Current Focus

April 2017

A monthly market comment from Rivers Capital Management. Views expressed here are subject to change and for professional advisors only

RIVERS CAPITAL MANAGEMENT

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Summary

- Sterling depreciation unlikely to continue but do not expect a reversal
- Exports increased in Q4 2016 but the current account remains negative
- Foreign Direct Investment sharply higher as foreign companies buy UK assets
- Inflation risks are elevated from import costs but the Bank of England is unlikely to act
- Inflation a lower risk than high valuations and politics

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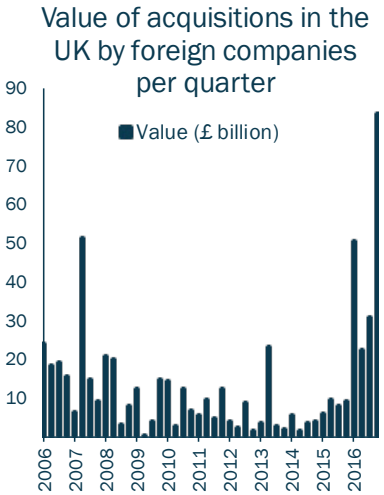
Market Comment

March was generally a positive month for investors, although increased volatility reflected heightened investor concern in some asset classes. The pound modestly strengthened against the US dollar as the Federal Reserve indicated interest rates would rise more slowly than had previously been expected. US Dollar weakness was minor compared to the recent moves seen in sterling, but still affected commodity prices and caught some investors off guard. As discussed in previous Focus Reports we lowered risk across all portfolios on March 9th by decreasing exposure to equities and adding diversification. Valuations are high by many measures and we believe protecting capital now will enable investors to be opportunistic when valuations become more attractive in the future.

With dollar weakness claiming some headlines during March we thought it timely to turn to the value of sterling and explain why we think the significant moves we saw last year are unlikely to be repeated, or reversed. The value of sterling has affected inflation expectations already and we explain why we think this is a threat to the UK economy, but why that threat is unlikely to lead to interest rate rises any time soon from the Bank of England.

Over the last 12 months the pound has lost about 16% against the Euro, 13% against the US Dollar and 21% against the Japanese Yen. Any assets held in those currencies, which is not subsequently currency hedged, will have benefited UK investors at least by a similar amount. While lower risk assets tend to be currency hedged, as is our policy, sterling depreciation has significantly boosted returns over the last year for investors in most non sterling equity and higher risk assets. In sterling terms the UK FTSE 350 one year return of 22% has been strong and exceeded the 15% return from Gold but it trailed the 30%+ GBP returns of many other indices. To put that in context for the US investor the 6% return on UK Equity is ok compared to the 0% on Gold but certainly he would have done better by staying invested at home.

The devaluation in sterling is widely attributed to Brexit, but in reality it



Source: ONS

started before that. The currency has been declining for a number of years as low interest rates and a consistent current account deficit has seen global demand for the currency fall. The decline accelerated sharply after last June's referendum but has been stable, or even slightly appreciating, since the start of this year. Two factors have stalled the decline; rising exports and rising foreign direct investment (FDI). The decline in currency has been very positive for exporters who saw a significant up-tick in trade during the final quarter of 2016. While trade imports continue to exceed trade exports with the service sector being the primary balancing factor, any rise in exports is unambiguously good for the currency if it can be sustained (trade deals will help!). The increase in FDI was significantly affected by a number of large foreign led mergers and acquisitions. The headline grabbing attempted acquisition of Unilever would have been an even bigger example of this had it occurred. Even without Unilever the chart here shows that the acquisition of UK assets by foreign investors rose substantially in 2016. This may have the effect of increasing demand for sterling, but the selling of the family silver analogy will not be lost on many.

Just as exports have benefited from the fall in sterling the opposite is obviously true on its effect on the cost of imports. Even when taking into account services, which the UK is a significant net exporter of, the balance of trade remains negative despite the recent increase in exports. The cost of imports has risen significantly over

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the last year as commodity prices have risen and sterling weakened. Inflation, an often forgotten terror from the 1970s and 80s, seems to be the biggest concern for many at present. The March official inflation level of 2.3% is above the Bank of England preferred level of 2% but it's difficult to argue that it is out of control. With core inflation (which excludes energy, food and alcohol) falling modestly to 1.8% it's unlikely to concern Governor Carney a great deal. In fact in February Mark Carney attributed all of this inflation to the currency factor and indicated he would be looking at employment costs more closely. Having recently lowered his target full employment level to 4.5% he is clearly looking for reasons not to slow the economy in what he expects to be a difficult transition period for the UK. And who can blame him.

