Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update
October 2023

Contents:
Performance Update
Asset Class Review
Where next for Interest Rates?
Final Comment

Performance Update

September saw a wide disparity in performance from different stock markets, with the FTSE 100 and MSCI Japan growing 2.40% and 1.77%, respectively and the FTSE 250, S&P 500 and Euro Stoxx falling 1.48%, 1.13% and 1.86% respectively. Our portfolios generally experienced a slight fall between 0.12% and 2.10%.

Concerns that the US Federal Reserve may keep interest rates high for an extended period prompted falls in US stock markets. The S&P 500 was up 2% by the middle of the month but fell to over 1% lower. US interest rates will probably have to move higher this year as well, and the worst-case scenario is that they will peak at 7%.

Conversely, the UK saw interest rate expectations fall as inflation and wage demands dropped more than expected. The Bank of England paused their rate hikes, and the current 5.25% rate is expected to be our peak. Corporate bonds moved higher on the news, but strangely, government bonds fell. Inflation-linked bonds fell by 4%, which is significant.

The China economy is struggling, and its stock market is falling. Shares in Evergrande, once the world's most valuable listed property developer, were suspended in Hong Kong. The property and debt crisis in China is threatening the Chinese economy. China is trying to reduce the amount of debt and speculative investment without crashing the economy.

Just when inflation appears to be under control, the oil price is beginning to rise and is approaching $100 again. Oil is a critical raw component that affects the prices of many goods. On the positive side, the cost of copper is continuing to fall, which is probably a sign of a slowing Chinese economy.

Economic experts are finding it very difficult to forecast what is happening. This is what is causing the current volatility. Suppose the inflation figures surprise on the upside or downside. In that case, this affects interest rate expectations, which in turn affects global growth expectations and the prices of bonds and equities will then fall or rise significantly.

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	-0.12	-0.06	2.21
Cautious	-0.24	1.13	2.81
Balanced	-0.35	0.90	2.36
Adventurous	-0.53	1.13	1.90
Dynamic Equity	-0.46	1.49	3.42
Income Generating	-0.65	-0.04	6.94
Fourth Industrial Revolution	-2.10	2.05	7.11
Retirement Investment Solution 1	-0.28	1.00	1.77
Retirement Investment Solution 2	-0.32	1.06	1.91
Retirement Investment Solution 3	-0.36	1.11	2.05

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 30.09.2023.

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	x	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	✓

Out of the leading 23 markets we monitor, only 8 are above trend.

Cautious, Balanced and Adventurous portfolios

This month, we saw a trend reversal, with European and healthcare equities going below trend. Overseas corporate bonds went above trend, which had much to do with sterling falling. Whenever we analyse the trend of a market, we always convert the trend into sterling as that is what is important to us. There is no point in investing in a market trending upward, but sterling appreciates, so we lose money. We continued with the theme of 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

The first change in months was made with US equities being replaced by Europe smaller companies. This is a bit of a surprise and would typically signal an increase in risk, as US companies are usually the safest and smaller companies the riskiest. However, we think it has more to do with US companies being very expensive and thus falling back. In contrast, smaller European companies are cheap but becoming less cheap as they advance higher.

Foundation portfolio

We experienced two of our selected markets move below trend and just one above trend. Thus, risk exposure has been decreased again. The good news is that we are seeing some growth in the markets we have more exposure to due to them being above trend. Japanese equities and UK corporate and overseas government bonds all made gains during the month, which helped the portfolio minimise losses during a difficult period. We remain more defensively positioned than usual.

Income Generating portfolio

The portfolio remains more volatile this year than usual and is more correlated to equities. The chart over the page shows how the portfolio is moving more in synch with our higher-risk Dynamic Equity portfolio, which invests in global equities. We must expect more volatility until we see more stable economic numbers. Currently, inflation and interest rate expectations are changing each month, causing income-generating assets to be much more volatile.

Fourth Industrial Revolution portfolio

Only the cybersecurity sector produced a positive gain last month, and technology generally fell more significantly than other sectors. We remain at a pivotal point for the portfolio as we continue to have a ceiling in which the portfolio has stayed within the previous high at each recovery. Hopefully, we are close to the stage where it will break higher, but we probably need interest rates in the US to peak before that happens.

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 fell this month, whereas exposure to bonds slightly increased. The portfolios remain much less volatile due to their higher-than-average cash exposure.

Summary of Portfolios

The good news is that the UK's economic data is deteriorating but in a good way for our wealth. Growth is sluggish; wage demands are falling, and inflation is falling. This has caused the Bank of England to pause interest rate rises, and we could be the first major country to lower them to help support the economy. Our economic weakness has caused sterling to fall significantly and thus help push up the value of our overseas assets.

