Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update

April 2023

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Performance Update

March was a very volatile period for global stock markets, with the S&P500 and Euro Stoxx rising by 1.51% and 0.74% respectively. However, the FTSE 100 and 250 fell by 2.47% and 4.63%. Bonds rebounded somewhat. This caused our portfolios to range between -1.70% and +0.81%. The volatility over the month was unusually high with the good initial gains being wiped out so that we experienced some reasonably high losses mid-month before a recovery took place.

The collapse of Silicon Valley Bank (SVB) and Signature Bank as well as the takeover of Credit Suisse caused stock markets to fall. However, US regulators have stepped in to hopefully stop further contagion and we saw a recovery towards the end of the month in most markets.

UK Inflation rose to 10.4%, which was an unexpected jump after 3 consecutive months of decline. This was an increase from the previously recorded rate of 10.1% and above the forecast of 9.9%. This was a shock as the sterling price of oil is down 25% since the summer and natural gas is down 80%. Economists still expect inflation to be below 4% later this year. Interest rates rose last month as a consequence of the shock rise, after many had previously expected them to not go up any further. By contrast, US inflation fell to 6.0%, the slowest pace of growth since September 2021. Interest rates are now expected to fall by the year's end in the US and this has caused sterling to start appreciating against the dollar.

Bonds rebounded with UK Gilts and UK Inflation-linked bonds growing by 2.91% and 7.91% respectively. This is despite UK interest rates rising. The general consensus globally is that we are near the end of interest rate rises and this is now beginning to push up the value of bonds as investors are attracted to the relatively high levels of income that can be generated.

UK house prices fell in March at their fastest annual pace for 14 years, according to the latest figures from Nationwide. The lender said prices were down 3.1% compared to a year earlier. Prices have fallen for 7 months in a row as the fallout from a significant jump in interest rates is beginning to affect affordability.

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	0.45	2.27	-3.02
Cautious	0.19	1.67	-1.37
Balanced	0.06	1.45	-2.50
Adventurous	-0.62	0.75	-4.56
Dynamic Equity	-0.80	1.90	-5.83
Income Generating	-1.70	6.97	-3.17
Fourth Industrial Revolution	0.81	4.61	-5.05
Retirement Investment Solution 1	-0.37	0.37	-5.00
Retirement Investment Solution 2	-0.47	0.50	-5.28
Retirement Investment Solution 3	-0.56	0.62	-5.53

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 31.03.2023.

Trend Following Signals

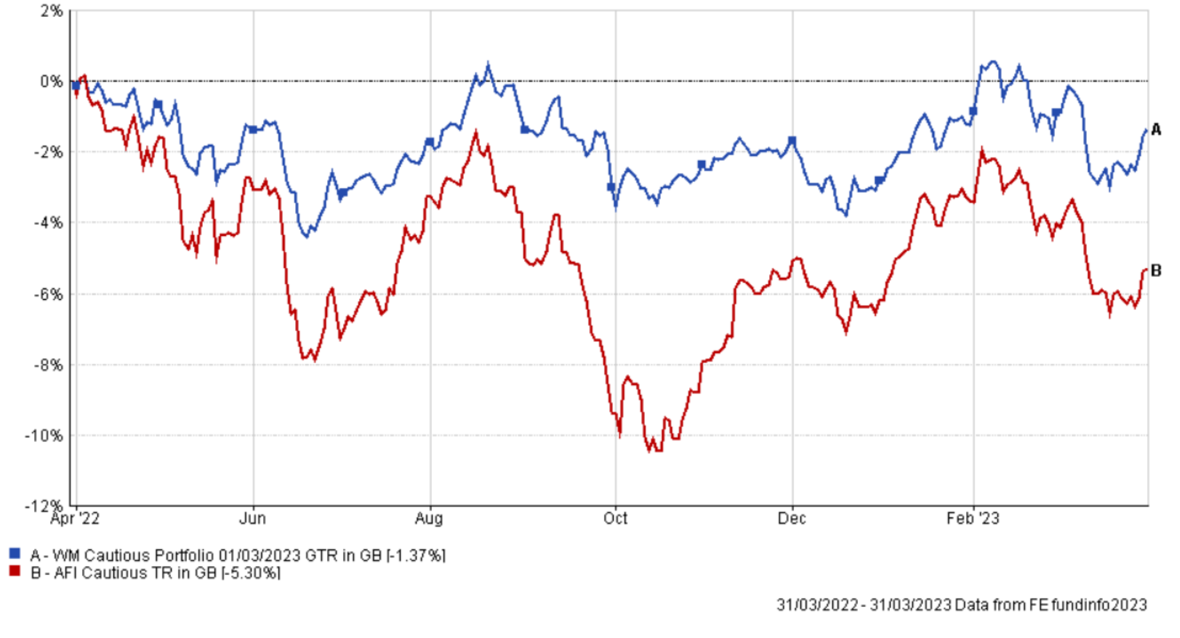
The table below shows whether the asset class is in a positive trend (✓) or a negative trend (x). A positive trend is when the market is above the average price over the previous 200 days. The portfolios will have more exposure to those asset classes in a positive trend and less (if any) to those in a negative trend. These are the main asset classes we monitor:

Asset Class	Trend Signal		Trend Signal
Global Equity	✓	Emerging Market Equity	x
UK Equity	✓	Commodities	x
Europe ex UK Equity	✓	UK Corporate Bonds	x
US Equity	✓	UK Corporate Bonds (Short dated)	✓
Japan Equity	✓	UK Index-Linked Bonds	x
Pacific Equity	x	Global Bonds	✓
Gold	✓	UK Gilts	x
Global Property	x	Emerging Market Bonds	x
Global Infrastructure	x	Overseas Corporate Bonds	x

Most equity markets remain above trend, and we are now seeing some bond markets break above trend.

Cautious, Balanced and Adventurous portfolios

The portfolios kept a similar exposure to equities but slightly increased their bond exposure. Over the last year, all three portfolios have outperformed the average cautious, balanced and adventurous portfolios. The chart below shows how our Cautious portfolio (blue line) has performed against the average cautious portfolio (red line). It shows not only the outperformance but also how it has been much less volatile, which is a result of our portfolio holding much more cash during this difficult period. The charts of the Balanced and Adventurous portfolios show similar characteristics.



Dynamic Equity portfolio

US smaller companies fell over 7% during the month and dropped out of our best-performing "momentum" asset classes. They were replaced by Japanese smaller companies which have been performing consistently well over the last year. The portfolio also has an allocation to "quality" companies and "quality" has been outperforming "momentum" over the last year. This shows the benefits of diversifying the portfolio through investment philosophies as we use both momentum and quality when building the portfolio.

Foundation portfolio

The Foundation portfolio benefitted from the rebound in bonds over the month and posted a positive return of 0.45%. Exposure to bonds was further increased as they are beginning to move into upward trends. It is believed that we are close to the end of the interest rate rises, and rates may even fall this year which would further support bonds.

Income Generating portfolio

After a great run, the Income Generating portfolio fell 1.70% as its holdings in UK equities underperformed. The portfolio is our best-performing one over 6 months and has a current yield of just over 3%.

Fourth Industrial Revolution portfolio

The portfolio rose 0.81% as the largest global technology companies rose significantly. The best-performing underlying fund was the L&G Global Technology fund which rose 7.84% and the worst-performing one was the Herald Investment Trust which fell 9.21%. The gap between the best and worst performers was over 17% and this shows how volatile investing in companies that are on the cutting edge of technological change can be.

Retirement Investment Solutions

The Solutions invest in three of our portfolios, the Foundation, Dynamic Equity and Multi-Asset Trend Following. The Dynamic Equity portfolio will always invest in equities, whilst the other two are very diversified, increasing and decreasing exposure to asset classes depending on whether they are above or below trend. Currently, there is a higher-than-average exposure to equities, and the exposure to bonds is beginning to increase although from a relatively low base.

Summary of Portfolios

This is a very volatile period as we are seeing the effects that significant rises in interest rates (from a very low base) are having on the global economy and different sectors. We have already seen a pension crisis in the UK and recently a potential banking crisis with three banks failing. The catalyst was the fact that banks hold bonds as “safe” capital, and due to interest rates rising and thus bonds falling in value, banks have suffered significant losses. However, regulators stepped in to protect banks, and the lessons learned from 2008, have ensured that globally important banks are much more capitalised now and are able to withstand these shocks.

