Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update

January 2022

Contents:

Performance Update

We experienced another Santa Rally at the end of 2021, with the FTSE 100 up 4.75% and the S&P 500 up 2.06%. This helped our portfolios rise between 0.55% and 3.12%. The Fourth Industrial Revolution portfolio suffered a loss of 0.23% as the Clean Energy component suffered a fall of 10.87%.

While equity markets advanced, bonds suffered losses, with inflation-linked gilts falling by 5.92% and UK Gilts by 2.68%. Overall, bonds fell during the year with UK Gilts suffering a 5.14% loss, largely due to the expectation that interest rates will rise in 2022 and 2023. December saw the Bank of England raise interest rates for the first time in 3 years. Although the increase from 0.10% to 0.25% was only small, it suggests an intention for them to continue along this path.

Inflation is climbing at the fastest pace in 10 years. It is now running at 5.1% and is expected to exceed 6% in the next few months. Rising energy costs have been a big factor in this rise. We are very reliant on Russian gas supplies and the delayed negotiations of a new gas pipeline into Europe is causing a significant amount of price volatility. The potential invasion of Ukraine by Russia is also linked to the pipeline deal.

The Omicron variant is extremely transmissible, but many people are reporting milder symptoms that are little more than a cold. As we wrote last month, history has shown that viruses become more contagious and less virulent as they mutate. The next big discussion on the agenda, is how long do we need to isolate for. The period has already reduced from 10 days to 7 days and there are now discussions about reducing it to 5 days. Some are even saying that we should remove the isolation period altogether in order to keep the economy open.

Sterling rose to $1.3532 against the US Dollar, an increase of 1.75% over the month as the Bank of England was the first major economy to raise interest rates. This provided a headwind for our portfolios as they have a significant amount invested in the US. However, over the last 6 months, Sterling has fallen from over $1.42 so this could be the start of a recovery.

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	0.55	3.76	7.15
Cautious	1.08	3.75	9.10
Balanced	1.41	4.10	10.93
Adventurous	1.68	5.96	14.05
Dynamic Equity	2.47	8.86	17.07
Income Generating	3.12	5.75	13.26
Fourth Industrial Revolution	-0.23	4.05	10.02
Retirement Investment Solution 1	1.61	5.12	11.46
Retirement Investment Solution 2	1.76	5.69	12.33
Retirement Investment Solution 3	1.91	6.20	13.13

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 31.12.2021.

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	x
UK Equity	✓	Commodities	✓
Europe ex UK Equity	✓	UK Corporate Bonds	x
US Equity	✓	UK Corporate Bonds (Short dated)	x
Japan Equity	✓	UK Index-Linked Bonds	✓
Pacific Equity	x	Global Bonds	x
Gold	✓	UK Gilts	x
Global Property	✓	Emerging Market Bonds	✓
Global Infrastructure	✓	Overseas Corporate Bonds	✓

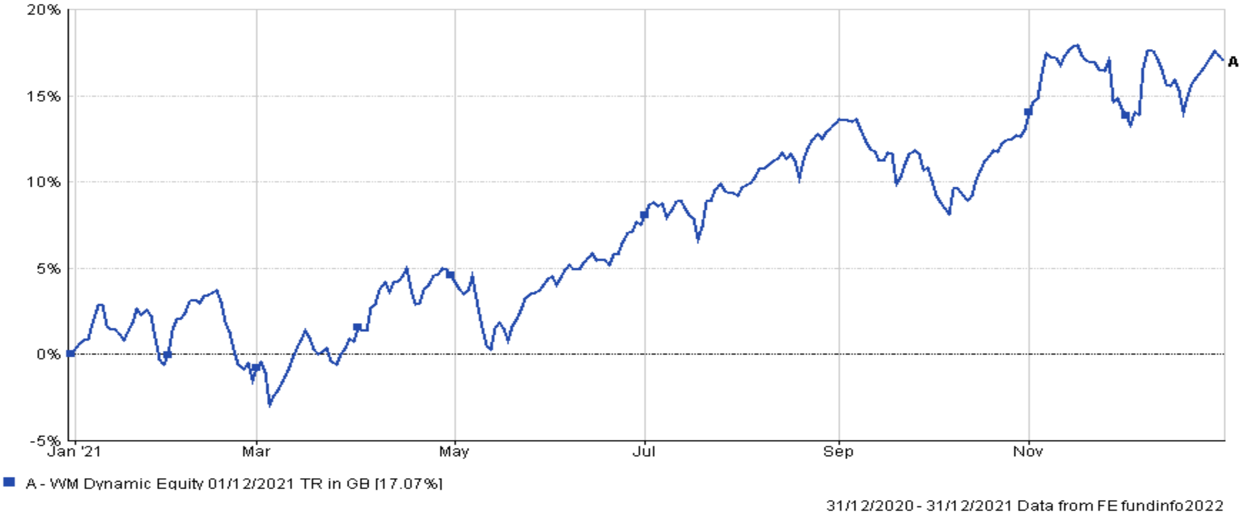
This month UK corporate and global bonds moved below trend.

