Watson Moore
INDEPENDENT FINANCIAL ADVISERS LIMITED

Monthly Investment Update

February 2024

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Performance Update

It was a mixed month for major stock markets, with the FTSE 100, FTSE 250, and Emerging Markets falling by 1.27%, 1.55%, and 4.53%, respectively. Meanwhile, the Euro Stoxx, S&P 500, and Nikkei 225 rose 0.39%, 1.79%, and 3.43%, respectively. Our portfolios had a mixed month, performing between -0.88% and +1.93%.

Inflation isn't under complete control yet. US Consumer Price Inflation (CPI) came in higher than expected in December at 3.4%, and UK CPI was unexpectedly high at 4%, with alcohol and tobacco being the most significant contributors. Economists had expected a continuation of the recent falls.

The above result is that interest rate cuts are expected to be deferred, and the chances of cuts in the first half of this year are falling. The yield on UK 10-year gilts increased from 3.57% to 3.79% but briefly exceeded 4%. This volatility shows how sensitive the economy is to the inflation data.

After a strong December, bonds gave up some of these gains, with UK Gilts and UK corporate bonds falling 2.66% and 1.45%, respectively. This is why the lower-risk portfolios suffered losses over the month, as they currently have full exposure to bonds due to them remaining on a long-term upward trend.

UK equities suffered falls as they are more sensitive to "bad" inflation news. This is mainly because they pay higher dividends; thus, the dividend yield is less attractive if interest rates do not fall. By contrast, US and European equities hit new highs, and this helped our higher-risk portfolios grow. Once a stock market hits a new high, it attracts more investors and moves even higher.

Sterling remains relatively stable, although it is mildly appreciating. Interest rates are expected to fall in the US first as inflation is lower than in the UK. This would mean that the UK is more attractive as a place to deposit cash as it will generate a higher level of interest, and therefore, Sterling could be boosted. This would be great news for our overseas summer holidays but push down the value of our overseas investments.

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	-0.88	3.75	3.62
Cautious	-0.57	3.98	5.68
Balanced	0.08	4.27	5.61
Adventurous	0.98	5.28	5.77
Dynamic Equity	1.93	6.92	6.42
Income Generating	-0.36	3.66	3.58
Fourth Industrial Revolution	0.22	6.21	13.51
Retirement Investment Solution 1	0.14	3.64	4.09
Retirement Investment Solution 2	0.44	4.09	4.36
Retirement Investment Solution 3	0.71	4.51	4.61

Please note that these figures do not include the platform or Watson Moore's fees.*All figures are sourced from Financial Express to 31.01.2024.

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

Of the leading 23 markets we monitor, 20 are now above trend.

Cautious, Balanced and Adventurous portfolios

Bonds suffered losses last month, which caused the Cautious portfolio to fall as it has its maximum exposure to bonds. Infrastructure was sold from the Cautious and Balanced portfolios, whilst Emerging Market equities were sold from the Balanced portfolio. The Adventurous portfolio remains fully invested, but Indian equities replaced smaller European companies.

Dynamic Equity portfolio

After being the best-performing asset class in December, smaller European companies struggled and were replaced by Indian equities. The portfolio benefitted from its exposure to the US, Japan and technology markets as they continue to be the best-performing asset classes. In addition, the portfolio holds the iShares MSCI World Momentum ETF, which grew by 7.10% in January, making it one of the best-performing funds in the UK. The Momentum fund (blue line) significantly outperformed its benchmark (red line) in January as it has a high weighting to some of the biggest outperforming technology companies.

Foundation portfolio

The portfolio remains nearly fully invested, with only commodities and infrastructure below trend. Bonds suffered falls in January after a strong run, which acted as a headwind for the portfolio. The portfolio continues to have the maximum amount allowed in bonds, as none of the individual bonds fell below the trend.

Income Generating portfolio

The portfolio experienced a slight loss after some previously solid monthly returns. Overseas equities performed very well, but bonds and UK equities suffered due to inflation going up rather than down as expected. This caused the expectation that interest rates would not be cut as quickly, and bonds and higher-yielding UK equities suffered losses.

