Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update

September 2023

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Performance Update

August was volatile for global stock markets, with the S&P 500, FTSE 100 and Euro Stoxx falling 0.08%, 2.50% and 3.13%, respectively. This caused our portfolios to fall between 0.25% and 1.57%.

August was highly volatile as bond yields rose to recent highs before falling again. The UK –ten-year gilt rose to 4.75% before falling back to 4.33%, roughly where it started the month. This extensive range affects equities as a higher yield entices investors out of equities and into bonds. The FTSE 100 was down 5% at one stage before recovering somewhat.

We are in a period in which good economic news causes stock markets to fall and vice versa. The commentary in Reuters sums up the current situation, "It was the fastest contraction in German business activity in over three years and had traders betting that the European Central Bank could now pause interest rate hikes. That view that borrowing costs may finally be cresting helped lift the Euro Stoxx share index by 0.5%".

Inflation has fallen significantly, but we are at a pivotal point where it could persist at a higher-than-average rate for several years, or we will see a deflationary trend immediately afterwards. This depends on whether we get a hard economic landing (big recession) or a soft landing (slow down with mild/no recession). This is why slowing economic data (but not too much) is proving to be good news, as it will mean lower inflation and interest rates but not a full-blown recession.

Whilst UK inflation fell to 6.8%, it is still the highest among all the G7 countries. We are also seeing food and energy prices rise again, albeit relatively modestly. There is a fear that inflation will become embedded and interest rates will not fall for some time.

Bonds were mixed, with UK government bonds falling 0.23% but UK corporate bonds rising 0.11%. Inflation-linked UK government bonds fell by 0.88% though.

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

Portfolio	Performance % 1 month	Performance % 6 months	Performance % 1 year
Foundation	-0.25	0.50	-0.99
Cautious	0.38	1.56	1.02
Balanced	-0.52	1.31	0.21
Adventurous	-0.67	1.04	-0.69
Dynamic Equity	-0.69	1.14	-0.45
Income Generating	-1.14	-1.06	0.78
Fourth Industrial Revolution	-1.57	5.44	3.46
Retirement Investment Solution 1	-0.51	1.31	-1.11
Retirement Investment Solution 2	-0.55	1.25	-1.10
Retirement Investment Solution 3	-0.59	1.21	-1.10

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 31.08.2023.

Trend Following Signals

The table below shows whether the asset class has 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	x	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	x
Gold	x	UK Gilts	x
Global Property	x	Emerging Market Bonds	x
Global Infrastructure	x	Overseas Corporate Bonds	x

Some bond and equity markets broke below trend; out of the leading 23 markets we monitor, only 9 are above trend.

Cautious, Balanced and Adventurous portfolios

This month, we saw a trend reversal, with the FTSE 100, FTSE 250, emerging market equities, overseas government bonds and emerging market bonds all going negative. We are, therefore, back to a more defensive positioning in the portfolios, with a significant amount held in cash. The good news now is that the cash is earning a good level of interest. Much of the cash is invested in the Fidelity Cash fund, earning over 5% annually.

Dynamic Equity portfolio

There were no changes this month. Japan, US, Europe, UK, Global, and Technology equities remain the momentum investments for the portfolio. Property, India, Emerging markets and Pacific Equities remain low on the momentum scale.

Foundation portfolio

We experienced 4 of our selected markets move below trend and just one above trend. Thus, risk exposure has been decreased. This is a reversal of last month's increase in risk. The good news is that last month, we increased exposure to UK corporate bonds, and they produced a good positive return despite bonds generally falling.

Income Generating portfolio

The portfolio remains highly correlated to the expectation of where interest rates will be heading. If they are expected to peak sooner and stay high for less time, then the portfolio outperforms, which it did in July. However, if we expect interest rates to peak slightly higher, the portfolio tends to underperform. August saw income-producing assets underperform with infrastructure and higher dividend-paying companies dragging down the overall performance.

Fourth Industrial Revolution portfolio

We are entering a pivotal point for the portfolio as we have experienced a sequence of higher lows (denoted by the green line). Still, the performance has yet to beat the previous high at each recovery, and we have a ceiling (red line) that needs breaking through. We believe that this triangle pattern will be broken over the next few months to the upside or downside.

Retirement Investment Solutions

The Retirement Investment 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 and bonds fell this month, reversing last month's increase.

Summary of Portfolios

The future direction of interest rates is the key factor affecting the performance of our portfolios. Central banks are trying to engineer a soft landing. This means they are trying to bring down inflation and cool the economy without enduring a hard recession. They are trying to achieve this by raising interest rates. So far, the global economy has been much more resilient than envisaged. This has meant that interest rates have had to keep rising, which in turn has caused bonds to "crash" and kept a lid on any equity gains.

