Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update
December 2023

Contents:

Performance Update
Asset Class Review
Battered Britain
Final Comment

Performance Update

Stock markets endured a difficult month as geopolitical tensions in the Middle East continued to weigh on investor sentiment. The major stock markets fell, with the FTSE 100, Euro Stoxx, FTSE 250, and S&P 500 falling 3.69%, 2.92%, 6.33% and 1.53%, respectively. Our portfolios fell between 0.66% and 5.61%.

Higher interest rates and bond yields have spooked equity markets, with the S&P500 falling into correction territory. A correction is when it falls by more than 10%, which it did between 31st July and 27th October.

The yield on US Treasury 10-year bonds rose significantly from 4.57% to 4.93%. This increase in bond yields affects equities as a higher yield entices investors out of equities and into bonds. Smaller companies also tend to fall more than larger companies as they tend to have more debt and, therefore, suffer the most if interest rates rise.

Bonds fell over the month except for UK Gilts and UK corporate bonds. This tells us that UK interest rates have probably peaked. The critical question now is when will the Bank of England start cutting interest rates. Economists now predict that rates will remain at this level for an extended period. Still, some expect a rate cut in 2024, with further cuts in 2025, reducing the level to 4.5% by the end of 2025. This coincides with inflation below 2% or lower by the end 2025. However, if we get a recession, expect rates to come down much quicker. This could be a perfect time for investing in bonds.

Oil prices remain relatively well-behaved despite geopolitical tensions and have come down around $5 during October, which indicates that Iran will not escalate the war in Israel. This is helping reduce inflation, with eurozone inflation slowing to just 2.9% in October, down from over 9% at its peak.

The price of gold increased by over 7%, and the trend following portfolios increased exposure. Gold typically performs better when interest rates fall and during economic stress and geopolitical uncertainty.

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	-0.66	-0.84	1.27
Cautious	-0.98	-0.32	1.45
Balanced	-1.26	-0.90	0.48
Adventurous	-1.56	-1.05	-1.01
Dynamic Equity	-2.87	-2.44	-2.35
Income Generating	-2.74	-4.42	0.96
Fourth Industrial Revolution	-5.61	-1.31	-0.66
Retirement Investment Solution 1	-1.44	-1.00	-0.60
Retirement Investment Solution 2	-1.69	-1.27	-1.02
Retirement Investment Solution 3	-1.92	-1.52	-1.40

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 31.10.2023.

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	x	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	x	UK Index-Linked Bonds	x
Pacific Equity	x	Global Bonds	x
Gold	✓	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 7 are above trend.

Cautious, Balanced and Adventurous portfolios

The portfolios continue to have a higher weighting to cash and are thus more defensive than usual. Equity exposure was further reduced as Japan and global equities fell below trend. Gold moved above trend, and the Cautious and Balanced portfolios increased their weighting. The chart at the bottom of the page shows how much less volatile and more defensive the Cautious portfolio (blue line) has been compared to a good industry benchmark, the AFI Cautious sector.

Dynamic Equity portfolio

The six asset classes that display the most significant momentum remained the same, and therefore none were changed.

Foundation portfolio

Japanese equities fell below trend, so exposure was decreased. However, gold and commodities moved above trend, and exposure increased. The chart below (similar to the Cautious portfolio) shows how much more defensive the Foundation portfolio (green line) has been over the last two years when compared to a comparable benchmark (red line).

Income Generating portfolio

The portfolio has some exposure to smaller UK companies as they are currently generating high levels of dividend income. UK smaller companies suffered sharp falls during the month, which impacted the portfolio. However, the UK equity funds we invested in have made positive gains over the last year and are performing well.

Fourth Industrial Revolution portfolio

Every fund within the portfolio fell as interest rate expectations increased in the US. The portfolio will benefit when we hear that global interest rates have peaked and are expected to come down. The portfolio has fallen 0.66% over the last year and remains highly volatile.

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 gold increased. The portfolios remain much less volatile due to their higher-than-average cash exposure.