Fourth Industrial Revolution portfolio

This was a mixed month for the portfolio. Seven of the underlying funds grew, with the L&G Cyber Security fund rising 5.93%. It is now up 33.31% over the last year. However, the iShares Global Clean Energy and L&G Battery Value-Chain funds fell 10.66% and 7.61%, respectively. These sectors are significantly correlated to interest rates. The fact that interest rates are not expected to be cut as quickly caused significant losses for the two funds. The portfolio is still the top-performing one over the last year.

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 performed exceptionally well last month, and this helped the three solutions achieve positive gains despite bonds falling.

Summary of Portfolios

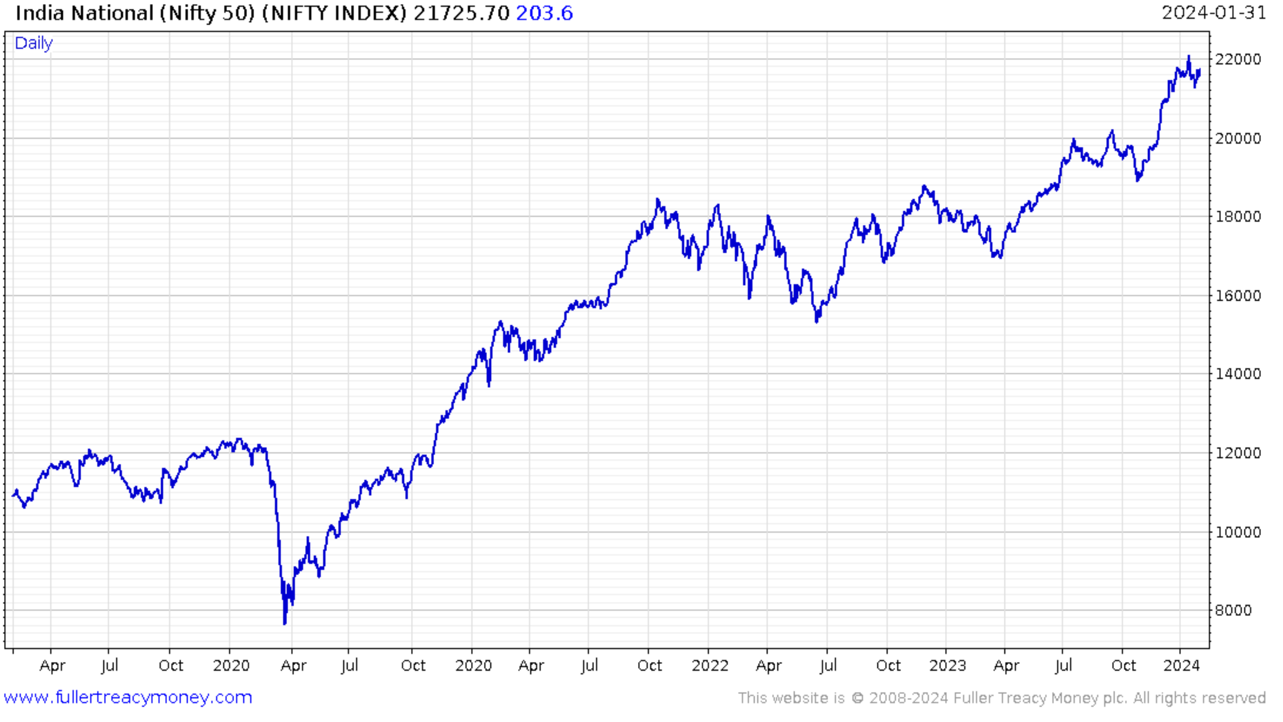
The performance of our wealth remains highly correlated to inflation and interest rates. An unexpected rise in inflation caused experts to predict that interest rates will not be cut as quickly as expected. This caused losses in our bond funds, and our lower-risk portfolios suffered. Our higher-risk portfolios benefitted from new highs in European and American stock markets and the “Momentum” asset classes continuing to perform well.