We are now in a strange position in which bad economic news (but not too bad) is treated as good news for asset prices, as it leads to expectations that interest rates will not have to rise as much and will fall sooner than expected. Therefore, the doom and gloom in the press does not necessarily translate into your wealth declining. Even if we get a recession in the UK, as long as it is short and shallow, we could even see asset prices rise. Conversely, when economic data is positive, this may make central banks force a few more interest rate increases through, and this will cause bonds and probably equities to fall.

Our simplistic view is that the economy remains strong as consumers run down their savings to keep their lifestyles up. Therefore, there is a significant lag between interest rate rises and a slowdown in the economy. We believe we are close to the time consumers begin to tighten their belts significantly as they are close to running down their cash reserves, which will cause a slowdown/recession imminently. We could see a dramatic slowdown in the economy, or perhaps central banks have somehow engineered a "goldilocks" slowdown, which will be the catalyst for a recovery in asset prices.

Asset Class Review

This section will give you an insight into our current thinking. This month, we look at some important charts from bonds and equities.

US Treasury yields – pivotal moment

The chart below shows the yield on 30-year US Treasury bonds. This is the interest rate the US government must pay when borrowing money for 30 years. It is also considered the risk-free rate of return, as US Government bonds are considered the world's safest investment and, therefore, one of the most important charts that affect your wealth as every other asset class is affected by the return you can achieve without risk. August initially saw the yield go up and stock and bond markets fall. This was down to the expectation that interest rates would have to move higher and remain there for an extended period. However, as the month progressed, economic data deteriorated, and the yield dropped, causing stock and bond markets to recover.

European equities – failed break out

Last month, we wrote with optimism that the Euro Stoxx 50 had broken above its ceiling of 4400 and looked set to move higher. Unfortunately, this has been a "failed" breakout, and we are now back trading in the range and effectively moving sideways. A market can have many failed breakouts; sometimes, we must be patient. A failed breakout is caused by an underlying optimism from investors buying the market and the breakout. However, there is not enough optimism, and the more pessimistic investors use the breakout as an excellent time to lock in some profits. This pattern can repeat many times until one of the arguments wins.

FTSE 100 – remains in a range

The FTSE 100 remains trading at around the 7500 level and is back at the same level 5 years ago. The FTSE 100 has been helped by a weaker sterling as 70% of the top 100 UK companies' earnings are derived from overseas and thus increase in sterling terms when sterling is weak. The FTSE 100 only has 2 of the world's top 50 companies – Shell and Astra Zeneca and 4 in the top 100.

