Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

# Monthly Investment Update
## January 2023

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## Performance Update

Global stock markets failed to have a "Santa Rally", with the FTSE100, Euro Stoxx and S&P500 falling 1.49%, 0.93% and 6.70% respectively. Bonds fell during the month with UK Gilts declining 4.54% and UK Inflation-linked bonds down 6.50%. Our portfolios declined between 1.03% and 4.99%.

Stock markets have ended the year on the back foot after hopes of a "Santa Rally" were dashed by concerns of more supply chain disruption in Chinese factories from surging Covid cases.

2022 was unprecedented. Covid restrictions were lifted, air travel resumed, masks removed, and holidays resumed. Then Russia invaded Ukraine, gas and oil prices soared, technology giants faced turmoil, and 14 years of cheap money ended. Inflation returned after 40 years, and interest rates rose. This caused both bond and equity markets to suffer crashes. It was perhaps the most turbulent year investors have ever seen.

Fortunately, sterling fell from $1.35 to $1.20, which cushioned our investments in the US by making them 11% higher when converted back to sterling. However, sterling had fallen by 20% at one stage and is beginning to recover.

The outlook for global markets could begin to improve if central banks pivot towards cutting interest rates to support economies in recession. Markets currently expect both the Federal Reserve and Bank of England to begin cutting in the second half of this year amid signs that inflation has peaked.

Despite all the media doom and gloom, the unusually mild winter throughout Europe is extremely positive news as this has helped reduce the price of natural gas from 369 to 186, a near 50% fall in December. The price is now down to a level before the war in Ukraine started. A typical family's energy bill is now forecast to be £500 less than previously predicted, which in turn will reduce inflation and save the Government billions in the support it promised.

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

| Portfolio | Performance % 1 month | Performance % 6 months | Performance % 1 year |
|---|---|---|---|
| Foundation | -1.03 | -0.12 | -5.16 |
| Cautious | -1.04 | 0.56 | -4.81 |
| Balanced | -1.42 | 0.70 | -5.70 |
| Adventurous | -2.19 | 1.30 | -8.46 |
| Dynamic Equity | -1.77 | 5.72 | -7.85 |
| Income Generating | -1.08 | 2.68 | -5.13 |
| Fourth Industrial Revolution | -4.99 | 2.70 | -20.63 |
| Retirement Investment Solution 1 | -1.25 | 0.05 | -7.38 |
| Retirement Investment Solution 2 | -1.35 | 0.86 | -7.61 |
| Retirement Investment Solution 3 | -1.44 | 1.60 | -7.81 |

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 31.12.2022.

## Trend Following Signals

The table below shows whether the asset class is in a positive trend (✓) or a negative trend (x). A positive trend is when the market is above the average price over the previous 200 days. 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 | x |
| Europe ex UK Equity | ✓ | 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 | ✓ |
| Global Infrastructure | x | Overseas Corporate Bonds | x |

Global equity, US equity and infrastructure dropped below the trend.

## Cautious, Balanced and Adventurous portfolios

US equity exposure was reduced on the Cautious and Balanced portfolios. Last month we saw equity exposure rise on Pacific, European and UK equities. We are therefore experiencing a rotation in "momentum" as US equities are underperforming. Infrastructure was purchased in December but sold this month as it continues to be a volatile asset class which is being affected by interest rates. There were no changes to the Adventurous portfolio which has already shifted out of the US.

## Dynamic Equity portfolio

No changes were made this month.

## Foundation portfolio

Infrastructure and US equities were reduced as they moved below trend. Despite significant volatility in equities and bonds last year, the portfolio was relatively stable and didn't fall below an 8% loss at any stage.

