

Monthly Investment Update

July 2022

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Performance Update

Global stock markets have had one of the worst starts on record, with many falling into bear market territory (a fall of 20% or more from their high). Last month the FTSE 100, FTSE 250 and S&P500 fell 5.44%, 8.91% and 5.29% respectively. Overall, our portfolios fell between 2.15% and 5.96%.

Headline inflation figures raced ahead, with the UK expected to see inflation peak at around 11% this month. This has caused Central Banks to raise interest rates in order to try and combat it. The US Federal Reserve (Fed) raised rates by 0.75% which was the biggest hike since 1994. Since 1950 the Fed has embarked on “monetary tightening” 12 times, with 9 of them resulting in a recession. Stock markets have already priced in that a mild recession is coming at the end of this year or the start of next.

Normally when we enter a recession, interest rates are cut to try and stimulate the economy. Whilst typically equities fall, Government bonds tend to move higher and offset some of the losses, especially for more cautious investors. This time, however, interest rates are rising, and lower-risk Government bonds have fallen in line with equities. Over the last year, UK Gilts have fallen 14.54% and Inflation-Linked bonds are down 23.3% (they fell an incredible 14.1% last month).

Whilst headline inflation is running away, the price of many commodities is now actually falling. Copper has fallen 22% in the last 3 months; wheat is down 24.6% last month and even oil fell 3.27% in June. Inflation could therefore fall quite quickly over the next 6 months. We are also experiencing shrinkflation again, in which many products shrink rather than have price increases. For example, the number of packets of crisps in a Walkers multipack has already fallen 8% (from 24 bags to 22 bags). Similarly, Kleenex tissues have seen a reduction of over 11% (down from 72 in a box to 64).

Our Trend Following portfolios have significantly raised the amount they have invested in cash this year and have very little invested in bonds. There are only a few markets that remain above trend. Interestingly China moved above trend this month after many months of being below trend.

The performance of the portfolios over the last month, 6 months and 1 year are shown below:

Portfolio	Performance % 1 month	Performance % 6 months	Performance % 1 year
Foundation	-3.09	-5.05	-1.40
Cautious	-2.15	-5.33	-1.72
Balanced	-2.72	-6.35	-2.40
Adventurous	-3.69	-9.64	-4.11
Dynamic Equity	-5.96	-12.84	-4.92
Income Generating	-4.95	-7.57	-1.83
Fourth Industrial Revolution	-4.92	-22.71	-19.37
Retirement Investment Solution 1	-3.53	-8.02	-3.30
Retirement Investment Solution 2	-3.92	-8.91	-3.69
Retirement Investment Solution 3	-4.28	-9.71	-4.05

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	x	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	x	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. UK & Pacific equities fell below trend this month.

Cautious, Balanced and Adventurous portfolios

These portfolios continue to have a high weighting in cash and no exposure to bonds. The cash weighting this month was again increased as Pacific and UK equities fell below trend. The cash position currently stands at 57.6%, 50.2% and 47.0% for the Cautious, Balanced and Adventurous portfolios, respectively. This means that returns, negative or positive, will be much lower going forward, and will continue to be until we experience a reversal of the current negative trends.

Dynamic Equity portfolio

There were no changes this month. We still have a relatively high weighting in US equities, which have benefitted from a strong dollar and weak sterling. Sterling has fallen 12.3% against the dollar which has meant that an investment in US equities over the last year has actually led to a gain when converted into sterling.

Foundation portfolio

The portfolio is our most diverse portfolio as we retain some exposure to each asset class even if it is below trend. Therefore, we are using diversification as well as trend following to try and help smooth out returns. The exposure to bonds remains at the minimal amount possible and the cash position remains elevated. It is our best-performing portfolio over 1 year.

Income Generating portfolio

The individual funds that make up the portfolio have one of the widest range of returns that we have experienced. For example, the BNY Global Income fund, which invests in quality global companies, has grown by 8.35% over the last year. Just as good is the VT Gravis UK Infrastructure fund which has grown by 8.86%. However, the Jupiter Investment Grade fund has fallen by 14.65% over the last year and the Nomura Global Dynamic Bond fund is down 13.57%. Our process has ensured that we have had more money in the better-performing funds.

[Fourth Industrial Revolution portfolio](#)

The portfolio fell in line with global equity markets and has suffered significant falls over the last year due to rising interest rates. Most technology-orientated companies are classified as growth companies, with profits that will increase a long time in the future. When interest rates are low the opportunity cost of waiting for those profits is less relevant (i.e. if we invest in a business, we are not losing any/much interest, so we are not worried about receiving a dividend for a while). However, when interest rates go up, we lose, say, 4% interest that we could have achieved in a bank. Therefore, we are looking to receive dividends sooner rather than later and so are less willing to pay as much for future profits (share prices go down). If we experience a peak in inflation (see asset class review) then this could be an excellent time to be investing in this portfolio as it is likely that interest rates will not go up as much as expected.

[Retirement Investment Solutions](#)

The Solutions continue to have a high level of cash, and equity exposure was further reduced as UK and Pacific equities moved below trend. Despite suffering falls last month, they continue to significantly outperform most cautious and balanced risk portfolios.

