Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update

February 2023

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Performance Update

January was a great month for most asset classes, with the FTSE100, Euro Stoxx and S&P500 rising by 4.35%, 8.71% and 3.82% respectively. Bonds rose during the month with UK Gilts advancing 2.76% and UK Inflation-linked bonds up 3.90%. Our portfolios advanced between 1.51% and 6.09%.

Stock markets globally are recovering, and we are experiencing a change in their direction from being on negative trends to positive ones. Figures dating back to 1929 show that if the S&P500 posts a gain in January, then it goes on to rise another 8.6% on average for the rest of the year. This all bodes well for a positive 2023. We must remember that asset classes go up when bad news gets slightly less bad. The International Monetary Fund predicts that the UK is the only G7 country that will see its economy shrink this year (by 0.6%). Therefore, expect the headlines to be bad in our press but remember that the UK economy is not that important for our investments.

Bonds were one of the worst performers in 2022 as interest rate hikes caused significant losses. However, with inflation beginning to fall and the peak in interest rates close (they could even fall towards the end of the year), bonds are now beginning to look attractive and are showing the first tentative signs of a recovery. Just a few months ago markets were betting on UK interest rates going up to 6%, but today they believe that they will peak at just over 4% before they will have to come back down again.

The US has led the global stock market race for many years as technology companies have been the best performers, with the US hosting most of the world's best technology companies. However, we are beginning to see a change in the momentum with the FTSE100 at a near-record high and Europe and emerging markets advancing much quicker than the US over the last few months. Will 2023 see the previous underperformers “catch up”?

Gold is rising and is close to its all-time high in sterling terms. Gold can go up when the expectation is that interest rates will fall over the long term. Conversely, gas prices continue to fall, and this has the same stimulative effect as a big tax cut and will also reduce upward pressure on inflation.

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	1.81	-0.75	-0.84
Cautious	1.61	0.44	0.27
Balanced	1.71	0.31	-0.17
Adventurous	2.10	0.77	-1.39
Dynamic Equity	1.69	1.81	0.68
Income Generating	2.41	0.65	-0.26
Fourth Industrial Revolution	6.09	-0.47	-3.96
Retirement Investment Solution 1	1.51	-0.75	-1.46
Retirement Investment Solution 2	1.52	-0.41	-1.24
Retirement Investment Solution 3	1.53	-0.09	-1.04

Please note that these figures do not include the platform or Watson Moore’s fees.*All figures are sourced from Financial Express to 31.01.2023.

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	✓	Emerging Market Equity	✓
UK Equity	✓	Commodities	x
Europe ex UK Equity	✓	UK Corporate Bonds	x
US Equity	✓	UK Corporate Bonds (Short dated)	✓
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

