Current Focus

May 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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Summary

- UK General election has few global investment implications but could affect sterling
- Political risk remains elevated but valuation levels continue to be our primary concern
- Seasonal weakness during June to October supports a more cautious stance
- Rivers managed portfolios remain underweight risk with a bias to passive solutions

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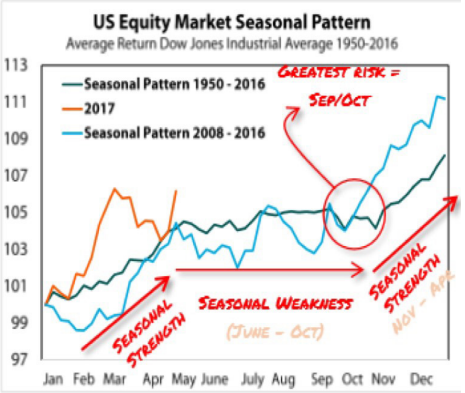
Market Comment

With an announced General Election in the UK and rising geopolitical tensions between the US and North Korea there has been much to distract investors during April. Sterling appreciated against major foreign currencies and many asset classes lost value, but our cautious positioning across the models protected portfolios as volatility increased. It is concerning that UK Consumer confidence appears to have diminished due to inflation, in recent months, but with the important UK Manufacturing survey marking a 3 year high the economic picture is undoubtedly mixed. Coming into what could be an interesting period we remain moderately underweight risk with an overweight allocation to passive.

The UK election is widely expected to be a victory for the Conservatives who are seeking a more dominant majority in the face of a weakened and divided opposition. The only realistic question is the size of the victory and from an investment point of view how that may affect the value of sterling. Interestingly both a big Conservative majority or a hung parliament seem to be favoured by sterling speculators. The expectation appears to be that a large Tory majority (the most likely outcome) increases the chances of a 'softer' Brexit as it dilutes the influence of the more extreme members of the Conservative party. A surprising result which leads to a hung parliament is similarly expected to lessen how 'hard' Brexit is, although few pundits are predicting such an outcome. From an investor point of view the effect on sterling matters as sterling strength would likely reverse some of the gains in non-sterling denominated assets UK investors benefited from over the last 12 months. In all results except the extreme we don't think the currency reversal will be very significant in any case. While we have recently increased the proportion of currency hedged assets this was more related to general risk reduction than taking an implicit currency position. See last month's Current Focus for a more detailed look at sterling drivers.

Overall while the UK election is likely to dominate headlines for the next two months we think it is unlikely to have a significant effect on global investment markets. For that to be the case the result would have to very surprising and by that we mean more surprising than either Brexit and/or President Trump's election both of which only required a few percentage points swing. Even if the UK Election doesn't add much geopolitical risk the ongoing European elections, tensions in Syria and North Korea and the general unpredictability of President Trump do combine to maintain it at a high level and it remains clearly in our thoughts. Having said that we continue to maintain that it is high valuations in both equities and bonds that we think should concern investors most.



Source: The ECU Group, Datastream

Whether risk comes from Politics or valuation levels one factor we think is also worth considering is seasonality and it is this we want to Focus on this month. Seasonality is the tendency, for whatever reason, for equity markets to be strong between November and April and relatively weaker from May to October. As rational investors we would be reluctant to accept such a strategy as 'sell in May and go away, come back for St Leger's day' but the evidence is actually remarkably strong – even if St Leger's Day (16th September this year) may be too early given that evidence. ECU Economic Research have done some interesting work on this phenomenon: Looking at the total US equity market return since 1950 the chart shows how, on average, markets have struggled through the summer. This

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pattern has been fairly accurately repeated since 2007 and so far at least the 'Trump' rally since November last year fits the pattern reasonably well. Despite the adage it appears that early autumn (September and October) have been, in fact, the most challenging months so waiting a bit from St Leger's Day appears sensible. Most compelling is that recently, and over the long term the period November to April seems to account for nearly all the total equity return of the last 65 years.

