Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update
July 2021

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Performance Update

The portfolios had a good month, rising between 0.52% and 7.36%. The FTSE 100 and S&P 500 rose 0.41% and 2.30% respectively. However, due to sterling falling, the S&P 500 grew by 5.00% in sterling terms.

Sterling had been rising strongly but this reversed significantly in June. Last month, it fell 2.70% against the US Dollar which boosted returns as a significant amount of our portfolios are invested in the US. The reason for this reversal is that the Bank of England believes that the jump in inflation will only be temporary and therefore interest rates will not have to rise as much as they have in the US. Money tends to flow to the stable countries that pay the higher levels of interest, hence why money flowed out of sterling last month.

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. Emerging markets are underperforming though due to the fact that vaccination rates are generally low, whereas countries like the UK are optimistic that the increase in the infection rate will not cause a spike in deaths and therefore the economy can fully re-open.

Bonds have largely remained below trend, but UK bonds had a good month with UK Gilts rising 1.10% and UK Corporate bonds 1.01%. This is again due to the expectation that interest rates in the UK will not rise as much as previously predicted.

Stock markets have recovered, and many have risen above their pre-Covid levels to hit new all-time highs. President Biden declaring a 'deal' on a $1.2 trillion infrastructure plan certainly helped, but has led investors to worry about the next problem that could cause stock markets to crash again. This is where the word “inflation” pops up and whether the recent rise in inflation is short term (transitory) and will then fall back, or whether it will become a longer-term problem. The Bank of England has talked down the problem, but there is a fear that inflation will spiral out of control.

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	1.17	3.27	7.46
Cautious	1.07	5.15	10.43
Balanced	1.41	6.56	13.96
Adventurous	2.17	7.64	14.99
Dynamic Equity	3.69	7.54	17.95
Income Generating	0.52	7.04	16.56
Fourth Industrial Revolution	7.36	5.74	25.87
Retirement Investment Solution 1	2.17	6.03	12.36
Retirement Investment Solution 2	2.42	6.29	13.23
Retirement Investment Solution 3	2.66	6.53	14.04

Please note that these figures do not include the platform or Watson Moore’s fees.*All figures are sourced from Financial Express to 30.06.2021.

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

This month saw UK corporate bonds and UK index-linked bonds move above trend.

Cautious, Balanced and Adventurous portfolios

Both the Cautious and Balanced portfolios added exposure to UK corporate and index-linked bonds. The Adventurous only added exposure to UK corporate bonds and switched money from underperforming emerging markets and into UK smaller companies, which have recently performed well. All three portfolios have the maximum amount invested in equities and have experienced strong recent returns.

Dynamic Equity portfolio

The momentum philosophy 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 saw emerging markets replaced by UK smaller companies due to the growing fear that emerging markets will be hit hard by the Delta variant. However, it is hoped that the high vaccination rate in the UK will ensure that the death rate remains low and that the economy will fully reopen this month.

Foundation portfolio

The portfolio increased exposure to UK corporate and index-linked bonds as they both moved above trend. The portfolio continues to provide steady returns - exactly what it was designed to achieve. It is extremely diversified and will always invest some money in bonds, equities, infrastructure, property and commodities.