## Income Generating portfolio

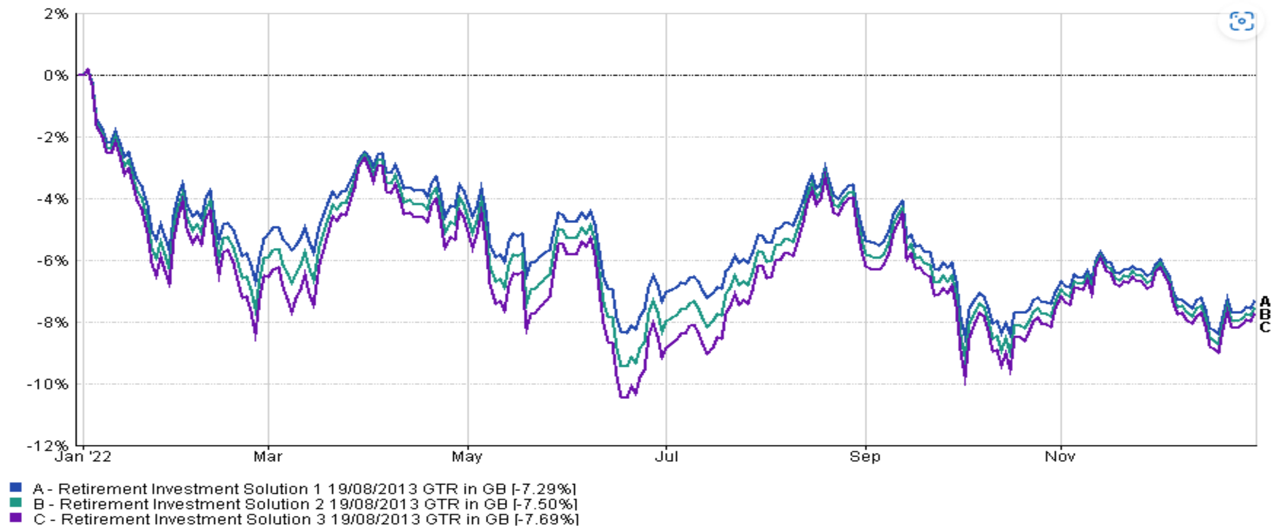
The portfolio invests in 15 funds, 5 of which made positive returns in 2022. The best-performing fund returned 8.12% and the worst fell 19.42%. What made last year even stranger was that the best-performing fund was an equity fund whereas the worst was a bond fund. Usually, in difficult times, you would expect the opposite to occur.

## Fourth Industrial Revolution portfolio

There was certainly no Santa Rally in technology shares as all 9 of the underlying funds fell in December. However, two (iShares Global Clean Energy and AXA Framlington Biotech) actually made a gain over the calendar year.  2022 was certainly a difficult year for technology investors, although our portfolio has recovered a little from its low seen in June.

## Retirement Investment Solutions

Despite the volatility and significant losses in both bonds and equities,  the Solutions ended the year down less than 8% and have recovered a little from their June lows.  2023 sees them commence with very little invested in bonds and December saw a reduction in exposure to US equities.




31/12/2021 - 30/12/2022 Data from FE fundinfo2023

## Summary of Portfolios

US stock markets moved below trend, so we have seen a reduction in exposure to them. Over the last few months momentum has changed so that the previous underperforming stock markets (notably Europe and Asia) are beginning to outperform, and exposure has shifted out of the US and into them.

We have had a profound movement upward in bond prices for the last 40 years. 2022 broke this trend as we saw bonds having one of their worst-ever years. The number of times in which bonds and equities trended downwards in tandem in a given year is frighteningly small so we don't have a lot of precedent for these kinds of moves. This is why there is still so much negative sentiment around.  The biggest question for 2023 is *'how far will Central Banks raise interest rates?'*.

The answer to that question depends on how high inflation will remain (it has begun to fall globally) and how much central banks want to kill it off, even in the height of a recession. One possibility that is being discussed is that the forthcoming recession will cause inflation to fall significantly, and central banks cut interest rates towards the end of 2023. This will almost certainly cause bonds to rebound and should see equity prices rise over the year as well (as long as the recession is not too deep).

