Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update
May 2022

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Performance Update

Global stock markets fell in April with the FTSE 250, Euro Stoxx & S&P 500 falling 1.77%, 0.93% and 8.74% respectively. The FTSE100 rose 0.76%. As a result, our portfolios fell between 0.46% and 6.60%.

Volatility remains high on an intra-day and daily basis, as markets have plenty on the radar including inflation, the Ukraine war, China's Covid-19 outbreak, and interest rate rises. During the pandemic we experienced money printing on a scale that was previously unimaginable. This has caused the inflationary pressures we are faced with today. Central Banks are pulling liquidity out of the market to unwind this as well as raising interest rates.

The US stock market fell significantly last month due to its high weighting to technology companies, which are particularly hit hard when interest rates rise. The good news is that, as the US is expected to raise interest rates more than the UK, the value of sterling is falling against the US Dollar so, whilst the S&P500 fell 8.74% in dollar terms, it only fell 4.30% when converted to sterling.

We are in a corrective phase for stock markets, which has normally presented a great buying opportunity. The worry this time is that rising interest rates will only reduce economic growth, not inflation, and we will be left with stagflation.

Bonds also suffered losses for their fifth consecutive month, with the price of UK corporate bonds falling by 2.42% and UK Gilts by 2.26%. The Foundation portfolio is our only portfolio that currently invests in bonds, and exposure is only at the minimal amount.

Last month agricultural prices rose again. Ukraine will plant and grow less food this year and there are issues with harvesting and shipping the crops. Supermarkets are getting used to missing lines of product, with a shortage of cooking oil the latest problem. This rapid rise in the price of basic food is causing serious problems for the budgets of many people, especially those on lower incomes and in lower-income countries. Politicians need to help with the cost-of-living squeeze otherwise they risk failure at the next election. We may also see some uprisings, similar to the Arab spring of 2011.

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	-0.46	0.19	4.11
Cautious	-0.67	-1.02	2.52
Balanced	-1.05	-1.13	2.69
Adventurous	-1.73	-3.26	2.20
Dynamic Equity	-2.77	-2.62	5.22
Income Generating	-0.88	0.66	5.47
Fourth Industrial Revolution	-6.60	-16.00	-9.96
Retirement Investment Solution 1	-1.10	-1.53	3.08
Retirement Investment Solution 2	-1.39	-1.79	3.28
Retirement Investment Solution 3	-1.65	-2.03	3.46

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 30.04.2022.

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	x	Emerging Market Equity	x
UK Equity	✓	Commodities	✓
Europe ex UK Equity	x	UK Corporate Bonds	x
US Equity	x	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, and the US and World equities broke back below 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 April, and we have missed out on most of these falls. Exposure to equities was decreased as US equities in particular fell in April. All three portfolios saw exposure cut in US and World equities. The Adventurous portfolio saw North American equity exposure cut as well, but exposure was initiated in mining companies as they have moved up to the top place in the momentum screen after the increase in all commodity prices.

Dynamic Equity portfolio

The momentum philosophy that forms the core of this portfolio removed its exposure to technology as many technology companies fell significantly in April. They were replaced with mining companies via a purchase in the JP Morgan Natural Resources fund. The Fund buys companies such as Rio Tinto and BHP Group, which are benefitting significantly from the rise in commodity prices.

Foundation portfolio

The Foundation portfolio fell the least during the month, which highlights the fact that it is our lowest risk portfolio. Exposure to bonds remains at the minimal amount possible which has helped protect the portfolio from the further losses experienced in bond markets. The cash position remains elevated at around 30%. This was increased as we reduced exposure to US equities.

Income Generating portfolio

The portfolio is proving to be very defensive during this volatile period. This can be demonstrated when we compare the performance over the last year to the Dynamic Equity portfolio. Whilst they have achieved similar returns, the blue line (Income Generating portfolio) has not risen or fallen as much during the journey:

Fourth Industrial Revolution portfolio

This is our most volatile and risky portfolio, with every underlying fund falling in April. Since launch the portfolio has performed in line with the main US stock market (S&P500), albeit in a more volatile way:

Retirement Investment Solutions

The Solutions invest partly in the Dynamic Equity portfolio so suffered losses from this, but the balance is invested in trend following portfolios which now have a high level of cash, thus protecting them from further falls. They have the minimum amount invested in bonds and equity exposure was reduced a little as US equities moved below trend. The investments in commodities, infrastructure and property continue to perform very well.

Summary of Portfolios

The primary aim of central banks is to quell inflationary expectations, which they do through raising interest rates and removing liquidity from the market (reversing quantitative easing). The total assets of central banks has already contracted by $1.75 trillion since mid-February. That has unwound about 13% of the pandemic liquidity infusion. Interest rates are also rising, with the US expected to raise rates more than other countries. This has pushed up the value of the dollar and helped protect our portfolios due to their significant US exposure.