Cautious, Balanced and Adventurous portfolios

December capped off a great year for these 3 portfolios as they benefitted from rising trends in most equity markets. Bonds however, have provided a headwind to performance as they have fallen during the year. This month there were no changes to the equity side of the portfolios, but we sold out of UK corporate and overseas government bonds. Rising interest rates in 2022 could put bonds under extreme pressure and hopefully our trend following process will protect us if bonds indeed fall again in value.

Dynamic Equity portfolio

The portfolio recorded a return of 17.07% in 2021. You can see how it initially struggled before accelerating higher from around June:



We exited US smaller companies this month after exiting European smaller companies last month. They were replaced with global equities.

Foundation portfolio

Another steady return this month. The equity part of the portfolio made good gains, but the bond portion fell. This portfolio will always have a much more diversified approach and will not remove exposure to an asset class entirely. This way we attempt to achieve steadier returns.

Income Generating portfolio

After a poor November, the Income Generating portfolio was our best performer in December. This is largely due to the fact that it has a greater proportion invested in the UK than our other portfolios and less money overseas. Sterling rose over the month, and this provided a small headwind to overseas assets.

Fourth Industrial Revolution portfolio

The portfolio fell as technology related companies came under pressure. There was also a wide divergence in performance of the underlying holdings, with the iShares Global Clean Energy fund falling 10.87% while the Herald Investment Trust rose 5.25%. This shows how diverse the portfolio is and how different sectors will perform in very different ways. The portfolio is up an incredible 93.85% over the last 3 years.

Retirement Investment Solutions

Again, the Solutions produced some good returns. Equity exposure remained unchanged, but Bond exposure decreased. We are very pleased with the performance over the year:

Summary of Portfolios

We experienced another Santa rally and our portfolios benefitted. US stock markets have been the star performers in 2021, but many investment analysts are predicting that Europe, Japan, China and everything else will catch up with the US in 2022. While it has been another difficult Christmas with the numbers infected with the Omicron variant surging, most people have experienced only mild symptoms. This has been good news for stock markets as it seems unlikely that we will have further lockdowns and the global economy will remain open.

Financial conditions are likely to tighten this year with interest rates going up, Governments reigning back on spending and taxes increasing to reduce the deficits. While inflation is likely to hit 6%, it is believed that the supply chain disruption will abate by the middle of the year, oil prices are unlikely to surge higher and shipping costs are already falling, thus inflation will come down. However, broader inflation is likely to remain with prices going up, just not as quickly. If inflation is around the 3-4% level then this would be really good news as the deficit will fall each year in real terms, while interest rates will not have to rise that much.

2022 looks set to be another interesting year for investment markets!

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 focus on the best, worst and most volatile asset classes in 2021.

S&P 500 – the most consistent uptrend

The S&P 500 is the most important stock market in the world, housing companies such as Apple, Microsoft, Amazon and Tesla. You can see how it has advanced in a steady, consistent uptrend (between the green tram lines):

China - the most consistent downtrend

In contrast, Chinese stock markets have followed an almost identical but opposite, downtrend. China has struggled to cope with Covid-19. Initially they quarantined entire factories so that they could keep manufacturing open, but due to the sheer size of the population they are unable to provide enough healthcare if Covid-19 spreads rapidly so have decided to keep strict rules in place. This has in turn hurt their economy.

Global stock markets excluding US – Up then Down

If we take out US companies from the Global stock market index, you can see how 2021 has been a year of two halves. This index is made up of companies such as Nestle, Samsung, Roche and Toyota and has a lot broader base than the S&P 500, which is mainly reliant on technology. As we begin 2022 global investors are beginning to think that non-US companies will now start to outperform US ones as they are extremely undervalued by comparison:

Bitcoin- one of the most volatile investments

Bitcoin is a cryptocurrency that uses blockchain technology to make secure and quick financial transactions. Some investors believe that it will be the new global currency of the future and replace the US Dollar, while others think that it is a gimmick and will ultimately be worthless. 2021 experienced considerable volatility:

In Summary

2021 produced some strong gains for investors, with the US providing the best returns. We are clearly in a strong uptrend which shows no signs of finishing. However, other stock markets have not performed as well and could begin to catch up in 2022.

What Could Go Wrong (or Right)?