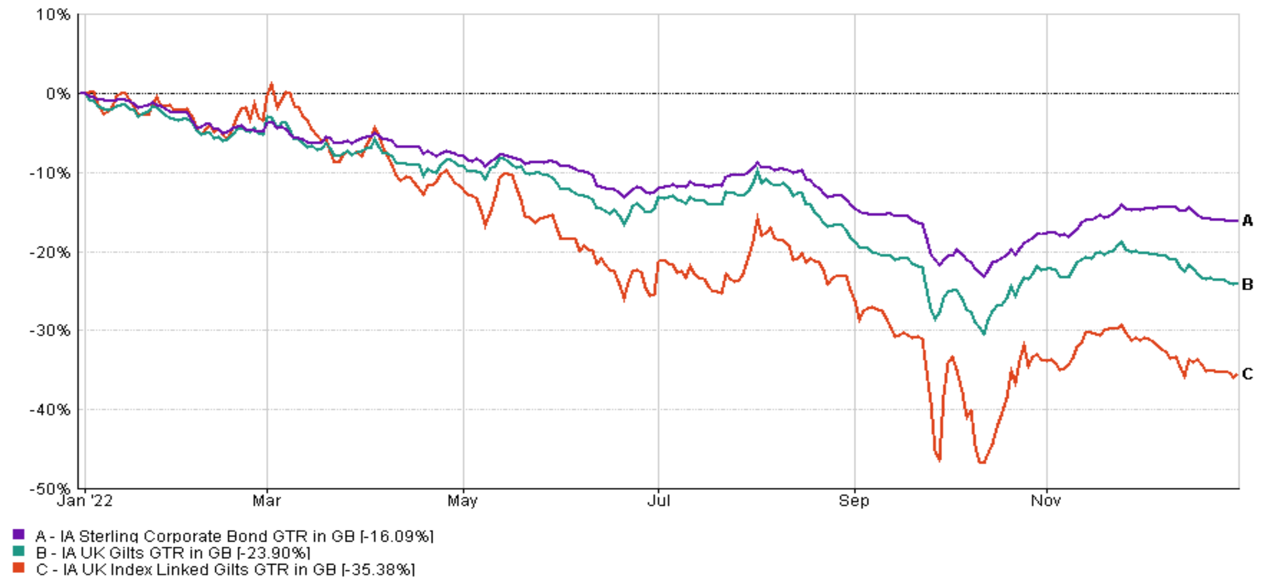
The Santa Rally didn't happen this year, as concerns that the spreading of covid in China will cause further supply chain disruption. China has abandoned its COVID-zero policy as it has realised that it is impossible to stop the spread and eventually it will rip through the country. Official Government estimates are that 3.7 million people are being infected each day, with unofficial estimates at 37 million each day. The worst economic and healthcare fallout will be in this quarter and then the infection rate should start to lower.

# Asset Class Review

This section will give you an insight into our current thinking. This month we look at the major movers of 2022.

## Low-Risk investments fall significantly

Globally, interest rates rose significantly in order to combat inflation. This caused yields (the level of income) on bonds to also rise, as the yield on a bond is closely linked to longer-term interest rate expectations. As bond yields rose, we saw the price of bonds fall. The chart below shows the performance in 2022 of UK Corporate Bonds, Government Bonds and inflation-linked bonds. Cautious investors tend to hold more in bonds, and this caused many lower-risk portfolios to fall significantly.

