Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update
April 2022

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Performance Update

Despite the terrible news that we are witnessing coming out of Ukraine, our portfolios advanced between 2.09% and 6.10% in March, helped by the FTSE 100 & S&P 500 growing 1.42% and 5.69% respectively. It's not hard to find reasons for caution. The war in Ukraine still has commodity markets in turmoil, with fertiliser the latest product to accelerate higher in price. Oil prices are still elevated, adding to inflationary pressures, and we are beginning to experience price rises in just about everything we buy. However, the bad news in Ukraine is getting slightly less bad, which is why stock markets moved higher.

It is forecast that the Russian economy will see a downturn of 10% this year due to sanctions. However, oil revenues are at near record levels and the forecast is for the economy to rebound by over 2.4% in 2023. The only way for sanctions to realistically work is for a full energy embargo. Will the German economy be able to withstand that?

The biggest economic impact of the invasion has been on the commodity supply chain and prices. The Office for National Statistics reported UK Consumer prices rose by 6.2% in the year to February, up from 5.5% in January. This was the highest reading since March 1992. This could move even higher as the impact of the War will only start to come through over the next few months. The cost-of-living squeeze will be tough.

Bonds also suffered losses for their fourth consecutive month, with the price of UK corporate bonds falling by 1.01% and UK Gilts by 1.88%. Interest rates rose in the US and UK, with the US pencilling in 8 further rises of at least 0.25%. Gold has become the safe haven, rising by 3.59% in sterling terms. The Foundation portfolio is our only portfolio that currently invests in bonds, and exposure is only at the minimal amount. It is benefitting from its exposure to gold and commodities though.

Despite the record number of Covid cases in the UK, the milder symptoms from omicron are not causing a strain to the NHS and our economy has now re-opened. The same has happened in the US. However, China has a zero Covid policy and whilst this worked for Delta, it is proving to be very difficult to keep out Omicron. There is the potential for China to lock down much more of the country and thus cause further global supply chain problems.

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	2.42	1.42	6.87
Cautious	2.09	0.55	5.49
Balanced	2.47	1.02	6.67
Adventurous	2.87	0.28	7.21
Dynamic Equity	6.10	2.80	12.30
Income Generating	3.40	2.53	9.10
Fourth Industrial Revolution	4.03	-8.46	0.95
Retirement Investment Solution 1	3.29	1.31	7.61
Retirement Investment Solution 2	3.74	1.49	8.24
Retirement Investment Solution 3	4.15	1.65	8.81

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 31.03.2022.

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

All Bond markets remain below trend, but Pacific, US and World equities all broke back above trend.

Cautious, Balanced and Adventurous portfolios

These portfolios continue to have a high weighting in cash as we have no exposure to bonds. Bonds fell again in March, and we have missed out on most of these falls. UK Gilts are now down 7.25% this year and this shows the benefit of allowing trend following to cut exposure to asset classes that are falling. The equity exposure within the portfolio also did well with the infrastructure fund that is held within the Cautious and Balanced portfolios growing by 11.45%. In addition, the global property fund which is held in all 3 portfolios grew by 7.52%. The exposure to equities was increased on the 1st April, but Japan, Europe, Technology , emerging markets and UK smaller companies remain below trend.

Dynamic Equity portfolio

The Dynamic Equity portfolio will be highly correlated to global stock markets, and we experienced strong gains last month. The momentum philosophy that forms the core of this portfolio retained its exposure to US equities and they were one of the best performing regions. No changes were made this month.

Foundation portfolio

Exposure to bonds remains at the minimal amount possible which has helped protect the portfolio from the further losses experienced in bond markets. This portfolio will always have a much more diversified approach and the exposure in gold and commodities proved to be very profitable. Whilst cash positions remain high due to the fact we have a low exposure to bonds, we did invest more this month in equities as the US, Pacific and Healthcare moved above trend.

Income Generating portfolio

We enacted the first rebalance in nearly a year within this portfolio, by increasing exposure in UK infrastructure and floating rate notes. The infrastructure investments have already proved to be very profitable, and we expect them to continue to do very well, whilst producing high levels of income. We increased exposure to the VT Gravis UK Infrastructure fund from 5% to 7.5%. The Fund has grown by 12.81% over the last year and it is generating an income of 3.69%. The M&G Global Floating Rate Note fund has grown by a steady 3.74% over the last year and pays an income of 4.24%. It helps to protect us against rising interest rates. In order to fund these purchases, we removed all exposure to our emerging market bond funds. Whilst they produce high levels of income, the invasion by Russia has caused them to fall and they are now down as much as UK Gilts over the last year. The exposure to Russia was very small, but there is now a real concern that other emerging economies will struggle as a result of higher inflation.