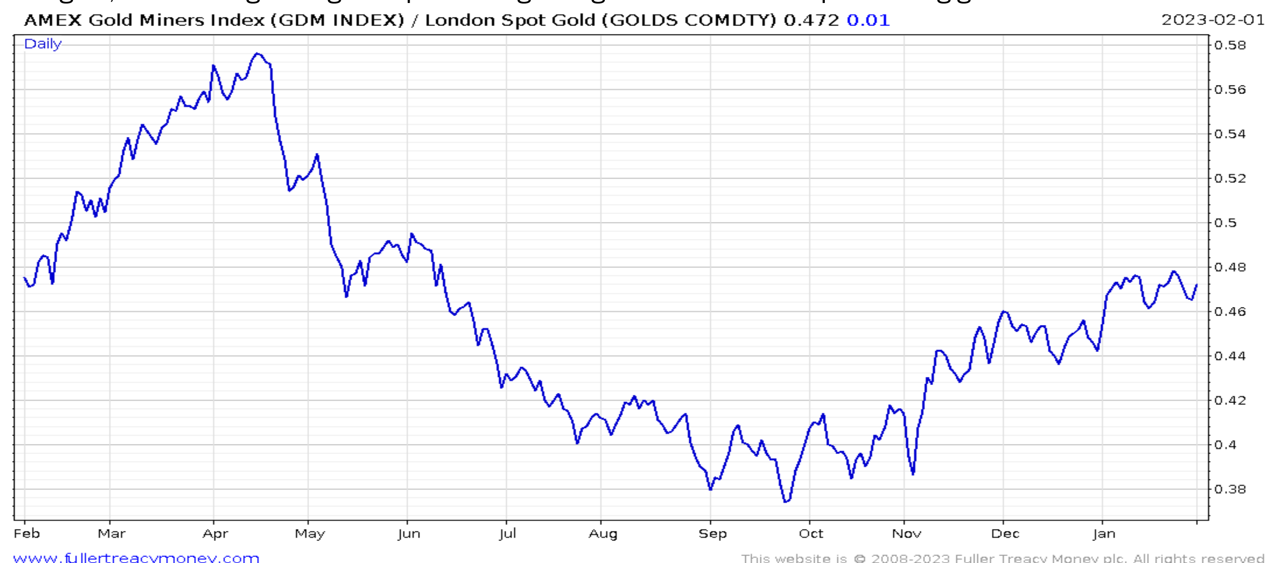
The majority of equity markets are now above trend and bonds are getting much closer to being above trend as well.

Cautious, Balanced and Adventurous portfolios

The Cautious and Balanced portfolios increased exposure to equities, notably US, Global and smaller UK companies. The Balanced portfolio also increased exposure to emerging markets. They both benefitted from their current exposure to European equities which proved to be the best-performing region in January. Bond exposure also increased slightly as short-dated corporate bonds moved above trend. The Adventurous portfolio shifted money out of India and into Gold miners and remains fully invested in equities.

Dynamic Equity portfolio

Indian equities suffered and fell down the momentum scale. They were replaced by Gold miners which are benefitting from the price of gold moving close to its all-time high. As the price of gold increases, the price of gold miners tends to go up even more. The chart below shows the relationship between gold miners and gold, with the higher it goes up meaning that gold miners are outperforming gold:



Foundation portfolio

US equities and smaller UK companies moved above trend, so exposure was increased. In addition, exposure was increased to short-dated corporate bonds.

Income Generating portfolio

With both bonds and equities rising and interest rates expected to peak shortly, the good news led to the Income Generating portfolio being our second-best performer last month. The dividend yield is just over 3% which means that it is comparable to most good bank accounts, yet also provides the opportunity for capital growth over the longer term.

Fourth Industrial Revolution portfolio

Will 2023 see a recovery in technology shares? Our Fourth Industrial Revolution portfolio rose 6.09% as every underlying fund advanced in January. The best-performing one was the iShares Digitalisation fund which rose 11.1% and the worst-performing one was the AXA Framlington Biotech fund which grew 1.58%.

Retirement Investment Solutions

Exposure to equities increased significantly as more markets moved above trend. Hopefully, markets will continue their good start to the year, and we can benefit from this. The Solutions now have the most invested in equities since January 2021. Exposure to bonds also increased slightly as UK corporate bonds moved above trend.

Summary of Portfolios

Investors neglected to invest in Europe last year because of the assumption the region would experience a deep winter of discontent because of the impending energy crisis. Regional governments instead spent whatever was necessary to ensure that did not happen. That resulted in natural gas prices spiking during the summer. However, the gas price has subsequently collapsed, proving to be very good news for European stock markets. Emerging markets are also recovering quickly, and this could be attributed to China giving up on its zero Covid policy and fully reopening the economy. This has led to European and emerging stock markets outperforming recently.

Falling energy prices have the same effect on the economy as tax cuts as well as reducing inflationary pressures. This leads to the expectation that interest rates will not have to rise much higher and fall much sooner. We could be about to enter another "goldilocks" period in which economic growth is not too strong and thus interest rates don't need to rise; and not too weak that we avoid a recession.