Summary of Portfolios

In the US President Biden celebrated his 81st birthday on Monday 20th November, reminding everyone he will be 82 come the next presidential election and 86 by the end of the next presidential term. This is becoming more of an issue for US voters who worry over various press reports suggesting more lapses of age are creeping into the president's public performances.
Whilst his opponent Mr Trump is only four years younger, he is not attracting the same criticism over age. He remains preoccupied by the blizzard of court cases against him which so far have not lost him support with many Republicans though shock his critics. Recent polls are not kind to either potential candidate for the presidency with more people disapproving than approving of both candidates.
The bookmakers have Trump as the favourite, and there is no clear contender to these two. Why is this important? The US stock market has been one of the best performing markets in the world and has begun to rally again. Investors are not concerned who becomes President as it is the economy that is most important.
In the UK we have reached a situation in which the political party that wins the next election have their hands

Two years ago, no one expected interest rates to rise this high, and this has negatively impacted the performance of many asset classes globally. The main asset class that fell were bonds, which experienced a significant crash. Bonds fall when interest rates rise more than expected, with the rises over the last two years causing many bond asset classes to fall by 20% or more. Equities have been less affected but have suffered from significant volatility. For example, the FTSE 100 was 7451 on 1st January 2022 and 7321 on 31st October 2023. In between, it has gone from above 8000 to below 7250. It has fallen slightly overall but has been relatively volatile.

The good news is that interest rates in the UK appear to have peaked. Inflation remains elevated, but we are expecting a slowdown in the UK economy, which will mean the Bank of England does not need to increase rates again. In the US, rates may have peaked, or if they do go up further, it should only be one increase. The US economy remains more robust, but there are signs of it weakening.

We still believe that there is a significant lag between interest rate rises and a slowdown in the economy. We are now beginning to experience that slowdown. There is a strong possibility that the "goldilocks" slowdown (in which inflation is tamed, interest rates fall, and economies do not experience a strong recession) 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 the weakness in equity markets.

US Treasury yields – now trending downwards

We have been monitoring this chart as it shows the risk-free rate of return against which most asset cases are priced. Two months ago, the yield hit 5% and interest rates were expected to continue to rise globally. However, you can see a big reversal last month, with the yield hitting 4.4%. This tells us that we are probably at the peak of interest rates in the current cycle and that they should start to come down in 2024. This move down has helped increase the value of other asset classes and ultimately, our portfolios.

US stock market- trending downwards

After a strong recovery, we are seeing the US market give up some of the gains from this year. There is a clear short-term downward trend with lower highs and lows since the summer.

Gold- is it about to break the ceiling

There are many reasons why gold is advancing higher, but it has hot a very important level as it is around the level of the last three peaks. This level has acted as a ceiling in which the price has fallen back. Could it now break through and go much higher? Our portfolios have the maximum allocation to gold and hopefully, we will benefit significantly.

UK smaller companies – bouncing

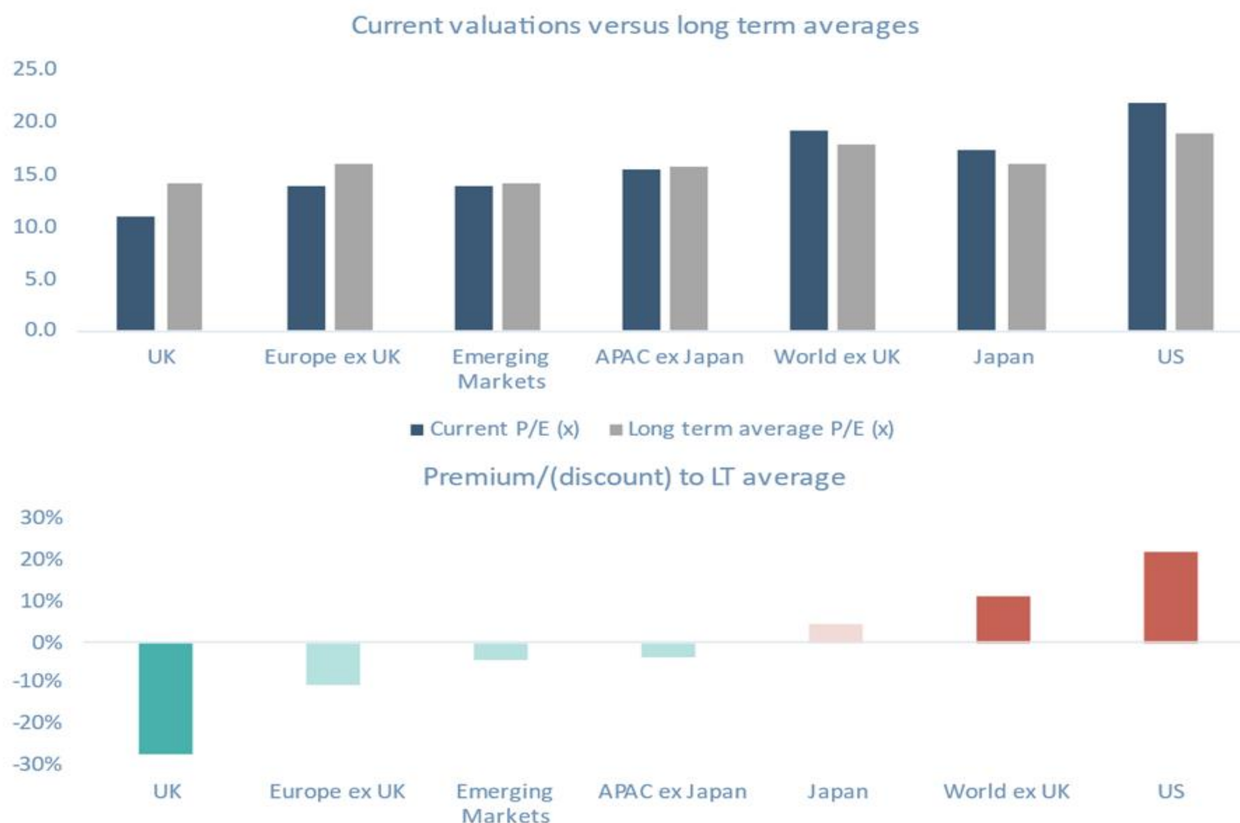
Last month we wrote: *"Smaller UK companies have been one of the most unloved asset classes in the world and have fallen sharply recently. 17,000 is a level that the market has traded at previously and then bounced back from. The dividend yield is over 4%, which makes this stock market attractive. If we get a global stock market recovery, this market could be the one that gains the most*." You can see how it has bounced and grew by x% in November.