The last 2 years has been a roller coaster ride for stock markets and life in general. However, if we just looked at where stock markets were 2 years ago and compare them to now, then we can see how good Covid-19 has been for our wealth. The FTSE 100 is up just 4.76% but the Euro Stoxx is up 23.25% and the S&P 500 is up 47.60%, mainly due to a high number of technology companies which have benefitted the most from lockdowns. So, what is likely to derail this upward trend in global stock markets? We have identified 4 potential problems that could cause a correction or crash in 2022 (or not!).

1/ Inflation is Persistent - Central Banks first described the rise in inflation last year as transitory. They believed that a shortage in the supply chain as well as the statistical anomalies of lockdowns, would cause inflation to rise significantly before falling back to low levels again. They have now removed the word transitory as inflation is expected to go above 6% in the UK and US. What happens if inflation stays at this level throughout 2022 or goes even higher? The best two ways of reducing inflation is to raise interest rates and reduce the money supply. If interest rates go up to 4%, how will Governments pay for the debts that they have taken on? Taxes would need to rise, and Government spending would need to fall. This would almost certainly cause a typical boom and bust recession. However, if inflation remains below 5%, then interest rates will not need to rise much, and the value of the debt would be falling each year in real terms. This would be fantastic for the economy as we would have the Goldilocks scenario.

2/ Covid doesn't go away – While the good news is that the Omicron mutation appears to be less virulent, what happens if future mutations keep coming back in 2022 and evade the vaccines? What happens if we get a strain that causes a higher hospitalisation rate? What happens if the vaccination process causes more mutations? After all this is a huge experiment that we are undergoing. In the first lockdown, Governments pumped in lots of money to keep the economy afloat (e.g. furlough) and consumers kept on spending on new goods such as TVs. If we keep getting lockdown after lockdown, then Governments can't take on much more debt to bail us out and individuals and companies will shy away from spending due to the continued uncertainty. This will surely lead to an economic recession and stock market crash. However, the good news is that we must be getting very close to Herd Immunity (1 in 16 in London had Covid before Christmas) and Omicron is so far appearing to be much milder than Delta. By the end of Winter, we could be returning to a more normal world, where we socialise more, travel more widely and cause a continuation of the economic boom.

3/ High Energy prices cause a Recession – it has been argued that the recession in 2008 was caused partly by oil prices rising from just over $50 a barrel in January 2007 to just under $150 by July 2008. Today oil prices are around $80, doubling in just over a year. What is more concerning is gas prices which spiked last year at over $5.50, having been as low as $1.44 in 2020. Rising demand for energy, coupled with supply disruptions (remember the petrol crisis?) have given us exceptionally high energy prices in our homes and cars. Effectively this acts as a tax on consumers and could cause economic growth to deteriorate and even a recession. However, climate change activists have kick-started governments into looking at alternative energy production such as wind and solar and to consider building more but smaller nuclear power reactors. The investment in this could eventually give us cheap, plentiful energy. Think what could happen if Tesco were to put solar panels on every store roof and we were able to store electricity in batteries close to every home? We would probably pay for energy like we pay for broadband- a simple monthly fee for unlimited connectivity. The breakthrough in energy production could happen in 2022.

4/ Russia or China invade Ukraine or Taiwan (or both at the same time) – an invasion by Russia could cause gas disruption (see above) but it is unlikely that the West would start a war and more likely that they would intervene with even more economic sanctions. However, China invading Taiwan could prove to be much more devastating economically. Could the West not intervene? What would happen to the global supply of semi-conductors? Taiwan produces the majority of them, and this could cause a shortage of just about every electrical product globally.

Summary

Predicting the future is impossible (who predicted Covid-19 and then stock markets to rise?). However, we must always be aware that there are scenarios that could cause crashes in stock markets and a significant loss of our wealth from time to time. Our trend following strategies will hopefully protect our wealth against severe losses if any of the above does indeed occur in 2022.

Final Comment

At the end of last year we experienced another Santa Rally, making 2021 a great year for investing. The Omicron variant is proving to be less severe than the Delta variant and this is extremely good news as it signals the possibility that we can start to live with Covid-19 without having to experience much disruption to our daily lives. US stock markets are clearly on the strongest uptrend, but 2022 could see other markets outperforming as they catch up.

The Bank of England was the first major economy to raise interest rates and there will need to be a fine balancing act between reducing inflation, while keeping interest rates low. Although there are a lot of potential problems that the global economy could face, currently the outlook is extremely favourable and hopefully, returns in 2022 will be as good as in 2021.

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

Tel: 01708 250624

Email: chrismoore@watsonmooreifa.com

www.watsonmooreifa.com