FTSE250- smaller companies underperforming

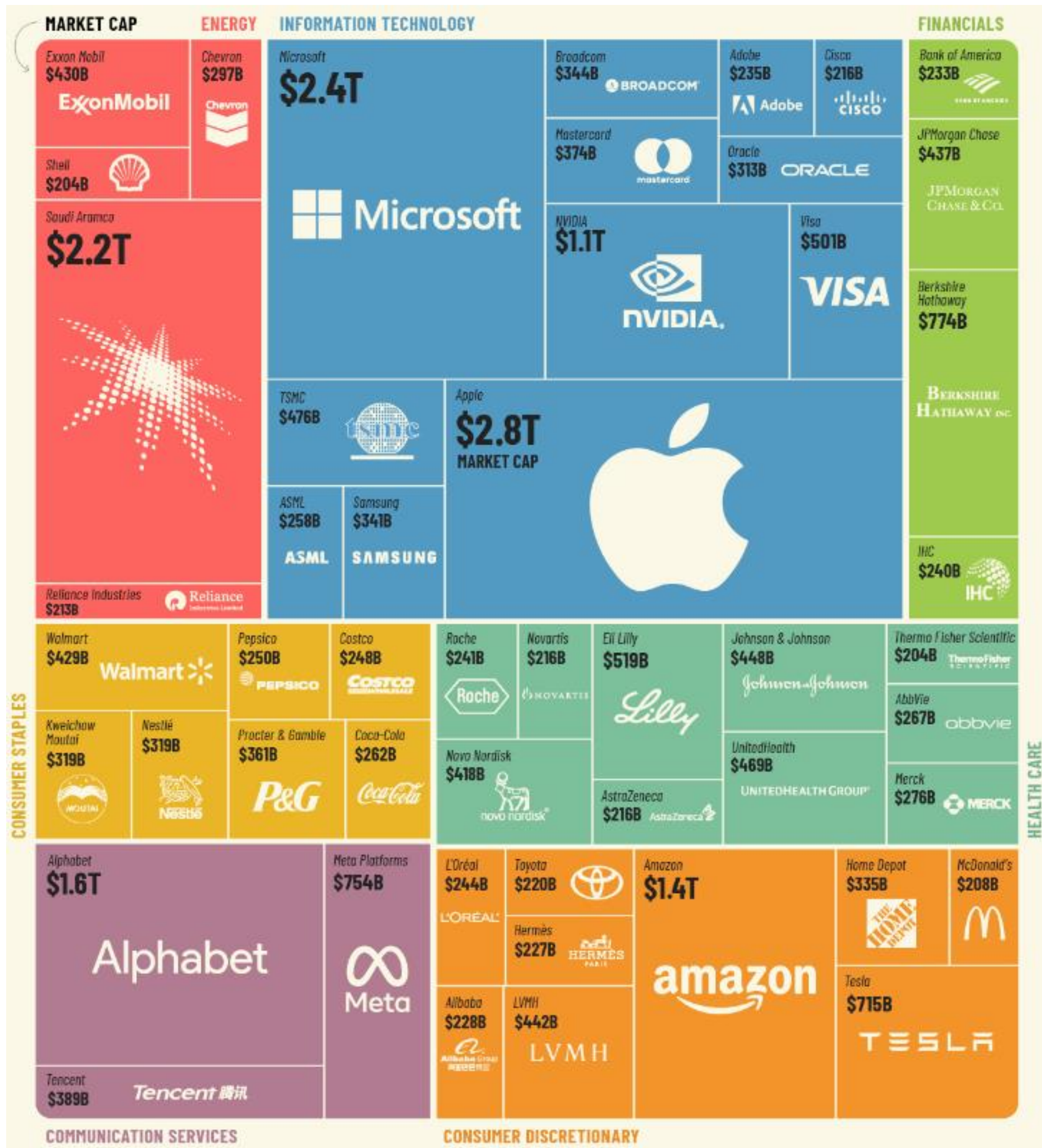
Whilst the FTSE 100 trades sideways, the FTSE 250 is on a downward trend. Smaller companies globally are underperforming because they tend to be the ones most sensitive to interest rate rises, i.e., underperform as interest rates rise and vice versa.

In Summary

Just when we thought that interest rates were not expected to rise as much as previously thought, August proved that we continue to be in a very volatile economic climate in which it isn't proving easy to forecast what is exactly happening to the economy and thus where interest rates will be in the next year. Global stock markets continue to be volatile, with smaller companies underperforming and optimists matched by the number of pessimists.

