that inflation is just around the corner as the cost of our supermarket shop will be rising shortly. .



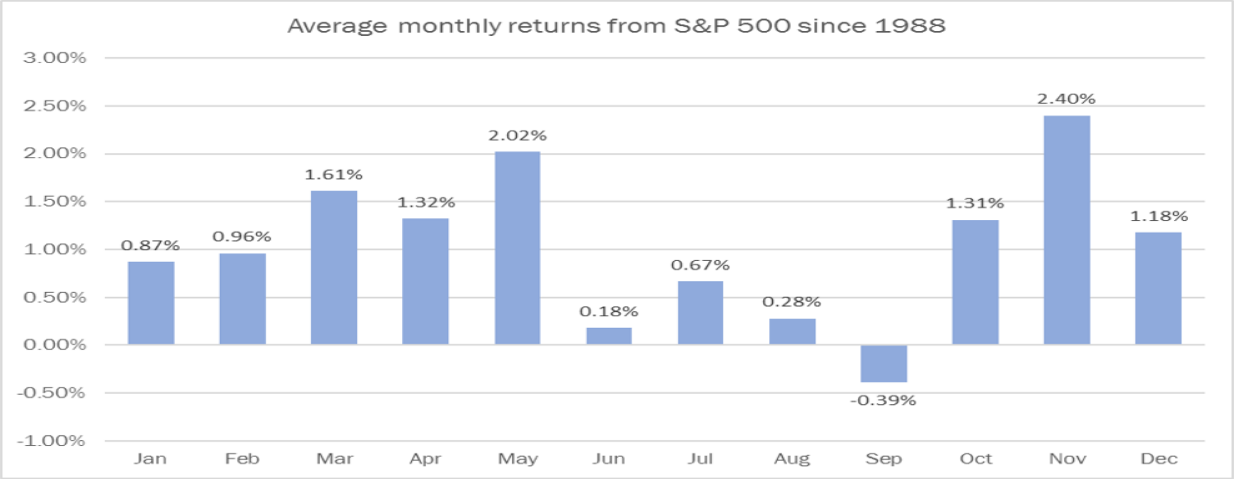
In Summary

Stock markets remain on strong upward trends and are enjoying the positive news flow, particularly in terms of the vaccine rollout and the continuation of money printing in the US. Even bad news within a specific country is not derailing the upward trend. We are also experiencing strong gains in commodities, and this is likely to push up inflation in the short to medium term. Currently stock markets are not worried about this, although if inflation moves higher than expected, it could cause stock markets to correct.

Sell in May?

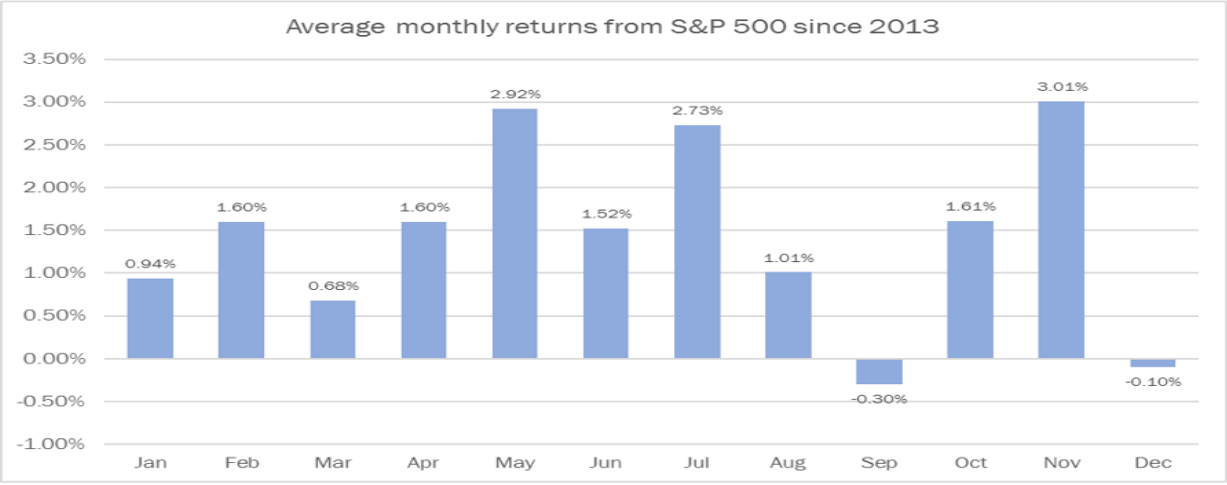
The old stock market adage, "sell in May and go away, come back St Ledger's day", has been a remarkable forecaster of stock market returns. The notion being that stock markets were dominated by the upper class and while they were busy enjoying the summer attending sporting events and on their summer retreats, liquidity would be thin. Anyone trying to sell would be met by an absence of buyers and prices would fall. Better to wait until the world's oldest classic flat race, the St Leger, has taken place at Doncaster Racecourse in mid-September and business returned to normal, before venturing into the market.

It isn't just the FTSE 100 that has benefited from a Santa Rally, as most global stock markets have similar seasonal statistics. The chart below shows the average monthly return for each calendar month from the S&P 500 since 1988 and you can see the effects of the summer months, with September being the only negative month. Interestingly May is the second highest month:



The wisdom behind the adage dates to a time when markets actually did slow down over the summer, but today stock markets don't slow down, as you can trade from your phone and laptop. In addition, computer algorithms are trading all day and every day without any human interaction. Therefore, the summer holiday and sporting events are no longer a barrier to trading. We believe that with every passing year the sell-in-May strategy gets less and less relevant.

When analysing the data, we can see that it has worked over the long-term, but since 2013 the seasonal pattern appears to have broken down some what. September is still a negative month though:



We are currently in a strong upward trend in global stock markets and therefore we prefer to invest in upward trends rather than by months of the year. Of course, there is still every possibility that we get a correction over the summer, as markets cannot continue to go up in a straight line, but they could also continue this upward trend for many, many more months.

**All figures have been produced by Financial Express and are available upon request.*

Final Comment

Equity markets are in a clear, upward trend and our portfolios are benefitting. Even a resurgence of Covid in India has not dampened down the enthusiasm of investors, as they believe that the roll out of vaccinations will increase globally and in the poorer areas, before long. Even the seasonal factors that have dampened stock market returns during the summer months may no longer be a headwind for returns going forward.

We remain bullish about our portfolios for the following reasons:

- The roll-out of vaccinations in the wealthier nations are reopening the global economy. The bad news from India will also hopefully prompt a fairer global distribution of vaccines, thus ensuring every country can participate in the strong economic growth over the next year.
- Politicians will continue to do whatever it takes to support the economy.
- 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. For example, it is now very difficult to book a summer holiday in the UK.
- Confidence has returned to the UK, and we are seeing smaller companies begin to benefit from the removal of uncertainty surrounding Brexit. In fact, it's beginning to boost UK manufacturing as we can no longer be so reliant on Europe to deliver essential goods such as vaccines.
- Those companies that have survived this year are likely to have implemented cost savings and may find less competition due to other companies falling by the wayside. Therefore, the profitability of some of these could increase significantly. This is simple Darwinian theory being applied to economics.
- Inflation is currently only expected to increase in the short-term and therefore we should only experience modest (if any) increases in interest rates. Higher inflation will help reduce the value of debt each year in real terms.

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