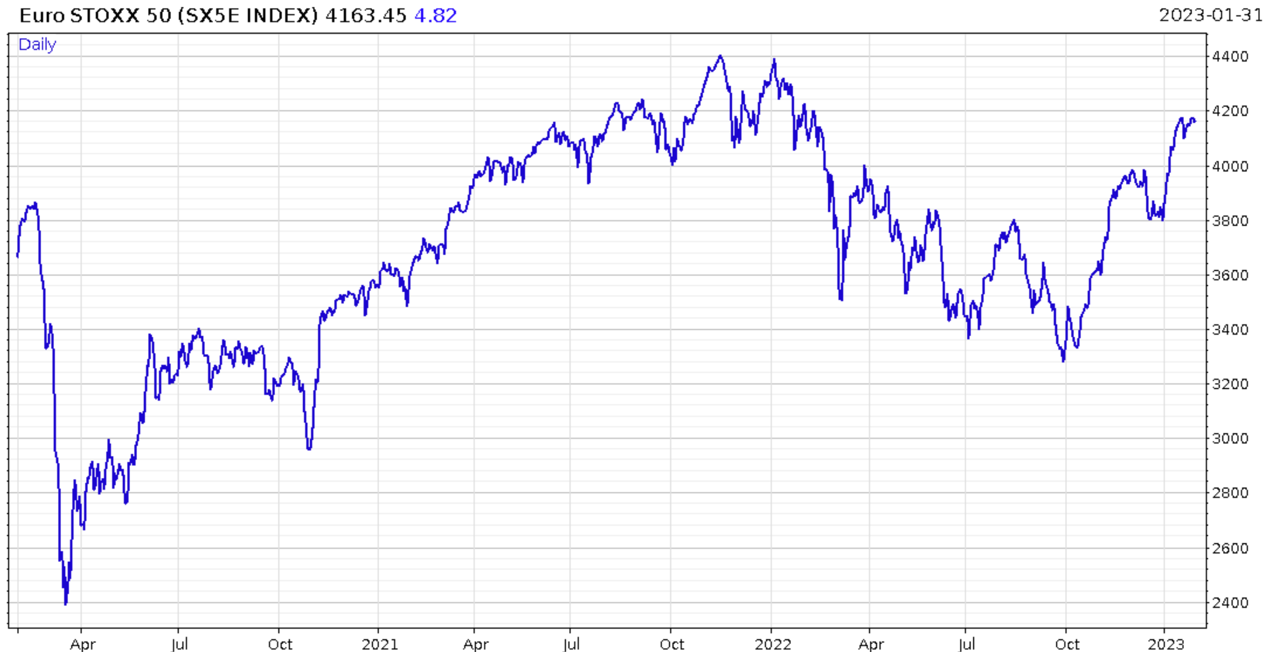
Our portfolios have reacted by investing more in equities and are also beginning to move back into bonds.

Asset Class Review

This section will give you an insight into our current thinking. This month we look at how equity markets have broken higher.

