Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update

August 2022

Contents:

Performance Update

Global stock markets bounced from their lows, with the FTSE100, Euro Stoxx and S&P500 rising 3.67%, 4.48% and 8.97% respectively. This helped our portfolios grow between 1.73% and 9.51%.

The headlines are terrible. The US entered a recession (two-quarters of negative growth); interest rates in the US jumped by 0.75% to 2.5%; scaremongering tactics in the Conservative leadership election say that if Liz Truss's tax cuts go through then interest rates will have to rise to 7%; and inflation in the UK hit a 40 year high of 9.4%. So why did stock markets go up? Businesses in America are doing well and creating 400,000 jobs a month and posting better than expected revenue. In addition, an economic slowdown should mean that inflation naturally falls and therefore interest rates don't go up as much – another case of bad news is good news!

Despite interest rates rising, they are now not expected to rise as much as previously thought. This led to bonds going up in value in July and clawing back some of their previous losses. UK Gilts rose by 3.01% but are still down 14.41% over the last 12 months.

Whilst headline inflation is continuing to run away, there is now a feeling that it has peaked as the price of many commodities has fallen (despite McDonald's raising the price of their cheeseburger from 99p to £1.19!). The major outlier is gas prices, and this is what Putin is using as his negotiating tactic. The spike in natural gas prices will remain a big challenge for consumers and businesses as Winter looms.

A strong US dollar has helped our portfolios as we have a significant amount invested in the US. As sterling falls against the dollar then the price of our investment goes up when converted back to sterling. However, we could be at the end of this particular trend and there are signs that sterling is recovering.

Inflation in the UK is likely to be much higher than elsewhere and, with all the current political instability, we can expect some negative headlines. Please remember that what happens in the UK does not affect our investments as much as what happens in the US and elsewhere.

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	2.45	-0.09	-0.28
Cautious	1.73	-0.17	-0.92
Balanced	2.11	-0.48	-0.81
Adventurous	2.63	-2.15	-2.48
Dynamic Equity	5.59	-1.11	-1.12
Income Generating	4.62	-0.90	1.33
Fourth Industrial Revolution	9.51	-3.50	-11.77
Retirement Investment Solution 1	2.33	-0.71	-1.17
Retirement Investment Solution 2	2.81	-0.83	-1.28
Retirement Investment Solution 3	3.25	-0.95	-1.38

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 31.07.2022.

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	✓	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	✓

UK, US and Pacific equities have all just moved back above trend. Overseas corporate bonds have as well and are the only bond market that is above trend.

Cautious, Balanced and Adventurous portfolios

The portfolios reduced their weighting in cash by increasing their exposure to equities and initiating an exposure to bonds. We are beginning to experience a reversal of the current negative trends in some markets as they move back above trend. The portfolios are still relatively defensively positioned as most bond markets are below trend as well as around half of the major equity markets.

Dynamic Equity portfolio

There were no changes again this month. We still have a relatively high weighting in US equities, which has helped the portfolio significantly. However, we might just be experiencing a bounce in sterling as interest rates here are expected to rise quickly. This could act as a headwind to returns going forward. If sterling does indeed appreciate against the dollar, then the portfolio may react by switching more money into non-US equities.

Foundation portfolio

Returns last month were relatively strong at 2.45%. The portfolio benefitted from the strong returns from bonds as they began to reverse this year's declines. Exposure was increased in equities as the UK, US and Pacific markets moved above trend. Overseas corporate bonds also moved above trend, so exposure was increased.

