Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update
August 2023

Contents:

Performance Update

July proved to be a good month for global stock markets, with the S&P 500, FTSE 100 and Euro Stoxx rising 1.99%, 2.35% and 1.94% respectively. Bonds and gold also rose. This caused our portfolios to rise between 1.03% and 2.16%.

Could July prove to be the turning point for the UK economy? Inflation surprised to the downside, falling to 7.9% in June, from 8.7% in May. Economists had predicted a drop to 8.2%. The Bank of England is now expected to raise interest rates by 0.25% and not 0.5%, with the expectation that interest rates will peak at 5.75% and not 6.25%. This has helped income-producing assets (bonds and dividend-paying companies) to rise.

The good news for inflation has also sent Government borrowing costs down which could mean lower taxes before the election next year (the pre-election bribe!). It is also a boost for mortgage holders as fixed-rate mortgage deals are starting to come down.

Inflation in the US is now down to 3%, which is the lowest rate in two years and down from a peak of more than 9% a year ago. The US raised interest rates by 0.25% and they are expected to peak at the same rate as the UK at 5.75%. US unemployment remains at record lows of 3.6% and there is now talk that the US is heading for an "immaculate soft landing" whereby it will bring down inflation without pushing the economy into recession through higher interest rates. This helped support equities in July.

As the yield on bonds fall, the price of bonds rise. UK Gilts are still showing a loss of over 30% during the last 3 years but managed to rise 0.71% in July. This could be the start of a major recovery. Corporate bonds rose by 2.01% and could also be set for a strong recovery.

The one downside for the month has been the increase in the price of oil with it rising from $70 to just over $80 for the month. It is rising as we are now expecting the US economy not to enter a recession, but this is a good news/bad news story as it could also cause inflation not to fall as quickly.

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	1.15	-0.12	-0.87
Cautious	1.03	1.64	2.08
Balanced	1.13	1.29	1.60
Adventurous	1.53	0.46	1.14
Dynamic Equity	1.91	-0.47	1.33
Income Generating	2.16	-0.04	0.61
Fourth Industrial Revolution	1.70	6.87	6.37
Retirement Investment Solution 1	1.34	0.44	-0.32
Retirement Investment Solution 2	1.43	0.26	-0.15
Retirement Investment Solution 3	1.50	0.10	0.01

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 31.07.2023.

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	✓
US Equity	✓	UK Corporate Bonds (Short dated)	✓
Japan Equity	✓	UK Index-Linked Bonds	x
Pacific Equity	x	Global Bonds	✓
Gold	x	UK Gilts	x
Global Property	x	Emerging Market Bonds	✓
Global Infrastructure	x	Overseas Corporate Bonds	x

Most equity markets are above trend and we have just seen UK corporate bonds move above trend as well.

Cautious, Balanced and Adventurous portfolios

We are beginning to see more markets break above trend, with the FTSE 250, emerging market equities, UK corporate bonds and emerging market bonds all going positive this month. 12 of the 20 main markets we monitor are above trend. This is the first time in a while that we have experienced more than 50% above trend.

Dynamic Equity portfolio

There were no changes this month. Japan, US, Europe, UK, Global and Technology equities remain the momentum investments for the portfolio. Europe has been one of our main "momentum" investments this year and you can see how it has recovered but since February has not moved higher. The stock market now looks set to break out (see asset class review) and we could be rewarded over the next few months for holding European equities.

Foundation portfolio

We experienced 4 of our selected markets move above trend and thus exposure to risk has been increased. The Foundation portfolio has a higher allocation to bonds than the other portfolios and thus is set to benefit the most if interest rates start falling. This could happen in 2024.

Income Generating portfolio

All 17 of the underlying holdings within the portfolio made positive returns in July. This is a result of the expectation that interest rates will not go as high as previously expected, which helped both bonds and other income-producing assets. Smaller UK companies benefitted, with the Unicorn UK Income fund rising 2.75%. This fund invests in high dividend-producing smaller UK companies and has a yield of 4.96%. The portfolio could be set for some strong returns going forward.

Fourth Industrial Revolution portfolio

4 of the underlying holdings rose over the month and 5 declined. The portfolio still grew by 1.7% as we had strong performance from the iShares Digitalisation fund (up 4.11%) and the Herald Investment Trust (up 3.20%). The worst performer was the iShares Global Clean Energy fund which fell 2.12%.