Fourth Industrial Revolution portfolio

After experiencing a pull back over the last year due to the fear of how rising interest rates will hurt growth companies, we are continuing to see parts of the portfolio rebound significantly. The underlying companies within this portfolio are trying to solve the worlds problems and, due to this, we believe will produce excellent long-term returns. The clean energy fund grew by 5.79% on top of the previous months 11.62% gain as the world looks at how we can become less dependant on Russian gas and oil much sooner. The cyber security fund grew by a further 7.20% as these companies are now vital in protecting the West from an escalation of cyber security warfare from Russia. This may now be a good time to invest in this portfolio.

Retirement Investment Solutions

The Solutions invest partly in the Dynamic Equity portfolio and benefitted from the strong gains there. In addition, the falls in global bonds did not affect the Solutions as there is only a small exposure to them. The investments in gold and commodities performed very well over the month, as did infrastructure and property. Last month we reduced exposure to equities, but the equity rebound has meant that we have increased exposure to US, Pacific and healthcare equities this month. We are extremely pleased with how the Solutions have performed during these difficult times.

Summary of Portfolios

Russia acting irrationally does not make sense. Suppose for a moment that Putin never intended to conquer all of Ukraine: that, from the beginning, his real targets were the energy riches of Ukraine's east, which contain Europe's second-largest known reserves of natural gas (after Norway's). Combine that with Russia's previous territorial seizures in Crimea (which has huge offshore energy fields) and the eastern provinces of Luhansk and Donetsk (which contain part of an enormous shale-gas field), as well as Putin's bid to control most or all of Ukraine's coastline, and the shape of Putin's ambitions become clear. He's less interested in reuniting the Russian-speaking world than he is in securing Russia's energy dominance.

This means it is now a national security issue to develop alternative supply chains and energy independence is a much more urgent argument than decarbonisation over the longer term. We therefore expect an infrastructure boom in the building of wind, solar and nuclear power as well as making the most of existing oil fields in friendly areas such as the North Sea. This infrastructure spend is on top of the factories that need to be built to produce more armaments and the eventual reconstruction of Ukraine.

We are therefore in a pivotal moment in which the global economy needs to adjust to higher prices, higher interest rates and de-globalisation. There will be winners and losers from this change, and we have already seen bonds lose and mining and infrastructure companies benefit. Those companies that are best positioned to pass on higher prices are also set to benefit. This means we need to be flexible in the way we invest money and our trend following and momentum strategies are hopefully best positioned to do this.

Asset Class Review

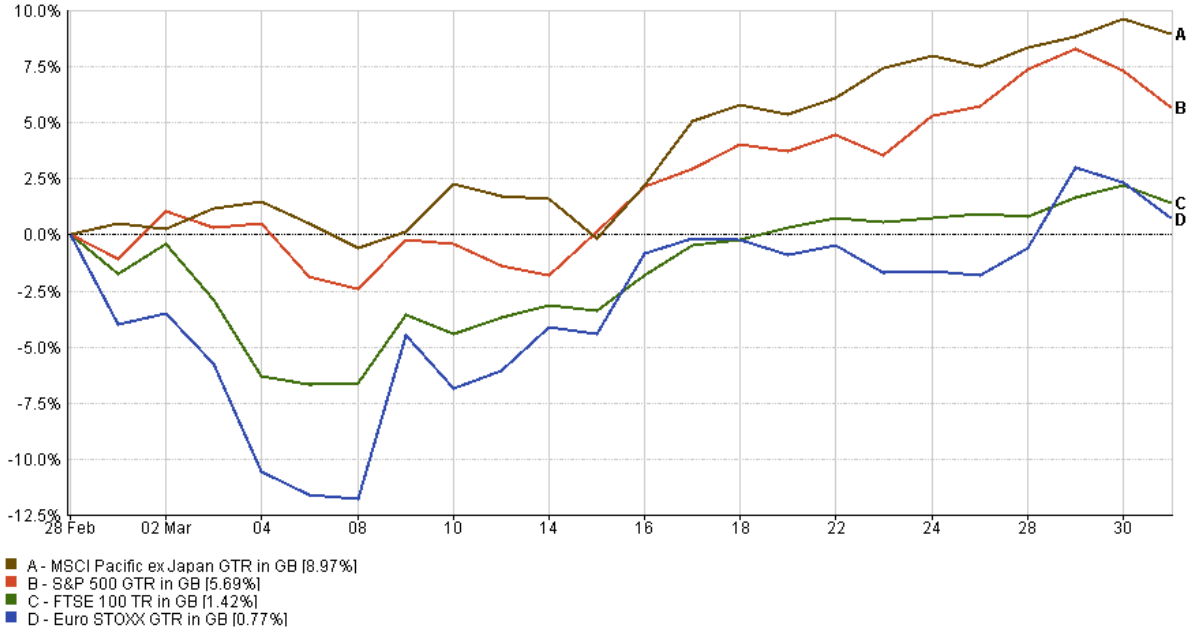
This section will give you an insight into our current thinking and we have included some charts that we believe look interesting. This month we continue to focus on how the invasion has affected certain asset classes.