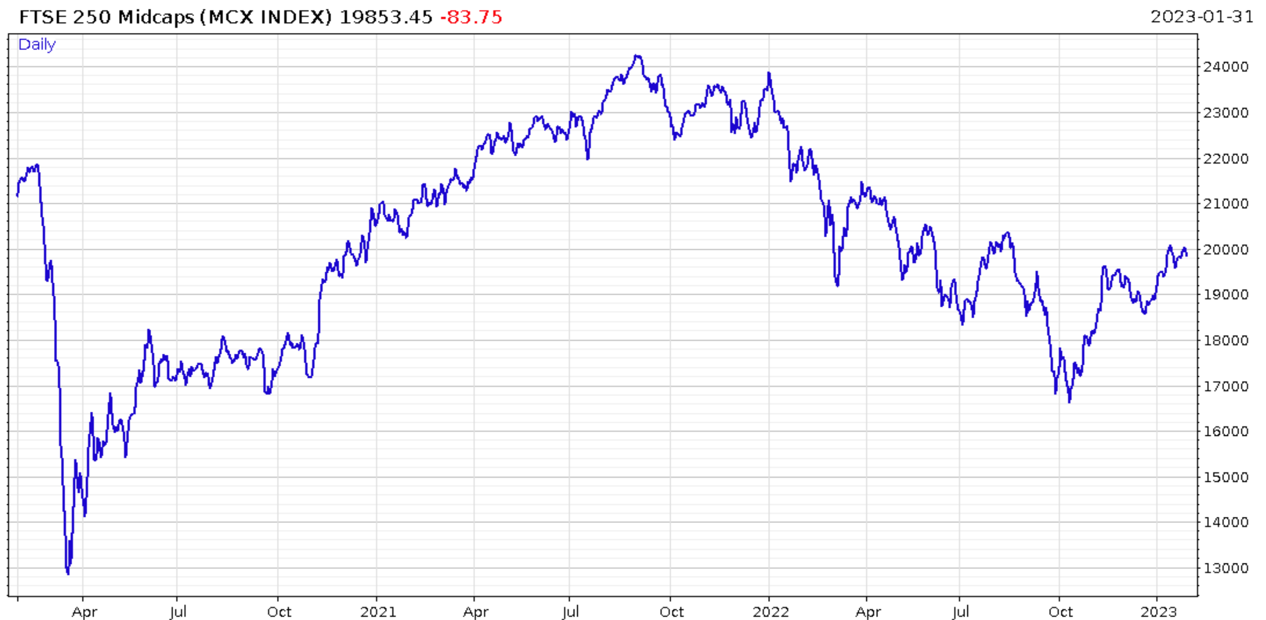
Europe – a higher low and high

Last month we looked at how the downward phase of lower lows and lower highs in European stock markets appears to have been broken. Subsequently, we have seen the main European market break significantly higher, posting a higher low and higher high. This is very positive.