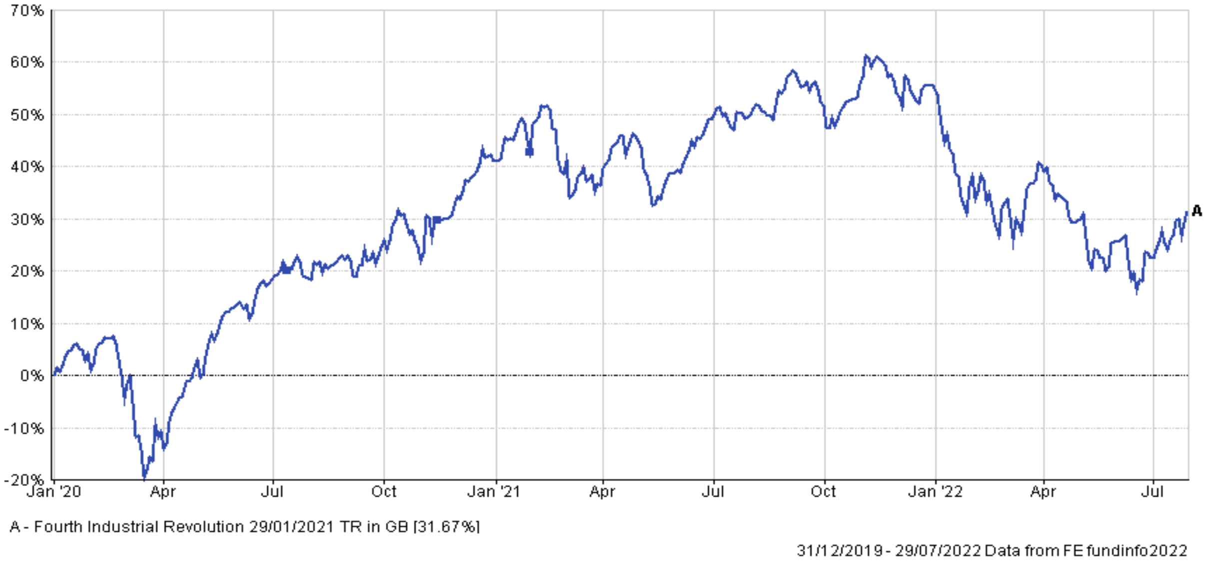
Income Generating portfolio

The portfolio produced a strong return last month of 4.62%. Even though we have experienced central banks raising interest rates, they are now not expected to rise as much as previously expected which helped the portfolio as income-producing assets performed well. This is because if the FTSE 100 pays a dividend yield of 3%, and interest rates are at 1.5% then the FTSE 100 becomes attractive. However, if you can get 5% from keeping your money in the bank then the FTSE 100 is less appealing. The portfolio will therefore benefit from some weaker economic figures which will lead to interest rates not rising as much.

Fourth Industrial Revolution portfolio

Last month we wrote: "*If we experience a peak in inflation 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*."

The portfolio grew 9.51% in July with the Clean Energy fund growing by an incredible 18.15%. From the chart below you can see how volatile it has been but also how strong this rebound could be:



Retirement Investment Solutions

The Solutions reduced their cash levels as US, UK and Pacific equities moved above trend. They all benefitted from their exposure to the Dynamic Equity portfolio.

Summary of Portfolios

Stock market movements can appear counterintuitive at times. We move through cycles where good news is good news and the stock market moves significantly higher. However, when the economy or inflation is running too hot, good news becomes bad news, as it signals that interest rates are going to need to be raised. It then moves on to bad news being bad news, and stock markets fall. Next, bad news becomes good news, as it highlights that interest rates may be near a peak and easier conditions are on their way. However, the first glimmer of good news is then positive, as it portends better times ahead and good news becomes good news again. We are currently in the "Bad News is Good News" zone and this reflects how we have suffered some large falls in stock markets this year but are now seeing signs of stock markets recovering.

Last month we wrote:

"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."

Perhaps this is the start of the bounce back. However, it is still early signs and there is so much uncertainty in politics and economics.

Asset Class Review

This section will give you an insight into our current thinking. This month we look at the most important charts affecting our wealth.

Copper– down nearly 30% from its high

Last month we looked at how much copper had fallen recently, and it continued its falls in July. 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. It has fallen over 30% from its high and this could be signalling that inflation will begin to fall. We do have a short-term break in the downward trend though which could signal an end to the current falls.

US Dollar Strength has helped our portfolios – but is that about to change?

All of our portfolios have a significant amount of money invested in the US. In times of stress, we have seen the US dollar strengthen against sterling and this has helped protect our investments somewhat. For example, the S&P500 suffered a maximum loss this year of 22.50%, but when converted into sterling it only fell 14.49%. The chart shows that the current exchange rate hit the same approximate level as previous lows and has bounced somewhat. This could be the start of a sterling recovery, but also hopefully a stock market recovery.