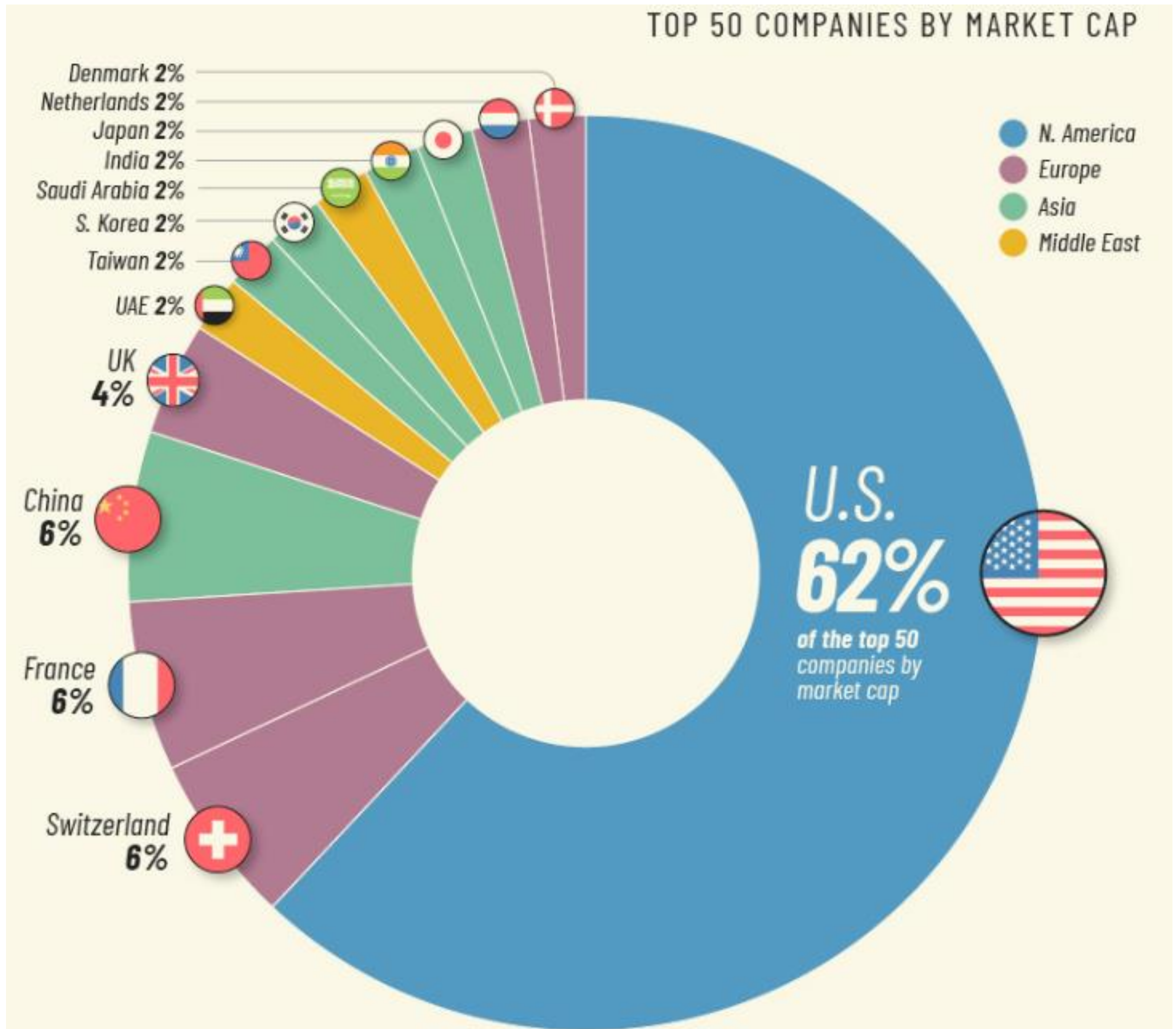
Top 50 Global Companies

The website www.companiesmarketcap.com is an excellent site to look at the world's most valuable companies. The graphic below shows the most beneficial 50 companies by market capitalisation, split into their different sectors. The bigger the box, the more valuable the company is.



You will recognise most of the names, and if you don't recognise the company names, you will probably be aware of the products that they produce. However, the average age of the top 50 companies has decreased over the last 20 years. Whilst Coca-Cola was founded in 1892, Tesla only became a public company in June 2010 and is now nearly three times as big. Many of the biggest companies are technology-based, and many were born after the average age of our clients. This makes us wonder what the top 50 will look like in 10,20- and 30 years. Especially as technology is growing exponentially in our lives, and artificial intelligence will revolutionise the products we purchase in the future.

When looking at the geographical location of the top 50 companies, it is no surprise that 62% are US-based. 9 of the top 10 are US-based, with Saudi Aramco the only non-US company (the third biggest).



The figures above use the market capitalisation of the top 50 companies, which is simply the company's share price multiplied by the number of shares. Interestingly, if we change the data to list the top companies by revenue (earnings), the geographical distribution becomes more even. For example, Amazon dropped from 5th place to number 60. Furthermore, when we search by number of employees, China climbs much higher up the list with 11 of the top 50 employers. Ireland has the 4th biggest employer – Accenture.

So why look at this data? Firstly, it shows the current dominance of the US and technology in global stock markets. Many UK investors have had a much higher weighting to UK companies than their market capitalisation dictates, with some of our clients previously having between 50-100% of their wealth invested in UK companies. Our portfolios have a much more global weighting, with a current bias towards the US, as they should do currently.

Secondly, looking at how the list has changed over the last 20 years, you can see how the investment world has changed significantly. Suppose you do not embrace new technologies and companies within your investment strategy. In that case, you will likely miss out on some of the best opportunities in the future. Will the US continue to dominate, or will other countries produce some valuable companies?

Finally, market capitalisation is just one measure of the importance of global companies, but what happens if the companies that produce the most revenue become much more profitable in the future? It is, therefore, essential to keep monitoring trends and adjusting our portfolios to try and take advantage of the potential returns from embracing the inevitable change that our lives will see.

Final Comment

Just as we expected interest rates to peak, we have more uncertainty about whether we may now have a few more rate rises than expected. This is causing asset prices to continue to be highly volatile. We are in a strange situation in which good news is treated as bad news for investments and vice versa.

Our view is that the effect of the sudden and sharp increases in interest rates has not yet taken full effect in the economy as consumers have been supplementing their expenditure from cash savings. However, over the next few months, we will likely see a sharp slowdown in business activity, which is precisely what central banks want. It would be sensible to pause any further increases in interest rates and take some time to see the effect of the recent rises. But how many people in high positions have been sensible over the last few years?

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Authorised & Regulated by the Financial Conduct Authority

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.