Property prices are now coming under pressure and property companies are perhaps the next sector that will come under intense scrutiny as they will need to refinance their debt at a much higher level. In addition, growth companies (typically technology companies) and private equity funds have been reliant on cheap capital, and after significant interest rate rises and banks less willing to lend, we could see these sectors come under the spotlight next.

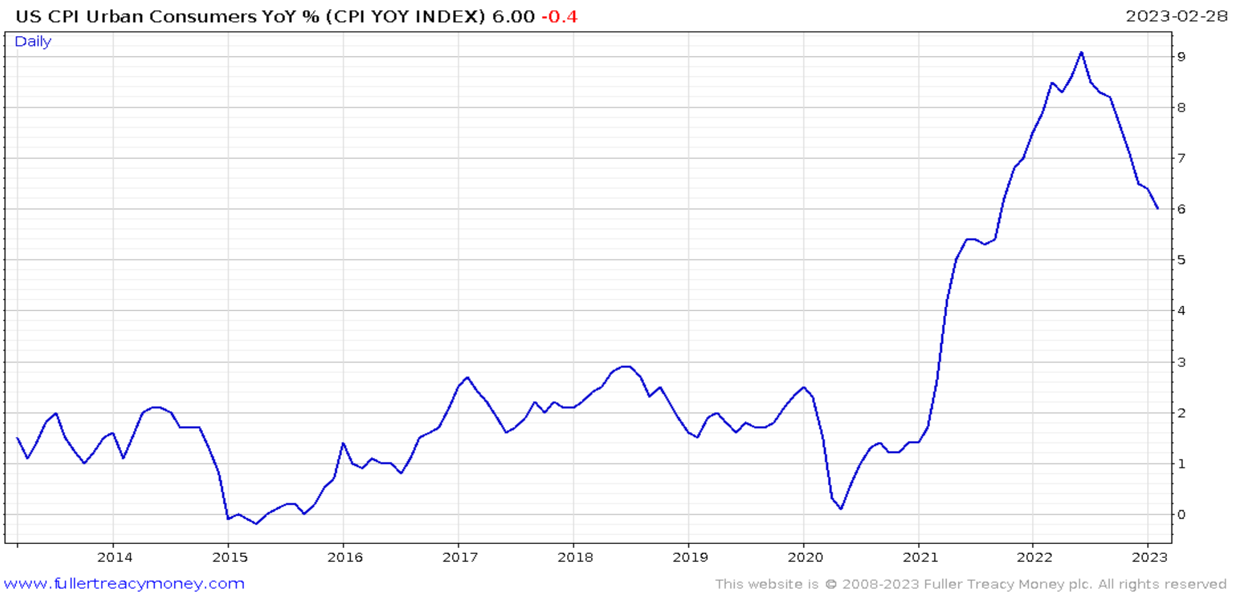
We must expect more bad headlines over the coming months but with interest rates expected to have peaked and come down towards the end of the year, we could see some strong gains in bonds and equities going forward. Just do not expect them to go up in a straight line and we will have some challenging times ahead as well.

Asset Class Review

This section will give you an insight into our current thinking. This month we look at the impact of the major investment stories- banks and inflation.

US Inflation Falling

The US Bureau of Labour Statistics last month reported that inflation in the United States, as measured by the Consumer Price Index (CPI), declined to 6% on a yearly basis in February from 6.4% in January. This reading came in line with the market expectation. Inflation is nearly falling as quickly as it rose, suggesting that this is a temporary spike. Interest rates look as though they have now peaked and could come down in the US which will help banks and the economy. The UK appears to be further behind the curve, having experienced an increase in inflation recently.



US Interest rate expectations dropping

Inflation is falling and this has led to the expectation that interest rates have peaked. The chart below shows the yield on 2-year US Government bonds, and you can see how March saw its peak at over 5% before rapidly dropping to 4.03%. This is a significant fall, and many commentators are expecting rates to fall by the year's end. This is good news.

Credit Suisse- a slow demise

The chart below shows the share price of Credit Suisse over the last 10 years. It should come as no surprise that the bank was struggling. By contrast, UBS who has taken over Credit Suisse, saw its share price rise over the same period.

