Current Focus

June 2017

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

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Rivers Capital Management
27 Gloucester Place
London
W1U 8HU

+44 (0)20 7866 2140

Summary

- Surprise UK General election result of a hung parliament
- Possible coalition government difficult, repeat general election now likely
- Brexit negotiation risk now increased with new repeat referendum now possible
- Current UK Exposure is minimal and overall positioning is defensive
- Rivers managed portfolios remain underweight risk with a bias to passive solutions

Contacts

Richard Bonnor-Moris
020 7866 2137
rbm@riverscm.com

Eduardo Tomacelli
020 7866 2138
etomacelli@riverscm.com

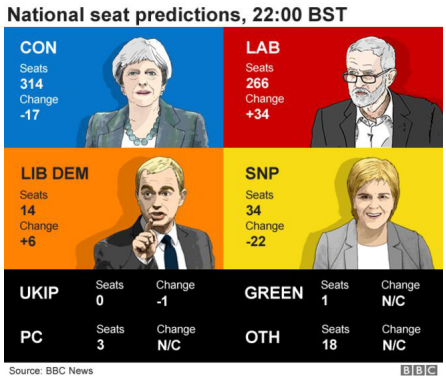
Najib El-Rayyes
020 7866 2139
ner@riverscm.com

Mark Hill-Reid
020 7866 2140
mhr@riverscm.com

Market Comment

In the early hours of June 9th, it appears as if the Conservative decision to hold a snap election has not been vindicated. An indecisive result now seems certain. The surprise to most commentators throughout the night appears to be the extent to which the increased turnout, led by a motivated youth vote, has favoured the Labour Party. The Conservatives will have the most seats but the landslide victory that was initially predicted seems a distant memory. The most likely outcome now appears to be a Conservative led minority government although a repeat of the election before year end must have a high probability. This result is not being favourably met by currency or equity speculators who view any weak government very negatively. How this result effects Brexit negotiations only time will tell but they will undoubtedly be the domestic political focus for the foreseeable future. We believe Mrs May called the election in the first place to strengthen her majority and lower the influence of the more ardent Brexit supporters in her party, and that has undoubtedly back-red on her. It looks likely now that if a government can now be formed it may not even involves Mrs May at all as a new conservative leader is installed.

From an investor perspective the U.K. looks increasingly unattractive. The likelihood of a repeat of the election is high and the effect of that on the Brexit negotiations remains highly unpredictable. With Article 50 already initiated the prospect of an extension or pause must now be considered and the issue of a second EU referendum is likely to be raised. While that may be welcomed by some currency investors this is currently being eclipsed by the uncertainty. Within the Rivers portfolios direct U.K. Equity exposure is limited, the portfolios all hold an underweight weight to U.K. assets and most foreign equity assets are unhedged. On the positive side overall the election result is unlikely to affect global markets significantly. The portfolios have held a risk underweight across all portfolios since March. Since then we have believed European and Asian equities are more attractively valued than the U.S. and U.K. Equities and the election result does little



to change that.

Our primary concern for some months has been the valuation levels of both equity and bond markets, which in some assets has reached extreme levels. The growth of investment values has outstripped earnings and economic growth significantly since the financial crisis of 2008/9. This has reached a critical level in recent months. We accept that valuations can remain high for extended periods and indeed that they could get higher but the risk, in the current political environment, is that a correction occurs before corporate earnings can catch up. Indicators of global growth remain reasonably positive but the growth surge that appeared to be very co-ordinated in the first few months of 2017 appears to be faltering. This does not necessarily lead to a prediction of a contraction but the rate of change has made it difficult for markets to continue the positive trend sustainably without an obvious catalyst.

Political risk continues to add to this concern and the outcome of the UK election overnight has only added to that concern. Despite the UK election the biggest global political risk remains in the US where the apparent inability for President Trump to deliver on many of his election promises does not appear to be reflected in equity valuations that remain at levels comparable to the bubbles of 1999 or 1929. The economy in the US is growing but much of the optimism seen since Trump's election (surrounding tax cuts and consequential earnings growth) is exaggerated. In May the International focus was on a fairly bizarre first foreign tour by President Trump. The tour

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managed to lower some global geo-political tension but did little to change the escalating difficulties the president is having at home.