US Treasury yields- signs of a slowdown, peak in inflation and interest rate rises slowing down

The chart below shows the yield (interest rate) that you can receive from investing in US government bonds. As the yield goes up government bonds fall which is why we have seen big losses on bonds as well as equities this year. Despite the US increasing interest rates last month by a huge 0.75%, the yield has fallen to 2.64% from nearly 3.5%. These falls signal that interest rates will not have to rise as much as expected due to the fact that the economic slowdown may naturally bring inflation under control – bad news is good news!

Stock markets recovering – is this just an oversold bounce?

The chart below is of the FTSE 250 which measures the performance of smaller UK companies. However, the pattern is very similar to many other stock markets at the moment. The red line is the average price of the index over the last 200 days and acts as a smoother trend line. You can see how the index fell significantly below the trend line and has bounced back somewhat. This could be simply what is termed an oversold rally (investors try and bottom pick) but then suffer further falls, or it could be the start of a more sustainable rally. We will have to wait and see!

In Summary

Bad news is good news as fears of a global recession and economic downturn have started to support equity and bond markets. The reason is simple. Bonds and equities both want interest rates to remain low and if we see slow economic growth this should help bring down inflation naturally and then interest rates do not have to rise as much as expected.

Blockchain & Bitcoin

Bitcoin is getting more and more media coverage, but what is it? Bitcoin is the world's 1st cryptocurrency and is based on the world's first public blockchain network. Bitcoin lets you send and receive value to and from anyone in the world just with a computer and internet connection. It is revolutionary as it works without the need of a middleman i.e., a bank, who charges you for sending money. Bitcoin was launched in 2008 but its creator(s) is known only by the pseudonym they chose: Satoshi Nakamoto. There are theories of who they are, but no one has the definitive answer.

Bitcoins are mined by solving algorithms and the amount in circulation will be limited to 21 million bitcoins by 2140, after which there will be no more created. This is unlike traditional stores of money in which central banks can print more and more e.g., dollars and pounds when they need to. This is one of the reasons why some people believe that Bitcoin will eventually be the global currency as there is no interference from governments, banks and corporations, leading to stable inflation, quick transactions and at no cost. It is based on "Blockchain", which is a ledger in which individuals record transactions and these transactions are stored in many places at the same time. As a result, every time something in the blockchain is changed, everyone in the network is notified and has to agree on the changes. This makes blockchain extremely difficult to hack into and provides additional security that banks at the moment can not.

The problem with Bitcoin is that it isn't currently stable in value and is linked to speculation and the amount of money that has been printed by central banks. This is the probable reason why it jumped in value during the money printing of the Covid pandemic but collapsed as soon as interest rates began to rise. At this stage, Bitcoin is not included in any of our portfolios but that doesn't rule it out in the future, perhaps when it becomes more stable. The price of Bitcoin over the last 5 years is shown below:

Whilst Bitcoin is an incredible work of technology, the Blockchain foundations could be used to decentralise and replace other choke points and make data more secure. Land registry, healthcare, insurance, and supply chain management could all be using Blockchain in order to make them more efficient and secure. For example, Blockchain technology can allow hospitals to safely store data like medical records and share it with authorized professionals or patients. This can improve data security and can even help with accuracy and speed of diagnosis. It can help speed up property transactions and help with tracking, verifying ownership, ensuring accuracy of documents, and transferring property deeds.

Conclusion

Blockchain technology will become more widely spread and help make our lives simpler, more efficient and our data more secure over the next decade. Bitcoin is the first trial in the use of Blockchain and it has the potential to be the world's reserve currency. Equally, it could be replaced with something different and therefore become worthless in the future. This is what makes Bitcoin so exciting but also so risky!

Final Comment

July saw stock markets rebound significantly. At the same time bond markets recovered and this led to some strong returns within our portfolios. Whilst news headlines can seem very negative and depressing, the investment world can be very different as we enter the bad news equals good news phase. Clearly, we are all experiencing significant price rises and will continue to do so over the coming months. This is on top of those of us who have mortgages and will see our monthly payments rise either immediately or when our fixed rate expires. However, we must look past this gloom and with a slowing global economy, commodity prices falling, and interest rates expected not to rise as much, our investments are benefitting.

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