Are Sanctions Working – reducing the Ruble to Rubble?

The easiest way to judge this is by looking at the value of the ruble, against the US dollar (see chart below) - the higher it goes then the more rubles you need to buy a US dollar. You can see how dramatic the change was when sanctions were first announced. However, subsequently the ruble has mostly recovered as Putin has resorted to extreme financial measures to blunt the West's penalties and inflate his currency. Russia's Central Bank has jacked up interest rates to 20% and the Kremlin has imposed strict capital controls on those wishing to exchange their rubles for dollars or euros. In addition, oil and gas revenues have gone up due to the higher prices of both. Time, as well as Europe stopping the imports of oil and gas, are the only way sanctions will work.

A Terrible War but Stock Markets Advance

The news and pictures coming out of Ukraine have been devastating. However, stock markets go up when bad news becomes slightly less bad news. Russia pulling back from Kyiv is certainly good news as is the falling oil price. This has helped bolster stock markets in March with the major ones advancing as follows:



US Bond Yields surge higher

Bond yields rose again in March as central banks raised interest rates and the US said that there maybe a further 8 rises of 0.25% each. They even intimated that the next rise could be by 0.5%. The yield on the US 10-year bond started the month at 1.825% and finished at 2.338%. As yields go up, prices of bonds fall, and UK Gilts are down 7.26% this year. Cautious investors usually hold a lot of their investments in bonds, but our trend following strategy has ensured that our exposure to bonds is now at the minimal amount and thus this has protected our Cautious investors.

Oil begins to fall

The higher the oil price goes, the better it is for Putin as he will make more money to fund his war. The price was heading above $125, and some even talked about $200. However, the US announced it was releasing 1 million barrels of oil per day from its strategic reserve for the next 6 months and the price is beginning to fall again. This is good news for Ukraine and our cost-of-living squeeze.

In Summary

Stock markets advanced due to bad news getting slightly better. Oil prices falling is extremely good news and so far, the impact from the invasion on financial markets has not been that severe (yet). We do know that markets will continue to be volatile over the next few months though, perhaps more so in bond markets than stock markets.

What is the Inverted Yield Curve?

The bond market just flashed a warning sign that has correctly predicted almost every recession over the past 60 years: an inversion of the US Treasury note yield curve. The curve inverted briefly on the 29th March for the first time since September 2019. That shouldn't be particularly surprising, given how Russia's invasion of Ukraine -- and its economic ramifications -- continue to weigh heavily on the global economy. But what is it and why does it matter?

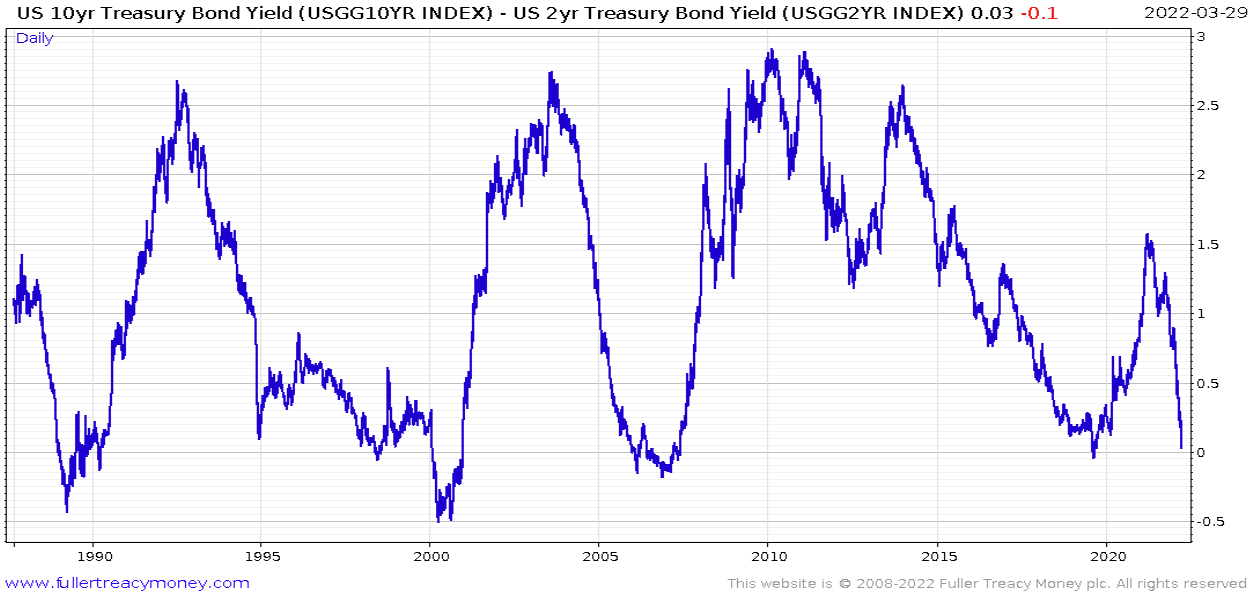
What is the Yield Curve?

