Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

# Monthly Investment Update
## June 2022

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## Performance Update

Global stock markets had a mixed month with the FTSE 100 gaining 0.81%, but the FTSE 250 and US equities fell 1.14% and 2.21% respectively. Overall, our portfolios fell between 0.48% and 3.32%.

Stock markets fell considerably at the beginning of the month, but then experienced a rebound which helped pare some of the losses. Whilst there hasn't been any resounding good news, the rebound coincided with some positive company results in the US and inflation figures which give us some hope that we have passed the peak in inflation.

Food is going to be at the centre of political debates in the months ahead. The disruption to grain and vegetable oil markets by the loss of exports from Ukraine and Russia has driven up prices of grains by half and some vegetable oils by more, as people contemplate shortages. Sri Lanka has already replaced their Prime Minster partly as a result of food riots. Argentina has seen her inflation rate surge to 58%, with mass protests on the streets as their cost-of-living crisis deepens. The poor will be hit the hardest and need support. Longer-term technology advancement will need to be harnessed to provide a future of abundant food and energy – whilst Covid proved to be a catalyst for biotech companies, the war could be the catalyst for green energy and agrotechnology.

We remain in a corrective phase for stock markets, which has normally presented a great buying opportunity. There are signs that the corrective phase is over, but the worry remains that rising interest rates will only reduce economic growth, not inflation, and we will be left with stagflation. We, therefore, continue to highlight that the potential gains or losses over the next few months from our portfolios could be much greater than normal.

A further acceleration in global inflation kept up the pressure on central banks to raise interest rates even more during the summer. Germany's inflation rate hit 8.7% and was last this high during the 1973/74 oil shocks. This caused bonds to fall once again. The Foundation portfolio is our only portfolio that currently invests in bonds, and exposure is only at the minimal amount.

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 | -0.92 | -1.63 | 2.70 |
| Cautious | -0.63 | -2.21 | 1.44 |
| Balanced | -0.71 | -2.34 | 1.66 |
| Adventurous | -0.48 | -4.38 | 1.81 |
| Dynamic Equity | -1.07 | -4.72 | 4.97 |
| Income Generating | -0.49 | 0.44 | 4.10 |
| Fourth Industrial Revolution | -3.32 | -19.31 | -9.55 |
| Retirement Investment Solution 1 | -0.98 | -3.21 | 2.30 |
| Retirement Investment Solution 2 | -1.00 | -3.53 | 2.60 |
| Retirement Investment Solution 3 | -1.02 | -3.83 | 2.87 |

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 31.05.2022.

## 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 | x | Emerging Market Bonds | x |
| Global Infrastructure | ✓ | Overseas Corporate Bonds | x |

All Bond markets remain below trend. Global property fell below trend this month.

## 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 May, and we have missed these falls. Exposure to equities was decreased as global property companies went below trend. The Adventurous portfolio outperformed due to a strong return from its mining position. This investment is considered too high risk for the Cautious and Balanced portfolios.

## Dynamic Equity portfolio

There were no changes this month. Last month's investment into the JP Morgan Natural Resources fund proved to be effective as it rose 7.57%. The Fund buys companies such as Rio Tinto and BHP Group, which are benefitting significantly from the rise in commodity prices.

## Foundation portfolio

The 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 31%. This was increased as we reduced exposure to global property companies.

## Income Generating portfolio

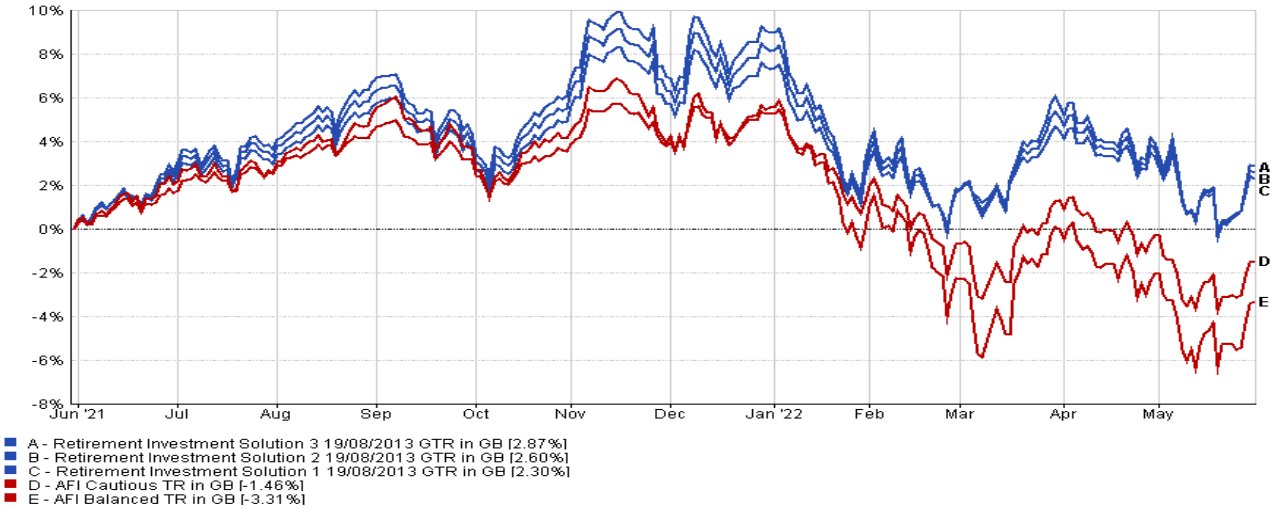
The portfolio is our best performing one over the last 6 months, as some of the funds have proved to be very resilient during these difficult times. Investors have moved money out of the high growth non-dividend paying companies and into those that have stable and higher dividends. The chart below shows how one of our holdings (blue line) has outperformed the MSCI World Index over the last 6 months:

## Fourth Industrial Revolution portfolio

We are beginning to see pockets of growth within this portfolio as clean energy and biotech have started to make good gains rising by over 4% last month. However, the biggest global technology companies are still struggling with the L&G Global Technology fund falling by 5.25%. Whilst overall the portfolio fell 3.32%, it recovered by 4.70% from the 12th of May. This could be the beginning of a longer recovery period, but in order to see that we will need to see inflation start to come down and thus interest rates will not have to rise as much as expected.

## 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 global property moved below trend. The Solutions are designed to be more defensive and protect wealth during the difficult times and if we compare the average cautious and balanced risk portfolios (red lines) to our 3 Solutions (blue lines) over the last year, you can see how they have fallen significantly less recently:




## Summary of Portfolios

If the price of a good goes up from £1 to £1.10 in a year, then we have 10% inflation. The price then has to rise to £1.21 next year for inflation to remain at 10%. Whilst inflation numbers remain elevated, there is optimism that the current spike is down to one-off factors mainly driven by the Ukraine war. Some investors believe that inflation will thus start to fall as we begin to adjust to high oil and gas prices, as well as a shortage of different food groups. Technology will almost certainly help in the long run but in the short term, we are seeing an increase in the production of energy through fossil fuels in Europe, investment in renewable energy and farmers increasing the planting of crops that are in short supply.

If interest rates do not have to rise as much as expected, this will act as the catalyst for a rebound in both bonds and equities. In addition, if we get some resolution in the Ukraine war then we should expect a rebound in asset prices. Therefore, we remain in a pivotal moment in which we must expect higher than average daily and monthly swings in the value of our portfolios. We remain positive that technology will help solve a lot of our longer-term economic problems with cheaper future energy and food, but in the short term, we still remain vulnerable to Putin, higher inflation, rising interest rates and a zero Covid policy in China. 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. The big question being asked at the moment is, "are we over the worst of this current correction?". The charts below look at where we are in the current correction and there are signs that we may be at the bottom.

## FTSE250– below pre-Covid levels but may have hit a floor

The FTSE250 recovered extremely well after the Covid crash, but we have recently experienced a series of lower highs with the market falling back to below where it was pre-Covid. However, it looks like we have hit a floor at which it has now bounced twice from, and this could indicate an end to the current correction. The yield on the FTSE250 and FTSE100 is 2.76% and 3.90% respectively, which demonstrates that the UK appears to be at a level that offers good long-term value.


## Euro STOXX 50 – a similar pattern is seen in Europe

The pattern is almost identical, with a floor appearing and the stock market below pre-Covid levels. The dividend yield is 2.37%. Again, the stock market appears to be offering good long-term value and we could now be set for a period of higher highs and lows whilst a recovery occurs.

## Technology – still overvalued?

The Nasdaq100 comprises mainly of the biggest global technology companies such as Apple, Microsoft and Amazon. The rally after the Covid crash was exceptional and this stock market was leading every other market higher. However, leaders also tend to lead in both directions and the falls this year have been significant and have led other stock markets lower. The market could still fall significantly further from here but remain above pre-Covid levels. Whilst the biggest technology companies are still falling, the good news is that we are beginning to see recoveries in other technology-related sectors such as clean energy and biotech.


## Emerging Markets – in a consistent downtrend

China's decision to operate a zero covid policy continues to provide a headwind for emerging markets. The market is below pre-covid levels and shows no sign of breaking the downtrend yet.