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. Exposure to equities rose again this month, and exposure to bonds is beginning to increase.

Summary of Portfolios

Finally, we have some better news for the UK with inflation coming down more than expected. This has had the knock-on effect of reducing the expectation that interest rates will now peak at 5.75% and not 6.25%. Fixed-rate mortgage deals are beginning to come down (unfortunately so are fixed-rate saving bonds) and the expectation is that the UK may suffer only a mild recession at worst. The UK economy is by no means a picture of health, it just hasn't been as terrible as everyone imagined.

By comparison, inflation in the US is now only 3%. Interest rates are still rising but are expected to peak at the same level as the UK. Their economy is growing at 2.4% (the UK is barely growing) and there is a feeling that we are heading for a very "soft landing". A soft landing is defined as " the goal of a central bank when it seeks to raise interest rates just enough to stop an economy from overheating and experiencing high inflation, without causing a severe downturn". The positive news in the US is why stock markets are continuing to move higher.

This could also mean that some of the recent worst-performing asset classes, have a strong rebound and become the best performers. European equities are performing well but over the years US equities have significantly outperformed and have produced around double the returns over the last 5 years. Could this be about to change? UK Gilts have fallen by over 30% over the last 3 years and thus could also be viewed as cheap if inflation falls in the UK more than expected. Infrastructure, real estate and China have also underperformed over the last few years but are beginning to advance higher, with the MSCI China index moving 9.54% higher in July. We could be moving into a period in which returns are very good for certain asset classes.

Asset Class Review

This section will give you an insight into our current thinking. This month we look at some of the important charts from bonds and equities as well as a chart for chocolate lovers!

Mortgage rates peaked?

The chart below shows the yield on 5-year UK government bonds. This is effectively the interest rate that the UK government must pay when borrowing money for 5 years. It is also the rate at which banks use to price their 5-year fixed-rate mortgages. This month was important as it looks like it was a turning point with the yield finally beginning to fall after hitting nearly 4.75%. We have already begun to see banks reducing their fixed-rate mortgages.

European equities break out

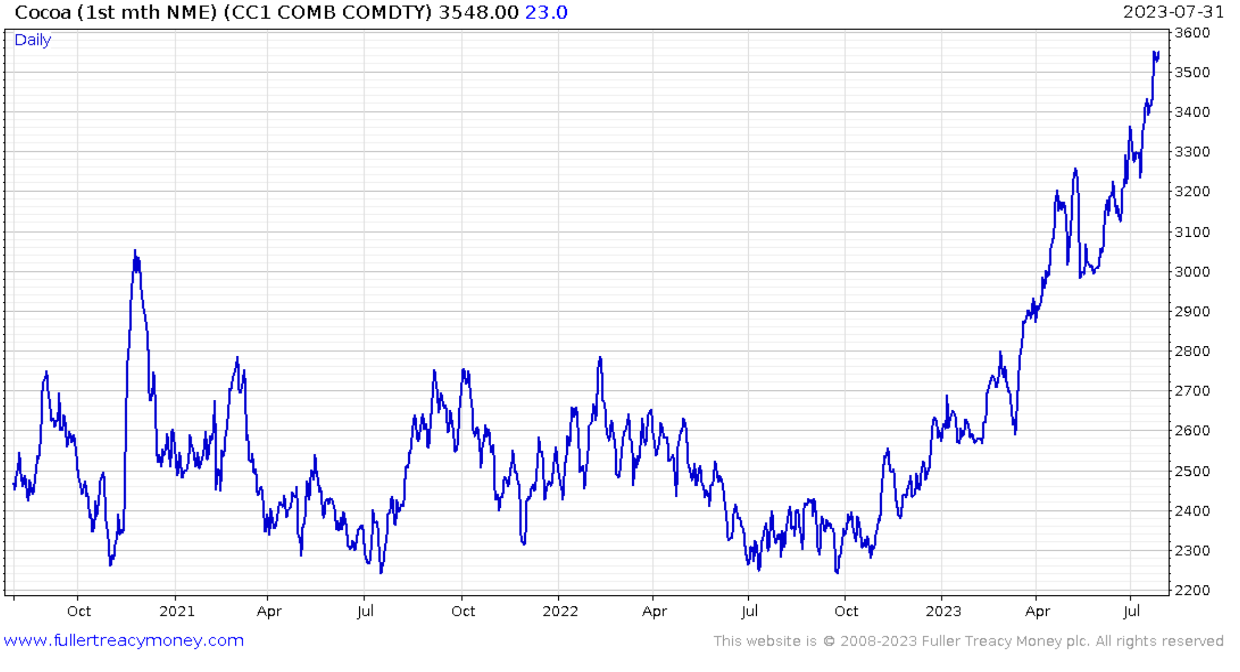
For those of you that have been reading the investment update for several years, you will remember that stock markets will hit a ceiling at which they struggle to break through. The ceiling for the Euro Stoxx 50 was 4400, and you can see how in late 2021 and for the last 3 months, it has failed to break through this level. However, on the last day of July, it broke above 4400. History shows us that once a ceiling is broken, the stock market tends to surge higher with the previous ceiling then acting as a future support level (floor). This could be a very good period for European stock markets.