We therefore remain 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 continue to see bonds lose value 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

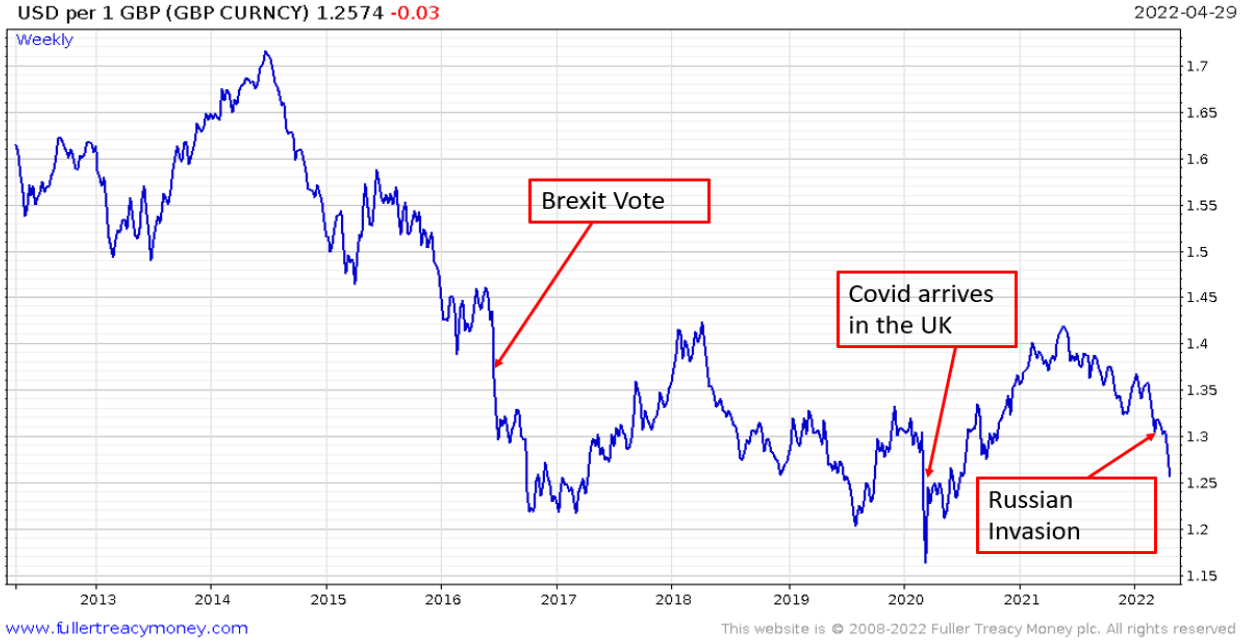
This section will give you an insight into our current thinking. There are so many charts that have moved significantly this year and we are focussing on those that have probably affected our wealth the most.

S&P500– consolidating after big gains

The S&P500 houses the largest and most successful companies in the USA, such as Apple, Microsoft, Amazon and Tesla. The stock market has been one of the worlds leading performers over the last 3 years, but it is now in a corrective phase as technology companies are no longer in favour. Is this a great opportunity to buy some of the worlds leading companies cheaply, or the start of a more significant pull back to where we were pre-covid?

Sterling falls significantly against the dollar

The good news is that as sterling falls, our investments in US stock markets go up when converted back to sterling. This is a major reason why our portfolios have been somewhat protected from the recent stock market falls. You can see from the chart how sterling fell after the Brexit vote, and how it fell after Covid hit our shores. Sterling was beginning to recover but the Russian invasion of Ukraine has resulted in another significant fall in sterling.



Food prices moving higher again

The chart below shows the price of a basket of agriculture commodities, and you can see that it surged higher after the start of the invasion. The chart was beginning to give up some of these gains, but April has seen it move higher. Therefore, there will be no respite in the cost of our supermarket shop and thus inflation. The additional problem is that as sterling falls, it increases the price of agriculture commodities when rebased into sterling. This means the UK could face higher inflation than other western countries. Higher food prices in 2011 caused uprisings in Egypt and Libya and we could be about to see more political unrest globally.