The bad news is that Europe and the US have more robust economic data, with inflation trending upwards again in some countries. This has caused the expectation that interest rates will have to go up much higher, and this could lead to a more significant downturn in economic growth, leading to a fear of stagflation. This is where inflation remains high, unemployment moves much higher, and economic growth is low or negative. If this happens, global stock markets will almost certainly fall.

We still believe a significant lag exists between interest rate rises and a slowdown in the economy. This could mean we are not far away from the possibility of 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 – shoot up higher

The chart below shows the updated yield on 30-year US Treasury bonds. This is probably the most important chart that affects our long-term wealth. Last month, we looked at how it was a pivotal time as it looked like interest rates might have peaked. However, economic data subsequently has caused the yield to go much higher. In turn, interest rates will peak at a higher level and stay higher for longer. This is because the US economy is still not cooling enough despite the significant interest rate increases. The fear is that a strong economy will cause inflation to move much higher. If interest rates don't rise now, then in the longer term, they will have to move much higher to bring inflation back down.

China– imploding

China has a property crisis. Two of its biggest privately owned property companies are effectively bankrupt, and the state will eventually take over their assets. The state has been worried about its booming property sector since 2020, and this made it more difficult for developers and consumers to get credit, leading to unsold properties. Without this intervention, there would have been a more significant boom and bust. Selling land and housing has also been a great source of tax revenue for the Chinese regions, and a housing bust has seen tax revenues plummet. The Chinese stock market has suffered sharp falls over the last few years, and it looks like it will hit its previous 2022 low. Eventually, it will turn around, but the trend remains down.

Oil – rising again and could lead to higher inflation.

Oil is one of the most critical raw contributors to global inflation. The chart below shows how it peaked in 2022, with inflation peaking shortly afterwards. The falls from the peak also helped lead to inflation falling, which we are now experiencing. However, if the current trend continues and oil goes above $100, we could see another spike in inflation during 2024.

Sterling weak against the US Dollar- helping our portfolios

Interest rates are expected to go up in the US but have peaked in the UK. This has meant that more money has flowed into dollars in the expectation that you will receive a higher level of interest. This has helped contribute to a rising dollar, shown by the blue line below falling recently. An increasing dollar helps our wealth as we currently have a lot of money invested in the US within our portfolios. When it is converted back into sterling, it is worth more. Compared to the rest of the world, a weak UK economy has its benefits!

In Summary

We are seeing some significant trends develop in asset classes, with inflation, interest rates and high debt levels all causing concern. The best path forward is for global growth to slow (but not too much), leading to lower inflation and interest rates. Sterling falling is helping to protect our wealth once again. Indeed, these are interesting times!

Where next for Interest Rates?

Interest rates in the UK have risen 14 times on the run and now stand at 5.25%, their highest for 15 years. In July, investors believed the Bank of England was on track to take interest rates to 6pc by the end of 2023 and as high as 6.5% in 2024. However, signs of a cooling job market since then and a surprise fall in inflation last month have caused the expectations of the direction of interest rates to change dramatically quickly. We must remember that predicting the future is difficult and virtually impossible, as many variables always affect every decision. The Bank of England, therefore, voted last month to keep interest rates unchanged in what was a surprise move, and now the experts believe that interest rates have peaked at 5.25%. The chart below is the yield you can get from buying UK government bonds for two years. You can see how rates do appear to have peaked and have gone down somewhat but could stay at this level for another year before possibly a couple of rate reductions at the end of 2024 or early 2025:

However, the UK economy appears slightly out of sync with Europe and the US. The US economy is expected to grow by 2% this year, 1.5% next year and 1.8% in 2025. The UK economy is expected to grow by 0.5% this year and next and only 0.25% in 2025. Therefore, US interest rates might have to rise and stay higher for longer than the UK to cool the economy and put a lid on inflation.

In Europe, interest rates are expected to keep going up and stay higher for longer. The chart below demonstrates how the yield (linked to future interest rates) has risen significantly on 10-year German government bonds. The level is lower than in the UK, but the trend is up.

In conclusion, it appears that there will be no more interest rate rises in the UK, and rates should stay at this level for a year at least before falling slightly. This depends on inflation coming down and the economy cooling, which it appears to be doing. However, Europe and the US seem to have inflation rising again. In addition, the US economy is still very robust, which should mean interest rates will go up again in Europe and the US.

Final Comment

Asset prices remain volatile as economists adjust their expectations of where interest rates will peak and how long they will stay high before falling. We appear to have significant changes each month, and bonds and equities are reacting to these changes. The UK seems to have seen a peak in interest rates, but the US and Europe should see a few more rises. It may also take over a year before they start to come down.

Last month, we wrote:

"Our view is that the effect of the sudden and sharp increases in interest rates has yet to take 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."

The pauses have happened!

,

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

Tel: 01708 250624

Email: chrismoore@watsonmooreifa.com

www.watsonmooreifa.com

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.