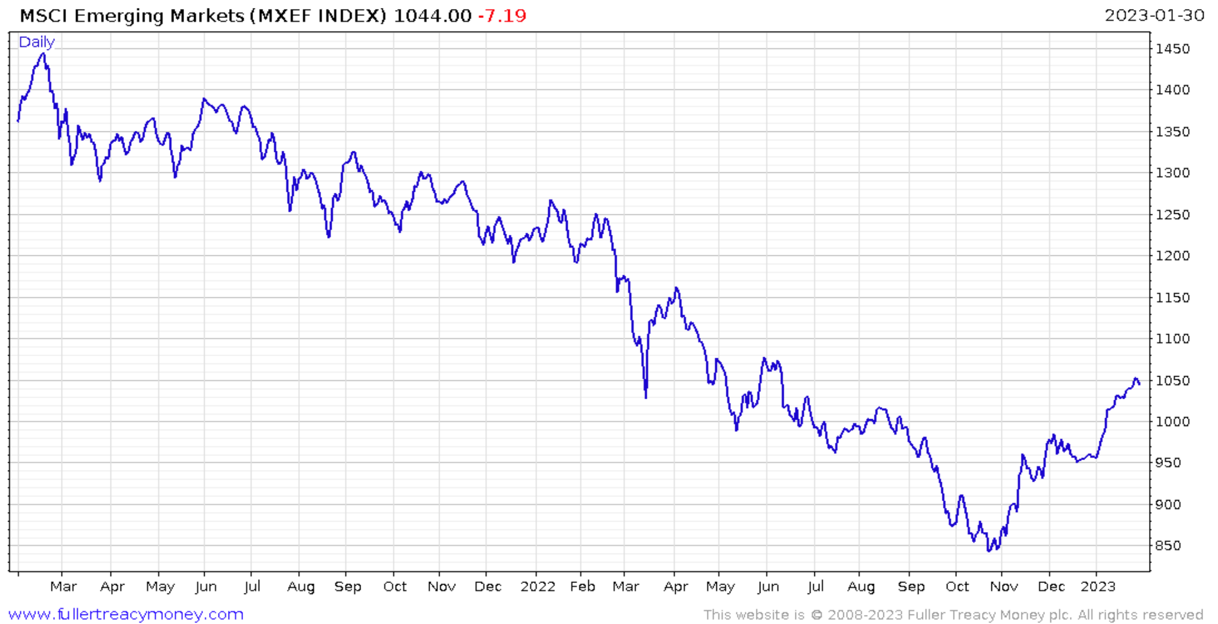
FTSE250 – breaks higher as well

Whilst the FTSE100 is approaching a record high, the FTSE250 (which measures the performance of smaller UK companies) remains a long way from its record highs. The cost-of-living crisis and weak economic outlook, together with the political uncertainty have created a challenging environment for UK companies. However, the FTSE250 is now displaying a similar recovery as Europe and has moved into a new upward phase with a higher low:



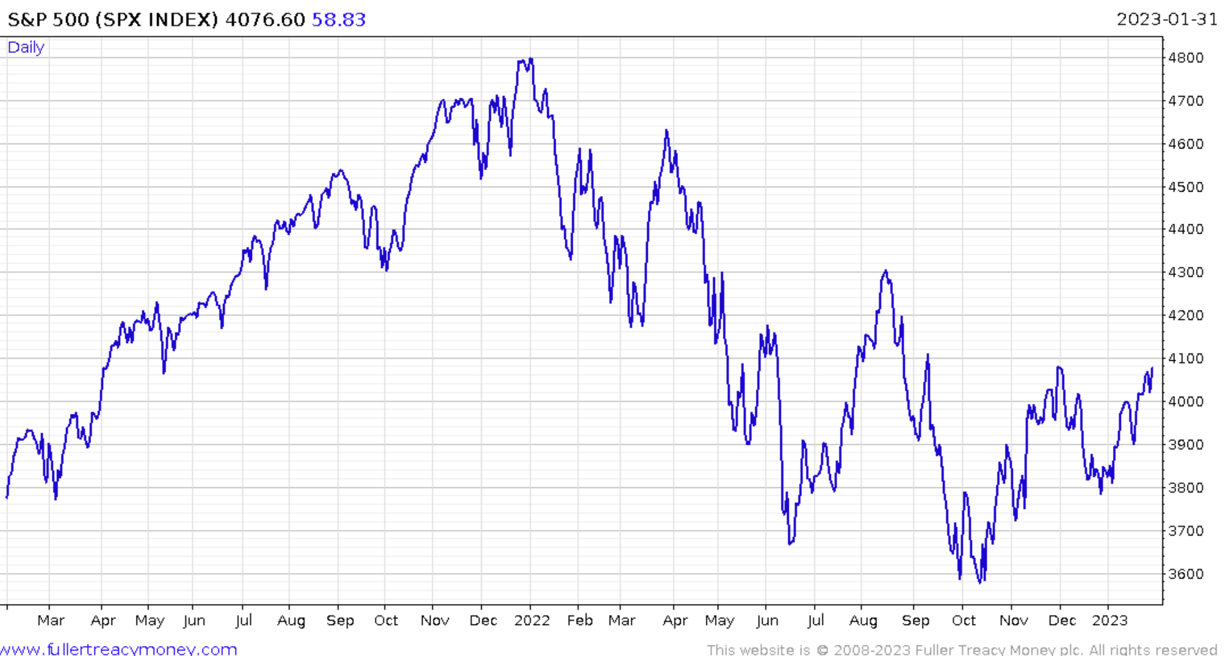
Emerging Markets are in a new up-phase

Emerging markets have been one of the worst-performing regions over the last couple of years. However, they appear to be embarking on a new uptrend which commenced in November last year. Like Europe, emerging markets have underperformed the US for many years, and we could be about to see them catch up



US Equities - a tentative recovery

Whilst other stock markets are displaying a clear change in direction, the main US stock market is not as clear-cut. From the chart below we can see it posted a higher low in January, but it hasn't yet posted a higher high. As we discussed last month, we need to see it move above 4100 in this rebound so that it will hit a higher high.