Technology – advancing higher

The Nasdaq 100 houses most of the world's biggest technology companies and you can see how most of the big losses from 2022 have been regained this year. This is one of the most volatile markets in the world and in the next section we delve deeper into what the Nasdaq 100 is.

Bad news for Chocolate lovers

Chocolate in the UK tends to contain between 20-85% cocoa. Dark chocolate has more cocoa than white chocolate. As you can see in the chart below, the increase in price of cocoa is not great news for chocolate lovers, especially those that prefer dark chocolate!



In Summary

July could prove to be a turning point as inflation has come in lower than expected and thus interest rates are not expected to rise as much as previously thought. This is helping to support equities, in particular technology companies, but it could also be a catalyst for a resurgence of European stock markets. Whilst inflation is falling, expect the price of chocolate bars to rise.

What is the Nasdaq 100?

The Nasdaq 100 is a technology-laden index which tracks the performance of the largest 100 companies on the US Nasdaq exchanges. It has gone up 21% per annum over the last 10 years but has also fallen significantly from time to time. Between 27 March 2000 and 26 September 2001, it fell 73.77% and more recently it fell 26.18% during 29 November 2021 – 16 June 2022.

Probably the most talked about US index is the S&P 500 and when we compare the relative performance of the Nasdaq 100 against the S&P 500, you can see how the value of the S&P 500 has declined over the years by comparison (the lower the line goes the better the outperformance of the Nasdaq 100):

This means the Nasdaq 100 has significantly outperformed and now the ratio of the two is back to the technology bubble level of the year 2000. Perhaps this means technology is now historically overvalued. The main difference between the two indices is that the Nasdaq 100 has a much higher weighting to telecom, media and technology at 67.75% compared to the S&P 500 at 36.51%. Technology companies have outperformed significantly as they have become embedded in our day-to-day lives.

The Nasdaq 100 also has a very high concentration of the biggest technology companies with Microsoft, Apple, Amazon, Nvidia, Tesla, Meta and Alphabet making up 54.91% of the index. This means their performance is the prominent driving force behind the index. In fact, if we compare the performance of the Nasdaq 100 (which gives more weighting to those companies that have the highest market capitalisation) against just simply allocating 1% to each of the Nasdaq 100 companies (this would mean just 7% allocation into the biggest 7 companies and not 54.91%) then you would have nearly doubled your return by being invested in the Nasdaq 100 (market capitalisation). This is one of the few stock markets in which equal weight has not outperformed over the long term.

In summary, the Nasdaq100 has been an exceptional performer as it has tracked the performance of the world's biggest technology companies, which have each grown exponentially over the years. However, it does look as though some of these companies could be overvalued relative to others as the ratio is now back at a level that called the technology market to crash in 2000.

Final Comment

It appears that the UK economy has reached a turning point with the rate of inflation beginning to fall more than expected. This in turn has ensured future interest rates rises will be lower than expected and will ease pressure on government debt repayments and mortgage rates.

An “immaculate soft landing” is also looking more likely in America and stock markets are advancing due to this. Globally we are seeing some much better economic numbers feed through, and this has helped increase the value of our wealth in July.

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

Tel: 01708 250624

Email: chrismoore@watsonmooreifa.com

www.watsonmooreifa.com