Asset Class Review

This section will give you an insight into our current thinking. This month, we look at stock markets breaking to all-time highs and what is happening to UK Gilt yields.

India – now the world's 4th largest stock market

India overtook Hong Kong to become the world's fourth-largest stock market last month, a sign that India is becoming a more dominant player in the developing world. The Indian stock market continued to hit new highs last month. Whilst India is advancing higher, Chinese markets have lost significant amounts over the previous year, with Hong Kong down 29.48%.



The S&P 500 hits a new high.

This is the world's most important stock market and the new all-time high shows that "momentum" is with the market. Once it exceeded the previous high, the stock market rallied much higher as buyers flooded with optimism. However, it pulled back a little during the last few days of January.

Europe – a new all-time high

Europe has struggled compared to the US over the last 20 years, but just as the S&P 500 broke to a new all-time high, the Euro Stoxx 50 broke above its 2007 high. We expect the market to rise from here and perhaps catch up somewhat with the USA over time.

Gilt yields rise – does this mean interest rates won't be cut in the short term?

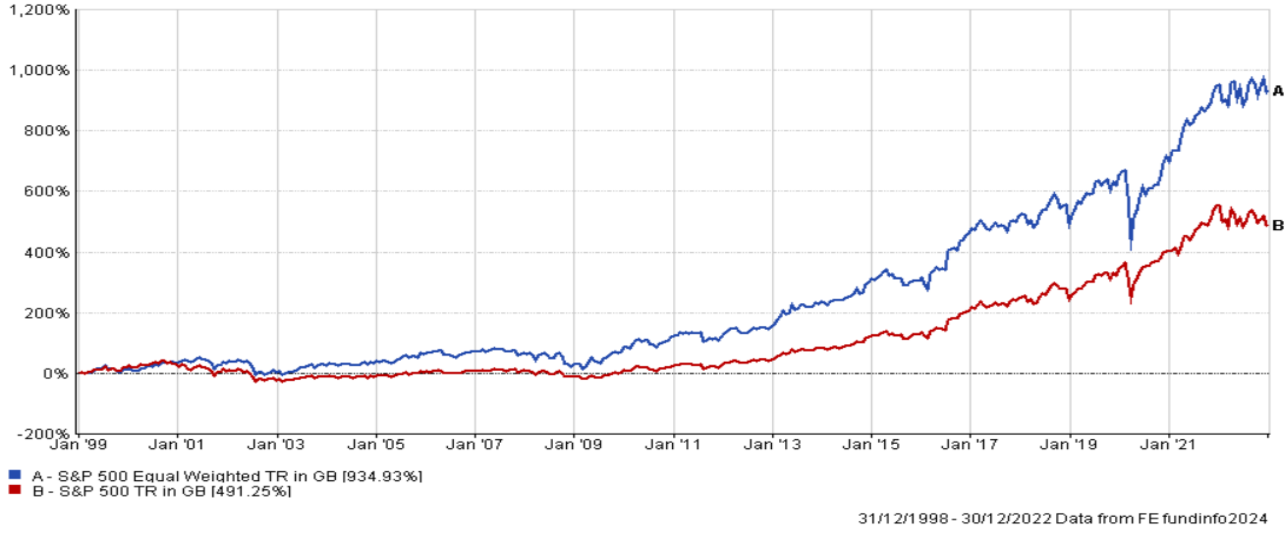
Inflation figures rose unexpectedly in the US and UK, which has been a blow to the expectation that interest rates will be cut imminently. The chart shows how the yield of 10-year UK Gilts fell to 3.5%, but last month, it rose to 4% before falling below 3.8%. Interest rates are still expected to be cut, but we may have to wait longer before this happens.

In Summary (same as last month!)