China - Zero Covid policy is affecting stock markets there

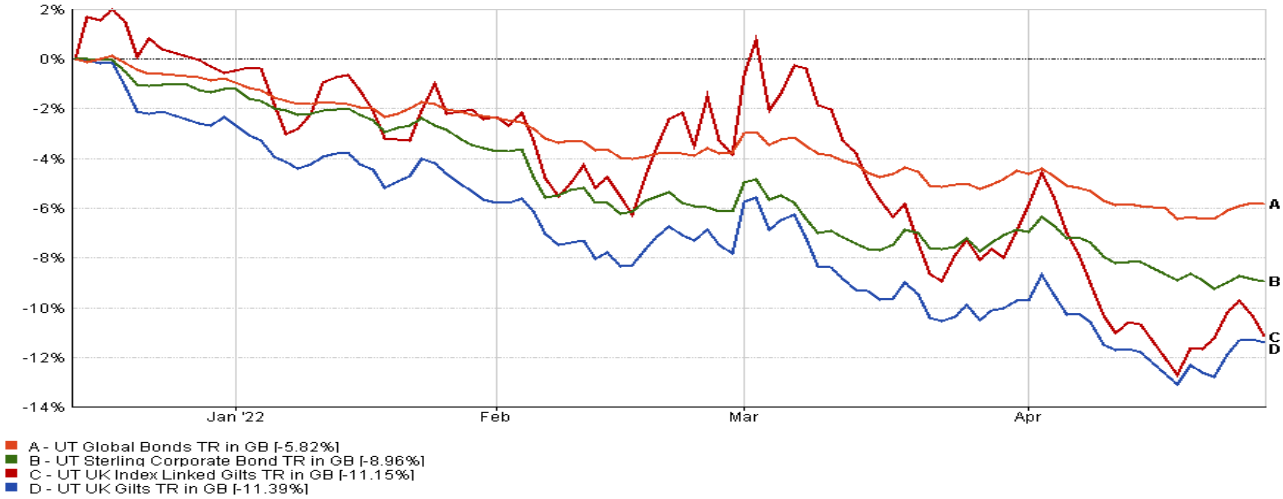
China's decision to operate a zero covid policy is hurting the global economy as it further exasperates supply chains. As our economy reopens, China's is locking down again, and the stock market has fallen further. Whilst we have very little money invested in China, it is a sign of what will happen if we see another more dangerous variant emerge and we are forced again to lockdown. This fear, as well as the lack of goods being supplied by China, is causing a headwind for stock markets and is one of the reasons why we have seen recent falls such as in the China CSI300 index below.

In Summary

After a resurgence in March, global stock markets fell in April. The worlds leading stock market, the S&P500, has fallen significantly and we are probably at a crucial stage where investors will "buy the dip" or we see little support and further significant falls. In recent times buying the dip has proved to be very profitable. The good news is that once again when we have a major world event, sterling has fallen which has helped protect our wealth.

James Bond - minus 007%

Since the 15th December, bond markets are moving in a very consistent downward trend. The chart below shows the average performance of funds in different bond sectors - UK Gilts, UK Index (Inflation) Linked Gilts, UK Corporate Bonds and Global Bonds:



What is happening?

Since the mid 80's the yield on US 30 Year Treasury bonds has fallen from over 14% to hit a low in 2020 of below 1%. The chart below shows how dramatic the fall has been:

As the yield falls, the value of the bond goes up and bond funds have grown by around 5% per annum since 1990. Recently with the spike in inflation, we have seen Central Banks start to raise rates and there is talk about future more significant rises. You can see the yield going up and bonds have thus fallen. From the chart above, you can see how bond yields rose in the 1970's to combat inflation. Whilst we are no where near 14%, comparisons are beginning to be made about the problems faced in the 70's being similar to those faced today.

Will interest rates go above 10%?

Inflation soared to 7% last month, the highest for 30 years, and the Bank of England is predicting 8% later this year. We have all started to feel it with the price of just about everything rising. The Bank of England has already raised rates from 0.1% to 0.75% and are expected to increase it to 1% this month (5th May), with economists predicting that they will rise to 3% in this current cycle. In 1979 Margaret thatcher raised interest rates to 17% to help combat inflation.