This analysis is interesting but given every year is different we do not believe it should be followed blindly, nor in fact be a primary concern. In the years 2009 and 2003 for example, when the market sharply rebounded from lows set in March, such a strategy would have been fool-hardy. However, given the historically high equity valuations of today, in particular in the US, and the elevated geopolitical risks previously discussed we already consider an underweight risk allocation appropriate. The seasonal effects are an additional factor that support this position.

It's worth noting in conclusion that with inflation rising and real interest rates negative whatever is 'sold in May' should sensibly be reinvested into something with a positive non-equity related return. Even more than usual we conclude that diversification will be of primary importance during the coming months. The ability to increase risk after either seasonal, valuation or politically related market corrections will depend on the ability to protect capital during such periods.

Benchmark Returns - 30th April 2017	1 Month	3 Month	6 Month	YTD	Since Incep*
Anchors					
Cash + 1%	0.1%	0.3%	0.7%	0.4%	1.2%
Inflation Linked UK Bonds	-0.8%	-0.1%	-3.9%	-0.7%	4.9%
Gilts	0.3%	3.8%	2.4%	1.8%	0.6%
Global Government Bonds (hedged)	0.5%	1.2%	-1.1%	0.4%	-2.7%
Enhancers					
Global Corporate Bonds (hedged)	0.8%	1.8%	0.4%	1.8%	1.2%
Global High Yield (hedged)	1.3%	2.7%	4.8%	4.1%	10.3%
Emerging Market Bonds (hedged)	-2.6%	2.4%	-3.1%	3.4%	8.7%
FTSE 350 TR Index	-0.5%	3.9%	6.9%	3.5%	15.7%
FTSE UK All-Small Cap	2.1%	6.9%	12.8%	8.5%	26.8%
Global Equity (MSCI)	-1.9%	2.5%	5.8%	3.1%	19.1%
European Equity (MSCI)	0.1%	5.8%	8.1%	6.1%	20.8%
US Equity (S&P)	-2.4%	2.1%	6.6%	2.2%	18.8%
Japan Equity (Topix)	-2.2%	-0.2%	-1.1%	1.8%	19.3%
Pacific Ex Japan Equity (MSCI)	-1.2%	5.5%	4.0%	10.3%	23.9%
Emerging Market Equity (MSCI)	-1.2%	5.0%	2.8%	8.8%	23.0%
Chinese Equity (Hang Sang)	-1.4%	2.5%	1.7%	7.1%	24.0%
Indian Equity (Nifty)	-1.1%	11.5%	5.2%	14.5%	21.7%
Diversifiers					
Commodity Index	-1.5%	-4.1%	-1.2%	-4.0%	-5.7%
Gold	-2.0%	1.7%	-6.5%	4.8%	-1.7%
Silver	-8.9%	-4.9%	-9.5%	2.5%	-5.8%
Brent Oil	-5.3%	-10.7%	0.7%	-13.2%	7.4%
UK Property	0.7%	2.1%	4.0%	2.6%	3.5%
Global Property Shares	4.8%	11.4%	12.7%	6.6%	12.5%
Rivers Model Portfolios					
Rivers Preservation Portfolio	*0.0%*	*1.5%*	*1.7%*	*1.4%*	*6.9%*
Rivers Cautious Portfolio	*-0.1%*	*2.2%*	*3.1%*	*2.7%*	*11.3%*
Rivers Balanced Portfolio	*-0.1%*	*2.7%*	*3.7%*	*3.4%*	*13.8%*
Rivers Adventurous Portfolio	*0.0%*	*3.1%*	*5.0%*	*4.3%*	*16.0%*
Rivers Aggressive Portfolio	*-0.1%*	*3.9%*	*6.5%*	*5.6%*	*19.3%*
Rivers Cautious Income Portfolio	*-0.1%*	*2.0%*	*2.0%*	*2.3%*	*6.5%*
Rivers Balanced Income Portfolio	*0.0%*	*2.5%*	*3.1%*	*3.4%*	*10.9%*

Source: Financial Express in GBP (unhedged unless stated) as at 30th April 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.