A yield curve shows the relationship between the yield (income) on the same bond but at different lengths until it matures. Generally, in developed countries, the curve of the yield plotted against maturity will slope gently upwards, reflecting the fact that investors expect to be paid more interest for locking in their investments for a longer period than a shorter one. The higher the rate they expect, the steeper the curve will be. It is very similar to when you go into a bank as they usually offer a better interest rate the longer you fix the term that you deposit your money with them. Therefore, a 3-year fixed rate bond pays more interest than a 1-year fixed rate bond.

A downward sloping (or 'inverted') yield curve suggests that investors expect long-term interest rates to fall and is often taken as a sign that an economic downturn is on the way. Currently some investors are concerned that interest rates will rise in the short term, but this will cause a recession and force central banks to cut interest rates thereafter. The recent yield curve inversion lasted only minutes whereas previous inversions lasted months at a time. We must see if this was a blip or the beginning of a more prolonged warning sign.

Why does it matter?

An inverted yield curve has happened before every single one of the last eight US recessions, with recession following inversion within 24 months. There has only been one "false positive" in that time. The yield curve over the last 35 years can be seen below and you can see that the recessions of 1990/91, 2001, 2008/09 and 2020 were preceded by an inverted yield curve (when the line goes below zero on the right-hand scale):



Should we panic?

Whilst the inversions in 1998 and 2005 preceded two big stock market crashes, on average, the S&P 500 has grown by 19.13% after a yield-curve inversion, before falling. It has also taken around 18 months from the start of an inversion to when the stock market peaks and begins to fall. We therefore feel that we shouldn't panic this time because:

1. The yield curve predicts recessions but does not give us the time they will happen. On average a recession has been over 15 months away from a yield inversion.
2. The yield curve hasn't inverted yet and in the UK the curve is beginning to go back to normal readings.
3. Economic data at the moment points to a global slowdown but no recession. In fact, we appear to be in a great position with low unemployment, rising wages and historically low interest rates.
4. The dividend yields on major stock markets are still enticing when compared to bonds, and investors wanting an income from their wealth might turn to equity markets and cause them to grow significantly. Historic data shows equity markets tend to do well in the year after an inverted yield curve.
5. Russia and Ukraine appear to be wanting to negotiate peace which, if successful, will lead to a reduction in commodity prices and perhaps interest rates will not have to rise as quickly.

In Summary

Inverted yield curves have been a great predictor of past recessions. This time the concern is that interest rates rise too quickly and choke off any economic growth, from an already fragile economy. The yield curve has not inverted yet (i.e. closed the day in inverted territory) but it is beginning to be discussed. Whilst a full inversion is a worrying moment, history suggests that we should not panic as stock markets tend to go up in the short term after the inversion.

Final Comment

The strong leadership displayed from the West has helped stop Russia from taking the whole of the Ukraine. Whilst the pictures are devastating, the improvement in news flow has helped stock markets to recover. Putin probably underestimated the support that Ukraine would receive, but in terms of economic gains, the East of the Ukraine is the “economic prize” and the one that Putin is now concentrating on.

We are beginning to see the full impact of rising commodity prices in our day to day lives, but we are now also seeing the start of the political and commercial fightback in order to transform our reliance on Russia. It is likely that we will see many smaller nuclear power stations built in the UK, in addition to wind turbines and solar panels. In agriculture, we have already seen US farmers switch from planting corn to soybeans as the amount of fertiliser required is significantly less for soybeans (the price of fertiliser is at record highs).

This is certainly a very interesting time for investment markets, and we will undoubtedly see many winners and losers over the next few months and years. Having a diversified portfolio and one that can significantly increase and decrease exposure to different asset classes is the best way to take advantage of the changes as well as hopefully to protect our wealth from those asset classes that fall the most.

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