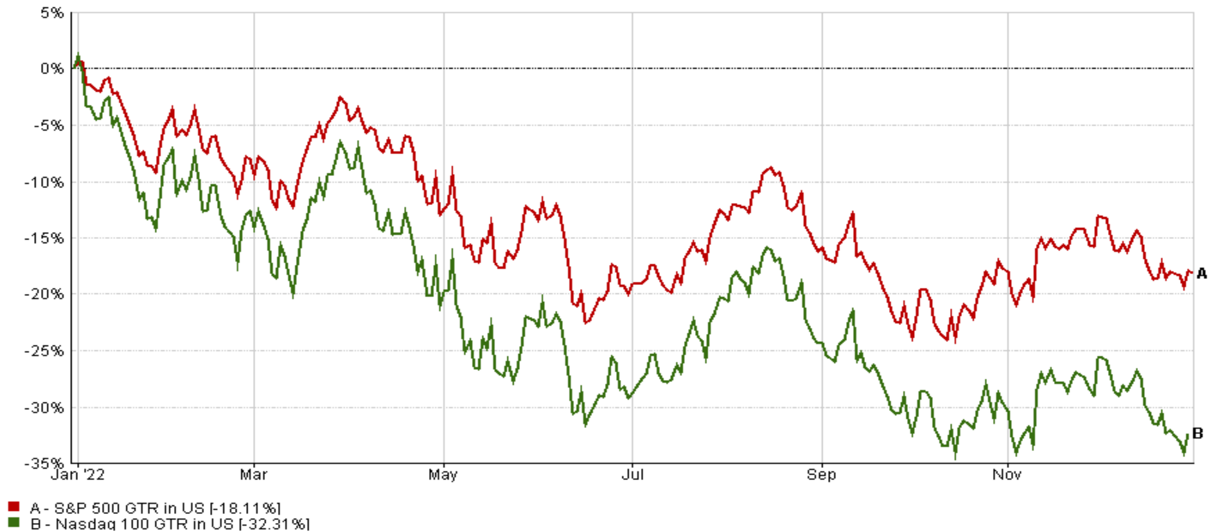



## FTSE100 outperforms the FTSE250

The FTSE100 was the only major market to deliver a positive return in 2022. It benefitted from a falling pound, which boosts companies that earn money abroad as well as a strong performance from energy and defence stocks including BP, Shell, and BAE Systems which all benefited from the invasion of Ukraine. However, the FTSE250 which tracks the performance of smaller UK companies fell significantly and in line with most other global markets.