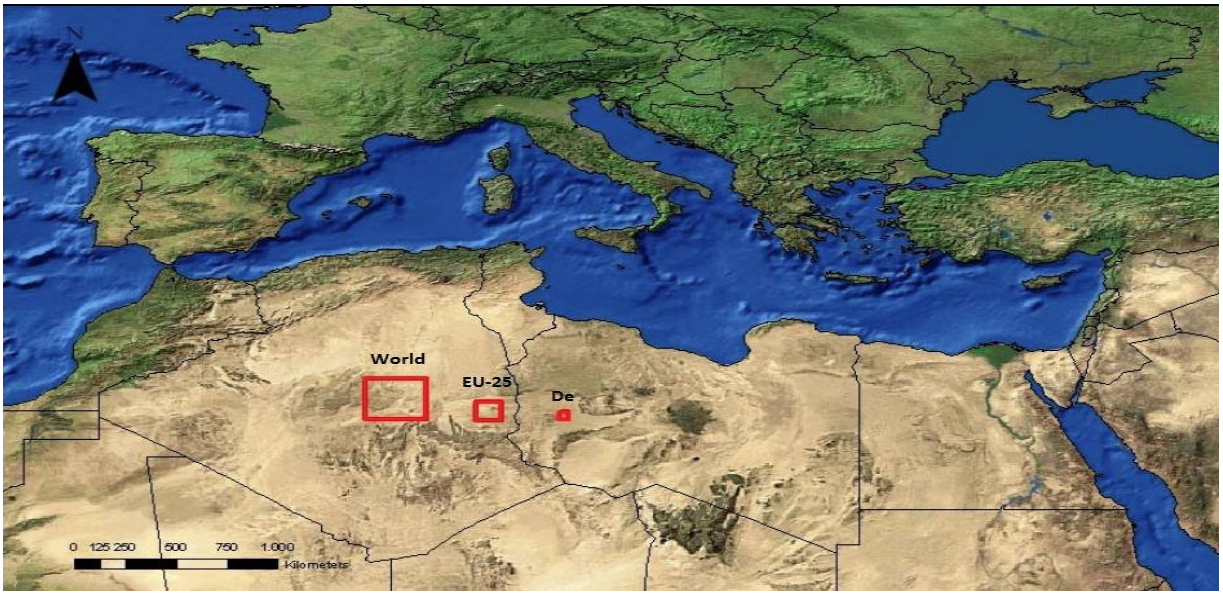

## In Summary

There is a lot of evidence that we could be at the end of this current correction, with UK and European markets bouncing off a floor. They are not expensive and offer an attractive dividend yield. However, technology companies could still fall from here and this would likely drag most stock markets down.

# Billericay Saves the World

Over the years oil and gas have caused numerous wars. It was arguably the reason behind the Gulf wars and, without the West buying Russian oil and gas, Putin would not have had the finances for his Ukraine invasion. It is also the main cause of global warming. However, a little company in Billericay could be about to play its part in reducing the importance of oil and gas in our lives.

"One Sun One World One Grid" (OSOWOG) is an initiative launched by Boris Johnson and the Indian Prime Minster designed to transport solar power to different countries. Effectively a criss-cross pattern of cables would transport electricity around the world to ensure that the global grid matches the supply of power with demand, owing to the intermittent nature of renewable energy. The map below is from 2017 and shows the predicted land in the Sahara desert that needs to be covered in solar panels to power the world, the EU and Germany with electricity – just a fraction of the Sahara desert!




The "Morocco-UK Power Project" is drawing widespread attention as the ambitious project could connect the UK to Morocco's renewable energy. You can generate three times more solar energy per square metre in Morocco than you could ever do in the UK. The objectives of the project are to create an abundant source of energy, energy security for the UK and a future in which you pay for electricity as you do for broadband (a one-off monthly fee for unlimited electricity).

Solar panels would generate the power in Morocco, which would then travel via four cables underwater with each cable being nearly 4,000km long - passing Spain, Portugal, and France, before reaching the National Grid in Devon. Initially, the project would produce 8% of the UK's electricity demand. The problems associated with transporting this electricity is where a company in Billericay comes in, called XLCC (or Xlinks).

Only a year old and run by the former CEO of Tesco, the company aims to deliver the project by 2030. They are currently designing a vessel, which will be built in UK shipyards, that will lay the HVDC cable (again manufactured in the UK) across the ocean that will allow the electricity to flow into the National Grid in Devon. A lithium-ion battery, like those used in cars, will store the electricity to be used in Britain when it is needed most. This will stop our reliance on coal-fired power stations that have to produce electricity when the sun doesn't shine, and the wind doesn't blow in the UK.

## Conclusion

Whilst the news headlines can be depressing, there is also so much under-reported great news from companies and technologies that are helping to solve some of the world's most pressing problems. Many of these businesses are based in the UK and build upon the great and ground-breaking technological research that emanates from our world-class Universities. Who would have thought a small town in Essex would be at the forefront of stopping future wars and curtailing global warming?

## Final Comment

What happens with inflation is currently the most important factor affecting our wealth. Hopes that inflation has peaked provided stock markets with a reason to rebound towards the end of last month, but inflation remains elevated and prone to supply chain disruptions. There are signs that we are at the end of the current corrective phase in stock markets but must remain wary that there is much uncertainty as to what is happening with the war in Ukraine, inflation, interest rates and how China is handling Covid. Governments globally are concerned and are beginning to try and support consumers, but if they don't do enough then we should expect political upheaval and thus more uncertainty.

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**