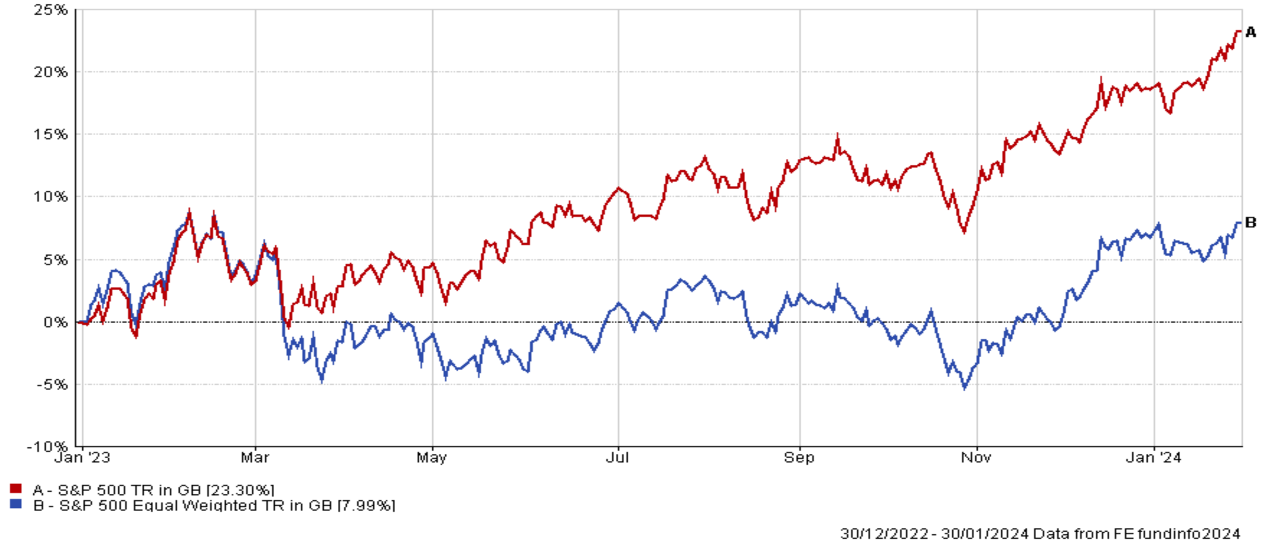
A market moving to a new all-time high is highly positive as it signals that investors are optimistic about the future. Technically, it attracts more buyers and few sellers when it breaks to a new high. Therefore, the index can move significantly higher. Momentum, thus, is currently in our favour.

The Big Get Bigger

Historically, smaller companies have outperformed bigger companies. The argument is that smaller companies are typically more nimble and able to grow much faster than larger ones. An excellent way to demonstrate this is by comparing the return of the S&P 500 (market capitalisation weighted) to the S&P 500 Equal Weighted. The market capitalisation index (red line) means that you invest in the largest 500 American companies in proportion to the value of each company, i.e. you have more money invested in the companies that are the biggest. The Equal Weighted Index means that you invest the same (0.2%) in all 500 companies and, therefore, have more money invested in the smallest companies. From January 1999 to January 2023, the equal-weighted index produced nearly double the returns of the market capitalisation index, which means smaller companies outperformed.



However, since January 2023 bigger companies have significantly outperformed:



The seven biggest companies in the S&P 500 are Apple, Microsoft, Amazon, Nvidia, Alphabet, Meta and Tesla. They are collectively known as “the Magnificent Seven”. These companies account for around 28% of the S&P 500 and are worth over $12 trillion. These businesses are highly profitable and are at the forefront of some of the most significant growing sectors, such as cloud computing, electric vehicles and artificial intelligence. The growth rates have been exceptional, with Nvidia’s share price growing by over 1000% in the last five years and Apple’s by over 300%.

Therefore, we are in a period in which the momentum is with the biggest global companies as they are at the forefront of technological changes across the economy. Most of the portfolios are invested in a “Momentum” fund, which is highly weighted to the Magnificent Seven. The Fund grew by 7.10% last month, and we benefit from the big getting bigger.

Final Comment

After a “Santa Rally” in which bonds and equities advanced, January was a month in which bonds fell and stock markets were mixed. Inflation rose unexpectedly and had the knock-on effect of potentially delaying interest rate cuts. The economy and investment markets are susceptible to changes in inflation after experiencing the recent rapid rise of inflation. We still believe that we will see inflation fall, interest rate cuts sooner rather than later and asset classes advance higher.

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