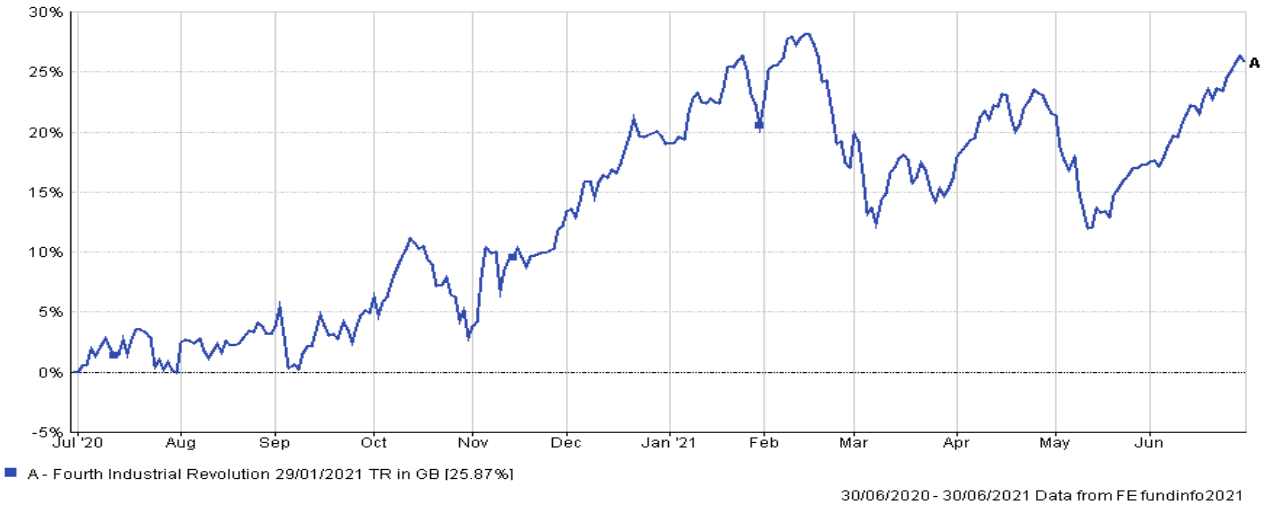
Income Generating portfolio

Last month the portfolio grew the least out of all of our portfolios, as it has more invested in the UK and thus did not benefit as much from sterling's fall. That said, it has been one of our best performing portfolios over the last year.

The amount of income generated by the portfolio is also recovering well. The yield was over 3.5% before the pandemic, but fell to below 2.4% as companies slashed dividends in order to preserve cash. It is now approaching 2.8% on a historical basis. This means that it does not take into account those companies that have recently restarted or increased their dividends. We therefore feel that the future level of income will soon be above the 3% level again.

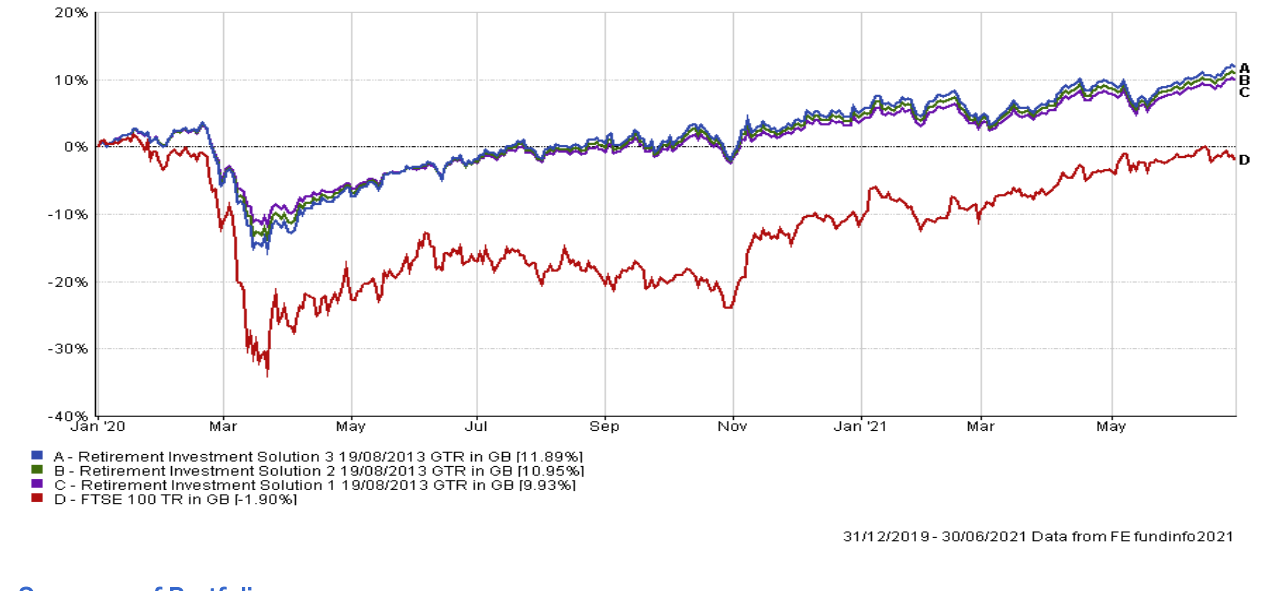
Fourth Industrial Revolution portfolio

The portfolio experienced strong returns this month as technology stocks recovered from their recent weakness. The chart below shows the performance of the portfolio over the last year and you can see how volatile it has been with regular swings of 10% or more in short periods:



Retirement Investment Solutions

The Solutions increased exposure to UK corporate and index-linked bonds as they both moved above trend, along with UK smaller companies. We are very pleased that our Solutions experienced relatively low losses during the 'Covid crash' but have been participating in the recovery. The chart compares the performance of the three Solutions to the FTSE 100, and you can see how much more stable the Solutions have been:



Summary of Portfolios

The fear of inflation, as well as the potential effect the Delta variant will have on the global economy, are dominating investment markets. The good news is that central banks believe that inflation will 'spike' higher and then quickly fall back. This means that interest rates can remain lower for longer and this has helped to boost bonds, stock markets and in particular, technology companies, in June. Many economists do not believe this and think that inflation will spiral out of control. This will remain a hot topic for the rest of the year and will no doubt cause some more volatility in markets.

The Delta variant has already caused a delay to 'freedom day' in the UK. Over the next few weeks, we will see the full benefit of the vaccines and hope that the death rate will not increase as much as the rate of infections. Sadly, countries that do not have the same vaccination rate may be hit harder and we are seeing their stock markets underperform. Our portfolios are flexible enough to adjust to this change and will always invest more money into those sectors and regions performing the best.

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.

The US breaks to new highs

The main US stock market broke to a new all-time high last month and you can see how steady the recovery has been. The S&P 500 is an extremely calm and steady stock market housing some of the world's biggest companies such as Apple, Microsoft, Johnson & Johnson and JP Morgan. The chart shows that investors are optimistic about the global economic recovery:

The FTSE-250 has paused

The data from Israel and the UK, where there is a lot of testing and genetic sequencing for variants, supports the view that high vaccination rates will hopefully reduce the threat from variants. This is particularly relevant as the Delta variant spreads quickly in the UK. Case numbers in the UK are increasing and it is reasonable to expect a lag before the trend in deaths rises. In the next three weeks there will be observable data on whether the high vaccination rate acts as an obstacle to severe infections, or not. The FTSE-250 has paused over the last few months, following a breakout to new highs. There is no real sign of selling pressure, so investors are still willing to give the benefit of the doubt to the validity of vaccine data and progress towards reopening. If the death rate doesn't rise significantly, and 'freedom day' isn't pushed back again, then we can expect this market to move higher:

Asia falls behind

The ASEAN region and emerging markets generally, are further behind in their vaccination efforts and have fewer resources. The higher transmissibility and anecdotal evidence that the Delta variant is more deadly, complicates the situation for these markets because it represents a short-term risk. India's experience suggests it is not a medium-term risk. This has led to Asia's stock markets to fall from their highs and lag behind the USA.

India – the worst is over

The spread of the Delta variant represents a challenge in the short-term, but even under the most dire of circumstances, the Indian example suggests that any downward pressure on stock markets will be temporary.

In Summary

The US is racing ahead, whereas other stock markets are pausing and have fallen from their previous highs. If, as expected, a high vaccination rate breaks the link between hospitalisation and an increase in infection rates, then we would expect most markets to trend higher again. It will also not be long before the wealthier nations start to seriously help to vaccinate the global population and this should enable Asia and the emerging markets to begin to trend higher.

Inflation, or not?

One of the most surprising aspects of the pandemic has been how resilient major economies have been despite the fear that closing the global economy would cause economic disaster. After the initial stock market crash, governments and central banks have flooded the economy with money and we are now set up for a 'boom' period. Stock markets have recovered, and many have risen above their pre-covid levels to hit new all-time highs. This has led us to start worrying about the next problem that could cause stock markets to crash again. This is where the word 'inflation' pops up and the question of whether the recent rise in inflation is short-term (transitory) and will then fall back, or whether it will become a longer-term problem. By looking at charts we can start to see which it is.