Gold- Close to an all-time high

There are many reasons why the price of gold moves higher but falling interest rates, falling inflation and general economic uncertainty are all conducive to a higher price. The price looks set to break to a new all-time high, but the ceiling of 2000 may prove tough to break through in the short term.

In Summary

The headlines and general economic concern caused by the banking sector in March caused stock markets to behave in a very volatile way. However, the general economic data of falling inflation and thus expected lower interest rates, should help equity and bond markets to recover.

The 2023 Banking crisis?

March proved to be a dramatic and unnerving time for stock market investors. The collapse of Silicon Valley Bank (SVB) and Signature Bank in the US sparked fears about weaknesses in the banking sector. In Europe Credit Suisse was forced to merge with UBS and now Deutsche Bank is on the ropes. It would be natural for this situation to seem reminiscent of the 2008 global financial crisis, but ultimately, the lessons learned from 2008 should be enough to prevent anything so severe from being repeated.

What's Going on with Banks?

The basic business model of banks is that they pay interest to depositors, which allows them to lend money at a higher interest rate and therefore make a profit. Banks should benefit when interest rates rise as the margin between the depositors' and borrowers' interest rates goes up and therefore, they make more profit. However, we have seen the value of banks fall recently. There are two main problems that banks face; the borrowers of money can't pay it back (credit issues); or there is a run-on of people taking their deposits out and banks are unable to repay them (liquidity issues).

Banks keep a large amount of their capital in reserve in order to meet withdrawals. This has generally been used to purchase high-quality Government bonds, which if kept to maturity ensure that the bank will get their money back plus an income. 2022 saw interest rates rise and Government bonds crash which meant that the capital of banks fell significantly. This is not a problem if no one wants their money out as the bonds can then be kept to maturity and the balance sheet simply keeps the maturity value and not the current value. However, if large numbers of people take money out at the same time, then the bank will be forced to sell the bonds at a loss.

What happened at SVB?

SVB had an unusual depositor base drawn primarily from startup US businesses, who raised a lot of cash to help fund their business until they make a profit. In the US the deposit protection scheme is set at $250,000 (in the UK it is £85,000) but most of the deposits were over this amount. As interest rates rose the start-up companies found it more difficult to float on the stock market and/or raise more money so they drew down on their deposits. This forced SVB to sell its bonds at a loss and ultimately wiping out the bank's capital and causing it to be insolvent. Therefore, SVB was an unusual situation and regulators have subsequently set up a process to ensure that banks do not have to sell their bonds going forward and this should stop any future panic and collapses.

What happened at Credit Suisse?

Credit Suisse's problems were not from financial instability as it had significant surplus capital and liquidity, but from the fact that it was deemed an incompetent bank, having become embroiled in controversy. For example, the bank agreed to pay a fine in October 2022 of Euro238 million to settle money-laundering charges. They also lost $5.5 billion on one of their investments in 2021. This year it posted its biggest annual loss since the financial crisis. Effectively the bank had lost credibility and was forced to be taken over by UBS (another global Swiss bank).

What next?

There is a general nervousness around banks and Deutsche bank is the latest to have concerns. It does appear that banks are well capitalised though, and the regulators are helping to stop any further collapses. In addition, inflation is coming down globally (even though the UK went up last month) and analysts are expecting interest rates in the US to start coming down which should mean bonds go up in value and thus the bank liquidity problem is resolved. However, banks could be less willing to lend going forward and this could cause a recession. Property companies could also find it more difficult to finance their debt and property prices could fall.

Stock markets are reacting well though due to the fact that there has been significant market intervention to support the banks and the expectation that the "capitalist" system will continue to bail out banks. Therefore, we have a strange scenario in which banks have underperformed but higher-risk technology stocks are outperforming.

In summary

Whilst the headlines have been terrible, this does not appear to be anywhere near the banking crisis of 2008. Bigger banks are in a far better position than they were in 2008 and regulators are ready to help at all costs.

Final Comment

If we look past the headlines, the global economy is performing in a way that is conducive to rising asset prices. We have managed to avoid a recession for now, but the economy is not growing too much, thus we are in the Goldilocks period that we have discussed many times before. This has led to inflation falling (except in the UK) and there is now talk of interest rates falling by the year's end. This should help all asset classes and those that have fallen the most could also recover the most.

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