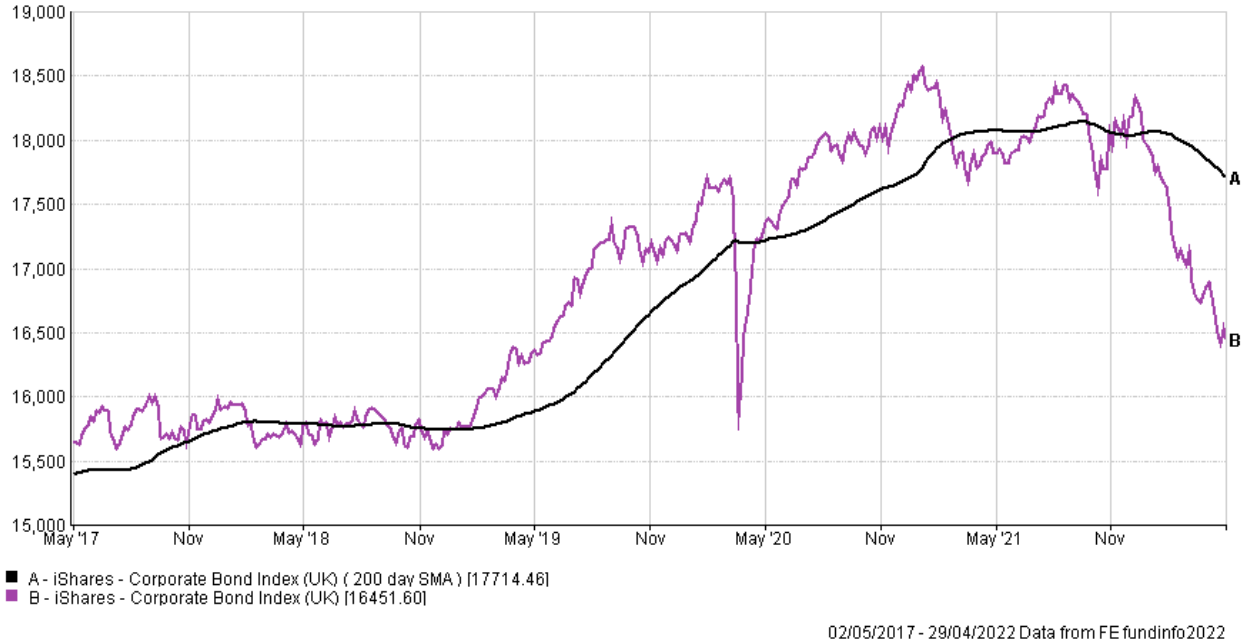
Back in the 70's inflation in the US hit 20% and the cause – money printing and rising oil prices (up 300% in the oil crises of 1973). We have two similar problems today.

Governments are now beginning to reign in their economies with the UK one of the first to raise taxes in order to pay for the monetary support given during the initial stages of the pandemic. Higher taxes, higher interest rates, less money being printed and higher costs of food and energy, are naturally reducing economic growth (a recession is not being ruled out). This should in turn naturally reduce inflation and interest rates peaking at 3% is the probable short to medium term likelihood. In the medium to long-term moving away from oil and gas (particularly Russian) should help bring stable energy costs and this should calm inflation.

The problem we have is that we are enduring a very volatile environment in which we could see further problems in the supply of goods and commodities due to the China lockdowns and Russia tightening its grip on the economic powerhouse within Ukraine. Thus, we could continue to have high inflation despite rising interest rates and enter a period known as stagflation (high inflation and low/negative economic growth).

How do we protect your Wealth from Falling Bonds?

By employing trend following as our investment philosophy on most of our portfolios, it simply reduces or removes exposure to an asset class when it moves below the trend line (the average price of the asset over the last 200 days). The chart below shows the price of UK Corporate Bonds in purple and their trend line in black. Exposure to corporate bonds was removed at the beginning of January 2022 when the purple line was below the black line and thus, we have missed most of the falls. This has in particular helped protect our more cautious clients, as cautious investors tend to have more of their wealth allocated to bonds.



In Summary

Interest rates are rising to combat inflation, and this has led to steady losses in bond funds. We are expecting interest rates to continue to rise and inflation to be stubbornly high, but the general expectation is that we will see interest rates peak at around 3% for this cycle. What happens in the long term no body knows, but one of the main reasons that inflation and interest rates have fallen over the last 30 years is globalisation. For example, we have traded more with China who have in turn lowered production costs and inflation. We are seeing the unwinding of globalisation as we try and reduce our dependency on China and Russia and thus, we have a catalyst for a continuation of inflation. However, the second main pillar of falling inflation remains–technology advancement. Technology is reducing costs as we become more and more efficient in how we produce goods. We see technology advancement growing exponentially and this should help keep a lid on inflation and stop interest rates from having to advance too much.

Final Comment

We are all experiencing the effects of higher taxes, higher inflation and higher interest rates in our day to day lives. This is causing much uncertainty within investment markets, and we are in a corrective phase for stock markets, where they give up previous gains. There is a fine balancing act that central banks must go through to ensure that the economy does not slow too much and dip into a recession, coupled with ensuring that inflation does not run too hot.

Inflation should naturally fall as we have less money to spend on goods, but with the supply of food and goods from Ukraine, Russia and China all falling, we have a very uncertain period for inflation. Demand can fall but so has supply.

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.

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

Tel: 01708 250624

Email: chrismoore@watsonmooreifa.com

www.watsonmooreifa.com