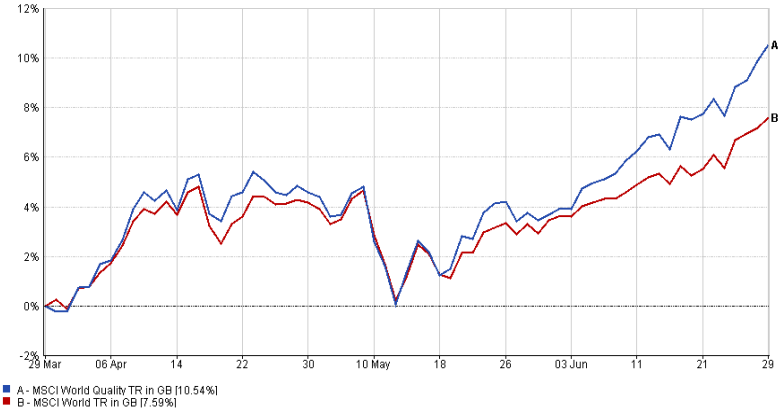
The price of commodities is a great indication of whether the raw materials that make the goods we buy will rise in the future and hence will be inflationary. The chart of the price of copper (below) is an excellent one to look at as it is very similar to many other commodities.

You can see how the price had been falling (deflationary) before the surge in April 2020 when central banks started to pump money into the economy. However, you can see now that the price has begun to fall again, which confirms the view that inflation will be transitory.

Other signals that confirm that inflation may only be transitory are the falling bond yields in the US from just over 1.7% to just under 1.5%. This confirms that interest rates may remain lower as they do not have to rise to prevent inflation from spiralling out of control. We have also seen a recovery in growth stocks (such as technology companies) and these tend to do better in a low inflationary and low interest rate environment.

However, there remains a big fear that inflation will be a long-term problem and we will see a return to the 70s. Inflation occurs in the economy when demand exceeds supply and prices rise due to the 'gap'. Governments can print as much money as they like when it doesn't move around in the economy and circulate. Economists refer to this as the velocity of money and this has fallen sharply over the years. If this velocity increases for a long period i.e. you spend your cash savings and then that company buys more goods and pays their staff a bonus which then gets spent, then this could trigger inflation. Inflation at under 4% is probably the best solution to reduce the real value of Government debt each year, but it is thought that if it rises above this figure for a longer period, then interest rates will need to rise, and this could derail the economic recovery.

The best way to protect your wealth against the fear of inflation is to invest in those companies that can easily increase the prices of what they sell. Think of companies such as Nestle, Coca Cola and Microsoft. These companies are known as 'quality' companies. The chart below shows how quality global companies (blue line), have outperformed the average company (red line), over the last few weeks.



This is a sign that while economists believe that inflation will be transitory, some investors are already taking measures to protect their wealth should inflation become a longer-term problem. Our portfolios have wealth invested in funds that already invest in quality companies.

Final Comment

Inflation is being given the benefit of the doubt and central banks believe that it will only spike higher in the short-term. This in turn means that interest rates will stay lower for longer and the economic recovery will continue for the next few years at least. The benefit of the doubt is also being given to the fact that a vaccinated population will not succumb to any new Covid variants and that lots of assistance will be given to the poorer regions. As a result, equity markets continue their upward trends, although some have paused for a bit. Our Fourth Industrial Revolution portfolio had an outstanding month as technology companies are enjoying a low inflation and low interest rate prediction.

We remain bullish about our portfolios for the following reasons:

- The G7 group of leading nations pledged to donate one billion coronavirus vaccines to poorer countries, thereby ensuring every country can participate in strong economic growth over the next year.
- President Biden announced a $1.2 trillion infrastructure deal which will further support the economy and confirm that Governments will continue to print money.
- 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. For example, it is now very difficult to book a summer holiday in the UK.
- Confidence has returned to the UK with house prices rapidly rising, and we are seeing smaller companies beginning to benefit from the removal of uncertainty surrounding Brexit.
- 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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