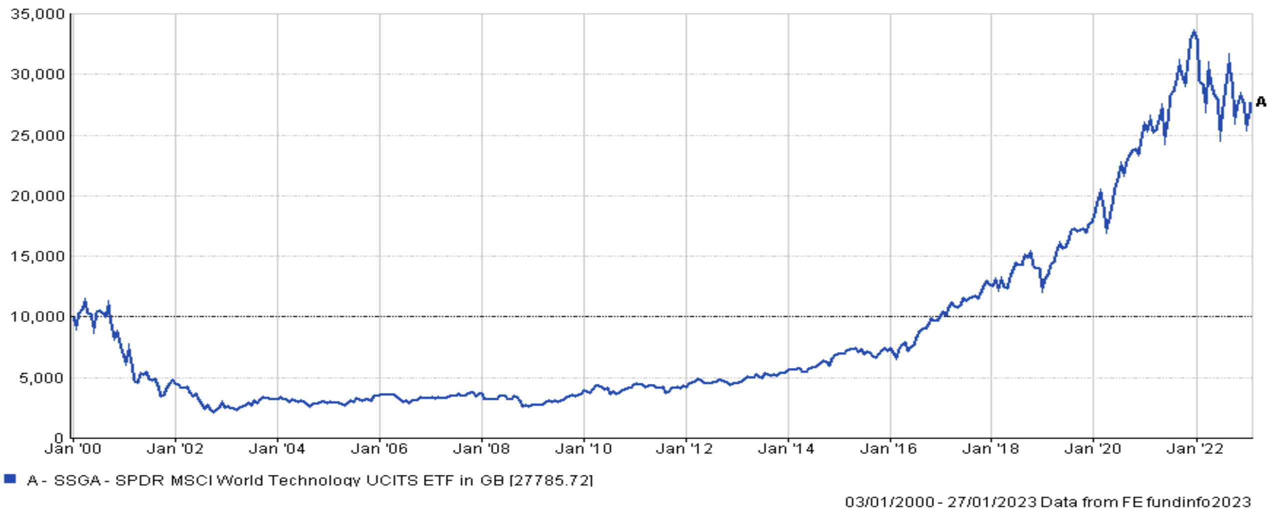
In Summary

January proved to be very positive as we have experienced many more markets moving into an upward phase. It appears to be that the markets that have been underperforming over the last few years are now displaying the strongest upward momentum, whilst the US is lagging behind.

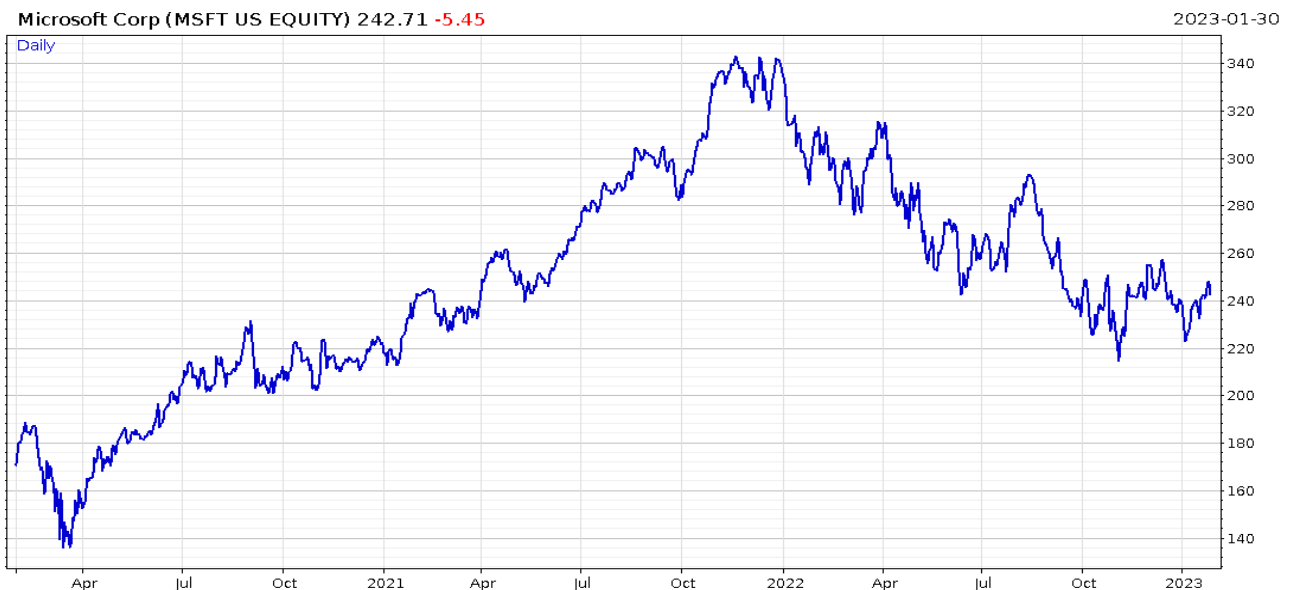
Technology - Boom or Bust?