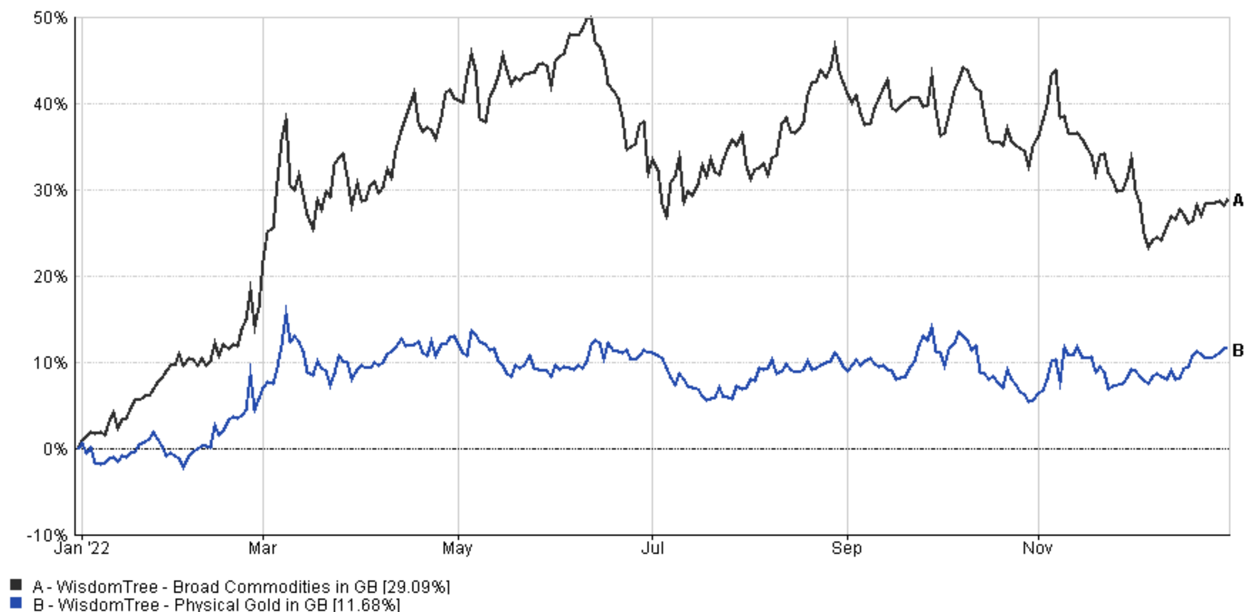
## US Bear markets

At one stage the main US stock market (S&P500) had fallen by more than 20% during 2022, which signals a bear market. It subsequently recovered to fall 18.1% for the year. The technology-laden Nasdaq100 lost 32.3% over the year which does compare favourably to 2008 (down 41.57%), and 2002 (down 37.58%). Fortunately for us, sterling also fell significantly, and this helped reduce the losses from the S&P500 to 7.8% and the Nasdaq100 to 23.8%. It could be argued that British politicians have done a huge amount of positive work for you last year!




## Commodities rally but only in the first half

Putin's invasion of Ukraine was the catalyst for commodities to rise significantly and in turn, push interest rates to a higher level than expected. The broad commodity index (which includes oil, gas, copper, gold, soybeans and corn amongst others) rose 29.09% but was up 50% at one stage before falling back in the second half of 2022. Gold was also a positive performer rising 11.68% in sterling. However, most of this gain was simply from sterling depreciation as gold only rose 1.4% in US Dollars.




## In Summary

We saw significant losses in both bond and equity markets in 2022, as we entered an unusual global economic slowdown (probably a global recession) in which interest rates were forced to rise to combat inflation. Usually, interest rates are cut during a recession which ensures that bonds rise in value, helping offset some of the equity market losses.

# Lower Lows, Lower Highs

2022 was a disappointing year for investing as most markets moved lower. What will 2023 have in store for us? Will there be a change in direction, and could there be a strong rebound this year? One way to spot a change in the direction of markets is to look at the recent lows and highs of a market. If we are experiencing a sequence of lower lows and highs, then we can say that the market is consistently moving lower and vice versa. The S&P 500 is currently displaying a clear sequence of lower highs and lower lows indicating that we are very much still in a downward phase:

If the S&P 500 moves above 4100 in this rebound, then we will have a higher high and the downward phase would be broken. We have some major markets that appear to have broken out of the downward phase, most notably Europe:

Whilst we appear to have broken the downward phase, this does not mean we immediately go into an upward phase. It simply means that the consistent downward phase has been broken. The chart over the page is of the Nasdaq100 and it shows that we have broken the consistent lower lows pattern and now appear to be in a ranging pattern in which the market moves sideways:

## Why do we get lower lows and highs and vice versa?

Very simply it is all about simple demand and supply, giving the market a rhythm. When markets start to fall, we have more sellers than buyers. At some stage, the optimists step in and believe that the market will bounce back so start buying. This creates a low and then the market rallies for a bit. However, the sentiment remains negative, and the number of sellers drowns out the buyers again. This creates a lower low. Once again, the optimists step in creating another high but the pessimists use this small rally to once again sell. This creates a lower high. This circle carries on until we see the number of buyers and sellers even out and we get a ranging motion similar to what is probably happening in the Nasdaq 100. For a change to occur into a positive phase, the pessimists either have nothing left to sell or are converted to optimists and demand exceeds supply. We then see higher highs and higher lows develop.

## Summary

Most of the major equity markets remain in a downward phase in which we are still experiencing lower lows and highs. Some markets are probably ranging and have broken the consistent downward pattern. However, there are some markets that look like they have changed direction such as Europe. Perhaps the best example of what could happen to equity markets in 2023 is India in which we have seen the downward phase move very quickly back into the upward phase.

## Final Comment

2022 will go down as one of the most volatile periods for investment markets, especially with bonds "crashing" and nearly destroying the UK pension industry. Fortunately, the incompetence of the UK Government also caused sterling to fall significantly, and this helped protect our portfolios somewhat. The fall in the price of gas by 50% in December has not been widely reported in the mainstream press and is a significant change. This should result in lower inflation, lower Government expenditure, and possibly lower future taxes which could be the catalyst to spark a recovery.

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

**Tel: 01708 250624**

**Email: chrismoore@watsonmooreifa.com**

**www.watsonmooreifa.com**

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