[Summary of Portfolios](#)

Stock markets have suffered one of their worst starts to a year on record. It is very easy to see why markets have been so weak. As Covid-19 closed the economy and forced us to stay at home, every major government printed billions in extra money to help keep the economy from being decimated. This has now created inflation on a scale not seen since the 70s. The invasion of Ukraine has further caused problems and led to higher inflation as well as supply chain problems. The main tool central banks have to bring inflation under control is to raise interest rates, and, if necessary, push the economy into a recession. These actions have caused stock markets to give up their 2021 gains as well as cause bond markets to fall significantly.

The good news, however, is that a terrible start to a year is generally followed by a strong second half. Research has shown that the S&P500 has been down by 15% or more in the first half of the year on six occasions since 1930 and on each of these occasions, the second half has shown a strong bounce back with an average gain of 22%. If inflation falls from here, interest rates don't rise as much as expected, employment remains strong and we have a possible truce in Ukraine by the Autumn, then we would expect a similar rebound this time around.

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 the prices of some major commodities and how they have fallen recently – is this signalling that inflation will fall shortly?

Copper- down 20% from its high

Because of copper's widespread applications in most sectors of the economy – from homes and factories to electronics and power generation and transmission – demand for copper is often viewed as a reliable leading indicator of economic health as well as future inflation. For inflation to continue to go up then prices must continually rise. Copper peaked at the beginning of the Ukraine war, and you can see how this has been one of the factors in the high inflation rates that we now have. However, it has fallen over 20% from its high and this could be signalling that inflation will moderate in 3-6 months time.



Corn –fallen by over 22%

Corn is one of the major agricultural commodities, and the chart pattern below is similar to many other agricultural products. The price has fallen over 20%, which should lead to less inflation going forward, especially with the probability that the Ukraine harvest will now be shipped out from the war zone.



US Gas –fallen by over 40%

The invasion of Ukraine caused gas prices to spike in both Europe and the US. However, since the high in May, US gas prices have fallen over 40%, again pointing to lower future inflation. The price is now back to where it was before the invasion.



All commodities – the price is falling but is way off previous highs

The Bloomberg Commodity Index measures the price of a wide-ranging basket of commodities including gold, agriculture, energy and industrial metals. The chart shows the price over the last 30 years, and you can see how it has fallen by 10% recently and is also back to levels seen in 2004. You can therefore see how we have experienced very little inflation over the last 20 years; why we have experienced high inflation now; and why we might just be at the end of this inflationary cycle.



In Summary

Stock markets have fallen due to interest rates rising in order to fight a rapidly rising inflation figure. Perhaps we are at the end of this inflationary cycle, due to the slowdown in the global economy (potential recession) as well as the fall in commodity prices. If this is the case then interest rates may not rise much more and this could be the catalyst for stock markets to move higher, having already hit their lows.

Shrinkflation Returns

As inflation continues to eat away at companies' bottom lines, businesses are rapidly choosing an alternative to raising prices: shrinkflation. Shrinkflation is the act of downsizing the size or quality of a good while holding its price constant. We have seen this occur regularly when we have been faced with previous inflationary cycles and/or recessions. Two of the most famous examples being that the number of "monster munch" feet in a packet dropped from 13 in the 80s to around 10 now; and the gaps between Toblerone chunks increased in 2014 thus reducing the weight by around 10%.

With the spiralling cost of living crisis affecting us all and inflation at a 40-year high, shrinkflation is happening again. Here are some examples:



Cadbury has shrunk the size of Dairy Milk sharing bars by 10%.



Walkers have removed 2 bags from its family pack. The bags cut probably have the most expensive flavouring.



Angel Soft paper towels have reduced from 425 sheets to 320, although the company says that they are now 20% thicker.



And our favourite! Folgers coffee reduced from 51oz to 43.5oz but still makes 400 cups! They have responded by saying that their beans are now better and therefore you need less.

In addition to reducing the sizes of products, Which?, has found that the number of promotional offers has fallen as well as the savings being offered for each promotion.

Most people are price-conscious but not weight-conscious; this is shrinkflation in practice. Applying shrinkflation does not impact inflation as inflation simply measures the price of a basket of commodities and doesn't consider the size. Real inflation could therefore be much higher than the headline and shrinkflation is thus a hidden form of inflation.

Conclusion

Shrinkflation has been part of a company's armoury in their fight against inflation. Big global companies that have loyal customers and well-known brands constantly change the size, quality and number of offers on their products depending on the economic cycle. In a "boom" period price isn't as important and "mega" deals, two for one, and "biggest ever" are regularly seen. Conversely, during a recession/inflationary times, we experience the opposite.

The biggest global companies can therefore protect their own margins and sales by using shrinkflation and become almost immune to economic cycles. Our portfolios are full of these types of "quality" companies.

Final Comment

What happens with inflation remains the most important factor affecting our wealth as it is the biggest determinant of how far interest rates will rise in this cycle. We are currently seeing the input prices of the goods we consume fall rapidly and this should mean that inflationary pressures subside. If this is indeed the case, then interest rates will surely not have to rise as much as expected.

Lower inflation and lower interest rates should provide a catalyst for a rebound in stock markets despite a recession looking a distinct possibility. 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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