Technology was one of the worst performers in 2022 with one of the biggest technology funds (L&G Global Technology Index Trust) falling 27.78%. However, 2023 has started very well for technology companies with the same fund growing 8.73%. So, are we at the beginning of a recovery and new “boom” or are we going to face another year of losses?

Let's start by looking at the long-term history of investing in technology. The State Street MSCI World Technology Fund was launched just before the technology crash of 2000. This fund tracks the performance of the leading technology companies such as Apple and Microsoft and shares a similar pattern to most technology funds. The chart below shows that it fell over 70% as technology initially crashed, only regaining the initial investment 16 years later. However, investors who put in £10,000 at outset would have seen their wealth grow to £27,785 today:



Back in 2000, technology companies were not making a profit, and some didn’t even have any revenue! Anything with dotcom in their name successfully launched on the market and investors clamoured to own shares. Many companies had great ideas and these ideas form many of the current successful companies. However, back then the internet was slow, mainly accessed on a desktop and payment systems were not trusted. This ensured that many companies did not survive this era. Today's technology companies are completely different and include some of the world’s biggest companies. Microsoft is one of these companies. It has a diversified income stream by product and geography, stable cash flow and has increased its dividend each year over the last 10 years. However, its share price has fallen significantly, with this pattern typical of many of the big technology companies:

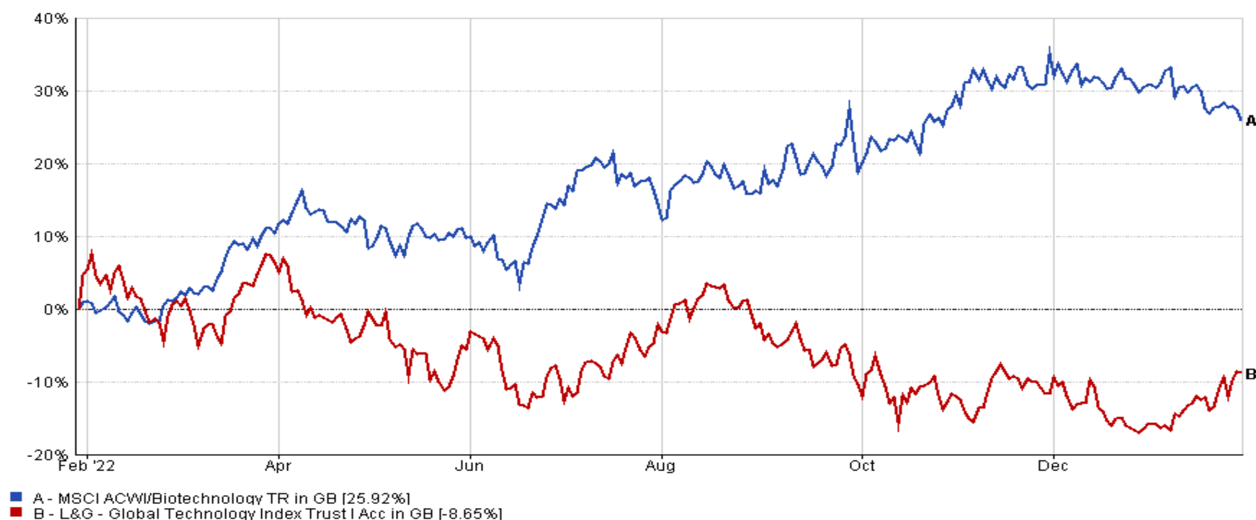


So why has Microsoft (and technology companies in general) fallen so much? We believe that there are two simple reasons. The first is that it simply went up too much during Covid. The share has grown by 29% since February 2020 but initially went up over 80% before falling back down. The second reason is that technology companies are very sensitive to rising interest rates as they promise growth over the long term and investors sacrifice lower profits now in the hope that profits will be significantly higher in the long term. When interest rates are low then the opportunity cost of investing in technology companies is small but when interest rates rise then you demand a higher return from technology companies and are unwilling to pay such a high premium. It is believed that inflation has now peaked, and thus interest rates will stop rising shortly and fall thereafter. This could represent the current low in technology shares, with a recovery coming.

The Future of Technology Companies

When a technology company is small, it has to innovate and produce new products that consumers want to buy. When it dominates the market, it becomes less innovative and tries to protect its market share. This has typically led to many of the biggest technology companies simply buying smaller competitors to take out the competition. Facebook's purchase of WhatsApp is typical of this. The biggest technology companies such as Microsoft, Apple and Amazon are embedded in our daily lives and will continue to be over the next 10 years. We believe that they will produce steady and consistent growth, but their growth will be much slower. In effect, they will become technology conglomerates producing consistent and stable cash flows that will move their share prices steadily higher.

We believe that some of the most innovative technology companies will be in sectors such as biotech, cyber security, clean energy, healthcare and artificial intelligence. These companies are involved in solving some of the world's greatest problems such as curing cancer, producing cheap abundant carbon-free energy and making the world a safer place from cyber attacks. It is these sectors that may produce the best returns going forward and of course, the biggest technology companies might just simply buy them at a high price. Comparing the performance of the biotech sector to that of the largest technology companies over the last year demonstrates what might happen for the rest of this decade with significant outperformance for certain sectors:



Summary

Technology companies are embedded in our lives, and they should produce stable steady returns for investors going forward. However, investing in a diverse range of technology companies that are involved in many different sectors and who are trying to solve some of the world's biggest problems may be the most profitable, but potentially much more volatile, way of making money for the rest of the decade. Our Fourth Industrial Revolution portfolio has a very diverse range of investments and is the ideal vehicle to capture the "boom" in technology.

Final Comment

Whilst 2022 will go down as one of the most volatile periods for investment markets and also one of the worst-performing ones, 2023 has started very well indeed. We are seeing most major equity markets move into upward trends and the ones that have performed the worst over the last few years are now outperforming.

The reason for this is that the bad news is getting slightly less bad, although it is difficult to see this in our mainstream press. Inflation is beginning to fall globally, interest rates are expected to be near their peak, Russia is not advancing in Ukraine and China has given up on its crazy zero Covid policy.

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The past is not necessarily a guide to future performance. The value of any investments can go down as well as up and you may not get back the full amount invested. Taxation is subject to change and you may have to pay tax on any gains. The Watson Moore portfolios are unlikely to exactly mirror our clients' portfolios due to the timing of the initial investment and the speed of response to our fund switch recommendations as well as the effect of charges. The figures above therefore assume a client invested on the launch day and have responded immediately to our recommendations. As from the middle of 2016, the portfolios have been run on a discretionary basis by our sister company WM Capital Management. All figures and charts are provided by Financial Express.