Sterling weakness offers a welcome incentive for exporters and so long as import costs don't translate to wage inflation interest rates will not be increasing soon. There is clearly interest from abroad in UK assets as well as their services and goods, provided the price is right, and this should prevent further depreciation of sterling but there seems little to justify a reversal.

Overall uncertainty remains high. The risk of inflation becoming systematic has risen but remains low. In our view high asset valuations and heightened geopolitical concern justify a more cautious allocation to risk for the coming months. In the UK these risks, if not Brexit shenanigans will soon surpass fears of inflation.

Benchmark Returns - 31st March 2017	1 Month	3 Month	6 Month	YTD	Since Incep*
Anchors					
Cash + 1%	0.1%	0.3%	0.7%	0.3%	1.1%
Inflation Linked UK Bonds	-0.4%	0.1%	-0.4%	0.1%	5.7%
Gilts	0.3%	1.5%	-2.0%	1.5%	0.4%
Global Government Bonds (hedged)	-0.2%	-0.1%	-3.0%	-0.1%	-3.2%
Enhancers					
Global Corporate Bonds (hedged)	-0.2%	1.0%	-1.4%	1.0%	0.3%
Global High Yield (hedged)	-0.1%	2.8%	3.6%	2.8%	8.9%
Emerging Market Bonds (hedged)	1.7%	6.1%	6.0%	6.1%	11.6%
FTSE 350 TR Index	1.2%	4.0%	8.0%	4.0%	16.2%
FTSE UK All-Small Cap	2.8%	6.3%	10.7%	6.3%	24.2%
Global Equity (MSCI)	0.6%	5.1%	12.6%	5.1%	21.5%
European Equity (MSCI)	3.4%	6.0%	11.3%	6.0%	20.7%
US Equity (S&P)	-0.4%	4.7%	14.0%	4.7%	21.7%
Japan Equity (Topix)	-0.7%	4.0%	9.1%	4.0%	21.9%
Pacific Ex Japan Equity (MSCI)	2.5%	11.6%	10.2%	11.6%	25.4%
Emerging Market Equity (MSCI)	2.0%	10.1%	11.0%	10.1%	24.5%
Chinese Equity (Hang Sang)	1.1%	8.6%	8.2%	8.6%	25.7%
Indian Equity (Nifty)	5.6%	15.8%	13.6%	15.8%	23.0%
Diversifiers					
Commodity Index	-2.7%	-2.5%	-0.2%	-2.5%	-4.3%
Gold	-0.9%	6.9%	-1.9%	6.9%	0.3%
Silver	-1.6%	12.6%	-2.0%	12.6%	3.5%
Brent Oil	-5.2%	-8.3%	12.5%	-8.3%	13.4%
UK Property	0.7%	1.9%	3.9%	1.9%	2.8%
Global Property Shares	-0.1%	1.7%	2.3%	1.7%	7.4%
Rivers Model Portfolios					
Rivers Preservation Portfolio	*0.1%*	*1.4%*	*2.3%*	*1.4%*	*6.9%*
Rivers Cautious Portfolio	*0.7%*	*2.8%*	*5.3%*	*2.8%*	*11.7%*
Rivers Balanced Portfolio	*0.7%*	*3.7%*	*6.4%*	*3.7%*	*14.3%*
Rivers Adventurous Portfolio	*0.8%*	*4.4%*	*7.7%*	*4.4%*	*16.3%*
Rivers Aggressive Portfolio	*1.1%*	*5.9%*	*10.1%*	*5.9%*	*19.7%*
Rivers Cautious Income Portfolio	*0.3%*	*2.5%*	*3.1%*	*2.5%*	*6.9%*
Rivers Balanced Income Portfolio	*0.7%*	*3.5%*	*5.0%*	*3.5%*	*11.2%*

Source: Financial Express in GBP (unhedged unless stated) as at 31st March 2017. *Rivers Portfolios since launch June 30th 2016

Model Performance is indicative only and is net of Rivers Capital Management Charge and Underlying Fund charge but not advisor or platform costs.