In Summary

We have experienced declines in global equity markets over the last few months. The catalyst has been that interest rates in the US (shown through an increasing bond yield) are potentially going to go up more than previously expected. This means that investing in stock markets is less compelling. If and when we see the yield on bonds begin to fall, then this could act as a catalyst for stock markets to recover back above their summer highs.

Battered Britain

British stocks are unusually cheap, whilst the US is expensive. The charts below show the long-term average price-earnings ratio (p/e ratio) of different countries and regions. The p/e ratio measures how cheap or expensive a company or stock market is. It is simply the stock market value of a company divided by how much it earns per share. The higher the value, the more investors are willing to pay for the earnings and the lower the figure, the less willing.



Source: Unicorn Asset Management and Bloomberg

From the graphics, you can see how the UK is nearly 30% below its long-term average – this means it is cheap! The US is over 20% above its long-term average. The problem of buying "cheap" investments is that they can get cheaper. The FTSE 250 has only grown by 4% since January 2018, but advanced 8% last month. Could this be a great time to invest in a stock market that is cheap but is embarking on a new upward trend?

UK smaller companies and their relationship with inflation is very sensitive and, in some ways, under-appreciated. The catalyst of unlocking value in the UK market may have arrived: Inflation (CPI) fell to 4.6% last month from 6.7%, having peaked at 11.1% in October 2022. Inflation is falling at the steepest pace in over 30 years, and in a significant change in sentiment the market is now forecasting meaningful interest rate cuts in 2024. If we look at the performance of UK smaller companies after previous inflation spikes, we can see how well they have performed over the next six months and up to 3 years.

Peaks in inflation	Next 6 months	Next 1 year	Next 2 years	Next 3 years	Crisis
August 1975	36%	27%	106%	219%	OAPEC oil embargo
May 1980	19%	41%	54%	111%	1979 Energy crisis / industrial action
September 1990	21%	29%	13%	74%	Lawson boom / Gulf War I

Our trend-following portfolios have increased their exposure to the FTSE 250 and enjoyed strong returns from the index last month. The index could just be about to embark on a strong period of outstanding returns.

Final Comment

There continues to be much uncertainty regarding interest rates, causing asset classes to remain volatile. However, a falling oil price due to Iran appearing not to be escalating the war with Israel should help subdue inflation. With the global economy also slowing down, we could be close to the peak of global interest rate rises, and this would provide support to both bonds and equities.

Interest rate rises have paused globally, and there is now talk that they will remain at the current levels for an extended period before falling. Each country will have a different cycle, with the UK perhaps one of the first countries to cut rates.

Watson Moore Independent Financial Advisers Limited
Essex House
Station Road
Upminster
Essex
RM14 2SJ

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.