In conclusion global equity markets have been in an uptrend. This rise can go further, however economic growth momentum and political risk in the US is starting to become a headwind. The U.K. result does little to change that. A period of political turmoil appears inevitable in the coming months. Valuations and political concerns have already resulted in capital flows appearing to switch from the UK and US to better value assets primarily in Europe and the Emerging Markets. We expect this to continue and moreover we continue to recommend a low risk allocation (a level 2 out of 7 - see *Riverscm.com* for explanation of our risk model). With many asset valuations high, we also think this is a difficult time for active managers to justify higher fees for stock selection. Because of that we currently have a high allocation to passive low cost investments which reduces cost in what we expect to be a difficult environment (a 50% passive allocation – see *Riverscm.com* for explanation of our dynamic Passive model). If markets continue to gain value our current position should sufficiently generate portfolio target returns over the seasonally difficult summer months. Moreover should a correction result, for whatever reason, we will to be able to reallocate capital to assets at more attractive valuations and at a time when active management will likely have more favourable conditions.

Benchmark Returns - 31st May 2017	1 Month	3 Month	6 Month	YTD	Since Incep*
Anchors					
Cash + 1%	0.1%	0.3%	0.7%	0.6%	1.3%
Inflation Linked UK Bonds	0.5%	-0.7%	1.8%	-0.2%	5.4%
Gilts	0.5%	1.1%	4.3%	2.3%	1.1%
Global Government Bonds (hedged)	0.4%	0.7%	0.9%	0.8%	-2.3%
Enhancers					
Global Corporate Bonds (hedged)	0.9%	1.5%	3.4%	2.7%	2.0%
Global High Yield (hedged)	0.7%	1.9%	6.8%	4.9%	11.1%
Emerging Market Bonds (hedged)	1.7%	0.8%	8.9%	5.1%	10.5%
FTSE 350 TR Index	4.4%	5.2%	13.5%	8.1%	20.8%
FTSE UK All-Small Cap	2.6%	7.7%	16.5%	11.3%	30.0%
Global Equity (MSCI)	2.3%	1.0%	9.2%	5.5%	21.9%
European Equity (MSCI)	4.9%	8.6%	18.5%	11.2%	26.7%
US Equity (S&P)	1.6%	-1.3%	6.9%	3.7%	20.6%
Japan Equity (Topix)	3.4%	0.5%	7.6%	5.3%	23.4%
Pacific Ex Japan Equity (MSCI)	4.9%	6.2%	14.3%	15.7%	29.9%
Emerging Market Equity (MSCI)	3.2%	4.0%	13.7%	12.2%	26.9%
Chinese Equity (Hang Sang)	4.8%	4.5%	9.6%	12.2%	29.9%
Indian Equity (Nifty)	3.3%	8.0%	20.1%	18.3%	25.8%
Diversifiers					
Commodity Index	-1.4%	-5.6%	-3.8%	-5.4%	-7.1%
Gold	0.6%	-2.3%	4.6%	5.4%	-1.2%
Silver	1.1%	-9.3%	1.7%	3.7%	-4.7%
Brent Oil	-2.8%	-12.7%	-3.4%	-15.6%	4.4%
UK Property	0.4%	1.9%	3.8%	3.0%	3.9%
Global Property Shares	-0.4%	4.3%	13.1%	6.2%	12.1%
Rivers Model Portfolios					
Rivers Preservation Portfolio	*0.2%*	*0.4%*	*2.7%*	*1.6%*	*7.2%*
Rivers Cautious Portfolio	*0.6%*	*1.2%*	*4.9%*	*3.3%*	*12.0%*
Rivers Balanced Portfolio	*1.0%*	*1.5%*	*6.3%*	*4.4%*	*15.0%*
Rivers Adventurous Portfolio	*1.2%*	*2.0%*	*7.6%*	*5.6%*	*17.4%*
Rivers Aggressive Portfolio	*1.8%*	*2.8%*	*10.0%*	*7.5%*	*21.5%*
Rivers Cautious Income Portfolio	*1.2%*	*1.4%*	*4.8%*	*3.5%*	*7.8%*
Rivers Balanced Income Portfolio	*1.5%*	*2.1%*	*6.5%*	*4.9%*	*12.5%*

Source: Financial Express in GBP (unhedged unless stated) as at 31st May 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.